SOME PRACTICAL AND LEGAL CONSIDERATIONS WHEN BIDDING AND STRUCTURING ALLIANCING PROJECTS

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1. INTRODUCTION

Over the last ten years in Australia, alliancing contracts have been increasingly used by governments and private sector organizations to deliver complex defence, infrastructure and building projects, as well as outsourcing maintenance contracts. Some recent projects awarded or being tendered on an alliance basis include the DMO's Airwarfare Destroyer project, Port Philip Bay deep channelling and the Tullamarine–Calder interchange projects in Melbourne, RTA's Windsor Road expansion project and Sydney Water's sewer mains renewal program.

Alliances generally fall into two categories: those alliances with greater risk sharing between the alliance partners, and those alliances where the contractor (rather than all alliance partners jointly) retains discrete liability for performance of the work under the alliance contract.

Under the first type of alliance, the parties are collectively responsible for performing work and assume collective ownership of all risks associated with the delivery of the project. This type of alliance has been generally used in delivery of projects where the risks (e.g. difficult ground conditions, adopting new design concepts, etc) are difficult to quantify and price, where there have been very tight time deadlines to meet, or a combination of both. They have been used for delivery of offshore platforms, sewer ocean outfalls, hydro–electric dams, railway electrification projects, water desalination projects, railway electrification, harbour deepening, museums, roads and large defence projects ranging from frigates and destroyers to torpedo projects and the like.

Under the second type of alliance, the contractor (rather than all alliance partners) retains the traditional type of liability for performance of the work. This type of alliance is generally used more for longer term strategic outsourcing relationships or projects where the parties are better able to identify, assess and quantify the risks assumed. For example, they have been used on the maintenance contracts for railway infrastructure, police facilities and industrial and gas processing plants.

In both types of alliances, the remuneration structure and the alliance leadership and management structures are virtually identical. The project owner will generally pay the contractor for its services on a 100% open book basis which covers the direct project costs of materials, labour and project specific overheads, a fee to cover corporate overheads and normal profit, and an equitable share of the 'pain' or 'gain' depending on the project outcomes compared to the parties' jointly agreed targets.

This paper will discuss some practical and legal considerations for parties to take into account when bidding for projects using alliance contracting, or structuring those projects. They include:

- contractors' joint venture arrangements (including proportionate liability considerations);
- duty of good faith;
- fiduciary relationship between the parties;
- concept of wilful default and 'no dispute' arrangements under project type alliances;
- insurance arrangements and limitation of liability;
- subcontracting arrangements; and
- estoppel, waivers and trade practices considerations.

2. PRACTICAL AND LEGAL CONSIDERATIONS

2.1 CONTRACTORS' JOINT VENTURE ARRANGEMENTS (INCLUDING PROPORTIONATE LIABILITY CONSIDERATION)

(a) Non–Owner Alliance Participants' Structure

For alliances, it is common for a number of contracting organisations to pool their resources and bid for an alliance project together. If the alliance is of the second type discussed above in section 1 of this paper, these organisations will usually contract on a joint and several basis with the owner; that is, if two or more parties assume the same obligations under a contract, legally the result will be (unless there are express provisions to the contrary, that is, that stipulate that particular participants are only severally liable for particular obligations or for particular percentages of responsibility) they are jointly liable for performance of the obligations.

It is similar to typical joint ventures between contractors engaged to carry out projects for a common owner.

The owner may recover the full amount of the legally recoverable loss resulting from any default from any one of the contracting organisations individually, or two or more of the contracting organisations jointly. If sued separately, the contracting organisation which has answered the claim can then recover contributions from its fellow contracting organisations.

(b) Proportionate Liability Legislation

It is now extremely important to consider the recent introduction of general proportionate liability legislation by various States and the Commonwealth[1] which, where applicable, affect fundamentally the common law position on joint and several liability. Before these recent changes, there had been proportionate liability legislation only in relation to building and construction law, in Victoria, South Australia, New South Wales and Northern Territory. Generally, under the proportionate liability schemes, liability is shared among concurrent wrongdoers according to a court's assessment of their respective levels of responsibility. Judgment is not to be given against a defendant for more than that amount. Importantly, wrongdoers who have intentionally or fraudulently caused loss or damage will not have the benefit of apportionment of their liability.

For example, a new Part VIA and section 82(1B) have been inserted into the Trade Practices Act 1974 (Cth) which provide for contributory negligence and proportionate liability concerning damages for economic loss or property damage caused by misleading and deceptive conduct under section 52.

In a claim for damages under section 82 for breach of section 52 resulting in economic loss or damage to property, liability will be apportioned even if the claim for the loss or damage is based on more than one cause of action (whether or not of the same or a different kind).

It is important to note that while there is a significant degree of consistency between the proportionate liability legislation across the various jurisdictions, there are also differences in the legislative drafting, that potentially allow plaintiffs to obtain advantage by commencing litigation in one jurisdiction over the other.

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There is no case law yet on the various proportionate liability laws, and as such there is no judicial guidance on a number of issues raised by them.

If the legislation applies, wrongdoers may be able to escape liability if they can show that another party fraudulently or intentionally caused the plaintiff to suffer loss. Owners would be better off avoiding the proportionate liability legislation so as to avoid any argument by a contractor alliance participant that it is not liable for a risk that it has been paid to assume under the contract. However, only the NSW and Western Australian legislation allow parties to contract out of the application of the legislation. In Western Australia, this requires an express provision to be included into the contract; whether this is necessary in New South Wales is moot (see section 3A(2); the prudent course in the absence of judicial guidance is to include such a provision).

It would be prudent for contractors to clarify with their insurers and carefully check the wording (in particular, the exclusions) in their insurance policies. Insurers may well take the position that they will not cover a contractor for any risk which is greater than the risk the contractor would have at law. In those circumstances, a contractor would be reluctant to agree to contract out of the proportionate liability legislation, and thereby take on an uninsured risk.

(c) Suggested Approach

Ultimately, each non–owner alliance participant has an exposure for the liability of the other non–owner alliance participant's failure to perform the work in accordance with the alliance contract. A recommended approach to mitigate that risk for non–owner alliance participants is for a separate agreement between the non–owner alliance participants which:

(i) clearly allocates the legal risks between them;

(ii) where practicable, has clear demarcations of the scope of work that each non–owner alliance participant carries out under the alliance contract;

(iii) has a dispute resolution process (which allows the non–owner alliance participants to refer disputes to independent experts) to determine responsibility for any remedial work or other liability that may arise under the alliance contract;

(iv) provides that each non–owner alliance participant manages its own liabilities through its own risk management program, in addition to a blanket 'knock–for–knock' agreement that requires each non–owner alliance participant to indemnify the other non–owner alliance participants for such liabilities caused by it under the alliance contract; and

(v) otherwise in respect of other liabilities, provides that each non–owner alliance participant's liability towards the other non–owner alliance participants be limited by an agreed regime (eg limited to amounts recoverable under an insurance policy, carve–outs for indirect losses, in the case of an non–owner alliance participant's wilful default under the alliance contract—no recovery against the other non–owner alliance participants, etc).

2.2 DUTY OF GOOD FAITH

Alliance contracts normally contain an express provision that the parties will act in good faith.[2] The obligations associated with good faith include co–operation, recognition of the legitimate interests of other parties, honesty, reasonableness and an absence of bad faith.

Actions which have been taken as acting in bad faith have been identified in the US as 'evasion of the spirit of the bargain, lack of diligence and slacking off, wilful rendering of imperfect performance, abuse of power to specify terms, and interference with or failure to cooperate in the other party's performance.'[3] Courts acknowledge that the content of the duty of good faith is impossible to precisely define and much depends on the circumstances of the act or omission.[4]

Importantly, the duty does not require self–sacrificing behaviour, and does not preclude a party from promoting their own legitimate interests. The duty is closely linked with a duty to behave reasonably.[5]

The duty of good faith has been judicially considered in its interaction with express contractual clauses relating to termination[6] and 'open–book' accounting.[7]

Australian courts at State Supreme Court level (especially in NSW) are moving towards implying good faith in commercial contracts even where there is no express provision, and recent cases have sought to narrow the divide between the Australian and international positions.[8] However, a recent case appears to have reversed the trend by disagreeing that commercial contracts are a class of contracts that carry an implied term of good faith as a legal incident.[9]

The duty of good faith was considered by the High Court in Royal Botanic Gardens and Domain Trust v South Sydney CC[10], but it did not express a concluded view.

2.3 FIDUCIARY RELATIONSHIP BETWEEN THE PARTIES

In project type alliances, the alliance participants typically 'associate' themselves and participate in a common venture based on co–operation. The alliance participants pool their respective resources and capabilities with a view to deriving separate benefits through co–operative deployment of the resource pool. This structure raises questions as to whether each alliance participant owes a fiduciary duty to each of the other participants.

This is to be contrasted with the normal assumption in traditionally structured contractual relationships, that each party will be entitled to act in its own interests subject to complying with its duty of co–operation and any applicable express or implied duty of good faith.

In determining whether a fiduciary duty exists in an alliance relationship the court will have regard to 'the form which the particular joint venture takes and the content of the obligations which the parties to it have undertaken' (United Dominions Corporation Pty Ltd v Brian Pty Ltd per Mason, Brennan and Deane JJ[11]). The courts are reluctant to impose fiduciary relationships upon commercial arrangements, but will be more likely to do so if there is a relationship of trust or dependence.

It is also interesting to note that in a case considering an alliance that has gone off the rails. the court held that the alliance arrangement was a joint venture.[12]

2.4 CONCEPT OF WILFUL DEFAULT AND 'NO DISPUTE' ARRANGEMENT UNDER PROJECT TYPE ALLIANCES

A key feature of project alliance contracts is the expressed intention of the parties that there are to be no legal disputes between them except in the case of wilful default by an alliance participant.

(a) Scope of Wilful Default

Wilful default is not confined to a breach of contract or legal wrong; at the same time, not all breaches or wrongs will be wilful default. As there is no legal definition as such under law, the exact constitution of wilful default will often be defined in the alliance agreement, and as such will vary from case to case. Generally, there are three common elements:

(i) it is wanton or reckless;

(ii) it has foreseeable consequences which are harmful and avoidable; and

(iii) it amounts to a wilful or total disregard for those consequences.

(b) Implications of the 'No Dispute' Regime

The majority of project alliance contracts currently in use in Australia today contain a clause precluding litigation except in the case of wilful default. This type of provision is arguably void on public policy grounds for ousting the legitimate jurisdiction of the courts to settle disputes over breaches of contract. It is also often drafted in such a way as to raise a query as to whether (for example) project insurance have any contractual obligation with real content to cover (e.g. has a professional indemnity policy anything to respond to if the drafting has removed any professional duty of care). In this regard, see section 2.5(b) below.

Two alternative drafting methods that do not forbid litigation are preferable:

(i) The contract may be drafted to make it clear that there is no breach unless there is wilful default. Effectively, this means the contractor promises to execute works only to a standard consistent with the absence of wanton or reckless disregard for harmful and avoidable consequences. However, such a qualified promise may be unpalatable to the principal.

(ii) The contract may be drafted with an exclusion clause which, for breaches not involving wilful default, excludes all liability other than such monetary disbenefit as arises from application of the alliance's gainshare / KPI arrangements, or liability that is covered by the alliance's insurance regime.

Consideration should also be given to preserving the alliance's rights to recover damages from the alliance's subcontractors if they cause loss or damage to the alliance.

2.5 INSURANCE ARRANGEMENTS AND LIMITATION OF LIABILITY

(a) Limitation of Liability

It is common for the non–owner alliance participants to seek a limitation of their liability under the contract. An obvious position in respect of unforeseen risks to limit the cost recoverable to a monetary cap.

From an owner's perspective, it is prudent to carefully consider the structure of such a regime to allow maximum recovery from various sources. These may include:

(i) recovery from the non–owner alliance participant under the alliance contract. Non–owner

alliance participants frequently seek to limit their liability for defective work to the cost of rework or re–performing the services to an agreed percentage of the reimbursable fees;

(ii) recovery under the insurance policies effected by the alliance participants; and

(iii) recovery from the subcontractors working under the non–owner alliance participants.

It is also common for limitation of liability not to apply to liability arising out of breach of intellectual property rights, wilful or reckless conduct, or fraud.

(b) Professional Indemnity for Each Party

An issue to consider is how each alliance participant's professional indemnity policies would respond in a project type alliance. A conventional professional indemnity policy only responds where the insured has incurred a liability to another party in connection with its negligence. Such a policy (whether taken out by the principal on behalf of the alliance, or by the negligent participant) will not respond as there would be no liability on the negligent project alliance participant.

(c) Project–Specific Professional Indemnity Policy

One preferred method places full joint and several liability on the non–owner project participants and requires a project–specific insurance professional indemnity policy to be put in place. The project specific insurance (if available and cost effective) would potentially eliminate the need for the alliance participants to dispute whose action or inaction caused a given loss, allowing the alliance participants to focus their attention fully on the project objectives.

(d) Concerns in the Current Marketplace

Another insurance–related consideration is that it is currently very difficult to get run–off cover of longer than one to three years.

Insurers currently in the Australian insurance marketplace generally will not issue 'first party' policies—that is, policies that cover the gap between traditional professional indemnity insurance (which sees the insurer indemnify the insured for a breach of professional duty of care it owes to third parties) and the non–blame culture inherent in a true project alliance (which provides for non enforceable obligations under the alliance contract, absent wilful default). However, some insurers are apparently looking to get back into the market to issue these type of policies for alliance projects as alliancing becomes more widely used.

Ultimately, this is a risk management issue for the owner to consider when choosing a project alliance delivery strategy—the trade off for not paying a 'huge' risk premium for contractors taking the risks in connection with the delivery of the project to meet the owner's pressing requirements in exchange for managing the risk through project alliance delivery strategy and essentially 'self–insuring' the project.

2.6 SUBCONTRACTING ARRANGEMENTS

It is important for owners to also consider the proposed subcontracting arrangements to be put in place under the main alliance structure. For example, will those subcontractors be engaged on a project alliance basis (where the no blame except wilful default concept applies) or a traditional risk allocation approach where the subcontractor is responsible for any failure to deliver?

If the subcontracting strategy is based on a project alliance basis, the alliance's ability to recover damages (for breach of contract or in tort (such as negligence, etc) from subcontractors, subconsultants and suppliers may not be available under the 'no blame except wilful default' structure as the subcontractor alliance participants may not have any liability except in the case of wilful default or any losses under the pain–gain scheme.

The owner may seek to require subcontractors and suppliers to provide direct collateral warranties in favour of the owner in the event of a subcontractor/supplier default.

Careful consideration should be given to drafting any limitation of liability clause in the subcontracts so that it does not adversely affect the owner's ability to recover from the 'head' alliance contractor under the main alliance contract.

2.7 ESTOPPEL, WAIVERS AND TRADE PRACTICES CONSIDERATIONS

A party's legal relationship with the other parties in an alliance is of course not confined simply to the express terms of the contract. Through the doctrines of estoppel and waiver, the conduct of the parties can mould their legal relationships. The Trade Practices Act and Fair Trading Acts in each State and Territory also regulate the parties' conduct.

(a) Estoppel

Estoppel is an equitable principle which prevents a party, who by words or conduct leads another party to assume a particular state of affairs, from later acting contrary to that assumption. For an action to succeed on this basis, it is necessary to show some words or conduct on the part of the first party on which the

second party acted (or refrained from acting). It is also necessary to establish that it would be unconscionable to allow the first party to depart from the words or conduct.

(b) Waiver

Conduct by a party which makes it unfair, inequitable or unconscionable for that party to insist on their rights or to raise a defence may result in that right or defence being waived.

(c) Trade Practices Act

Section 52 of the TP Act prevents misleading and deceptive conduct. If a party acts to its detriment on misleading or deceptive assurances, undertakings, representations or conduct by another party, a cause of action may arise. The remedy will be damages to restore the plaintiff to the same position which would have existed had the breach not been committed. The section may be contravened by an innocent or reasonable misrepresentation.

It is important that each project alliance participant is clear as to what it represents and promises (through conduct and words) when negotiating (and performing) the contract and conducting the pre–contract alliance workshops.

REFERENCES

1. New South Wales: See Part 4 of the Civil Liability Act 2002 (NSW), section 109 of the Environmental Planning & Assessment Act 1997 (NSW); Victoria: See Wrongs Act 1958 (Vic); section 131 of Building Act 1993 (Vic); Queensland: See Chapter 2, Part 2 of Civil Liability Act 2003 (Qld); Western Australia: See Part 1F Civil Liability Act 2002 (WA); South Australia: See section 72 of Development Act 1993 (SA); Tasmania: See section 252 of Building Act 2000 (Tas); ACT: See section 26 of Construction Practitioners Registration Act 1998 (ACT); Chapter 7A of Civil Law (Wrongs) Act 2002 (ACT); Northern Territory: See sections 154/155 of Building Act 1996 (NT); Commonwealth: See Schedule 3 to the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2000 (Cth) which contains changes to the Trade Practices Act 1974 (Cth), the Corporations Act 2001 (Cth) and the Australian Securities and Investment Commission Act 2001 (Cth).

2. Contracts in the US, continental Europe and under the United Nations Convention on Contracts for the International Sale of Goods are subject to an implied requirement of good faith.

3. Restatement (Second) Contracts, section 205.

4. Restatement (Second) Contracts.

5. In Garry Rogers Motors (Aust) Pty Ltd v Subaru (Aust) Ltd, Finkelstein J stated: 'Provided the party exercising the power acts reasonably in all the circumstances, the duty to act fairly and in good faith will ordinarily be satisfied'.

6. An obligation of good faith which is only implied will not override express terms of the contract, such as a right to terminate. This extends to rights to terminate 'for any reason,' which will not breach a duty of good faith even if the termination is for reasons wholly unrelated to the performance of the other party. (Apple Communications Ltd v Optus Mobile Pty Ltd)

7. The requirement of good faith imposes an obligation on parties to genuinely keep their books open for review by the other party in an alliancing arrangement. This includes review after termination and during any legal proceedings. (Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd)

8. Renard Constructions (ME) Pty Ltd v Minister for Public Works (1992) 26 NSWLR 234; Hughes Aircraft Systems International v Airservices Australia (1997) 146 ALR1; Esso Australia Resources Pty Ltd v Southern Pacific NL (Receivers and Managers Appointed) (Administrators Appointed) [2005] VSCA 228; Tomlin & Ors v Ford Credit Australia [2005] NSWSC 540; ACI Operations Pty Ltd v Berri Ltd [2005] VSC 201; Hoppers Crossing Club Ltd v Tattersalls Gaming Pty Ltd [2005] VSC 114; Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd [2005] FCA 288

9. Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL (Receivers and Managers Appointed) (Administrators Appointed) [2005] VSCA 228

10. (2002) 186 ALR 289

11. (1985) 157 CLR 1

12. Doric Building Pty Ltd v Marine & Civil Construction Co Pty Ltd & Anor [2006] WASC 12