# Relationship Contracting: Babies and Bathwater

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On many projects these days there is some consideration, at least at the outset, of whether the parties should adopt a partnered approach, form an alliance or otherwise establish a contractual relationship – somewhat at odds with the old way of doing things. Regardless of its precise form, it seems *relationship contracting* is here to stay – and many see clear benefits in this.

Often parties intent on relationship contracting will automatically latch onto a specific form, such as *alliance contracting*, and then attempt to impose it on their particular project. But, as we shall see, it may often be better to start with a general *relationship contracting* approach, rather than automatically seeking to set up an affiance from the outset. This enables the parties to consider a range of options, addressing both their commercial and legal requirements, rather than one prescriptive solution which might (if inappropriately implemented) produce unexpected legal and commercial difficulties.

## DISTINGUISHING PARTNERING AND ALLIANCING

The starting point in all of this is to get the nomenclature right, particularly when dealing with alliancing. According to strong advocates of alliancing, for example:

▶ *Partnering* and *alliancing* cannot be used interchangeably, as they are fundamentally different; and a project delivery system which adopts some, but not all, of the distinguishing features of an alliance is not a true alliance.

In essence, *alliancing* is a consensual (although not necessarily contractual) relationship which has two fundamental features: a joining of *efforts* and a joining of *interests*. The first feature is shared with partnering and, indeed, traditional adversarial forms of contract, but the joining of interests is different and unique. Unlike partnering, which is usually superimposed on traditional hard-dollar forms of contract with an inherent tension between the parties' interests, alliancing deliberately aligns the interests of the parties

So while partnering can run into real difficulties when there is insufficient joint interest to fuel joint effort, the alignment of interests in an alliance ensures – commercially if not legally – that the commitment to joint effort does not become an illusory promise.

## RECOGNISING THERE IS A BABY IN THE BATHWATER

Parties considering an alliance need to distinguish between:

▶ the bathwater: the traditional adversarial approach to contracting; and

▶ the baby: a contract which, if things go wrong, provides the parties with an appropriate allocation of risk (if you like, an insurance policy of rights and obligations).

In their enthusiasm to throw out the bathwater, they should not be seduced into throwing out the baby ... unless of course this is their intention. The problem is that some of the key features of true alliancing can easily have this effect, even though the parties may be blissfully unaware of what they have done.

## WHAT DISTINGUISHES AN ALLIANCE?

Even if the form of relationship contracting which the parties are putting in place goes beyond partnering and provides a joining of both effort and interest, the parties are not necessarily constituting an alliance. To do so, according to the proponents of alliancing, it is necessary to have additional features peculiar to an alliance, the most significant being:

▶ careful selection of the alliance parties;

▶ early involvement of the contractor in the project;

▶ an up-front statement of mission, shared objectives and principles;

▶ a contract management structure enhancing team-building, communication, consultation, co-operation and collaboration, through the alliance board;

▶ provision for information to be shared on an open-book basis and the preservation of confidentiality and intellectual property;

▶ flexible workscope;

▶ a remuneration strategy which aligns the interests of the parties, frequently with a pain-share/gain-share approach to cost under-runs/over-runs, early completion/delays and other key performance indicators; and

▶ a no blame culture.

Most of these features are not controversial from a legal perspective. Indeed, many other types of contract, under which the contractor assumes significant risks, contain remuneration involving pain-share/gain-share and performance against key performance indicators.

Two features, however, have significant legal implications and need to be carefully understood by the parties before they take the plunge. These are:

▶ the way in which the alliance board operates; and

▶ the no blame culture.

## ALLIANCE BOARDS: THE VEXED QUESTION OF UNANIMITY

The contract management structure of an alliance departs significantly from the way contracts have traditionally been administered on construction projects. It usually involves two levels: an alliance board (the prime decision-making body) and a management team (which is appointed by and reports to the board).

The alliance board typically operates as a virtual corporation, with total responsibility for fulfilling the alliance's obligations and wide powers to do so. As the ultimate decision-making body, the board is typically required to resolve all issues unanimously, without recourse to a circuit-breaker able to provide certainty in the event of a deadlock.

This is where it becomes critical for the parties and their advisers to understand one of the stark differences between commerce and the law. Commercially, the parties may be quite prepared to accept the uncertainty inherent in an absolute insistence on unanimity. Commercial imperatives provide a strong motivation for the parties to seek agreed solutions and break through deadlocks in the interests of ensuring the progress of the project – thereby avoiding the need for the parties' bargain to be struck by a third party such as an independent expert.

Lawyers, on the other hand, are trained – at the risk of being perceived as wet blankets – to avoid contractual uncertainty, and the attendant risk of an unenforceable contract, at all costs. To do this they seek to provide objective deadlock-breaking mechanisms, such as an independent expert, for any circumstances where the parties are unable to agree on any subject matter, so that the project may continue to move forward.

Ultimately, of course, it is a commercial issue whether the parties require unanimity for all decisions at the alliance board level. However, parties making this commercial decision should do so only after they have been fully advised as to its legal consequences. It may be that parties who are told, 'If you choose to put this in your contract, you may not have a contract at all', will be prepared to explore less radical alternatives. This may be particularly the case for the public sector or where financiers have a significant role. With only a little imagination, it should be quite a simple task for the parties and their advisers to devise a modified relationship contracting decision-making mechanism which, on the one hand, gives the parties the maximum opportunity for unanimous resolution of all issues but which, on the other, provides the deadlock resolution mechanism needed for contractual certainty.

## THE 'NO BLAME' CULTURE

Proponents of alliancing vigorously maintain that unless an arrangement enshrines a *no blame* culture, with no party being liable to another party for any default (other than perhaps a wilful default), there is

no true alliance.

Under a true alliance contract, the wilful default exception might be defined to mean a wanton, reckless act or omission involving a wilful and utter disregard for its harmful and avoidable consequences. It might also exclude errors of judgment, mistakes or other acts or omissions made in good faith, even if they involved gross negligence.

Proponents of this true approach argue, with good reason, that this no blame culture is needed:

▶ Firstly, so that the parties feel free to consider alternative methods of design and construction, without the Damoclean sword of liability hanging over their heads if something goes wrong; and

▶ Secondly, so that, if something does go wrong, the parties immediately focus on solutions rather than on witch hunts.

Again, on the face of it, the commercial and legal positions differ. From a legal perspective, the exclusion of liability for any obligation under an alliance contract could, for instance, exclude a party's liability, both in contract and in tort, to use reasonable care in preparing the design of the project. If the design were fundamentally flawed because the party designing it failed to use the reasonable care which would otherwise have been required, the other parties would have no recourse, unless they could show a wilful default. This might be so, even though their losses could be substantial, especially if major redesign and reworking were required and completion were to be significantly delayed.

In these circumstances, insurance issues would normally come to the fore. But in the absence of any liability for a breach of a professional duty, it is hard to see how the parties which have suffered loss could have recourse to any professional indemnity insurance. Further, quite apart from avoiding liability, the alliance party responsible for correcting the defective design (or other defective work or materials) might not only receive payments for the direct cost of the rectification but also its margin on this cost!

However, as with the issue of board unanimity, it would seem that, with some thought, there are several possibilities for satisfying both the commercial and legal interests of the parties. Firstly, drafted carefully, the provisions of a relationship contract dealing with liability for failure to perform could go a long way towards achieving the perceived commercial advantages of no blame clauses. At their simplest, these provisions could, without creating uncertainty of risk, motivate the parties to:

▶ get it right the first time;

▶ seek the most cost-effective and efficient solution to any problem; and

▶ solve the problem first and consider liability later.

Alternatively, parties to a true alliance, with the requisite no blame culture, who nevertheless harbour significant concerns about late completion or the ability of the project works to operate according to specified performance parameters (eg. in the context of a process plant) could explore the possibility of the alliance (rather than specific parties) taking out insurance to address such events. If satisfactory insurance products were to be available, on terms commercially acceptable to the alliance, this could assist in addressing these concerns.

## CONCLUSION

To summarise, we have seen how two of the distinguishing features of an alliance – an absolute requirement of unanimity for all alliance board decisions and a no blame culture – give rise to fundamental legal concerns. While a decision to adopt such a structure may very well be a commercial issue, it should only be made once the parties are fully aware of its legal – and hence commercial – consequences.

However, unless they have a burning desire to be able to call their project an alliance in its true sense, there is a ready range of other relationship contracting structures which are capable of delivering similar commercial benefits without the legal risks.

Marko Misko's article first appeared in Clayton Utz's *Projects Issues* (September 2000) and is reprinted with permission.