

# The Effective Use of Partnering and Alliancing

Jon Gunn, Special Counsel, Minter Ellison

*There is a tide in the affairs of men,  
Which, taken at the flood, leads on to fortune;  
Omitted, all the voyage of their life  
Is bound in shallows and in miseries  
On such a partnering sea are we now afloat,  
And we must take the current when it serves,  
Or lose our joint ventures.*

William Shakespeare  
Julius Caesar  
Act 3, Scene 2

MinterEllison

L A W Y E R S

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# 1. What are partnering and alliancing?

## 1.1 'Relationship contracting'

In the last decade the procurement, engineering and construction industries have experimented with new styles of contract in an attempt to achieve an outcome that is acceptable to all parties.

The term 'relationship contracting' has been coined to describe these different approaches. The Australian Constructors Association has defined relationship contracting as: '... a process to establish and manage the relationships between the parties that aims to: remove barriers; encourage maximum contribution; and allow all parties to achieve success'.

There is a wide range of relationships in the spectrum. At one end, there is the simple partnering charter. At the other end of the spectrum, there is the alliance-style agreement. In the middle, there are contracts involving incentives and direct cost reimbursement.

As the possibilities for misunderstanding are significant, it is important to have a proper understanding of the terminology

## 1.2 Partnering

'Partnering' is generally understood to mean a commitment by those involved in a project or outsourcing to work closely and co-operatively, rather than competitively and adversarially. It has been described as *'a process of establishing a moral agreement or charter between the project team members along with a moral framework to assist in its successful implementation'*<sup>1</sup>.

Partnering has been widely used in Australia.

Partnering is a method which allows people to minimise or avoid conflict when they are engaged in a complex project. It is a way of unifying all the parties or stakeholders on a project into a team<sup>2</sup>. Partnering has been described as *'putting the handshake back into doing business'* and involving *'a return to the old way of doing business based on trust, respect, and good faith rather than suspicion, contempt and scepticism'*<sup>3</sup> and *'when a person's word was their bond and people accepted responsibility'*<sup>4</sup>.

## 1.3 Alliance contracting

An 'alliance contract', on the other hand, usually involves an agreement to work co-operatively and to share risk and reward, measured against key performance indicators. Under this style of contract, an alliance team is assembled to complete the project. The team is treated as separate from the parties to the contract. The alliance-style contract is relatively new in Australia. While linking price to performance against KPIs is the norm in outsourcing arrangements, alliance contracting has to date only been adopted on a relatively small number of projects, particularly in the resources industry. Recently alliancing has been used to effect in building construction for the Museum of Australia Project in Canberra and is now being successfully used in smaller value construction developments.

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<sup>1</sup> NSW Government's Partnering Guidelines. NSW Government's Capital Projects Procurement Manual.

<sup>2</sup> American Arbitration Association, *A Guide to Partnering in the Construction Industry*

<sup>3</sup> NSW Government's Partnering Guidelines.

<sup>4</sup> The Associated General Contractors of America 'Partnering' - A Concept for Success, September 1992, page 2.

## 2. Types of partnering

At its highest level, partnering is a strategic alliance. It has been described as 'a long-term commitment between two or more organisations for the purpose of achieving specific business objectives by maximising the effectiveness of each participant's resources. The relationship is based on trust, dedication to common goals, and an understanding of each other's individual expectations and values'<sup>5</sup>.

Partnering can exist at a number of levels:

- (a) long-term relationships between contractors and their clients that endure through a number of projects or contracts<sup>6</sup>;
- (b) long-term relationships between contractors and sub-contractors/suppliers also enduring through a series of projects; and
- (c) one-off, project specific partnering, starting at the concept stage, or more often after the contract has been awarded. Project-based partnering was initially championed by Colonel Charles Cowan, then of the US Army Corps of Engineers, with significant success. Partnering is now used by the Corps of Engineers on all construction contracts and has been widely embraced in the US in public sector procurement.

It is the latter part of this third level which has been the principal focus of efforts in the construction industry in Australia.

Although this paper focuses on the Australian experience of project-specific partnering, it also examines opportunities for long-term partnering.

## 3. Use of partnering and alliancing

### 3.1 The United States experience

Strategic partnering arrangements have been undertaken in the US by large private sector concerns such as Shell Oil and Bechtel since around the mid 1980's. In the latter part of the 1980's the procurement and construction industries in the United States realised that they needed to develop a new co-operative culture to overcome a dramatic increase in counter-productive litigation, a product of adversarial and unrewarding relationships. The industry perceived a need for a team-building process which created mutual trust and respect, harmonious relationships, and a win-win concept, rather than the notion that for someone to win, another must lose.

### 3.2 Partnering in Australia

Partnering was 'imported' from the United States in 1992 following a recommendation from the Gyles Royal Commission into the Building Industry in New South Wales, which unearthed a culture in which dubious business practices, unethical conduct, woeful industrial relations and contractual disputes were rife. These characteristics could be said to be symptoms of the *'adversary environment characterised by mistrust, the lack of shared objectives, the use of onerous contracts and the ever present risk of litigation'*.<sup>7</sup> Commissioner Gyles concluded that the results of projects depended far more on the relationship and understanding between the

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<sup>5</sup> US Construction Industry Institute (CII) Partnering Task Force, Interim Report, August 1989.

<sup>6</sup> NSW Government's Partnering Guidelines. NSW Government's Capital Projects Procurement Manual.

<sup>7</sup> Uher, What is Partnering? 34 Australian Construction Law Newsletter

parties than the structure or nature of the contracts. The Commissioner's report recommended amongst other things that partnering be trialed in NSW.<sup>8</sup>

Partnering is or has been used on construction projects to a value of \$30 billion Australia-wide and a further \$12 billion worth of Defence acquisition projects, such as the ANZAC frigates project. The Department of Defence in particular has embraced partnering in many of its large acquisition and facilities projects.

The NSW Government's policy is now to use partnering in all non-tendered construction projects over \$1 million in value.<sup>9</sup> The NSW Government has introduced construction contract C21, which attempts to incorporate non-adversarial aspects of partnering into the contract. The C21 contract now is for use on all non - tendered construction projects valued at over \$1 million.

In the private sector, partnering is being used in housing construction, materials supply, facilities maintenance and outsourcing.

### 3.3 Alliance contracting

BP pioneered the use of alliance contracting in the development of energy reserves in the North Sea in the early 1990s, with outstanding results. In Australia alliancing has been used in both private and public sectors. Major private sector projects include the Wandoo Oil alliance contract for Ampolex (\$480m) and the Port Headland Iron Ore alliance contract for BHP (\$700m). Public sector examples include the rail infrastructure maintenance for NSW Rail Access Corporation (now Rail Infrastructure Corporation) and the Northside Storage tunnel for Sydney Water.

## 4. Key elements and machinery of partnering

The partnering culture comprises the human value elements of:

- genuine commitment<sup>10</sup>
- equitable sharing of risks and benefits
- the development of trust and understanding.

The machinery for partnering involves a partnering workshop held at the commencement of a project. The workshop, attended by all participants, produces:

- mutually agreed mission statement and objectives enshrined in a Partnering Charter<sup>11</sup>
- a documented communication matrix or framework
- a procedure for continuous joint elevation

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<sup>8</sup> Partnering - A Strategy for Excellence, MB-CHAA, October 1992, page 1.

<sup>9</sup> Discussion with Denis Wilson, Master Builders Association, February 2002.

<sup>10</sup> Because of the need for the participants to be truly motivated, and their involvement to be voluntary and not imposed, one commentator is critical of the practice of public authorities in the US and Australia of announcing an intended partnering approach via a specification clause - Partnering and Personal Skills for Project Management Mastery, Alan Patching, 1994, pp40-41.

<sup>11</sup> Examples of 'Partnering objectives' include:

- stakeholders value management savings
- meeting the financial goals of each party
- limiting cost growth
- limiting review periods for contract submittals
- early completion
- no lost time because of injuries
- minimising paperwork
- no litigation

- a procedure for rapid resolution of disputes at the lowest possible level with escalation of unresolved disputes.

Partnering meetings are also held throughout the project to deal with issues as they arise.

There is usually a strong common element among the goals of all the parties. For example, procurers want quality projects, completed safely, on time and within budget. Contractors and service providers want to maximise profit and satisfy their clients to enhance future business opportunities. Customers desire a quality product as quickly as possible, at minimal cost.

The usual barriers between procurer and contractor may need to be broken down in this process. For example, contractors need to address design choices as well as materials. All players need to feel able to comment on every aspect of performance.

## 5. Key elements and machinery of alliancing

### 5.1 What does alliance contracting involve?

Key elements of successful alliance contracting include:

- joint view on risk (both as to what it is and how it is to be managed)
- shared and accepted view on remuneration consistent with the joint view on risk management
- acceptable methodology for dispute resolution.

### 5.2 Structure

The parties function as an 'alliance team', an entity which is separate to the individual parties. It has elements in common with a partnership or joint venture, but is easier to unwind than either. The Alliance Team is used as a vehicle for risk assessment, planning, leading, co-ordinating and controlling activities, implementing decisions and day to day management

### 5.3 Risk assessment, allocation and management

#### ***Risk assessment***

A useful starting point in identifying key risks is to ask the question - is there the potential for the occurrence of contingencies during the performance of the contract which may result in:

- injury to or death of persons (including employees);
- damage to or loss of property including property of third parties;
- an increase in costs or decrease in revenues; or
- imposition of legal sanctions (fines/gaol).

Identification tools used to identify specific risks in a project may include reviews of records and lost data, surveys and exploratory testing and flow charts investigating areas of uncertainty in the entire contract documentation. Flow charting is a particularly useful technique to identify the need for key loss controls (eg transportation, delivery/disposal of dangerous goods) and critical interdependencies in multiple plant operations.

Analysis of the exposures identified should then target areas for loss control activities by providing a better understanding of the primary components of those loss potentials, ie probability and severity of impact.

### ***Risk allocation***

For each potential risk identified, a decision must be made as to which party should be assigned the risk. Importantly, risk allocation should be undertaken with the objective of risk control and not to merely pass on risk. The key risk allocation principles are:

- Risks belong with the party who are best able to evaluate, control, bear the cost, and benefit of assuming the risk - this gives that party an incentive to manage the risk better
- Many risks and benefits are best shared
- Every risk has an associated and unavoidable cost which must be assumed somewhere in the process.<sup>12</sup>

Once risks have been allocated, provision will have to be made by the risk bearer to finance any losses as they occur. The traditional option for risk financing purposes is through the purchase of insurance.

### ***Management***

Risk management techniques used to prevent or reduce losses include:

- systems and procedures - these include emergency plans to recover from the risk, regularly scheduled meetings to identify and solve problems, delegation of authority to appropriate levels so decisions on changes and claims can be made promptly
- contingencies resourcing - invariably the scope will change during the course of a project. It is easier and faster to implement changes if the necessary funding is set aside
- alternative approaches - eg provision for taking a different route or means of accomplishing an objective or cancellation of the activity.

## **5.4 Remuneration in Alliance Contracts**

A fixed price contract is sometimes viewed as a licence for inefficient management due to a reduced incentive to manage and control progress and resolve or minimise problems. Under Alliance contracting the contractor gets paid:

- costs as incurred;
- lump sum to cover overheads; and
- fee to cover profit margin.

A guaranteed minimum profit on direct costs and overheads is seen to foster a co-operative, non-adversarial relationship. However the incentive to generate the best project results lies in the concept of reward, which is performance based and can be set by reference to budget (representing the total estimated cost of bringing the project to completion), schedule (representing the total estimated time of bringing the project to completion), and key performance indicators - indicators used to determine whether the alliance has achieved exceptional results. Key performance indicators may include time of delivery, safety, the environment, industrial relations and community relations.

Performance based remuneration measured by reference to key performance indicators ensures that some of the contractor's remuneration is at risk against the achievement of indicators. Contractors are driven with a total focus on project results, as the extent of any reward or loss

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<sup>12</sup> Conference on Construction Risks and Liability, American Society of Civil Engineers, 1979.

depends on the project outcome. Hence the interests of the principal and contractor are commonly aligned.

## 5.5 No blame dispute resolution

Typically, the parties agree not to litigate against each other unless there is wilful default.

## 6. Benefits of partnering

There is no doubt that when it works well partnering provides perceived benefits to all the stakeholders. Such benefits to be claimed include<sup>13</sup>:

1. Better project documentation, due to involvement of the contractor and sub-contractors in the design process and, in the case of outsourcing, service definition<sup>14</sup>.
2. Improved site management methods and project co-ordination, leading to improvements in safety, design, and purchasing.
3. The substantial reduction of variations and conflicts as cost factors by the solving of problems as they arise, and the sharing rather than secretive hoarding of information.<sup>15</sup>
4. Increased potential for developing more effective performance measures, stemming from the commitment to continuous improvement.
5. Partnering can make the job fun. The co-operative team spirit results in a meaningful working environment.
6. The improved image of the procurement and construction industries. The industry represents 7% of GDP and employs over 600,000 people, but has had a poor public image recently. It has had to lift its game, and partnering shows that the industry is serious about reform.
7. Improved communication. This outcome alone makes partnering worthwhile. Standard industry structures inhibit communication. With the sealed-bid fixed price contract, little discussion occurs before the contract is let between the owner and prospective contractors. This situation often continues after commencement of work, with communications being inhibited by each party seeking to protect its perceived self-interests. This is why the 'team' mindset offered by partnering is so significant.

Interestingly, a comparative study of the first 10 completed partnered and 10 similar non-partnered projects conducted by the NSW Department of Public Works and Services found that the partnered projects enjoyed overall savings of 2 to 3% of total project cost.

## 7. Partnering problems

Is partnering really working? Ultimately, time will tell, but it is probably fair to say that a significant number of stakeholders (particularly in the private sector) are presently less enthusiastic about partnering than in the mid-1990's honeymoon period. Indeed, one commentator<sup>16</sup> refers to an apparent failure of partnering in Australia, which may be attributable to:

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<sup>13</sup> Gerald de Valence, Benefits of Partnering, pp 3-5.

<sup>14</sup> Keith Drew, Managing Director of John Holland, quoted in Business Review Weekly, 21.8.95, p33.

<sup>15</sup> Drew, Supra.

<sup>16</sup> David Domkins, University of NSW IIR Conference, Sydney, March 1996

- (a) a failure to tailor partnering to fit the Australian culture;
- (b) a failure to include all relevant stakeholders; and
- (c) a lack of commitment by public works authorities' senior management and Ministers.

Many contractors blame various state government purchasing policies which, while playing lip service to value for money, are seen to inevitably award the contract to the lowest price credible tenderer, irrespective of any demonstrated commitment to partnering by other bidders.

Reported pitfalls involved in the partnering process include:

1. **Over-reliance:** In house skills can be run down. Participants use skills of other stakeholders, instead of their own, resulting in expense if a party wishes to withdraw.
2. **Perceived conflict:** Contractors and consultants may be seen to be too closely tied to a particular client, whose competitors might then exclude him from their own tender list for a possible conflict of interest, either real or imagined<sup>17</sup>.
3. **Cost of involvement:** Successful partnering requires the investment of significant management and staff time, effort and money. For many players this is accentuated, because partnering represents a major change in mind set, for benefits which are primarily intangible. In projects of smaller value or duration, the relative cost could outweigh the benefit.
4. **Lack of competition:** The perception that close-knit working relationships over a long period tend to severely erode competition<sup>18</sup> is of greater concern in public sector procurement. This is discussed in section 7.2 below. However partnering and competition are not necessarily incompatible; indeed partnering may be another form of competition as it is likely to lead to efficiency and both consumer and producer satisfaction as well as higher profits<sup>19</sup>.
5. **Complacency:** This risk is obviously more acute with long-term partnering. The pitfall is that the players become so deeply immersed in the detailed mechanics of partnering that they lose market focus and become less competitive. One solution is to allow comparisons to be made between partnered and non-partnered projects and between different partnering arrangements by:
  - performing some work without a partnering arrangement
  - having more than one partnering relationship.
6. **Mistiming:** A frequently heard complaint is that project partnering is introduced too late in the process and not sufficiently far down the contractor - sub-contractor - supplier - union - worker chain. Sub-contractors supply over 80% of the input into projects or outsourced services but typically have next to no say in risk allocation in their subcontracts. It is simply not an efficient use of available resources to involve contractors and suppliers long after a project or services outsourcing is defined, although for the public sector government competitive tendering requirements have this result<sup>20</sup>.

<sup>17</sup> Loraine 1991, p4, quoted in De Valence, pp8-10.

<sup>18</sup> ICAC, Response to Contracts Paper 14.4 referred to in de Valence, page 8.

<sup>19</sup> C. Foster, Opening Address, NECD Conference Papers, Partnering: Contracting Without Conflict, 1991, pp2 and 4, quoted in de Valence at page 9.

<sup>20</sup> Sinclair, Partnering and Beyond, IBC Conference on Achieving World Class Construction, 30.8.94, pp5-6.

## 8. Benefits and pitfalls of alliancing

Alliances have been credited with creating an environment that promotes exceptional performance on high risk projects. Identified benefits include:

- Selection of the best possible team to deliver the project
- Principal can participate in design development without the usual exposure to claims for extensions of time, delay costs and variations
- Flexibility to respond to unforeseen technical issues without variation claims
- No dispute culture

From the contractor's perspective, alliance-style contracts are highly attractive and have few pitfalls, provided the risk/reward model is clearly defined and commercially acceptable. From the principal's perspective, issues for consideration include:

- Risk allocation
- A probity auditor may be required for public sector projects
- Cost

One of the pitfalls of this style of contract is that the principal does not have access to the full range of sanctions for poor performance that are associated with the traditional lump sum contract, such as liquidated damages for delay. The principal must pay the direct costs, irrespective of the quality of the performance.

The integrated team approach can blur the lines of responsibility for decisions. For example, under this style of contract the principal retains some of the design risk that a principal would usually seek to allocate to the designer. Many principals are uncomfortable in this environment and prefer the traditional risk allocation.

For public sector principals, the evaluation criteria for the assessment of tenders may leave the principal exposed to complaint. Complaints in relation to the assessment of tenders have the potential to create significant difficulty and can prevent projects proceeding, pending resolution of the complaint.

The selection process is more rigorous than the traditional tender evaluation process. This process can be expensive. There are also significant on-going costs associated with the facilitation of the alliance during the life of the project.

## 9. The legal interface

### 9.1 The inter-relationship with the contract

#### (a) *The official position - a moral not legal relationship*

Most commentaries on partnering distinguish it from a legally binding agreement, and accord it moral rather than legal status. The NSW Government's Partnering Guidelines are a good example:

'Partnering is not a contractual agreement nor does it create any legally enforceable rights or duties. It is the contract that provides the legal relationship, with Partnering establishing the working relationship amongst the stakeholders... Partnering is a process of establishing a moral agreement or charter between the project team members... The charter morally binds each stakeholder to act in the best interests of the project... a partnering relationship... is not a legal

relationship, joint venture or any other form of legal entity. It is simply a formal commitment between two or more parties to focus on creative co-operation and to work to avoid adversarial confrontation'<sup>21</sup>.

The Partnering Charter is seen as a document of a 'higher order' than the contract provisions<sup>22</sup>. In reality, however, it may not be morality which drives the commitment to the Partnering Charter, but a desire for the job to be successful, which benefits all the stakeholders<sup>23</sup>.

Notions such as the partnering stakeholders 'working together' and 'owning errors' do not fit readily into any legal construct. To take one extreme, if morality rather than law is to be the binding force between players in a partnering arrangement, why bother with a contract at all? The view is sometimes expressed that 'a contract means you cannot trust the other party'<sup>24</sup>.

#### (b) ***C21 Contract - partnering concepts in a standard form contract***

The C21 Construction Contract was released by the NSW Department of Public Works and Services in late 1996 and updated in 1999 for use in all projects valued at over \$1 million for which tenders are invited from selected tenderers are invited. C21 introduces partnering concepts into a standard form procurement contract for the first time. Mechanisms used include the following:

- (i) Promotion of Cooperation - The parties must do all they reasonably can to co-operate in all matters relating to the Contract: clause 3. However, the clause goes on to attempt to guard against the legal consequences in this way: '... but their rights and responsibilities under the contract (or otherwise) remain unchanged unless the parties otherwise agree in writing to change them'
- (ii) Early warning - Consistently with this, each party must do all it reasonably can to promptly inform each other of anything of which it becomes aware which is likely to affect the timing, cost or quality of the Works and the parties must then investigate how to avoid or minimise any adverse effect on the Works: clause 5.
- (iii) Duty not to hinder performance - Although such a term would usually be implied into a commercial contract, C21 spells it out: 'Each party must do all it reasonably can to avoid hindering the performance of the other under the Contract': clause 4

## **9.2 Procurement policy**

The formation of strategic alliances in particular may contravene the procurement policy considerations inherent in precepts recommended by the New South Wales Independent Commission Against Corruption (ICAC)<sup>25</sup>:

1. *Public property must be utilised so as to maximise public benefit.*
2. *All should have equal opportunities relative to public property.*
3. *Accordingly tenders should be called whenever large benefits will pass to or costs be incurred by either the State, or a party contracting with the State, in relation to public property.*
4. *If that general rule is departed from, the reasons for so doing should be recorded.'*

<sup>21</sup> NSW Government's Partnering Guidelines, October 1993.

<sup>22</sup> The binding imperative is driven not by fear of penalty or financial loss (as most contracts attempt to do), but rather from a feeling of integrity and honour (Uher, op cit,p51)

<sup>23</sup> Interview with Chris Milne, Barclay Mowlem.

<sup>24</sup> Patching, op cit, at pp28, 30.

<sup>25</sup> ICAC, Report on Investigation into the Silverwater Facility Operation, February 1990, p26-29.

The above factors make it difficult, if not impossible, for governments to enter into other than project-specific partnering arrangements. This is conceded by the New South Wales Government in its Partnering Guidelines: *'... probity considerations preclude Government Agencies from engaging in long-term strategic alliances...'*

Unfortunately, in practice, government departments view (or are perceived to view) these policies as precluding them from giving weight to the demonstrated commitment of a bidder to partnering, with most contracts awarded to the lowest dollar tenderer irrespective of the partnering credentials of the successful bidder. As one commentator notes, *'the less formal, longer-term, flexible nature of partnering will require ... some changes in public service culture, with a greater willingness to accept some risk and to be held accountable for overall results'*.<sup>26</sup>

(a) ***Standing Offers***

Providing procurement rules are satisfied, it may be possible for government to move toward longer-term partnering arrangements than at present without radical legislative changes.

To a limited extent it might be possible to work within existing procurement law to implement strategic alliances, particularly for long-term supplies of goods and services, including construction and related services, or for long-term maintenance for which designing a work scope in detail is often not practicable. The NSW Rail Access Corporation (now Rail Infrastructure Corporation), for example, which owns and maintains most NSW rail infrastructure, has embraced alliance contracting to meet its objectives, using functional specifications and performance-based remuneration.

Another solution is to use standing supply offers, also known as 'period contracts'. A standing supply offer is an offer to supply goods or services as requested by the procurer from time to time, but usually without a specified quantity, as the agency's specific requirements may not be known. Standing offers could be particularly useful for services needed for facility management such as maintenance, cleaning and repairs. Mechanisms such as progress or milestone payments, the holding of security or retention monies, and termination for failure to meet benchmark standards<sup>27</sup> can be used as an incentive to perform.

(b) ***Alliance contracting***

Alliance contracting in the public sector involves a number of relevant considerations. The commercial aspects of an alliance, including the identification of profit and overheads, the identification and weighting of selection criteria, the formula for pain share / gain share and performance incentives, could involve disclosure of commercially sensitive material. There may be a need to identify the boundaries within which this material should not be released into the public domain. The New South Wales Department of Public Works and Services is examining how the Department might become involved in alliance contracting and is preparing guidelines<sup>28</sup>.

The apparent subjectivity in the way in which project alliances are formed has been commented on by the ex-NSW Auditor-General, Tony Harris, who portrays the awarding of a project alliancing contract 'to the party the client liked best after sitting down and talking with them, rather than on price' as something that 'simply won't wash'<sup>29</sup>.

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<sup>26</sup> Andrew Podger, 'Partnering: the Defence View', Australian Journal of Public Administrations, Vol 53, No. 1, March 1994. The ICAC itself has recognised that partnering can *'give rise to particular challenge in ensuring the maintenance of probity and integrity in public sector and private sector relationships'*.<sup>26</sup>

<sup>27</sup> Alan Rose, Partnering Presentation, Attorney-General's Department, 15-16.2.94.

<sup>28</sup> Project Alliancing - Does It Work? by Juliette Pratley in Building Australia, July 1999, p35

<sup>29</sup> Building Australia July 1999 p 37

### 9.3 Competition law

Whether a partnering arrangement is a 'contract, arrangement or understanding', which is likely to substantially affect competition in the relevant market and therefore run foul of Section 45(2)(a) of the Trade Practices Act 1974 (Cth) (TPA), is governed by a wide range of variables including the number of competitors in the market, and whether the arrangement is project-specific or of a longer-term nature.

However, stakeholders cannot evade application of the TPA on the basis that the partnering charter is not legally enforceable. Depending on the facts, a partnering arrangement could constitute supplying goods or services on the condition that the purchaser will not buy from a competitor of the supplier, in contravention of the exclusive dealing provisions in section 47(2)(d) of the TPA.

### 9.4 Good faith

#### (a) *Partnering and good faith*

The NSW Government's Partnering Guidelines assert: 'Partnering is ... a formal recognition that every contract should include an implied covenant of 'good faith and fair dealing' [emphasis added].

Although there are a number of factors pointing towards the recognition of the implication in contracts of notions of good faith in Australia (see Mr Justice Priestley of the NSW Court of Appeal in *Renard Construction v. Minister for Public Works* (1992) 26 NSWLR 234 at 263-8) contrary to the impression given by the Partnering Guidelines, the proposition that all contracts include an implied good faith obligation is not yet law in Australia. However, in NSW the courts have been ready to imply a duty of good faith upon the parties of a contract<sup>30</sup>. The most likely explanation for this mistaken assumption is that the Australian partnering material has borrowed unquestioningly from the American material and thereby imported the legal position there. In the United States, partnering has been defined in almost identical terms, as 'a recognition that every contract includes an implied covenant of good faith'. In America, however, it is clear that contracts do include an implied covenant of good faith. Section 205 of the US Restatement of Law, Contracts 2d, 1981 states: 'Every contract imposes upon each party a duty of good faith and fair dealing in its performance and in its enforcement.'

Further, because good faith has received an increasing degree of statutory, academic and judicial recognition in Australia<sup>31</sup>, the obligation may some day become part of the general law and be imposed in any event. If a duty of good faith is implied into every contract, then partnering provides the machinery for identifying and understanding each party's aims and objectives, to which each party is obliged under its duty to act in good faith to show real commitment. So defined, good faith provides a legal framework for the partnering process.

#### (b) *What does good faith mean?*

What can be said, however, is that good faith is closely associated with concepts such as fairness, honesty and reasonableness. Good faith looks to the spirit rather than strictly to the letter of transactions. It means: 'a real commitment to the laws which govern contracts, to the contract

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<sup>30</sup> In *Alcatel v Scarcella* (1998) 44 NSW LR 349, Sheller JA held that '*The decisions in Renard Constructions and Hughes Brothers mean that in NSW a duty of good faith, both in performing obligations and exercising rights may by implication be imposed upon parties as part of a contract*'

<sup>31</sup> In *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* [2000] WASCA 102, it was held that a breach of a contractual agreement to disclose and agree on rates was a misrepresentation and breach of an obligation of good faith in a 'partnering' contract.

itself, and most importantly, to the other party's aims and objectives, provided these are or should be known and understood'<sup>32</sup>:

Good faith in this sense is almost totally synonymous with the partnering workshop which involves the parties jointly developing a set of mutually agreed objectives which become the shared objectives of the project.

Good faith can apply not only to the performance of contracts, but, as stressed in the US Restatement of Law, also their enforcement. It could require a commitment not to 'stretch' a party's promise in ways in which the other party knows or suspects the first party did not intend, or to insist on strict enforcement if to do so would create a 'truly intolerable imposition': Lücke, p164.

(c) ***Reflecting good faith in the Contract***

A 'good faith' clause recently used in a suite of contracts for a large engineering project reads:

'Where this Contract provides for an action to be done or the existence of a condition to be established, based on the judgment, determination or opinion of any entity, the entity forming the judgment, determination or opinion must:

- (i) act in good faith;
- (ii) act without discrimination;
- (iii) act in accordance with the best business practices where applicable;
- (iv) not act arbitrarily or capriciously; and
- (v) not base its judgment, determination or opinion on trivial, irrelevant or immaterial matters.'

The insertion of such a clause in a contract shows a genuine commitment by the parties (and particularly the owner) to partnering, as well as imposing a significant obligation to maintain an appropriate 'audit trail' with respect to decision making, in order to counter subsequent allegations of 'bad faith'.

## 9.5 Fiduciary obligations

Partnering participants may in certain circumstances be regarded as partners (in the partnership sense) or joint venturers, and thereby owe each other fiduciary obligations:

- (a) requiring them to act in the best interests of the partnering team as a whole rather than their own self interest; and
- (b) prohibiting them from undisclosed and unapproved conflicts of interest.

To minimise the risk of partnering a relationship bringing with it a fiduciary relationship the contract should exclude the existence of such a relationship .

This may need to be dealt with by appropriate provisions in the partnering charter.

## 9.6 Section 52 Trade Practices Act/Estoppel/Waiver

(a) ***A scenario***

Consider this scenario. The contract is a hard dollar contract with strict time bars for:

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<sup>32</sup> Lücke, p164.

- claims for extension of time
- claims for variations
- submission of disputes
- any other claims.

The contract also prohibits the contractor performing a variation without a written direction to do so. The time bars provide that if the builder fails to comply it has no entitlement. This approach is in widespread use.

The project is partnered. The owner wants to vary the foundation system. The builder is running late on the project due to poor site management. The variation delays and disrupts the builder due in part to constructability issues. As part of the partnering process, the builder and the owner and the owner's design consultants invest much time in trying to resolve these issues in the interests of the project.

The owner assures the builder, 'We'll sort out your variation entitlements once we've solved the constructability issue'. The builder fails to lodge its claims for extension of time, variations and disruption in time. Things then sour. Trust breaks down. The owner then relies on the time bars, saying that this is fair in any event as the builder was late anyhow due to poor management.

Is the partnering process irrelevant to the parties' strict legal rights in this scenario? It may be open to the builder to argue that the owner is liable for misleading or deceptive conduct (or conduct which is likely to mislead or deceive) under section 52 of the Trade Practices Act 1974 (Cth) or its State Fair Trading Act equivalents estoppel or waiver.

(b) ***Section 52 Trade Practices Act***

This prohibits conduct in trade or commerce which is misleading or deceptive or which is merely 'likely to mislead or deceive'. A party suffering loss from that conduct - even if the deception was unintentional - is entitled to damages under section 82 of the Act.

The provision is an even more powerful weapon where the representation is about the future. Under section 51A the onus is on the person alleged to have made the representations to establish that they were not misleading or deceptive.

In the above scenario, the owner would seek to argue that the 'We'll sort it out later' representation did not cut across the contract, and that although it was part of the partnering process, it did not amount to the owner telling the building not to worry about time bars for its claims. On the other hand the builder might contend that, in the context, the assurance had the effect of encouraging it to put on hold formal compliance with the notice requirements of the contract.

(c) ***Estoppel***

The operation of promissory estoppel requires the following elements:

- (i) the creation or encouragement by a person in another of an assumption that a promise will be performed;
- (ii) reliance on that encouragement; and
- (iii) departure from the assumption by the first person would be unconscionable<sup>33</sup>.

If the promisee alters its position in reliance on the promise, promissory estoppel can be a powerful sword (a cause of action) or a shield (merely a defence).

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<sup>33</sup> See Priestley JA in *Austotel Pty Ltd v. Franklins Selfserve Pty Ltd* (1989) 16 NSWLR 582 at 610.

(d) **Waiver**

The concept of waiver is closely allied with estoppel. It embraces:

- the giving up of one right in favour of another
- conduct which makes it unfair, inequitable, or unconscionable to insist on the right.

Construction and services contracts typically require formal written notice of variations, without which there is no entitlement to payment. The contractor might agree to perform certain work (without a formal instruction to do so) which, it transpires, is a variation, on the assurance of the owner's consultant that the work is necessary for the success of the project. The contractor carries out the extra work, but the owner refuses to pay. The owner may be estopped from relying on the requirement of written notice<sup>34</sup>.

(e) **Conclusion**

The risk of losing legal rights is inherent in partnering. The best protection is to comply with the notice provisions to ensure that rights are preserved. It is no guarantee attempting, as some contracts do, to require any waiver or variation to be in writing, because even that stipulation is capable of variation to less formal means by conduct or by agreement. One possible answer is the provision, either generally in the Partnering Charter or on a case by case basis, of temporary suspension of barring and notice provisions while problems are discussed and the partnering dispute resolution procedure is exhausted.

## 9.7 Intellectual property

The legal categorization of partnering arrangements can have important implications for this issue. Given the significance attached to the synergy of partnering teams, achieving more by working co-operatively than separately, there is a greater potential for creative output. Properly-drafted construction contracts and design consultancies deal with ownership of intellectual property produced by the individual players, but what of that developed and used by the team?

Intellectual property developed by a partnership is owned by the partnership rather than the individual partner. Similarly, confidential information or trade secrets acquired through participation in a joint venture may be exploited for authorised use only<sup>35</sup>.

Only an agreement between all relevant stakeholders can hope to deal effectively with the ownership and exploitation of intellectual property produced by them together. The ideal place for this is in the Partnering Charter.

## 9.8 Admissions/privilege

Charles Cowan advocates that the parties should always observe procedures dictated by the contract to preserve their legal rights. However, if difficulties arise, partnering (which is about recognizing that they will) requires that the parties make full and frank disclosure to one another concerning the existence of problems and search for the best solutions, irrespective of where legal liability might lie. A party in default may, as a result, make admissions of liability on which other parties might later rely. Such admissions may also compromise insurance policies, thereby upsetting the balance of risk established by the contract and other agreements.

One possible legal safeguard is to endeavour to ensure that admissions are only made on a 'without prejudice' basis. However, this label will not guarantee privilege; rather the circumstances of the discussions will govern the position. If the discussions truly are for the sole

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<sup>34</sup> This occurred in *Update Constructions Pty Ltd v. Rozelle Child Care Centre Ltd* (1990) 20 NSWLR 251.

<sup>35</sup> WR McComas, M Davidson and D Gonski, *The Protection of Trade Secrets*, Butterworths, 1981, 80.

purpose of negotiation and compromise, or for anticipated litigation or for submission to legal advisers for legal advice, then privilege may be available.

## 10. Nepean Hospital, NSW - a case study

### 10.1 Background

This \$24 million design development and construct (DD&C) project was the first response by the NSW Public Works Department to the recommendation by the Gyles Royal Commission that partnering be trialed. This was one of the first occasions anywhere that partnering has been implemented on a project as complex as a hospital. The job comprised a new 6-level building constructed around existing emergency and out-patient buildings.

(The US experience until the early 1990's was largely confined to major civil projects such as dams and roads, which tend to involve fewer players, simpler designs and more straight forward programming than multi-storey public buildings.)

The project won the 1994 Master Builders Australia Partnering Excellence Award which was presented by Charles Cowan.

### 10.2 Key dates

|                          |   |                      |
|--------------------------|---|----------------------|
| Contract awarded         | - | July 1992            |
| Partnering workshop      | - | November 1992        |
| Construction started     | - | January 1993         |
| Contract Completion date | - | 11 July 1994         |
| Completion achieved      | - | 20 June 1994         |
| Building fully occupied  | - | August-November 1994 |

### 10.3 Partnering process

After the contract was awarded to Barclay Mowlem, the PWD suggested a partnering approach. Although the need for the end users, designers and builders to work together ensured that partnering at the Nepean project was always going to stand good prospects of success, the traditional partnering paradigm could not be implemented without careful tailoring.

### 10.4 Workshop

The partnering workshop was held (once the design had been progressed) in November 1992 over 2 days and was attended by the parties then involved in the project. It came as a pleasant surprise to many participants that their goals, embodied in the Charter, were essentially the same. This reinforced a team ethos.

### 10.5 Project Forum of Sub-Contractors

Partnering on site at Nepean involved a two-tiered approach. The sub-contractors met after the Partnering workshop to discuss and agree common objectives. A 'Project Forum' of the head contractor and the 70-90 subcontractors met to regularly discuss matters of concern. Site related issues such as industrial policy and site process were generally dealt with up front by the Forum rather than imposed by the head contractor, and this led to a positive relationship with the workforce. The Project Forum was represented on the Partnering Team.

### 10.6 Partnering Meetings

The Project Partnering Team met monthly to monitor performance against the 10 partnering objectives. Once each member had nominated its own rating, an overall rating was achieved, not

by averaging, but by agreement. The exception to this was the 'Budget' rating, which was scored at the lowest rating given by any team members in recognition of the potentially adverse effect of a stakeholder feeling that it was financially disadvantaged.

This feedback exercise allowed early recognition of potential problems. At a monthly meeting Barclay Mowlem's architect pointed out that there was a conflict in the tender documentation between 1:50 room layout and 1:100 general arrangement drawings, which could have delayed completion by 3 to 4 months. Had the Contractor desired, it could have made a claim for \$300,000 and blown out project budget by \$3million. However the Architect, PWD and Hospital committed additional resources to the problem, which was resolved without causing delay.

The on site Partnering Team was committed to resolving potential problems themselves, rather than automatically escalating them off site while still attempting to come to a solution. For the Team it was almost a matter of honour not to take a problem higher, amounting to an admission that the Team could not solve its own problems. The Project was completed with no outstanding claims.

There were a large number of variations resulting in changes to the scope of the work, 2 of which were for over \$500,000. The contractor's Project Manager gave an undertaking not to claim delay costs, providing the PWD granted any extensions of time needed to 'keep the contract tidy'. This is what occurred.

## 10.7 Lessons

### (a) *Commitment from management*

Due to total commitment from senior management, the Partnering Team was able to take decisions knowing that they would not be countermanded at a higher level. Senior management of all stakeholders were committed to ensuring that no one person in their organisation had the right to threaten the success of the project, and were prepared to take out any 'bad eggs'. This was seen by the participants as perhaps the key reason for the success of partnering at Nepean Hospital.

### (b) *Flexible project structure*

The DD&C form of project structure gave the parties greater scope for partnering due to the contractors greater design role in contrast to a construct-only contract.

Quality outcomes were far in excess of those normally achieved. Towards the end of the Defects Liability Period there were only 30-40 outstanding defects, compared with a typical 600-700.

### (c) *Facility Handover*

The contract completion date was achieved early. But more importantly the early functional handover of the building for its medical uses was impressively early. The hospital was fully operational within 3 months of practical completion, rather than the usual 6 to 9 months.

## 10.8 Conclusion

Partnering may well have occurred in any event at the Nepean Hospital Project, but the formal structuring of the partnering arrangements gave all players an added level of confidence. All 2000 people who worked on the project took on the idea of partnering to a greater or lesser extent. Their prime motivation was not the moral force of the Partnering Charter or agreed subcontractor's objectives, but the benefits to be gained from the job being a success.

*I am occasionally asked if partnering works.  
My answer is, even if there were to be no  
financial or performance advantages, it is  
clearly the ethical way of doing business.*

Charles Cowan