

## Reserved Powers: Harnessing the 'Big Bad Wolf'

### 1 Introduction

A fundamental characteristic of the alliance is that decisions are made unanimously by its 'Alliance Board' and 'Alliance Management Team' (or similarly named bodies). Reserved powers are the exception to this rule. Reserved powers are those matters which may be decided by the Owner and the Owner alone.

Some (usually Non-Owner Participants) view reserved powers as the 'big bad wolf' of alliance contracting, cutting at, or indeed cutting out, the very heart of an alliance - its cooperative risk-sharing framework. This standpoint encourages Non-Owner Participants to resist the inclusion of reserved powers altogether.

Others view reserved powers as a way for Owners to 'have their cake and eat it too', to reap the cost benefits of an alliance while retaining control. The risk of this view is that Owners may use reserved powers so liberally that the alliance agreement itself is in effect reverted into a traditional principal-contractor arrangement and the benefits of alliancing are lost.

However, there is a middle road. By adopting a balanced approach, reserved powers can enhance the alliance relationship for all participants. Indeed, they can fit into and enhance the 'best for project' framework.

Given that the Owner is the participant that needs, will own and will pay for the facility to be created by the alliance, and usually will ultimately wear the overwhelming majority of the downside costs of any major time or cost blow outs or defects, it is perfectly understandable that the Owner will want to reserve to itself the right to make certain important decisions. Public sector Owners will have an additional set of 'public interest' type matters to add to such a list.

This article seeks to provide some sign posts to assist both negotiators and drafters to find that middle road.

These sign posts consist of three steps.

Step 1: Discern the type of reserved power and the rationale behind it.

Step 2: Limit the scope of the reserved power to the extent to which it is justified by alliance principles.

Step 3: Embed mechanisms in the alliance agreement which integrate the reserved powers within the cooperative framework.

But first, an overview of the advantages and disadvantages of reserved powers.

### 2 The potential advantages and disadvantages of reserved powers

The potential advantages of reserved powers include:

- speeding up decision making in circumstances where waiting for unanimous alliance board consensus would increase the damage to alliance assets (for example if there is an environmental emergency);
- in project alliances, ensuring the Owner retains sufficient control that the end asset is 'what they bargained for';
- allowing alliance contracts to be used in sectors and industries which would otherwise not consider using relational contracting at all, for example, by allowing government/military bodies to retain control of security-sensitive issues such as personnel and confidentiality; and
- helping manage those risks which extend beyond the life and scope of the project and thus have larger repercussions for the Owner than the Non-Owner Participants (for example protecting the Owner entity's image and protecting directors from OH&S penalties that may attach to them as individuals).

The potential disadvantages of reserved powers include that they can:

- undermine the cooperative culture of the alliance;
- allow decisions to be made in the absence of the people best-informed and best-positioned to give advice;
- create confusion over whether the alliance board or the Owner is making the decision (which can slow down the problem-solving process); and
- undermine incentive schemes by allocating responsibility to the Owner.

If framed too broadly, reserved powers can turn an alliance contract into a conventional adversarial contract, albeit with a few extra committees and painshare/gainshare mechanisms on the side. While this may be the participants' intention, they should carefully consider the implications of such an approach.

### 3 Step 1: Discern the type and rationale of the proposed reserved power

Although there are numerous exceptions, reserved powers can generally be placed in one of the following categories:

- emergency powers;
- scope change related powers;
- program related powers;
- compliance related powers;
- interest/image protecting powers; and
- industry/sector specific powers.

Analysis of the rationales behind these types of reserved powers will assist alliance partners to assess whether they will help, or hinder, their alliance.

#### 3.1 Emergency powers

Examples of this type of reserved powers include:

- (a) urgent protection of the works; and
- (b) urgent protection of the environment.

Rationale

The rationale underlying such reserved powers is that in cases of emergency it is best for the alliance if decisions are made promptly. Waiting for the unanimous decision of the alliance board could slow efforts at mitigation.

However, this rationale only justifies the use of reserved powers in circumstances of actual emergency or urgency. Subject to the particular circumstances, this rationale does not necessarily justify reserved powers for general reinstatement works or rectification of defects. By including broad reinstatement and rectification reserved powers, participants should consider whether they risk taking responsibility out of the hands of those best able to bear it.

#### 3.2 Scope change related powers

This type of reserved power gives the Owner the ability to unilaterally require change to the scope of the works.

Examples of this type of reserved power include decisions to direct changes to the scope of the project to:

- (a) increase, decrease or omit any part of the project (and give omitted work to others);
- (b) change the character or quality of any part of the work under the alliance;
- (c) change the levels, lines, positions or dimension of any part of the work under the alliance;
- (d) execute additional work under the alliance;
- (e) demolish or remove material or work no longer required by the Owner; or
- (f) change the functional requirements and fundamental design parameters of the project.

Rationale

The rationale behind such reserved powers is that the Owner needs to have the right to determine the shape of what, after all, will ultimately be its asset. Therefore, such powers may be best tailored to high level decisions such as in example (f).

The projects which frequently suit alliances are those involving a high degree of uncertainty as to its scope (including design). Reserved powers such as those in example (b), which give the Owner the power to direct the other Participants to change 'the character or quality of any part of the Work', have the potential in some circumstances to undermine or fetter the benefits of collaborative and/or innovative design input.

#### 3.3 Program-related powers

This type of reserved power gives the Owner the ability to unilaterally adjust the timing or sequencing of the works. Examples of this type of reserved power include that the Owner may:

- (a) change the timing or sequencing of any part of the work under the alliance;
- (b) accelerate the progress of the work under the alliance; or
- (c) suspend and recommence the work under the alliance.

Rationale

Prima facie, such powers appear more difficult to justify than design-related reserved powers since they concern the progress of the work rather than the shape of the end product. Nevertheless there will be times when it is best for the project for such decisions to be made unilaterally by the Owner. As a result, this type of reserved power is best applied following careful consideration of whether it is warranted by the characteristics of the particular alliance and project.

### 3.4 Regulatory compliance

Examples of this type of reserved powers include matters relating to:

- (a) compliance with environmental protection legislation and planning approvals and mining titles;
- (b) reporting obligations required under law or by the ASX; or
- (c) certain other design or OH&S requirements which may arise if the Owner is a government body.

#### Rationale

On the one hand, environmental and OH&S compliance encompasses such a broad range of decisions that, on a practical level, they are best dealt with in a collaborative way through the alliance board or alliance management team. However the penalties under OH&S and environmental protection legislation can be very significant and can attach to the Owner, and even to individual directors and managers, irrespective of the relational risk-sharing structure. It is this risk which can justify capturing such decisions under a reserved power. Alliance participants may consider limiting the ambit of such powers to matters relevant to particular OH&S and environmental regulations (for example the breach of which constitutes a criminal offence). It may also be prudent to specify that, ordinarily, compliance with OH&S and environmental issues will be monitored jointly. Indeed, it is not in the Owner's interest to develop a culture of the Owner being responsible for all such issues when the Non Owner Participants generally have more direct contact with personnel and the projects day to day activities.

### 3.5 Interest/image protection powers

Examples of this type of reserved powers include that the Owner may make decisions concerning:

- (a) any matter that affects the Owner's stakeholders;
- (b) any matter that affects the community;
- (c) communication with adjacent sites; and
- (d) media communications.

#### Rationale

As seen from the above examples, these reserved powers can be framed very broadly. The rationale behind such reserved powers is that matters that affect the image of a corporate entity or its stakeholders have consequences beyond the project at hand. Such consequences can impact the entity in all its activities, beyond its involvement in the alliance (including, for listed entities, their share price). Under the balanced approach, participants should specify those risks that particularly concern them and seek to limit the reserved powers to those matters of concern. For example, the Owner may choose only to have the power to unilaterally decide a matter 'that affects the

community' if 'in the Owner's reasonable opinion, a matter has the potential to impact the project or the Owner beyond the completion of the project'.

### 3.6 Industry/sector specific powers

Some sectors and industries have particular concerns which may necessitate the application of certain reserved powers. For example government bodies, particularly in the defence/security sector, may seek the inclusion of reserved powers regarding:

- (a) matters in respect of which the Owner is subject to legislative or other public accountability obligations;
- (b) the use of particular third party suppliers or subcontractors (e.g. where essential to achievement of a governmental procurement or industry policy objective);
- (c) selection of personnel; or
- (d) confidentiality or security issues.

#### Rationale

Often it is projects involving cutting edge technology and involving numerous uncertainties which benefit the most from alliance contracting. Yet often it is these same projects which involve security-related issues over which the Owner wishes to retain significant control.

Reserved powers offer a solution to this tension. If not for reserved powers, the government military/security sector may well be even more hesitant to utilise alliance contracting. Alliance participants should bear this in mind when considering how to frame reserved powers in such contexts.

### 4 Step 2: Limit the reserved power to the rationale

When negotiating an alliance agreement using this balanced approach, all alliance participants should seek to voice their concerns regarding the proposed reserved powers. In particular, the Owner should seek to clarify and specify each risk which it desires to manage through the use of reserved powers.

The benefits of a balanced approach are achieved by tightly tailoring, and restricting, the reserved powers to the particular concerns of the Owner. That is, the scope of each reserved power should be limited to the extent it is justified on a best for project basis, given the particular concerns of the alliance participants.

### 5 Step 3: Integrate the reserved powers into the alliance framework

Once the reserved powers have been tailored and limited to the Owner's particular concerns, there are several means of integrating them into the alliance framework. These mechanisms seek to ensure that the benefits of alliance contracting are enhanced, rather than undermined, by the Owner's use of such reserved powers.

## 5.1 Aim for a short list of reserved powers

As discussed, both Owner and Non Owner participants should seek to limit the reserved powers in number and in scope to those for which it is best for the project for the Owner to be able to exercise exclusive control.

## 5.2 Revert time and cost adjustments to the alliance board

A very effective way of integrating reserved powers into the alliance framework is to provide that any adjustments to time or cost parameters (sometimes referred to as "Knock-on-Effects") resulting from the exercise of the reserved power are determined by the alliance board, and not unilaterally by the Owner.

To this end, alliance partners should be careful when considering the inclusion of clauses which preclude reserved powers from constituting scope variations and so preclude them from attracting adjustments.

## 5.3 Alliance partners to liaise regarding exercise of reserved powers

The alliance agreement should clarify that reserved powers provide the Owner the right, although not the obligation, to determine the particular matters listed.

Furthermore, the Owner should be encouraged to consult with the Non-Owner participants before exercising its reserved powers.

The aim is to minimise confusion over who is deciding what and to minimise potential increased costs, delay and disruption in the performance of the services under the alliance.

## 6 Conclusion

Reserved powers have the potential to enhance alliance relationships and to allow alliance contracting to be used in sectors which otherwise would find it unacceptable.

This can be achieved by adopting a balanced approach whereby alliance partners:

- carefully discern the character, and rationale, of each of the reserved powers being proposed;
- tailor and limit the reserved powers to the particular concerns of the alliance participants; and
- seek to integrate the reserved powers into the alliance framework.

It is by walking this middle road that reserved powers can allow the participants to reap the full benefits of their alliance.

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