Alliancing in Australia: Commercial Advantage at the Expense of Legal Certainty?

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Turning the traditional concepts of construction contracting on their head, alliancing seeks to harness the synergistic benefits of co-operation and collaboration between the project participants. Research suggests that alliancing can work, at least in a commercial sense, delivering improved time and cost outcomes. However, it comes with increased risk for the owner of a project in the event that the project encounters unforeseen difficulties or the efficiencies promised by co-operation and collaboration do not materialise. Whether, from an owner's point of view, the increase in risk is justified having regard to the potential advantages of enhanced co-operation and collaboration is a difficult commercial question which depends upon the type of project, the alternative contracting model, the previous relationship of the parties and the personality of key management.

I INTRODUCTION

Alliancing was originally conceived in the 1990s when it was adopted for use in oil and gas projects in the North Sea. It emphasises co-operation between the parties, the avoidance of disputes, and the sharing of project successes and losses. In 1994, alliancing made its first foray into the Australian construction industry with the formation of the Wandoo Alliance. Whilst there have been failings along the way, there have been sufficient successes for it to become a recognised alternative to more conventional forms of contracting. However, quite remarkably, the alliance contract is still yet to be tested in an Australian court. Unenforceability remains a key concern, particularly if the contract contains agreements to agree on fundamental issues.

II WHAT IS ALLIANCING?

Alliancing is a form of relationship contracting characterised by co-operation and collaboration between the parties. It typically lends itself to use in the construction industry, but this need not exclusively be the case.

Alliance agreements usually exhibit the following features:

- integrated project team;
- joint decision-making between the parties on all key project issues;
- no-dispute clauses, whereby parties agree not to sue each other (except in limited circumstances) and to resolve issues between themselves only; and

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- unique payment structure consisting of:
    - guaranteed reimbursement of contractor's direct project costs;
    - an at-risk overhead and profit margin for contractor; and
    - gain/pain share regime, in which good and poor performance is shared equitably among the parties.

Before examining each of these features in greater detail, it is instructive to define some commonly used alliancing terms:

- **Owner** means the principal entity commissioning the project;
- **Non-Owner Participants** (**NOPs**) means all entities other than the Owner involved in the construction of the project, such as contractors and designers;
- **Target Outturn Cost** (**TOC**) means an estimate of all reimbursable costs, plus overhead, plus profit margin for project for all NOPs;
- **Initial (Agreed) TOC** means the agreed TOC at the time of entry into the alliance contract;
- **Final (Adjusted) TOC** means the last agreed TOC by the end of the project (adjustments primarily resulting from agreed variations);
- **Actual Outturn Cost** (**AOC**) means actual reimbursable costs, plus overhead, plus profit margin for project for all NOPs; and
- **Key Result Areas** (**KRAs**) means areas in which parties agree NOPs will receive a bonus if certain results are achieved.

Whilst there are no standard form alliancing contracts available in Australia, the Australian Government (Department of Infrastructure and Regional Development) has released guidelines for preparing alliance agreements, the National Alliancing Contracting Guidelines, including a template Project Alliance Agreement (**NACG PAA**).[1]

We will now return to the key characteristics of a typical alliance agreement.

A *Integrated Project Team*

In a traditional construction contract, each party forms its own team which, naturally, advocates its own interests. However, in an alliance, a notional board is constituted for the purposes of making the necessary management decisions in respect of the project.

[1] Australian Government Department of Infrastructure and Regional Development, *National Alliance Contracting Guidelines: Template 1 – Project Alliance Agreement* (September 2015). The NACG PAA will be referred to throughout this article to provide examples of how alliance agreements are typically drafted.

This board is commonly referred to as an Alliance Leadership Team (**ALT**). The ALT typically consists of no more than six to eight members, in which all participants hold representation.[2]

The ALT is granted exclusive power to make decisions throughout the NACG PAA. For instance, subclause 12(b)(2) provides that 'the ALT may determine any reasonable adjustment to any or all of the TOC, the KRAs and the Date for Practical Completion'.[3]

B *Unanimous Decision Making*

Alliance contracts typically require decisions of the ALT to be unanimous to ensure that all participants in the project agree on any proposed action. For example, subclause 6.6(b) of the NACG PAA provides that 'no decision can be made by the ALT unless...the decision is unanimous ... '.[4] The legal pitfalls associated with agreeing to agree matters in the future will be discussed later.

An obvious difficulty arises where the ALT is unable to arrive at a unanimous decision. Some alliance contracts provide a tie-breaker mechanism. For example, clause 2 of Schedule 14 of the NACG PAA provides that where the ALT is unable to resolve an issue in at least two separate meetings, followed by a meeting of the authorised officers of each participant, the owner must refer the issue to expert determination.[5]

At the outset, one could justifiably question whether such a referral system is at odds with core alliancing principles. Further, a difficulty arises with the idea that all disputes about issues before the ALT are capable of resolution by expert determination. Obviously, where the issue to be resolved is an expert one, such a mechanism may be appropriate. However, where the issue to be resolved is purely a commercial one, then there is no relevant expert issue; merely a need to resolve competing commercial interests between the project participants. This is discussed in further detail below.

C *No-Dispute Clauses*

A potent (and as we shall see later, equally problematic) feature of alliancing is the prohibition on parties commencing legal proceedings against one another. This usually takes the form of a "no litigation or arbitration" clause. Supporting this, is often a clause which provides that a failure to perform any obligations under the agreement will not give rise to any enforceable rights to the parties at law or in equity.

There are often limited carve-outs to the no dispute rule. For instance, parties usually retain their rights to sue in the case of "wilful default". Wilful default is generally a more egregious form of wrongdoing committed by a party. It typically includes events such as a deliberate

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[2] Richard Morwood, Deborah Scott and Ian Pitcher, *Alliancing: A Participant's Guide – Real Life Experiences for Constructors, Designers, Facilitators and Clients* (Maunsell Aecom, 2008) 100.

[3] Australian Government Department of Infrastructure and Regional Development, above n 1, 35.

[4] Ibid 25.

[5] Ibid 120. Note that for more serious offences, for example wilful default, arbitration and litigation are also options.

and purposeful act or omission, an act or omission undertaken with reckless disregard, a fraudulent act or omission, or a repudiation of the alliance agreement.

By way of example of how a no-dispute principle might operate in practice, clause 5.1 of the NACG PAA provides:

> (a)... subject to clause 5.3 [contains exceptions, for example, wilful default], the Participants agree that there will be no litigation or arbitration between them arising out of or in connection with this Agreement. The Participants must use their best endeavours to avoid issues arising as between each other and, to the extent an issue arises, must resolve the issue internally...
>
> (b)...a failure by a Participant to perform any obligation or to discharge any duty under...this Agreement...does not give rise to any enforceable right or obligation at law or in equity ...[6]

D *Payment Structure*

Another key differentiating feature of alliancing is the payment regime, which seeks to incentivise performance across a range of indicators and to distribute the gains and losses equitably among the participants to promote co-operation and resolution of disputes on a "best for project" basis.

The payment structure commonly comprises the following features:

- **reimbursable costs:** the NOPs are guaranteed to be reimbursed for costs they actually and reasonably incur (the NOPs must open books to the Owner for verification);
- **overhead and profit:** the NOPs earn overhead and a profit margin on their costs, but this can be reduced to nil (see below);
- **gainshare/painshare:** the Owner and the NOPs will generally share (in equal portions) in the benefit (or cost) where the AOC is less than (or greater than) the Final (Adjusted) TOC. Where painshare occurs, the NOPs' exposure is generally limited to their overhead and profit, whereas the Owner's exposure is unlimited; and
- **performance reward/liability amount:** the NOPs receive (or must pay) an additional amount from (or to) Owner if (non-cost) key performance criteria are (or are not) met (eg. quality, safety). Often these are also limited so that only the NOPs' overhead and profit margin are at risk, but nothing more.

The result is that, in most cases, the contractor will receive a full return in respect of its costs. This outcome is very different from that which prevails under all other forms of contract, except another form of cost plus arrangement where the contractor takes no responsibility for quality or timely completion.

[6] Ibid 23.

III ALLIANCING IN AUSTRALIA

Companies involved in oil and gas projects in the North Sea in the 1990s, such as British Petroleum, were the first to employ the alliancing method. Its adoption was a product of growing discontent with the perceived shortcomings of traditional construction contracting. It was sometimes argued that traditional contracts were fostering a master-servant relationship which was promoting a culture of distrust and blame attribution amongst the parties. Alliancing, with its focus on joint decision-making, shared exposure to gains and losses and internal resolution of conflicts was seen as a potential alternative.[7]

However, it should be remembered that the significant contracts in this industry had for some time often been let on an Engineering Procurement Construction Management (**EPCM**) basis, meaning the contractor was reimbursed its full costs margin and overhead. Accordingly, in this environment, the adoption of alliancing is less radical than it may be in other industries where, for example, contracts are let on a lump sum basis. Further, in some respects, the major oil companies are different to many owners. They have significant in-house engineering expertise and are very interested in the final design, particularly as it affects maintenance times, whole of life costs and reliability. Because of their in-house expertise, they often want a high level of control, making a cost plus arrangement commercially appropriate.

From the perspective of owners used to EPCM contracts in the oil and gas industry, alliance contracts arguably marked, at least in some respects, an increase in the risk assumed by the contractor. This is so because pursuant to a conventional EPCM contract, the contractor's margin and overheads were not usually at risk, by reference to key performance indicators. In alliance contracts, the contractor may suffer a negative adjustment to its margin or overheads because the project fails to achieve the standard specified in a key result area, even if the failure to achieve this standard is not attributable to any act or omission of the contractor. While the EPCM contractor was at risk of being successfully sued for breach, claims for breach of EPCM contracts are difficult because they usually require proof of a failure to exercise reasonable care in respect of a management function or design. That is, there is no strict liability which generally arises in design and construct contracts.

Owners used to lump sum or schedule of rates contracts will find that the change in risk assumed by them in an alliance is significantly greater than for those used to EPCM contracting.

Set out below are some examples of successful and unsuccessful alliance projects.

A *Successes*

The first alliancing project in Australia was the Wandoo Alliance which was formed in 1994. The purpose of the project, with Ampolex Limited as owner, was to develop a high-risk marginal oil field in Western Australia. The project, which was valued at $364 million,[8] is

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[7] Morwood, Scott and Pitcher, above n 2, 18.

[8] All amounts in this article are in Australian Dollars.

reported to have been a success. It is claimed that the oil field was brought into production seven months faster than benchmarked world performance for similar platforms and was delivered $13 million under budget.[9] Ampolex, effusive in its appraisal, opined that 'a properly formed alliance will deliver exceptional savings in project time and project cost to the client, resulting in exceptional profits for all participants and satisfaction to each individual employed within the alliance'.[10]

The Northside Storage Tunnel Alliance is also claimed to have been a success. It was constructed from 1997 to 2001. The project involved the design, manufacture and commissioning of a 16 kilometre storage tunnel and a 3.5 kilometre branch storage tunnel, overflow connection works and upgrades to the North Head Sewage Treatment Plant.[11]

Sydney Water Corporation (the owner) reported that despite the many constraints and difficulties, the project (which was valued at $465 million):

- achieved its targeted outcome of being ready for the 2000 Sydney Olympic Games;
- achieved exceptional results in its delivery of community relations, environmental management and safety systems; and
- was completed at a final cost which represented an increase of only 3.3% over the original Target Cost Estimate[12] (adjusted to include escalation and accounting policy changes) despite significant technical, environment and social problems and delays.[13]

However, absent independent audit, some care needs to be taken when considering these claimed successes. There are, of course, other projects where the alliance method of delivery has been an abject failure. Further, even where the success is real, it is difficult to draw a causal connection between the success and the contract strategy that was used. Would such a success have occurred anyway? There are many (probably the vast majority) of projects that are delivered on time and at a cost which sees the contractor make a reasonable profit when a lump sum contracting strategy has been adopted. How then can it be said with confidence that it is the method of contracting which is the cause of success?

In 2009, a study undertaken by Evans & Peck and the University of Melbourne on a sample of 46 current and past alliances in Australia (**E&P study**) found that, on average:

- the total value of alliance projects in road, rail and water sectors in New South Wales, Victoria, Queensland and Western Australia in 2004-2009 was $32 billion (representing 29% of total infrastructure spend in same sectors across all of Australia over that period); and
- although the private sector was the first to adopt alliancing, by 2009, it was almost exclusively used by the public sector (approximately $9.5 billion of public sector

[9] Morwood, Scott and Pitcher, above n 2, 19.
[10] Ibid.
[11] Ibid 20.
[12] Target Cost Estimate is generally defined as TOC less project-specific overhead.
[13] Morwood, Scott and Pitcher, above n 2, 20.

alliance project value, compared with less than $500 million of private sector alliance projects value in 2009).[14]

The E&P study also found that, on average, AOC was 45-55% higher than the estimated project cost at business case stage. This can be contrasted with 20% for traditional contracting methods and 5-10% for Public-Private Partnerships.[15]

Of the 45-55% cost increase exhibited by alliance agreements, the E&P study found that:

- 35-45% occurred between business case stage to Initial (Agreed) TOC;
- 5-10% occurred between Initial (Agreed) TOC to Final (Adjusted) TOC; and
- a negligible increase occurred between Final (Adjusted) TOC and AOC.[16]

It is argued that these results show that the bulk of the cost increase occurred between business case stage and Initial (Agreed) TOC. Therefore, it is contended that the cost overrun is more a result of inaccurate cost forecasting at the business case stage as opposed to any inefficiencies precipitated by the alliancing method. The E&P study suggests that this variance might be because alliancing is often adopted for high risk projects, rendering accurate business case forecasting difficult.[17] However, given that many of the chosen projects are likely to have come from the rail, road and water sectors, this seems unlikely and requires further detailed consideration to justify the contention. Likewise, the assertion that as the cost overruns are judged against business case estimates, it is likely to be a result of inaccurate forecasting at the time of the business case, needs solid evidence to justify the conclusion. Given that the structure of the alliance usually provides an incentive for the contractor to complete the project for the agreed TOC, the commercially sensible thing for the contractor is to agree a high TOC to ensure a greater probability of it being achieved or bettered (increasing the prospects of a bonus).

The responses provided by the 46 alliances which completed the self-questionnaires in the study provide some evidence of the commercial benefits of alliancing:

- 82.9% of owners (87.2% of NOPs) stated that the alliance delivered on time or better; and
- 85.7% of owners (95.7% of NOPs) stated that the alliance delivered on cost or under.

Despite this, the anecdotal evidence is that alliancing is less common now than it was some years ago. As noted above its use in the private sector seems to have declined over the years since the concept was introduced.

[14] Evans & Peck and the University of Melbourne, *In Pursuit of Additional Value: A Benchmarking Study into Alliancing in the Australia Public Sector* (Department of Treasury and Finance, October 2009) 7-8.

[15] Ibid 46-47.

[16] Ibid 46-47.

[17] Ibid 47.

B *Unsuccessful Alliancing Projects*

We turn now to consider two publicised examples of failed alliancing projects. In 1996, BHP Direct Iron Pty Ltd (**BHP**) entered into an alliance agreement for the development and construction of the Boodarie Iron Plant in Western Australia at a cost of more than $1.5 billion.[18] The plant was designed to convert iron ore fines (delivered via an under-harbour tunnel and a 7.2 kilometre conveyor) into iron briquettes (the final product containing an enriched form of iron).[19]

In May 2000, as a result of persistent commissioning difficulties, large cost overruns and significant operational issues, BHP decided to entirely write off the carrying value of the plant. In May 2004, an explosion occurred in the plant which resulted in the death of one employee and serious injuries to two others. In May 2005, in response to the incident, BHP was prosecuted by the Department of Industry and Resources. In August 2005, BHP announced it was preparing to permanently close the hot briquetted iron facilities at the plant (it has now been closed and sold for scrap).[20] Public reports suggest that the final cost of construction was $2.6 billion,[21] an overrun of $1.1 billion (approximately a 73% overrun).

Another example of an unsuccessful alliancing venture is the Djimindi Alliance. In March 1998, the Australian Government commissioned the procurement of a lightweight anti-submarine torpedo (MU90) and the integration of the new torpedo onto five Australian Defence Force platforms. The total budget for the project was $665 million. In its report, the Australian National Audit Office found that:

- the project did not deliver the full capability as originally expected;
- the project reached completion six years later than originally scheduled; and
- almost the whole of the budget was likely to be needed to deliver capability to just two of the five platforms.[22]

Relevantly, the report stated that the alliancing arrangement 'generated additional risk to [the] acquisition, did not mitigate risks it was intended to address, and shifted management focus away from project deliverables without demonstrating measurable benefits to project outcomes'.[23]

Within the public and private sectors there is a marked reluctance to discuss failure. Accordingly, it is surprising that there is any evidence of such failures. The two cases noted above are extreme. One required the writing off of a significant asset owned by a public

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[18] Australasian Institute of Mining & Metallurgy, *The New Research and Development Tax Incentive: Consultation Paper Response*' (2009) 9.

[19] BHP Billiton, *Fact Sheet: Boodarie Iron* (24 August 2005) <http://www.bhpbilliton.com/~/media/bhp/documents/investors/news/hbifactsheet.pdf?la=e>.

[20] Ibid.

[21] Ibid.

[22] Australian National Audit Office, *The Auditor-General Audit Report No. 37 2009-10 Performance Audit: Lightweight Torpedo Replacement Project* (2009-10) 18.

[23] Ibid 43.

company, with accompanying disclosure. The other was significant enough to justify consideration by the Australian National Audit Office. It therefore seems likely that there are other failures, not as significant, which have not been the subject of disclosure.

IV Legal Risks

Although Australian courts have not yet had the opportunity to rule on the enforceability of alliancing contracts, a number of arguments could be made asserting that such arrangements are void or unenforceable.

A *Intention to Create Legal Relations*

Under Australian law, in order for an agreement to be considered legally enforceable, the parties must have intended to create legal relations. This can be contrasted with agreements made in everyday domestic and social life in which no such intention exists and to which the law does not attribute legal consequences. Generally, parties will be presumed to have the requisite intention in a commercial agreement.[24] A notable exception is where an otherwise legally enforceable agreement contains what is known as an "honour clause". These clauses typically include words to the effect that the agreement is not intended to give rise to any legal consequences as between the parties, and generally, the law will respect this as a representation of the parties' true intention.[25]

Alliancing contracts are clearly commercial agreements. Therefore, the presumption is that the parties intend to create legal relations. As explained earlier, no-dispute clauses, in the extreme case, provide that alliance contracts do not give rise to any enforceable rights or obligations at law or in equity. This may appear to be akin to an honour clause.

However, where certain acts, such as wilful default, are excluded from this no-dispute rule, the parties clearly intend to retain some of their legal rights. Therefore where there are carve-outs of this type, it is unlikely that an alliancing agreement would be found to be unenforceable by reason of absence of an intention to create legal relations.

B *Illusory Consideration*

A valid contract also requires each party to receive consideration for their contribution to the contract. This can be in the form of an act or a promise to perform a certain type of act. The courts have been clear that they will not enquire into the adequacy of the consideration provided. However, there does need to be at least *some* identifiable value in the consideration exchanged.[26]

One needs to be careful where a discretionary promise is provided by one of the parties. For example, a party may have the *option* to perform an act under a contract. Since the party is

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[24] N C Seddon and M P Ellinghaus, *Cheshire and Fifoot's Law of Contract* (LexisNexis Butterworths, 10th ed, 2012) 232.

[25] *Jones v Vernon's Pools Ltd* [1938] 2 All ER 626, 630; *Rose and Frank Co V Crompton & Bros Ltd* [1923] 2 KB 261, 283.

[26] See, eg, *Thomas v Thomas* (1842) 2 QB 851.

not obliged to perform the promise or to pay damages for failure to perform, the very essence of the binding exchange of acts or promises required for a contract in common law countries, such as Australia, is absent and therefore the contract will be invalid.[27] In *British Empire Films Pty Ltd v Oxford Theatres Pty Ltd ('British Empire Films')*,[28] clause 9 of an agreement to supply films to be exhibited in theatres stated that 'under no circumstances shall the distributor be in any way liable for failure to supply to the exhibitor any of the films contemplated by the agreement'.[29] The majority held that since the distributor was not obliged to provide anything under the contract, the purported consideration of supplying films to the exhibitor was illusory.[30]

A similar conclusion was reached in *MacRobertson Miller Airline Services v Commissioner of State Taxation (WA) ('MacRobertson Miller')*.[31] In that case, the question was whether an airline ticket issued to a passenger, containing a broad condition that the airline reserved the right to cancel the ticket, constituted a valid agreement. The majority held such an exemption occupied the whole area of possible obligation, leaving no room for the existence of a contract of carriage.[32]

However, where the parties evidently intend to contract, courts will generally be slow to construe an exemption clause so broadly that it serves to negate all promises given by the party in favour of whom the exemption clause operates.[33] In other words, exemption clauses are generally read down so as to minimise the area of exemption.[34] Even in *British Empire Films* and *MacRobertson Miller*, the respective majorities were ultimately able to identify a form of consideration provided. In *British Empire Films*, the distributor's promise not to supply films to any other theatres which charged admission fees less than those prescribed in the contract was found to constitute good consideration.[35] Alternatively, it was held that a unilateral contract was created when films were actually supplied.[36] Similarly, in *MacRobertson Miller*, Barwick CJ found that a unilateral contract formed once the airline had completed its task of carrying the passenger.[37]

It could be argued that the presence of a no-dispute clause in alliancing agreements means that performance by either party is discretionary and therefore insufficient consideration has been provided by the parties. However, this is unlikely to be the case where the non-dispute clause has the usual carve-outs (such as wilful default) because unlike in *British Empire Films* and *MacRobertson Miller*, the parties do not have a completely unfettered discretion as

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[27] Seddon and Ellinghaus, above n 24, 185.
[28] [1943] VLR 163.
[29] *British Empire Films Pty Ltd v Oxford Theatres Pty Ltd* [1943] VLR 163, 166.
[30] Ibid, 167.
[31] (1975) 133 CLR 125.
[32] *MacRobertson Miller Airline Services v Commissioner of State Taxation (WA)* (1975) 133 CLR 125, 133.
[33] *Barnett v Ira L & A Berk Pty Ltd* (1952) 52 SR (NSW) 268, 275.
[34] Seddon and Ellinghaus, above n 24, 182.
[35] *British Empire Films Pty Ltd v Oxford Theatres Pty Ltd* [1943] VLR 163, 169.
[36] Ibid 170-1.
[37] *MacRobertson Miller Airline Services v Commissioner of State Taxation (WA)* (1975) 133 CLR 125, 133-4.

to whether to perform their promises under the contract. Therefore, alliance contracts are unlikely to be held to be unenforceable for want of consideration.

C *Agreement to Agree*

An enforceable contract in common law countries requires certainty, in the sense that the essential terms must be clear and complete.[38] The key risk for alliancing is that an alliance contract might be seen to contain agreements to agree on crucial matters.

An agreement to agree (also known as a deferred agreement) is a term in a contract in which the parties agree that they will agree on a certain issue in the future. These terms are generally unenforceable due to a lack of certainty about exactly how that deferred agreement is to be reached. However, many contracts which contain deferred agreements are not rendered void for uncertainty. Why is this so? Firstly, if the deferred agreement only relates to inessential or collateral matters, these can be severed from the rest of the contract, without any significant impact on the main obligations under the contract.[39]

Secondly, a court may be willing to imply a term into the clause to give it certainty. In *F & G Sykes (Wessex) Ltd v Fine Fare Ltd*,[40] the plaintiff and defendant entered into an agreement by which the plaintiff agreed to breed chickens for the defendant's stores. The agreement specified that the number of chickens to be supplied was to be 'not less than thirty thousand per week nor more than eighty thousand per week during the first year of the agreement and *thereafter such other figures as may be agreed between the parties*'[41] (emphasis added). The agreement also provided for a referral to an arbitrator in the event that there was a dispute between the parties. Lord Denning MR, in the majority, held that 'in a commercial agreement the further the parties have gone on with their contract, the more ready are the Courts to imply any reasonable terms so as to give effect to their intentions'.[42] Lord Denning MR considered that this was especially so where the contract contains a mandatory referral to arbitration. His Lordship therefore considered it appropriate to imply a term into the contract that the number of chickens supplied should be a 'reasonable number' in the second year of the agreement and onwards.[43]

Whilst this demonstrates that courts are sometimes willing to imply terms into deferred agreement clauses to make them more certain (and hence enforceable), this is often riddled with difficulty. Under Australian law, there is a high threshold for a term to be implied in

[38] See, eg, *Upper Hunter County District Council v Australian Chilling & Freezing Co* (1968) 118 CLR 429, 436-7.
[39] See, eg, *JB Rogers Ltd v Harry Lesnie Ltd* (1927) 27 SR (NSW) 427.
[40] [1967] 1 Lloyd's Rep 53.
[41] *F & G Sykes (Wessex) Ltd v Fine Fare Ltd* [1967] 1 Lloyd's Rep 53, 57.
[42] Ibid.
[43] Ibid 58.

fact.[44] The Privy Council decision in *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council*[45] set out the oft-quoted criteria:

> for a term to be implied the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term may be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; and (5) it must not contradict any express term of the contract.[46]

The most obvious difficulty with implying "reasonableness" terms to cure agreements to agree is that these terms often directly conflict with the express words used in deferred agreement clauses, that is, that the parties will reach an agreement.[47] Further, the concept of reasonableness is not always useful for determining the resolution of a dispute where both parties have reasonably taken opposing positions having regard to their own interests.

Thirdly, agreement to agree clauses can be accepted by courts where the parties provide a mechanism in the contract by which a final decision can be reached. For example, in *Hawthorn Football Club Ltd v Harding*,[48] the defendant agreed to play football for the plaintiff on fair and reasonable terms to be agreed between the parties. It was also agreed that any failure to reach agreement would be referred to arbitration. Tadgell J held that the opportunity for recourse to arbitration in the contract provided a means by which the terms not agreed could be fixed and hence there was no uncertainty in the contract.[49]

Alliancing agreements contain agreements to agree in that they vest the ALT with the power to determine all key issues on the project and usually require unanimity. Therefore any one of the members of the ALT casting a 'no' vote will result in no decision (or agreement) on potentially an important issue. The failure of the ALT to agree on important matters regulating the relationship of the parties is likely to be considered essential to the agreement and therefore severance would not be feasible. Although a court is unlikely to imply a term to give the contract greater certainty, if the agreement refers unresolved decisions to a final arbiter, such as an expert, this may cure the uncertainty. However, as we shall see next, referring decisions to an expert or arbitrator gives rise to other difficulties which may not be commercially acceptable.

If there is no dispute resolution mechanism provided for in the contract, there is a serious risk that the entire contract would be rendered unenforceable, as it would be extremely difficult to disentangle key project issue decisions from the operation of the rest of the contract. The result is that parties would likely only be entitled to pursue extra-contractual rights, such as under the law of restitution or estoppel, or possibly for misleading conduct.[50]

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[44] See, eg, *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337, 346.
[45] (1977) 180 CLR 266.
[46] *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council* (1977) 180 CLR 266, 283.
[47] Seddon and Ellinghaus, above n 24, 271.
[48] [1988] VR 49.
[49] *Hawthorn Football Club Ltd v Harding* [1988] VR 49, 57.
[50] Seddon and Ellinghaus, above n 24, 260.

D *Expert Determination to Resolve a Failure to Agree*

The common law has for a very long time recognised that disputes can be resolved by expert determination or appraisal. For example, it remains commonplace that a dispute about the quality of a commodity can be determined by expert appraisal. So if one party to a contract contends that a particular commodity is class A (a class recognised and defined by the relevant commercial community) and the other party contends that it is class B (another class recognised and defined by the same community), such a dispute can be readily settled by an expert determining on a final basis which class the relevant commodity is. Likewise, it is common for leases of commercial property to require that the rent be adjusted to market, periodically. Such clauses often require the landlord and tenant to agree the market rate, but failing agreement, for the rate to be finally determined by a valuer. Importantly, in these examples the expert is drawing on a recognised expertise supported by appropriate learning. It is an objective exercise having regard to factors unrelated to the parties.

When an expert or arbitrator is called upon to resolve an agreement to agree in respect of a commercial issue, rather than one which can be resolved by the application of a specified expertise, the "expert" is no longer making a decision by reference to a body of knowledge, but will favour one party's commercial interests over the other. Both may have taken a "reasonable" position often taken by such parties to such contracts, but those positions are different. By reference to what criteria is the expert to make a determination?

Of course, the possible outcomes are not binary. Therefore an expert may draft a resolution which is unsatisfactory to all. Accordingly, it is submitted that if such a course is taken the parties should as far as possible, set out the criteria which the expert is to use, rather than leaving it completely open.

Insofar as such matters are referred to arbitration, there is a further difficulty in those jurisdictions where the lex arbitri requires that any award be in accordance with law. It is not the role of the law to complete incomplete contracts. Therefore, unless the arbitrator is empowered to make an award, not in accordance with law, but by reference to considerations of general justice and fairness, it is difficult to see how a reference to arbitration improves the situation.

V INSURANCE

One further legal challenge alliancing faces concerns the application of traditional insurance policies.

Broadly, insurance cover is a contract in which one party transfers an identifiable and quantifiable risk to another in exchange for a premium. There are three main types of insurance cover commonly used in construction projects:

- **Contract works insurance** provides cover for physical loss and damage to any work carried out under the construction contract, and for materials and equipment stored on-site or off-site which are to be used in the project;

- **Public liability insurance** provides cover for personal injury and property damage suffered by third parties arising due to negligence of the insured; and
- **Professional indemnity (PI) insurance** provides cover for professionals, such as architects, engineers and other consultants, for negligence in carrying out their profession. [51]

Since PI insurance is generally a liability-based insurance (unlike the other two forms of insurance), it does not respond to a loss caused by, for example, a negligent design by an engineer, unless (and until) the engineer is sued and found liable. Importantly, it is the engineer who is insured, not the owner. The relevant "risk" in respect of which indemnity is provided is the liability of the engineer, not the loss suffered by the owner as a consequence of the negligence. The obvious issue with alliancing is that a participant is generally not liable for committing negligence, as liability for most acts are excluded under alliance agreements. In these circumstances the PI policy does not respond, as there is no liability on which to base a claim. Furthermore, as most policies of insurance exclude cover in the event of wilful default, claims made under these exceptions similarly do not attract the operation of a PI insurance policy.

One possible solution is to adopt, in place of a traditional PI insurance policy, a project specific "no blame" policy which covers "first party" losses. Such a policy responds, regardless of whether a party is legally responsible for the loss. However, these more exotic forms of policies are not always readily available in Australia. Further, insurers face increased risk where the person primarily charged with responsibility for the task does not carry any personal responsibility. The higher premiums demanded by insurers as a result of this might make their adoption less appealing to alliancing participants.

Parties to an alliance agreement need to carefully consider insurance issues to ensure that the project insurances function as intended and that their cost is appropriately catered for in the alliance budget.

VI EPCM – A More Robust Alternative?

Alliancing participants have to decide whether the purported commercial benefits of alliancing are outweighed by the limitations of the alliancing method identified above. It would be prudent for the parties to consider other methods of procurement which deliver similar commercial and practical advantages, but which do so in a much more legally certain and predictable manner. An obvious candidate is the EPCM model, mentioned briefly earlier.

In an EPCM contract, the owner contracts with an EPCM contractor, who:

- takes responsibility for the provision of engineering and design services (the "E");

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[51] Australian Government Department of Infrastructure and Regional Development, *National Alliance Contracting Guidelines: Guidance Note 2 – Insurance in Alliance Contracting: Selling Insurable Risks* (September 2015) 13-14.

- procures contracts with suppliers and contractors as agent of the owner (the “P”); and
- manages the construction phase of the project, that is, manages, supervises and co-ordinates all of the suppliers, construction contractors and other contractors as the owner’s representative (the “CM”).[52]

EPCM contracts differ from conventional construction contracts in that the contractor is not a principal in relation to the procurement of contracts with suppliers and contractors, or in relation to the construction of the project. Although the EPCM contractor procures the contracts with suppliers and contractors, it does this merely as agent of the owner, meaning each trade contract (i.e. the contract entered into by the EPCM contractor for the performance of work or the supply of equipment and materials) is a contract directly between the owner and the trade contractor.

A key advantage of the EPCM method is that it gives the owner significant control over the project. However, whilst the EPCM contract generally operates on a schedule of rates or cost-reimbursable basis, the trade contracts will typically operate on a lump sum basis. Therefore, unlike alliancing, there is generally no incentive regime which encourages the participants to co-operate to reduce costs and project completion time. Furthermore, as it is the owner who enters into the contracts with the trade contractors, the owner is the party that bears most of the risk of the project vis-a-vis the EPCM contract. However, the owner should, in a properly managed project, have the benefit of significant warranties from the trade contractors as to the quality, cost and time of the work the subject of each trade contract.

There are clearly marked differences between the EPCM and alliancing models. However, since traditional contracts are typically adopted in the EPCM method, the parties have much greater certainty in the enforceability of their contracts according to established principles compared with alliancing. Furthermore, the problems alliancing creates for obtaining insurance cover is unlikely to be an issue under the EPCM mode of delivery. Obviously the ‘pain gain’ remuneration model used in alliance contracting can be adopted and used in the EPCM model, putting the EPCM contractor’s profit and margin at risk, thereby aligning the interests of the EPCM contractor and owner in a similar way to an alliance contract. The owner would otherwise retain the right to claim for breach of the EPCM contract or trade contracts (arguably providing a further incentive for the project objectives to be achieved).

Alternative methods which deliver some of the benefits of alliancing, but which do so with much greater legal predictability, warrant serious consideration by the parties prior to entering into an alliancing arrangement.

VII CONCLUSION

It is reported that a number of alliancing contracts have been successful. However, there is no proven link between that success and the alliance model. It is likely that at least some (if

[52] David Cullen and Andrew Higgins, ‘The ABC of EPC and EPCM Contracting’ (2011) 23(8/9) *Australian Construction Law Bulletin (Newsletter)* 133, 134.

not a significant part) of the success is dependent upon other factors such as the quality of the people involved, the amount of planning done before commencement and good luck. Much more is required to establish the relationship between the model and success, and even more to establish that success is more likely under this model than any other. Further, the legal robustness of the alliance contract is yet to be tested by an Australian court, which is clearly undesirable given the level of risk and uncertainty parties already face on construction projects.