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CONSIDERING JOINT VENTURES AND ALLIANCE PARTICIPANTS IN RESPECT TO PREFERRED DELIVERY METHODS FOR COMMERCIAL BUILDING, CIVIL AND INFRASTRUCTURE PROJECTS

Robin Lonergan
Partner

5th Annual Queensland Construction Law Masterclass – 18 February 2009

1. Introduction

Particularly in the current economic climate, parties are looking at new structures to enable development of buildings and infrastructure projects to proceed. Investors are more risk averse; the banks have less cash to lend, governments are looking to encourage construction.

The Federal Government's package for commercial property and the use of Future Fund is to be used for providing funding to existing commercial property where foreign bank funding has been withdrawn rather than for assisting new construction projects¹. Westpac and ANZ asked the government to avoid creating the impression that the commercial property fund was aimed at new construction. Westpac noted that the loans to projects under development would only be on "an exceptional basis" and even then without any intention "to take on construction risk". This scheme will see the government put in \$2 billion and the big four banks \$500 million each to create the commercial property facility with capacity to lend up to \$30 billion if necessary to be financed by the issue of government bonds.

¹ Australian Newspaper 27.01.2009

The players (including landowners, contractors, consultants and financiers) are looking for structures which will allow them to continue to develop construction buildings and infrastructure projects.

2. Risk Adverse

In the past, the construction industry has been seen as lacking in trust between the participants and accordingly with each party defending itself against the others². Poor relationships between the principal, contractor and sub-contractors lead to problems that affect time, cost and quality as well as damaging long term relationships between the parties according to a study in the Northwest UK carried out about how people worked in the construction industry. The participants were asked about issues such as trust and why it is important, some of the issues were:-

- (a) Honest Communications – the parties should be open and willing to share important information with the rest of the team and be honest giving information that reflects the real situation.
- (b) Reliance – the parties should be able to rely on the information that is given and to rely that when people say they will say something that they will do it – that promises will be kept. In construction there may be many specialist trades and not everyone will have expertise to understand what is being done and therefore will have to rely on the other person's experience and expertise.
- (c) Reputation - trust tends to be given to people rather than companies or organisations and will rely on individuals rather than an organisation. Despite this, organisations can build reputations which impact on whether people feel comfortable working with them in projects.

The benefit of trust is that the construction industry is uncertain and if the information is clear and accurate then other people can rely on it. Where parties are reliable, there is more likely to be repeat business so that trust can increase profit both on an individual project and in the long term. Generally it is easier to build the personal relationships on smaller projects but by changing the culture within organisations, trust can be built on larger projects. Joint ventures and alliance contracting are two methodologies which have developed to bring "trust" into projects.

The culture of blame has lead to inefficiencies as each party seeks to "cover its back" and to shift risk. The risk is shifted to the party which is in the weakest negotiating position within the contracts. It is often shifted to a party who has the least control over minimising the risk and the least ability to prevent the events occurring.

² Trust in Construction – Achieving Cultural Change (Centre for Construction Innovation in the North West (UK) 01.2002

A number of structures have been developed to minimise the confrontational nature of the relationships between the parties in the projects, to improve the trust between the parties and to establish a more collaborative approach.

Despite the various attempts at creating a new construction paradigm, the basic outcome sought is:

- a reasonable profit for each participant including the owner, contractor, subcontractor and consultant;
- completion of the project in a timely manner;
- to satisfy the social responsibility of the participants; and
- to minimise long term costs for the operation of the building/infrastructure project.

The weighting of these goals depends on the nature of the project and the nature of the participation of the parties.

Where the parties anticipate that the project will be on-sold quickly with short term profit for the developer, long term maintenance costs may be considered to be less important. With an infrastructure project such as a road, the government or the concessionaire will consider that the maintenance costs are as important as the original construction cost and that a designer may utilise techniques or materials which have a higher initial cost but will substantially reduce long term maintenance.

Some participants may have strong commitments to social responsibility for example ethical investment funds, churches and governments. Such principals may be willing to accept a greater cost for a project by having regard to the long term cost to society for issues such as being conscious of the source of materials, reducing long term energy costs, use of renewable or recyclable materials refusal, to use rainforest timbers etc. Many public companies have a social responsibility charter and reports relevant to that charter will be presented at the annual general meeting with as much importance as reports on financial performance.

3. Joint Venture/Alliance Contract

I will consider the two delivery methods of joint venture and alliance contracting for projects.

Diagram 1 – Alliance Contract

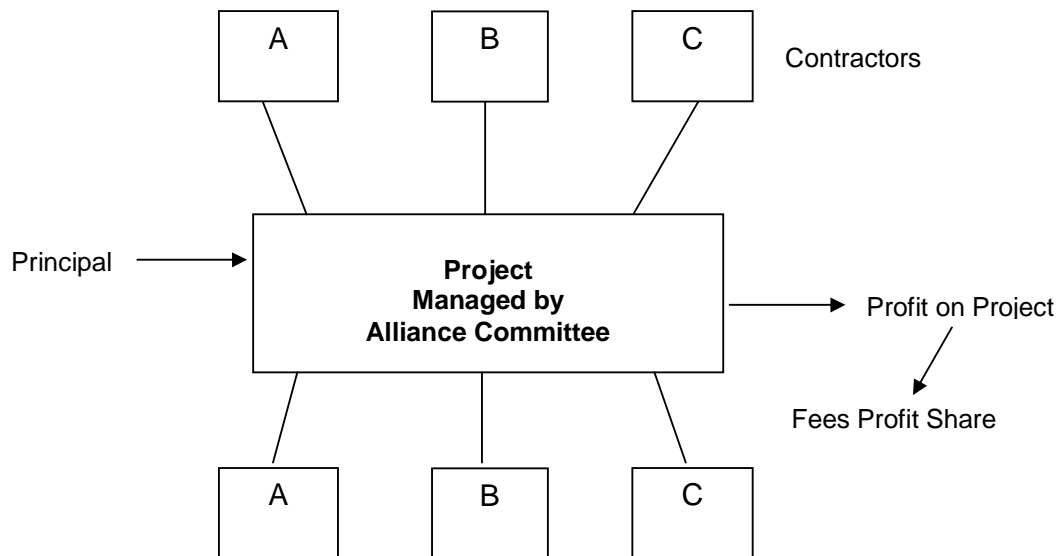
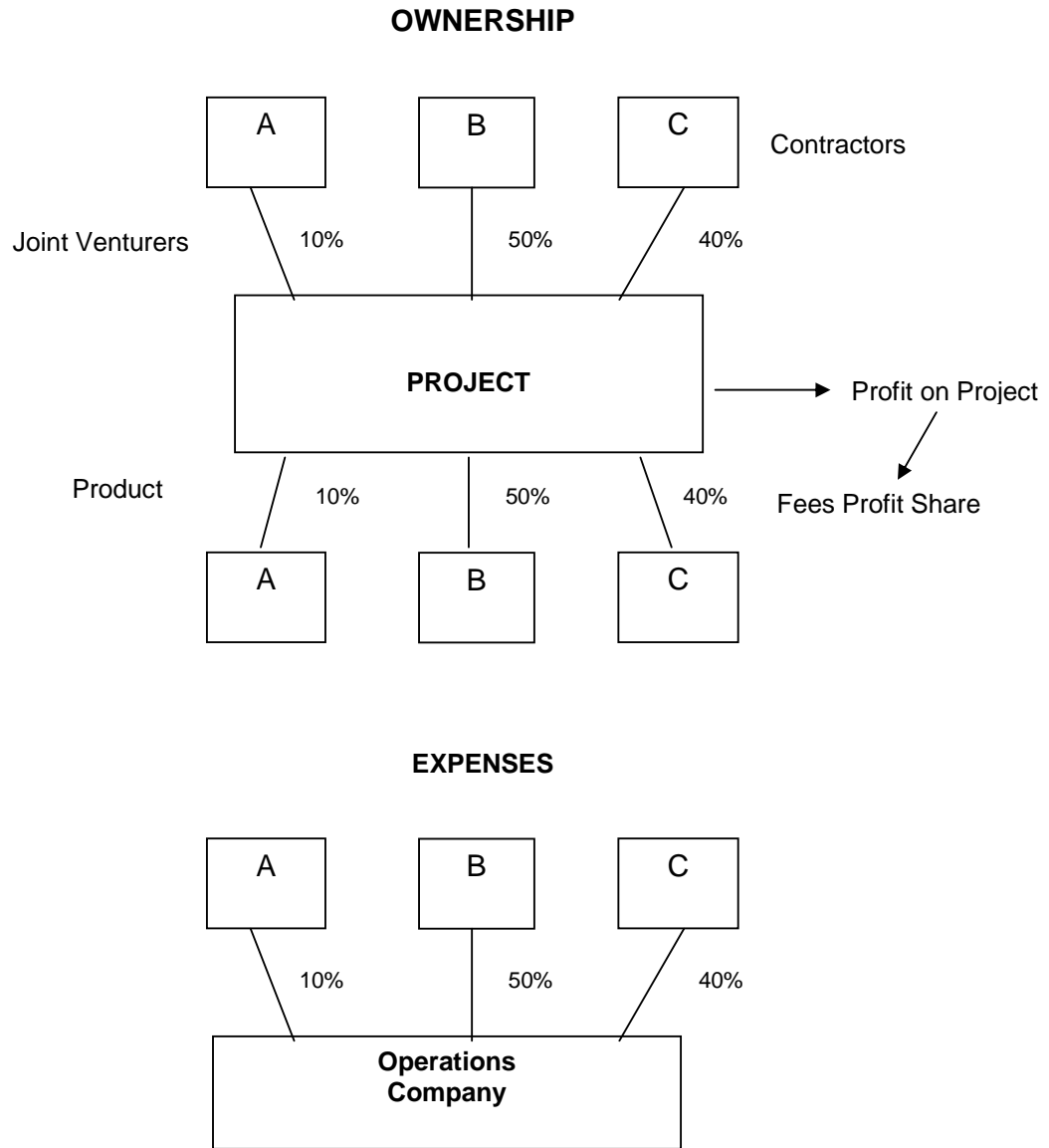


Diagram 2 – Joint Venture



Both of these delivery methods have the aim of ensuring that the participants share in the outcome – share the pain and the gain.

The unincorporated joint venture has been used for many years particularly in mining projects as a means of participating jointly without creating a new legal entity and without sharing liability. Traditionally it was developed as a tax effective means of carrying out the project. As it was developed in answer to tax matters, it can still be seen by the tax office as having an element of tax minimisation and therefore may have greater scrutiny than other structures.

The Australian Tax Office contract has been developed more from a culture of reducing risk and increasing trust between the participants. It requires greater cultural change within the participants and is usually not drive by tax considerations.

4. Joint Venture

4.1 What is a Joint Venture

The Australian Tax Office³ considers that a joint venture is characterised by the following:

- In Sharing of product outcome rather than the proceeds of sale or profits.
- Contractual agreement between the participants.
- Joint control.
- A specific economic project.
- Cost sharing.

Of these, the most important aspect is the sharing of the product of the outcome. In a mining joint venture, this may mean that the coal, iron ore etc which is extracted from the mine is taken to be owned by the participants in the joint venture in their respective percentages. In a joint venture operating a toll way concession, the participants own the concession revenue in their respective percentages. An arrangement which shares profit will be a partnership and not a joint venture.

The fundamental difference between an unincorporated joint venture and a partnership is that the joint venturers are only severally liable in the participation percentage and not jointly liable for the debts of the enterprise.

The other indication of a joint venture is that it is for a specific economic project rather than a continuous business. If there is continuous business, for example a number of different developments, then it is more likely to be characterised as a partnership. The ongoing operation of one project would not be characterised as a continuous business.

³ GSTR 2004/2 Goods and Services Tax: What is a Joint Venture for GST Purposes

The traditional view was that a syndicate which comes into existence for a limited period or purpose would not be a partnership for income tax purposes. For example construction of residential buildings which were divided equally between the venturers after construction is not a partnership either at general law or for income tax purposes⁴. There are various provisions which may require a limited partnership to be treated as a company for tax purposes.

For GST purposes, the parties may enter into an approved joint venture as a "GST joint venture", which means that the operator of the joint venture is responsible for the GST liabilities and entitlements arising from the operators dealing on behalf of the venture participants. The payments by the venturers to the operator are not considered to be a taxable supply for the purposes of the GST law. These joint venture provisions are similar to the GST group rules on the basis that it is operating in a similar way to a group by an unlimited basis. The GST joint venture is not treated as a single body for all GST purposes.

A GST joint venture will only be approved if:

- the venture is for an approved purpose;
- the venture is not a partnership, that is the income is not received jointly;
- each entity satisfies the participation requirements; and
- the application nominates an entity to be the joint venture operator, which need not be a party to the joint venture agreement.

The approved purposes reflect the common purposes for a joint venture including exploration or exploitation of mineral deposits, research and development, agriculture, generating transmission distribution of electricity etc. It can also specifically include the design, building or maintenance of residential/commercial premises subject to the counter-measures put in place to prevent exploitation of the margin rules.

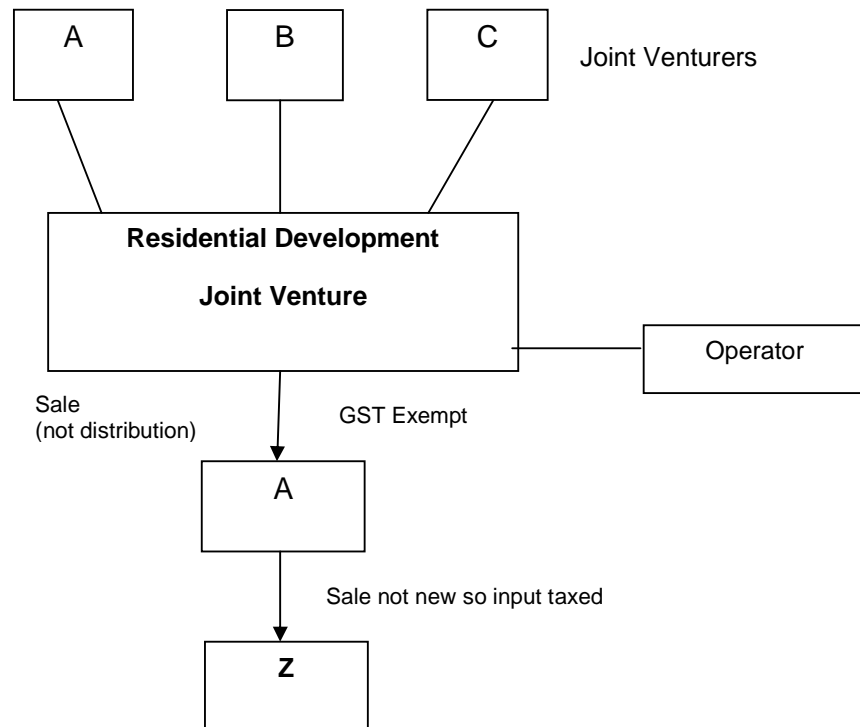
The participation requirements are that the entity:

- must participate or intend to participate in the joint venture;
- must be a party to the joint venture agreement;
- must be registered for GST purposes; and
- must account on the same basis as the other participants.

⁴ ARN Constructions 87atc 4790

GSTR 2004/3⁵ deals with avoidance of GST on the sale of new residential premises. Its purpose was to prevent avoidance of GST through entry into a scheme under which the parties purported formed a joint venture for the construction and sale of residential premises. The operator purports to sell the completed premises to a participant in the joint venture. It is argued that the sale is not a taxable supply under s.51-30(2) which provides that the supply made by the joint venture operator of a GST joint venture, to a joint venture participant is not a taxable supply if the participant acquires the things supplied for consumption, use or supply in the course of the activities for which the joint venture was entered into.

Diagram 3



The purpose of the scheme was to convert premises which were built from being "new residential premises" upon which GST would be payable to being a subsequent supply which is input taxed. The scheme relies on the transfer of the residential property from the operator to the participant as a GST exempt transaction on the basis that it is a supply within the joint venture. The proceeds for the sale of the residential premises to the third party is distributed amongst the participants as the participant pays for the residential premises to the operator the amount which the participant receives from the third party.

⁵ GSTR 2004/3 – 7 April 2004

The ATO has rejected the scheme in the ruling. It states that the sale by the joint venture operator to the participant is a taxable supply and that Section 51-30(2) does not apply because either:-

- the arrangement is not a joint venture for GST purposes; or
- the participant does not acquire the premises for consumption or use of the supply in the course of the activities for which the joint venture was entered into.

This ruling has caused some developers to be wary of using a joint venture vehicle for development. This should not be the case as the ruling has limited effect to prevent an unlawful scheme. On reviewing the structure of the scheme, the transfer from the operator to the participant is outside the joint venture purpose – it is not a payment between the participants and the operator to carry out the purpose of the joint venture. Under the nature of a joint venture, the participants own the product of the joint venture and therefore the product does not need to be sold by the operator to a participant.

Where the joint venture is properly (and lawfully) structured, the participant should be able to receive the product of the joint venture tax-free for on-sale. Where that product is residential premises, the participant would be entitled to keep those premises for its own use or to on-sell the premises with GST payable on the on-sale.

Another tax issue to consider are the Capital Gain Tax status of the land used in the Venture, particularly for any premises sold by the contractor.

4.2 Structure of Joint Venture

An infrastructure or property joint venture can link the participants commercially in a way to minimise disputes. For example, the participants may be:-

- landowner;
- principal contractor;
- designer;
- significant subcontractor;

In this type of structure, the parties would enter into a joint venture arrangement under which they would agree of their participation in the joint venture, the joint venture may appoint an

operator who would act as the project co-ordinator or that role may be undertaken by one of the participants (usually the contractor).

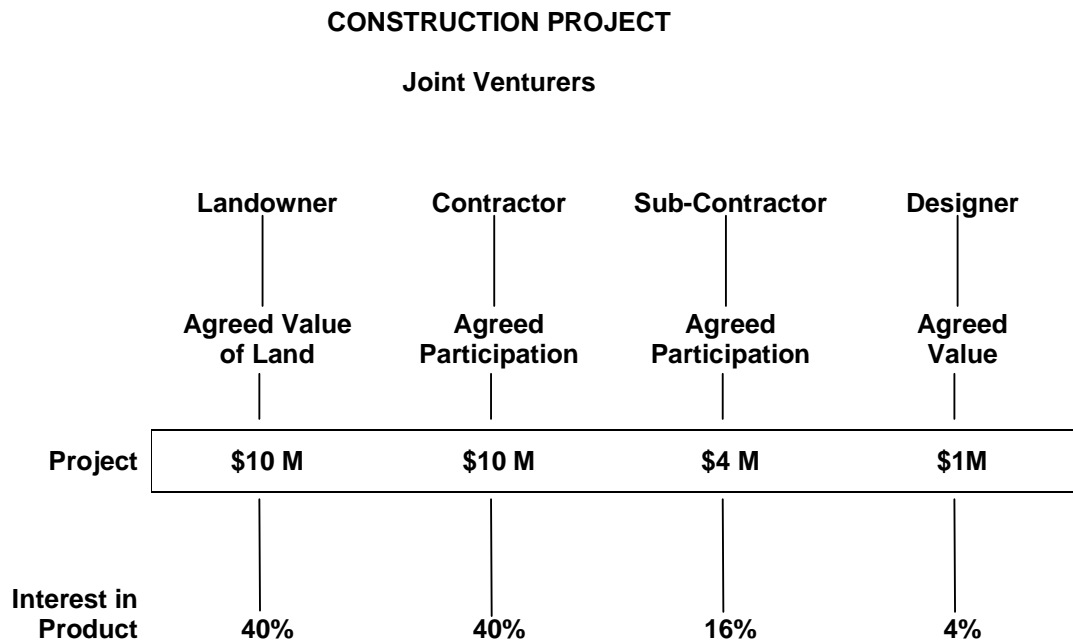
The benefit of the use of the joint venture is that the parties are commercially committed to each other and have a commercial reason to complete the project on time and within budget.

The joint venture agreement would need to identify the participation interests. It is easy to value the contribution by the principal as an agreed valuation of the land can be used.

The valuation of the contribution by the other participants is often more difficult. It may be necessary to have final drawings to be able to value the work by the other participants and any change to those agreed drawings/contracts would require the approval of all participants.

Another structure is for each participant to contribute its labour up to an agreed level.

Diagram 4



Under this scenario, the cost of construction in excess of the agreed participation by the contractor and sub-contractor would need to be paid by the joint venture participants in their participation percentage. Often the value of the designers work will be determined at the commencement of the project. The participation by the contractor and sub-contractor however

will be subject to a standard construction contract (upon which GST may not be payable if it can be structured to comply with Section 51-30(2) as a supplier within the joint venture).

The difficulty arises where there are variations during the project. The relationship between the contractor and the joint venture remains the same as the relationship between the contractor and the principal. Irrespective of the structure of the joint venture, the contractor/participant will still be seeking to maximise profit from the building contract potentially at the expense of the other participants. Where the joint venture engages an independent project manager to negotiate issues such as variations to time and cost, the joint venture may be able to provide that the decision of the Project Manager is final.

4.3 Advantage of Joint Venture

The main advantage of the joint venture is the high degree of co-operation and participation required to negotiate and administer a joint venture. This high degree of co-operation is likely to increase the trust between the parties, there are more likely to be regular meetings to discuss issues and to resolve problems and because of the contractual relationship under the joint venture agreement, the parties may have a less adversarial approach to each other.

It is a relatively simple structure that can be used on small projects.

5. Alliance Contract

5.1 What is an Alliance Contract

An Alliance Contract or relationship contract has developed as other forms of contracts such as engineering engineering, procurement, construction (EPC) contracts have lost popularity. The traditional EPC contract transferred risk from the developer to the contractor; the contractor would accept this risk (and often pass it on to sub-contractors) in exchange for a profit which is sufficiently large to fund that risk. The traditional contract worked where the market was buoyant enough that the contractor could include this profit margin in the tendered price.

As profit levels reduce in the current economic circumstances and as technology in the construction industry develops to potentially provide cost savings through the use of new technology other construction models have developed.

The Alliance Contract is an extension of a partnering arrangement. It codifies the relationship between the parties and generally covers:-

- (a) the parties are bound by the Alliance Contract;
- (b) the parties including the owner, contractor, designer, subcontractors form part of the Alliance team;
- (c) costs are 100% reimbursed;

- (d) the parties agree to share in profit or loss based on defined performance goals;
- (e) disputes are to be resolved within the Alliance Contract usually by the Alliance Committee;
- (f) no disputes can be brought outside the Alliance Agreement;
- (g) decisions of the Alliance Committee are binding and unanimous; and
- (h) the participants develop and commit to a set of Alliance principles setting out the key goals of the project.

According to the "Project Alliance and Practitioners Guide"⁶ :-

"Project Alliancing is about providing better value for money and improved project outcomes through a more integrated approach between the public and private sectors in the delivery of infrastructure projects."

The major advantage in the Alliance model is to shift risk so there is no allocation of risk to an individual party but risk is managed collaboratively through the Alliance Committee.

Various government bodies including the Queensland Department of Main Roads and Sydney Water have published statistics comparing Alliance Contracts to traditional contracts which show much better performance under the Alliance Contract. Projects came in at a lower cost, ahead of schedule and exceeding the expectations of the parties.

5.2 Alliance Structure

Generally an Alliance Contract will identify:-

- The Alliance Committee or board;
- Clarify the development of the integrated team; and
- establish the commercial arrangement.

5.3 Alliance Committee

The Alliance Committee comprises representatives of each of the Alliance participants. It has the primary role of administering the Alliance Project. Usually the partners will be the designer, the contractor and the owner. Each partner will have one vote and there is no provision for a casting vote. All decisions must be unanimous and there is no deadlock provision.

The structure of the Alliance Committee means that the owner does not have a final say in how the project will proceed and generally has no veto powers.

Some contracts will allocate some reserve power to the owner. For example, particularly where the owner is government, there may be overriding considerations such as national security which have to be considered. This may arise where the Alliance Contract deals with defence or IT matters which go to the heart of government.

The owner may also reserve a power to change fundamental aspects of the contract such as to prevent a change in scope of work greater than a certain percentage or to approve a variation to the contract in excess of a certain percentage or amount.

Reserve powers may also relate to long term potential liability for the owner particularly issues such as environmental concerns or the long term maintainability of the project where the Alliance is not continuing for the long term.

The problem with reserve powers is that it cuts across the nature of the Alliance relationship – instead of each of the Alliance partners being equal and having an equal say in the project, the owner has a superior position and a right of veto in a number of areas. If the owner exercises that veto power, there may be implications to the cost or profit which will impact on the sharing of the pain and gain.

The nature of the Alliance Committee is intended to take away the hierarchy of traditional contracts.

5.4 Integrated Development Team

The Alliance method is intended to minimise the confrontational nature of the traditional construction structure.

There is a change of philosophy and often prior to signing of the Alliance Contract, the parties will be involved in Alliance workshops, facilitated meetings between the various parties, employees and there may be ongoing involvement of the Alliance facilitator.

The intention of the structure is to break down the traditional silos on the workplace. One psychological method of doing this is for the alliance to have separate premises and often to work in a special alliance uniform logo etc so that the Alliance has a separate identity from the participants.

The lines of hierarchy within each of the participants blurs with the alliance having a separate hierarchy. While the relationship between the parties may become collegiate, other legal relationships will remain in place. For example, the employees of each of the participants remain employees of that party for tax and WH&S purposes. This can create complex contractual relationships where the employee of one organisation is required to take direction from the employee of another organisation.

⁶ State of Victoria Treasury 2006

On a long term basis, employees can lose the sense of identify with their employer and identify with the alliance. While this is the intention of the Alliance Contract, it can cause problems within the employer organisation when the alliance finishes. Does the employee lose his/sense of engagement with the employer.

5.5 No Disputes/No Blame

Fundamental to the concept of the Alliance Contract is that there is no blame and no disputes between the parties and each party releases the others from all liability. Some Alliance Contracts except wilful default from the general exclusion from liability. This of course leaves open what is intended by "wilful default". Generally the parties cannot claim against the other for negligence of any degree.

The philosophy is that if there is no blame and no disputes between the parties then the parties have no incentive to hide information.

As there is no blame and no disputes, the parties do not need to be concerned about issues such as extensions of time, liquidated damages or variations. These matters will be discussed in an open manner in the Alliance Committee where decisions can be made in the best interest of the project.

Because there is no blame, the design can be more innovative, the parties can incorporate new technology. If the project is delayed, the parties can discuss at the Alliance Committee methods to make up the time. As there is no blame, none of the parties need to maintain a critical path and no one owns the time float and workers can be used where they are most effective.

5.6 Profit

While the philosophical basis of the Alliance Contract creates a trusting environment, there needs to be an economic imperative to ensure that the parties abide by the arrangement even without blame or dispute.

Most Alliance Contracts provide for the contractor and the designer being reimbursed for their costs and then incentives for bringing the project in on or before time and on or under budget.

In negotiating the "cost" for the contractor and designer, the Alliance Contract needs to identify the nature of costs. Fore example, does it include an allowance for off-site overheads such as office expenses; can it include profit from subcontractors which are related parties. How do the parties negotiate for sub-contractors.

While an Alliance Contract is intended to be a risk sharing agreement, by ensuring that the contractor and designer are reimbursed their costs, the contract can become a "cost plus"

contract where the risk is shifted too the owner. The contractor and designer know that at the minimum they will be reimbursed their costs – they will not be out of pocket.

From a financing point of view, the owner needs to ensure that its financiers are satisfied with this arrangement.

6. Due Diligence

Prior to entering into an Alliance Contract or any type of relationship contract it is important that each participant undertakes complete due diligence on the other to understand the business culture of the other participants to check if they have a business culture which is conducive to the Alliance system, whether the people who will be engaged on the project day to day have the personality to participate in an Alliance situation and whether there is a genuine commitment by all participants to the Alliance concept.

The use of an Alliance Contract or other relationship contracting does not diminish the need to carry out extensive engineering/technical due diligence. It is often more important in negotiating an Alliance Contract to consider the interfaces between various subcontractors, a realistic cost plan and a realistic time schedule.

The Alliance Contract only applies between the Alliance partners. It is likely that all subcontractors will be engaged by the contractor or the Alliance under traditional contracts which would be entered into with the consent of the Alliance Committee.

As part of the due diligence, the participants need to consider insurance carefully. As there is no blame, a traditional professional indemnity insurance of the designer will not be effective. The designer will have no loss for its error therefore cannot claim under the policy. The owner may suffer loss because of the cost to redo work, the owner would not have an interest under the professional indemnity insurance. Often the Alliance participants would take out separate cover for their various interests under the Alliance Contract.

7. Obligation of Good Faith

The relationship under a joint venture or Alliance Contract creates a new set of relationships and legal obligations between the participants. In a traditional construction contract, the parties have an obligation not to commit fraud or misrepresentation, but there is no positive obligation of good faith. There is no restriction on one party taking advantage of its bargaining position or superior knowledge when dealing with the other. There is generally no obligation of general disclosure of information known about the project.

In a joint venture or Alliance Contract, the relationship is much closer.

In a joint venture, the participants may have fiduciary obligations in some aspects of the venture. For example, if a participant discovered information about the venture, such as that the coal seam extended further than the current mining lease, the participant may have a fiduciary obligation to advise the other joint venturers and if the participant took out a mining lease over the extended area in its own name, it is likely that it would be holding that mining lease on trust for the joint venture. The information relating to the extension of the mining lease is so intimately related to the mine that that information should be made known to the joint venturer as a whole.

Other aspects of the relationship do not carry fiduciary duty. For example joint venturers would not be required to act in good faith considering the impact on the other venturers in exercising a contractual right such as an assignment or consent to assignment of the contract.

The leading case dealing with this obligation of good faith is *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd*⁷. The facts of that case were that Placer was the operator for a joint venture of a number of mines in Western Australia. It had engaged Thiess to carry out the mining operations. Initially the contract was on the basis of a schedule of rates contract but because of the expense which had been incurred, Placer had proposed a partner in contract under which Thiess would be paid its costs plus an agreed percentage profit. The contract had a provision which allowed Placer to terminate the contract for its convenience without penalty other than payment of the demobilisation of costs. Following various discussions with Thiess, Placer decided to terminate the existing contract and to put the work to tender. Thiess tendered at a significantly lower rate.

Thiess brought an action against Placer claiming damages for loss of profits it would have earned had the contracts not been terminated. It was a claim for breach of fiduciary duty and misleading and deceptive conduct. Placer defended on the basis that it had an unqualified right to terminate the contracts and, during discovery, Placer became aware of material facts and claimed that Thiess had made material and fraudulent misrepresentations which induced Placer to enter into the contracts. Placer argued that Thiess had acted in bad faith.

The judge in the first instance, Mr Justice Templeton, reviewed the evidence in detail (the decision is almost 250 pages).

He held that Placer had an unfettered right to terminate. This was one of the aspects of the partnering agreement which did not attract any fiduciary obligations.

Most of the decision however was considering the surrounding circumstances to the parties entering into the partnering agreement. This is relevant in determining the percentage profit which was paid to Thiess. The analysis of the relationships which arose from this negotiation is

⁷ [2000] WA SCA 102
(2003) 77 ALJR 776 (on Appeal)

directly relevant to the payments under an Alliance Contract where the contractor and designer are usually entitled to be paid their "cost" but the profit is risk.

During negotiations between Thiess and Placer, it was proposed that the rates would be derived from an open book system from Haul Profiles, Cycle Times, ownership costs and operating costs plus a profit margin. The base rates were the rates in dollars per bank cubic metre ("BCM"). The rates were to be used by places to determine whether it was better to use Thiess to operate the mine or for Placer to operate the mine itself which it had done previously.

In addition to profit, Thiess would be entitled to claim overheads which would include head office charges. It was agreed that no profit would apply to those charges.

During the negotiations, there was discussion about repairs and accidental damage. Thiess advised Placer that Thiess had an internal plant department which obtained, services and repaired plant and equipment and then hired it to various operating departments. The objective was for the plant department to break even. The evidence given by a representative for Placer was that he had been told by Thiess that Placer would be charged the plant department rates, that is the internal hire rate by Thiess without profit. During disclosure, Placer discovered that Thiess had charged more than its internal plant rates. Thiess provides Placer with various costs for its internal plant rates. The impression given to Placer was that a 5% profit was being charged. In fact the profit was 10.87%. Placer was not told that the plant rates in the submission were not the internal plant rates which they appeared to be and which had been indicated to them.

The trial judge held that:-

"I accept entirely that Messrs Jukes, Trio and Parsons (senior staff at Thiess) derived no personal gain from the misrepresentations. I think that their conduct was motivated by loyalty to Thiess and the desire to ensure that it retained an important contract.

"They were in an invidious position. The 1989 contract had been very profitable for Thiess and it was anxious to retain Placer as a client. But Placer would accept only a 5% profit margin which was far below the level required by Thiess's business plan.

"... I am satisfied that Thiess's conduct was deceitful".⁸

In his conclusion the trial judge found that the Granny Smith contract imposed on Thiess the obligation of formulating in good faith equipment operating costs based on historical data. This was in the nature of the fiduciary obligation. Thiess was in breach of the contract because it inflated the equipment operating costs based on historical data for the purpose of deriving additional profit. Placer was entitled to damages for breach of contract in the sum of

⁸ Page 83

\$4,253,000.00. While the decision was overturned at the first instance, the High Court reinstated that order.

The Placer (Granny Smith) case is important on a number of issues:-

1. It confirms that the parties to a partnering agreement can have fiduciary obligations in some respects but other contractual rights (such as the right to terminate for convenience) do not have to be exercised having regard to the effect on the other party.
2. There are fiduciary obligations, obligations of good faith, arising from the relationship.

It highlights the importance of full disclosure but also the discussion by the trial judge of the evidence particularly of the senior management from Thiess indicates the pressure on the parties (particularly in the current economic climate) to justify the entry into the contract, the need to produce the required profit.

8. Representations

In the negotiation of a joint venture or an Alliance Contract, any other forms of relationship contracting, there are significant negotiations about the method that the project will proceed and the intentions of the parties. Under a traditional design and construct or EPC contract, the contract itself will set out the standard of skill, cost, variation procedures etc. The contract stands alone.

With a relationship contract, the pre-contractual negotiations will become more important. As was seen in the Placer (Granny Smith) case, the negotiations about the partnering agreement were vital to the interpretation of the final contract. Representations made about the methodology used to calculate cost could be relied upon in interpreting the intention of the final contract even though Placer had not specifically asked for a breakdown of the costs in that final contract.

Costs is only one aspect of a relationship contract. Representations can be made about other aspects which are less tangible which may affect the outcome of the project. These may include the commitment of a party to the Alliance concept.

While the Alliance Agreement will contain a provision dealing with no blame and no dispute, that waiver of liability will only relate to disputes or blame arising within the Alliance Contract itself. Where the misrepresentation arose to induce the party to enter into the Alliance Contract, the waiver will not apply.

Summary

The use of the joint venture or an Alliance Contract provides advantages for the construction of larger projects including significant buildings and infrastructure. These structures ensure that the participants share in the pain and the gain, that the participants have a vested interest in close dialogue, avoiding blame and looking for results and maximising the return on the project.

While these structures do not create partnerships, there are obligations of good faith between the participants. Each participant must ensure that it does not obtain an advantage from the other participants and is open in all dealings with them.

Issues can also arise about representations made during negotiations, meetings prior to the Alliance Agreement being signed which may have induced one of the participants to enter into the Agreement.

The existence of the obligations of good faith and the representations made may give rise to action outside the contract which would not be barred by the no blame, no dispute.

From the owners point of view, a development using an Alliance Contract can transfer power to the contractor and designer more than under a standard contract.

The great advantage however is that the parties are all working together. There are no disputes between the Alliance participants regarding the Alliance project and in practice, Alliance Contracting has been successful.

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In the past, the construction industry has been seen as lacking in trust between the participants and accordingly with each party defending itself against the others². Poor relationships between the principal, contractor and sub-contractors lead to problems that affect time, cost and quality as well as damaging long term relationships between the parties according to a study in the Northwest UK carried out about how people worked in the construction industry. The participants were asked about issues such as trust and why it is important, some of the issues were:-

- (a) Honest Communications – the parties should be open and willing to share important information with the rest of the team and be honest giving information that reflects the real situation.
- (b) Reliance – the parties should be able to rely on the information that is given and to rely that when people say they will say something that they will do it – that promises will be kept. In construction there may be many specialist trades and not everyone will have expertise to understand what is being done and therefore will have to rely on the other person's experience and expertise.
- (c) Reputation - trust tends to be given to people rather than companies or organisations and will rely on individuals rather than an organisation. Despite this, organisations can build reputations which impact on whether people feel comfortable working with them in projects.

The benefit of trust is that the construction industry is uncertain and if the information is clear and accurate then other people can rely on it. Where parties are reliable, there is more likely to be repeat business so that trust can increase profit both on an individual project and in the long term. Generally it is easier to build the personal relationships on smaller projects but by changing the culture within organisations, trust can be built on larger projects. Joint ventures and alliance contracting are two methodologies which have developed to bring "trust" into projects.

The culture of blame has lead to inefficiencies as each party seeks to "cover its back" and to shift risk. The risk is shifted to the party which is in the weakest negotiating position within the contracts. It is often shifted to a party who has the least control over minimising the risk and the least ability to prevent the events occurring.

² Trust in Construction – Achieving Cultural Change (Centre for Construction Innovation in the North West (UK) 01.2002

A number of structures have been developed to minimise the confrontational nature of the relationships between the parties in the projects, to improve the trust between the parties and to establish a more collaborative approach.

Despite the various attempts at creating a new construction paradigm, the basic outcome sought is:

- a reasonable profit for each participant including the owner, contractor, subcontractor and consultant;
- completion of the project in a timely manner;
- to satisfy the social responsibility of the participants; and
- to minimise long term costs for the operation of the building/infrastructure project.

The weighting of these goals depends on the nature of the project and the nature of the participation of the parties.

Where the parties anticipate that the project will be on-sold quickly with short term profit for the developer, long term maintenance costs may be considered to be less important. With an infrastructure project such as a road, the government or the concessionaire will consider that the maintenance costs are as important as the original construction cost and that a designer may utilise techniques or materials which have a higher initial cost but will substantially reduce long term maintenance.

Some participants may have strong commitments to social responsibility for example ethical investment funds, churches and governments. Such principals may be willing to accept a greater cost for a project by having regard to the long term cost to society for issues such as being conscious of the source of materials, reducing long term energy costs, use of renewable or recyclable materials refusal, to use rainforest timbers etc. Many public companies have a social responsibility charter and reports relevant to that charter will be presented at the annual general meeting with as much importance as reports on financial performance.

3. Joint Venture/Alliance Contract

I will consider the two delivery methods of joint venture and alliance contracting for projects.

Diagram 1 – Alliance Contract

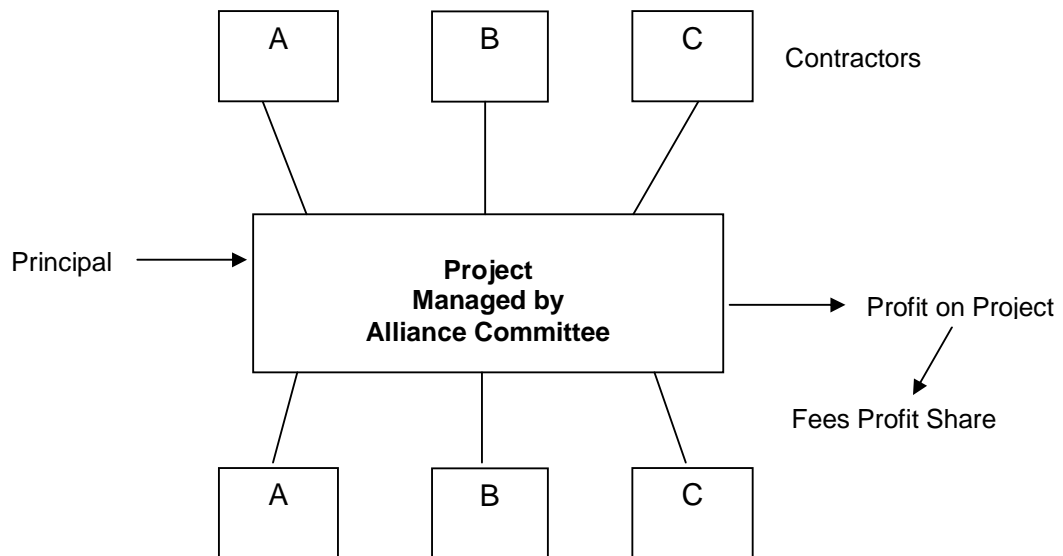
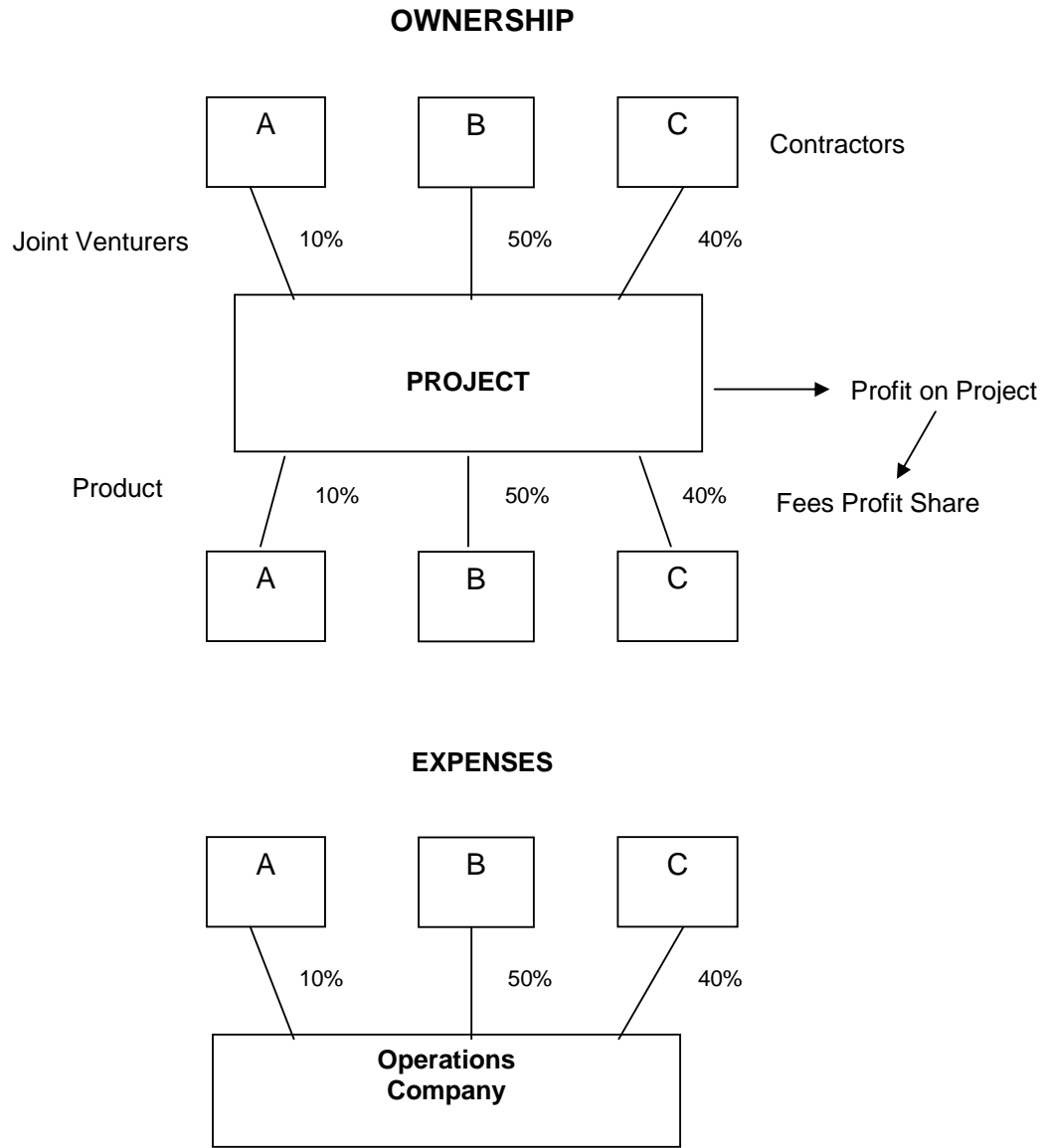


Diagram 2 – Joint Venture



Both of these delivery methods have the aim of ensuring that the participants share in the outcome – share the pain and the gain.

The unincorporated joint venture has been used for many years particularly in mining projects as a means of participating jointly without creating a new legal entity and without sharing liability. Traditionally it was developed as a tax effective means of carrying out the project. As it was developed in answer to tax matters, it can still be seen by the tax office as having an element of tax minimisation and therefore may have greater scrutiny than other structures.

The Australian Tax Office contract has been developed more from a culture of reducing risk and increasing trust between the participants. It requires greater cultural change within the participants and is usually not drive by tax considerations.

4. Joint Venture

4.1 What is a Joint Venture

The Australian Tax Office³ considers that a joint venture is characterised by the following:

- In Sharing of product outcome rather than the proceeds of sale or profits.
- Contractual agreement between the participants.
- Joint control.
- A specific economic project.
- Cost sharing.

Of these, the most important aspect is the sharing of the product of the outcome. In a mining joint venture, this may mean that the coal, iron ore etc which is extracted from the mine is taken to be owned by the participants in the joint venture in their respective percentages. In a joint venture operating a toll way concession, the participants own the concession revenue in their respective percentages. An arrangement which shares profit will be a partnership and not a joint venture.

The fundamental difference between an unincorporated joint venture and a partnership is that the joint venturers are only severally liable in the participation percentage and not jointly liable for the debts of the enterprise.

The other indication of a joint venture is that it is for a specific economic project rather than a continuous business. If there is continuous business, for example a number of different developments, then it is more likely to be characterised as a partnership. The ongoing operation of one project would not be characterised as a continuous business.

³ GSTR 2004/2 Goods and Services Tax: What is a Joint Venture for GST Purposes

The traditional view was that a syndicate which comes into existence for a limited period or purpose would not be a partnership for income tax purposes. For example construction of residential buildings which were divided equally between the venturers after construction is not a partnership either at general law or for income tax purposes⁴. There are various provisions which may require a limited partnership to be treated as a company for tax purposes.

For GST purposes, the parties may enter into an approved joint venture as a "GST joint venture", which means that the operator of the joint venture is responsible for the GST liabilities and entitlements arising from the operators dealing on behalf of the venture participants. The payments by the venturers to the operator are not considered to be a taxable supply for the purposes of the GST law. These joint venture provisions are similar to the GST group rules on the basis that it is operating in a similar way to a group by an unlimited basis. The GST joint venture is not treated as a single body for all GST purposes.

A GST joint venture will only be approved if:

- the venture is for an approved purpose;
- the venture is not a partnership, that is the income is not received jointly;
- each entity satisfies the participation requirements; and
- the application nominates an entity to be the joint venture operator, which need not be a party to the joint venture agreement.

The approved purposes reflect the common purposes for a joint venture including exploration or exploitation of mineral deposits, research and development, agriculture, generating transmission distribution of electricity etc. It can also specifically include the design, building or maintenance of residential/commercial premises subject to the counter-measures put in place to prevent exploitation of the margin rules.

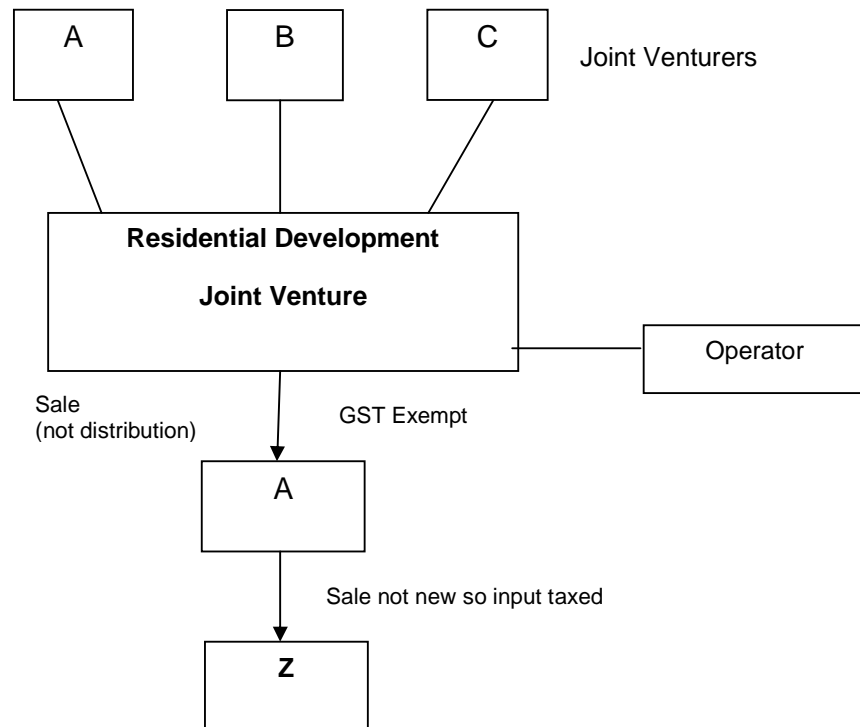
The participation requirements are that the entity:

- must participate or intend to participate in the joint venture;
- must be a party to the joint venture agreement;
- must be registered for GST purposes; and
- must account on the same basis as the other participants.

⁴ ARN Constructions 87atc 4790

GSTR 2004/3⁵ deals with avoidance of GST on the sale of new residential premises. Its purpose was to prevent avoidance of GST through entry into a scheme under which the parties purported formed a joint venture for the construction and sale of residential premises. The operator purports to sell the completed premises to a participant in the joint venture. It is argued that the sale is not a taxable supply under s.51-30(2) which provides that the supply made by the joint venture operator of a GST joint venture, to a joint venture participant is not a taxable supply if the participant acquires the things supplied for consumption, use or supply in the course of the activities for which the joint venture was entered into.

Diagram 3



The purpose of the scheme was to convert premises which were built from being "new residential premises" upon which GST would be payable to being a subsequent supply which is input taxed. The scheme relies on the transfer of the residential property from the operator to the participant as a GST exempt transaction on the basis that it is a supply within the joint venture. The proceeds for the sale of the residential premises to the third party is distributed amongst the participants as the participant pays for the residential premises to the operator the amount which the participant receives from the third party.

⁵ GSTR 2004/3 – 7 April 2004

The ATO has rejected the scheme in the ruling. It states that the sale by the joint venture operator to the participant is a taxable supply and that Section 51-30(2) does not apply because either:-

- the arrangement is not a joint venture for GST purposes; or
- the participant does not acquire the premises for consumption or use of the supply in the course of the activities for which the joint venture was entered into.

This ruling has caused some developers to be wary of using a joint venture vehicle for development. This should not be the case as the ruling has limited effect to prevent an unlawful scheme. On reviewing the structure of the scheme, the transfer from the operator to the participant is outside the joint venture purpose – it is not a payment between the participants and the operator to carry out the purpose of the joint venture. Under the nature of a joint venture, the participants own the product of the joint venture and therefore the product does not need to be sold by the operator to a participant.

Where the joint venture is properly (and lawfully) structured, the participant should be able to receive the product of the joint venture tax-free for on-sale. Where that product is residential premises, the participant would be entitled to keep those premises for its own use or to on-sell the premises with GST payable on the on-sale.

Another tax issue to consider are the Capital Gain Tax status of the land used in the Venture, particularly for any premises sold by the contractor.

4.2 Structure of Joint Venture

An infrastructure or property joint venture can link the participants commercially in a way to minimise disputes. For example, the participants may be:-

- landowner;
- principal contractor;
- designer;
- significant subcontractor;

In this type of structure, the parties would enter into a joint venture arrangement under which they would agree of their participation in the joint venture, the joint venture may appoint an

operator who would act as the project co-ordinator or that role may be undertaken by one of the participants (usually the contractor).

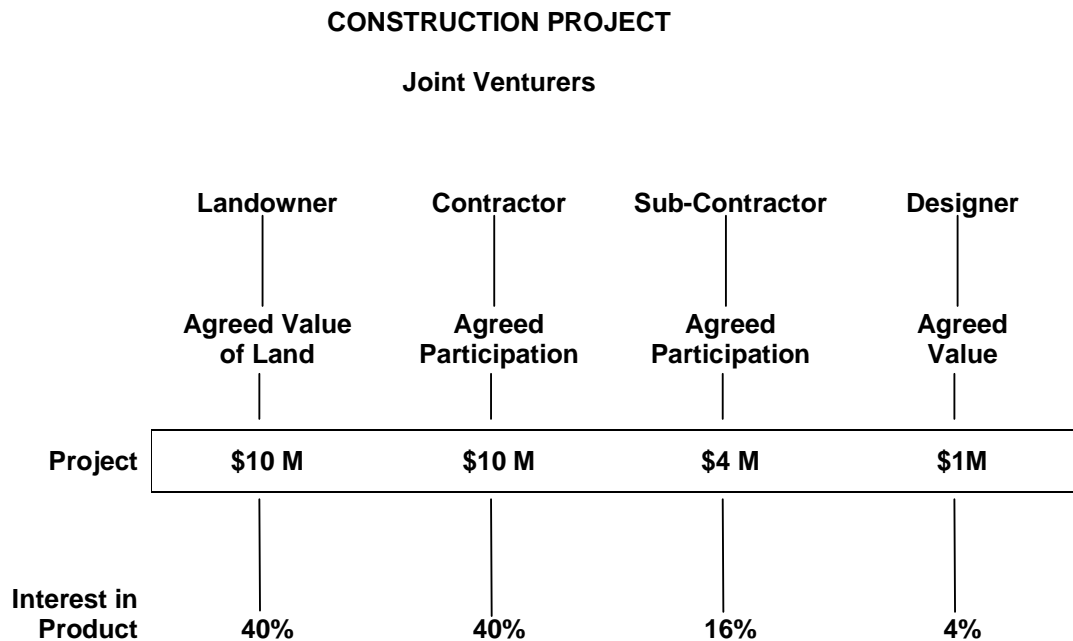
The benefit of the use of the joint venture is that the parties are commercially committed to each other and have a commercial reason to complete the project on time and within budget.

The joint venture agreement would need to identify the participation interests. It is easy to value the contribution by the principal as an agreed valuation of the land can be used.

The valuation of the contribution by the other participants is often more difficult. It may be necessary to have final drawings to be able to value the work by the other participants and any change to those agreed drawings/contracts would require the approval of all participants.

Another structure is for each participant to contribute its labour up to an agreed level.

Diagram 4



Under this scenario, the cost of construction in excess of the agreed participation by the contractor and sub-contractor would need to be paid by the joint venture participants in their participation percentage. Often the value of the designers work will be determined at the commencement of the project. The participation by the contractor and sub-contractor however

will be subject to a standard construction contract (upon which GST may not be payable if it can be structured to comply with Section 51-30(2) as a supplier within the joint venture).

The difficulty arises where there are variations during the project. The relationship between the contractor and the joint venture remains the same as the relationship between the contractor and the principal. Irrespective of the structure of the joint venture, the contractor/participant will still be seeking to maximise profit from the building contract potentially at the expense of the other participants. Where the joint venture engages an independent project manager to negotiate issues such as variations to time and cost, the joint venture may be able to provide that the decision of the Project Manager is final.

4.3 Advantage of Joint Venture

The main advantage of the joint venture is the high degree of co-operation and participation required to negotiate and administer a joint venture. This high degree of co-operation is likely to increase the trust between the parties, there are more likely to be regular meetings to discuss issues and to resolve problems and because of the contractual relationship under the joint venture agreement, the parties may have a less adversarial approach to each other.

It is a relatively simple structure that can be used on small projects.

5. Alliance Contract

5.1 What is an Alliance Contract

An Alliance Contract or relationship contract has developed as other forms of contracts such as engineering engineering, procurement, construction (EPC) contracts have lost popularity. The traditional EPC contract transferred risk from the developer to the contractor; the contractor would accept this risk (and often pass it on to sub-contractors) in exchange for a profit which is sufficiently large to fund that risk. The traditional contract worked where the market was buoyant enough that the contractor could include this profit margin in the tendered price.

As profit levels reduce in the current economic circumstances and as technology in the construction industry develops to potentially provide cost savings through the use of new technology other construction models have developed.

The Alliance Contract is an extension of a partnering arrangement. It codifies the relationship between the parties and generally covers:-

- (a) the parties are bound by the Alliance Contract;
- (b) the parties including the owner, contractor, designer, subcontractors form part of the Alliance team;
- (c) costs are 100% reimbursed;

- (d) the parties agree to share in profit or loss based on defined performance goals;
- (e) disputes are to be resolved within the Alliance Contract usually by the Alliance Committee;
- (f) no disputes can be brought outside the Alliance Agreement;
- (g) decisions of the Alliance Committee are binding and unanimous; and
- (h) the participants develop and commit to a set of Alliance principles setting out the key goals of the project.

According to the "Project Alliance and Practitioners Guide"⁶ :-

"Project Alliancing is about providing better value for money and improved project outcomes through a more integrated approach between the public and private sectors in the delivery of infrastructure projects."

The major advantage in the Alliance model is to shift risk so there is no allocation of risk to an individual party but risk is managed collaboratively through the Alliance Committee.

Various government bodies including the Queensland Department of Main Roads and Sydney Water have published statistics comparing Alliance Contracts to traditional contracts which show much better performance under the Alliance Contract. Projects came in at a lower cost, ahead of schedule and exceeding the expectations of the parties.

5.2 Alliance Structure

Generally an Alliance Contract will identify:-

- The Alliance Committee or board;
- Clarify the development of the integrated team; and
- establish the commercial arrangement.

5.3 Alliance Committee

The Alliance Committee comprises representatives of each of the Alliance participants. It has the primary role of administering the Alliance Project. Usually the partners will be the designer, the contractor and the owner. Each partner will have one vote and there is no provision for a casting vote. All decisions must be unanimous and there is no deadlock provision.

The structure of the Alliance Committee means that the owner does not have a final say in how the project will proceed and generally has no veto powers.

Some contracts will allocate some reserve power to the owner. For example, particularly where the owner is government, there may be overriding considerations such as national security which have to be considered. This may arise where the Alliance Contract deals with defence or IT matters which go to the heart of government.

The owner may also reserve a power to change fundamental aspects of the contract such as to prevent a change in scope of work greater than a certain percentage or to approve a variation to the contract in excess of a certain percentage or amount.

Reserve powers may also relate to long term potential liability for the owner particularly issues such as environmental concerns or the long term maintainability of the project where the Alliance is not continuing for the long term.

The problem with reserve powers is that it cuts across the nature of the Alliance relationship – instead of each of the Alliance partners being equal and having an equal say in the project, the owner has a superior position and a right of veto in a number of areas. If the owner exercises that veto power, there may be implications to the cost or profit which will impact on the sharing of the pain and gain.

The nature of the Alliance Committee is intended to take away the hierarchy of traditional contracts.

5.4 Integrated Development Team

The Alliance method is intended to minimise the confrontational nature of the traditional construction structure.

There is a change of philosophy and often prior to signing of the Alliance Contract, the parties will be involved in Alliance workshops, facilitated meetings between the various parties, employees and there may be ongoing involvement of the Alliance facilitator.

The intention of the structure is to break down the traditional silos on the workplace. One psychological method of doing this is for the alliance to have separate premises and often to work in a special alliance uniform logo etc so that the Alliance has a separate identity from the participants.

The lines of hierarchy within each of the participants blurs with the alliance having a separate hierarchy. While the relationship between the parties may become collegiate, other legal relationships will remain in place. For example, the employees of each of the participants remain employees of that party for tax and WH&S purposes. This can create complex contractual relationships where the employee of one organisation is required to take direction from the employee of another organisation.

⁶ State of Victoria Treasury 2006

On a long term basis, employees can lose the sense of identify with their employer and identify with the alliance. While this is the intention of the Alliance Contract, it can cause problems within the employer organisation when the alliance finishes. Does the employee lose his/sense of engagement with the employer.

5.5 No Disputes/No Blame

Fundamental to the concept of the Alliance Contract is that there is no blame and no disputes between the parties and each party releases the others from all liability. Some Alliance Contracts except wilful default from the general exclusion from liability. This of course leaves open what is intended by "wilful default". Generally the parties cannot claim against the other for negligence of any degree.

The philosophy is that if there is no blame and no disputes between the parties then the parties have no incentive to hide information.

As there is no blame and no disputes, the parties do not need to be concerned about issues such as extensions of time, liquidated damages or variations. These matters will be discussed in an open manner in the Alliance Committee where decisions can be made in the best interest of the project.

Because there is no blame, the design can be more innovative, the parties can incorporate new technology. If the project is delayed, the parties can discuss at the Alliance Committee methods to make up the time. As there is no blame, none of the parties need to maintain a critical path and no one owns the time float and workers can be used where they are most effective.

5.6 Profit

While the philosophical basis of the Alliance Contract creates a trusting environment, there needs to be an economic imperative to ensure that the parties abide by the arrangement even without blame or dispute.

Most Alliance Contracts provide for the contractor and the designer being reimbursed for their costs and then incentives for bringing the project in on or before time and on or under budget.

In negotiating the "cost" for the contractor and designer, the Alliance Contract needs to identify the nature of costs. Fore example, does it include an allowance for off-site overheads such as office expenses; can it include profit from subcontractors which are related parties. How do the parties negotiate for sub-contractors.

While an Alliance Contract is intended to be a risk sharing agreement, by ensuring that the contractor and designer are reimbursed their costs, the contract can become a "cost plus"

contract where the risk is shifted too the owner. The contractor and designer know that at the minimum they will be reimbursed their costs – they will not be out of pocket.

From a financing point of view, the owner needs to ensure that its financiers are satisfied with this arrangement.

6. Due Diligence

Prior to entering into an Alliance Contract or any type of relationship contract it is important that each participant undertakes complete due diligence on the other to understand the business culture of the other participants to check if they have a business culture which is conducive to the Alliance system, whether the people who will be engaged on the project day to day have the personality to participate in an Alliance situation and whether there is a genuine commitment by all participants to the Alliance concept.

The use of an Alliance Contract or other relationship contracting does not diminish the need to carry out extensive engineering/technical due diligence. It is often more important in negotiating an Alliance Contract to consider the interfaces between various subcontractors, a realistic cost plan and a realistic time schedule.

The Alliance Contract only applies between the Alliance partners. It is likely that all subcontractors will be engaged by the contractor or the Alliance under traditional contracts which would be entered into with the consent of the Alliance Committee.

As part of the due diligence, the participants need to consider insurance carefully. As there is no blame, a traditional professional indemnity insurance of the designer will not be effective. The designer will have no loss for its error therefore cannot claim under the policy. The owner may suffer loss because of the cost to redo work, the owner would not have an interest under the professional indemnity insurance. Often the Alliance participants would take out separate cover for their various interests under the Alliance Contract.

7. Obligation of Good Faith

The relationship under a joint venture or Alliance Contract creates a new set of relationships and legal obligations between the participants. In a traditional construction contract, the parties have an obligation not to commit fraud or misrepresentation, but there is no positive obligation of good faith. There is no restriction on one party taking advantage of its bargaining position or superior knowledge when dealing with the other. There is generally no obligation of general disclosure of information known about the project.

In a joint venture or Alliance Contract, the relationship is much closer.

In a joint venture, the participants may have fiduciary obligations in some aspects of the venture. For example, if a participant discovered information about the venture, such as that the coal seam extended further than the current mining lease, the participant may have a fiduciary obligation to advise the other joint venturers and if the participant took out a mining lease over the extended area in its own name, it is likely that it would be holding that mining lease on trust for the joint venture. The information relating to the extension of the mining lease is so intimately related to the mine that that information should be made known to the joint venturer as a whole.

Other aspects of the relationship do not carry fiduciary duty. For example joint venturers would not be required to act in good faith considering the impact on the other venturers in exercising a contractual right such as an assignment or consent to assignment of the contract.

The leading case dealing with this obligation of good faith is *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd*⁷. The facts of that case were that Placer was the operator for a joint venture of a number of mines in Western Australia. It had engaged Thiess to carry out the mining operations. Initially the contract was on the basis of a schedule of rates contract but because of the expense which had been incurred, Placer had proposed a partner in contract under which Thiess would be paid its costs plus an agreed percentage profit. The contract had a provision which allowed Placer to terminate the contract for its convenience without penalty other than payment of the demobilisation of costs. Following various discussions with Thiess, Placer decided to terminate the existing contract and to put the work to tender. Thiess tendered at a significantly lower rate.

Thiess brought an action against Placer claiming damages for loss of profits it would have earned had the contracts not been terminated. It was a claim for breach of fiduciary duty and misleading and deceptive conduct. Placer defended on the basis that it had an unqualified right to terminate the contracts and, during discovery, Placer became aware of material facts and claimed that Thiess had made material and fraudulent misrepresentations which induced Placer to enter into the contracts. Placer argued that Thiess had acted in bad faith.

The judge in the first instance, Mr Justice Templeton, reviewed the evidence in detail (the decision is almost 250 pages).

He held that Placer had an unfettered right to terminate. This was one of the aspects of the partnering agreement which did not attract any fiduciary obligations.

Most of the decision however was considering the surrounding circumstances to the parties entering into the partnering agreement. This is relevant in determining the percentage profit which was paid to Thiess. The analysis of the relationships which arose from this negotiation is

⁷ [2000] WA SCA 102
(2003) 77 ALJR 776 (on Appeal)

directly relevant to the payments under an Alliance Contract where the contractor and designer are usually entitled to be paid their "cost" but the profit is risk.

During negotiations between Thiess and Placer, it was proposed that the rates would be derived from an open book system from Haul Profiles, Cycle Times, ownership costs and operating costs plus a profit margin. The base rates were the rates in dollars per bank cubic metre ("BCM"). The rates were to be used by places to determine whether it was better to use Thiess to operate the mine or for Placer to operate the mine itself which it had done previously.

In addition to profit, Thiess would be entitled to claim overheads which would include head office charges. It was agreed that no profit would apply to those charges.

During the negotiations, there was discussion about repairs and accidental damage. Thiess advised Placer that Thiess had an internal plant department which obtained, services and repaired plant and equipment and then hired it to various operating departments. The objective was for the plant department to break even. The evidence given by a representative for Placer was that he had been told by Thiess that Placer would be charged the plant department rates, that is the internal hire rate by Thiess without profit. During disclosure, Placer discovered that Thiess had charged more than its internal plant rates. Thiess provides Placer with various costs for its internal plant rates. The impression given to Placer was that a 5% profit was being charged. In fact the profit was 10.87%. Placer was not told that the plant rates in the submission were not the internal plant rates which they appeared to be and which had been indicated to them.

The trial judge held that:-

"I accept entirely that Messrs Jukes, Trio and Parsons (senior staff at Thiess) derived no personal gain from the misrepresentations. I think that their conduct was motivated by loyalty to Thiess and the desire to ensure that it retained an important contract.

"They were in an invidious position. The 1989 contract had been very profitable for Thiess and it was anxious to retain Placer as a client. But Placer would accept only a 5% profit margin which was far below the level required by Thiess's business plan.

"... I am satisfied that Thiess's conduct was deceitful".⁸

In his conclusion the trial judge found that the Granny Smith contract imposed on Thiess the obligation of formulating in good faith equipment operating costs based on historical data. This was in the nature of the fiduciary obligation. Thiess was in breach of the contract because it inflated the equipment operating costs based on historical data for the purpose of deriving additional profit. Placer was entitled to damages for breach of contract in the sum of

⁸ Page 83

\$4,253,000.00. While the decision was overturned at the first instance, the High Court reinstated that order.

The Placer (Granny Smith) case is important on a number of issues:-

1. It confirms that the parties to a partnering agreement can have fiduciary obligations in some respects but other contractual rights (such as the right to terminate for convenience) do not have to be exercised having regard to the effect on the other party.
2. There are fiduciary obligations, obligations of good faith, arising from the relationship.

It highlights the importance of full disclosure but also the discussion by the trial judge of the evidence particularly of the senior management from Thiess indicates the pressure on the parties (particularly in the current economic climate) to justify the entry into the contract, the need to produce the required profit.

8. Representations

In the negotiation of a joint venture or an Alliance Contract, any other forms of relationship contracting, there are significant negotiations about the method that the project will proceed and the intentions of the parties. Under a traditional design and construct or EPC contract, the contract itself will set out the standard of skill, cost, variation procedures etc. The contract stands alone.

With a relationship contract, the pre-contractual negotiations will become more important. As was seen in the Placer (Granny Smith) case, the negotiations about the partnering agreement were vital to the interpretation of the final contract. Representations made about the methodology used to calculate cost could be relied upon in interpreting the intention of the final contract even though Placer had not specifically asked for a breakdown of the costs in that final contract.

Costs is only one aspect of a relationship contract. Representations can be made about other aspects which are less tangible which may affect the outcome of the project. These may include the commitment of a party to the Alliance concept.

While the Alliance Agreement will contain a provision dealing with no blame and no dispute, that waiver of liability will only relate to disputes or blame arising within the Alliance Contract itself. Where the misrepresentation arose to induce the party to enter into the Alliance Contract, the waiver will not apply.

Summary

The use of the joint venture or an Alliance Contract provides advantages for the construction of larger projects including significant buildings and infrastructure. These structures ensure that the participants share in the pain and the gain, that the participants have a vested interest in close dialogue, avoiding blame and looking for results and maximising the return on the project.

While these structures do not create partnerships, there are obligations of good faith between the participants. Each participant must ensure that it does not obtain an advantage from the other participants and is open in all dealings with them.

Issues can also arise about representations made during negotiations, meetings prior to the Alliance Agreement being signed which may have induced one of the participants to enter into the Agreement.

The existence of the obligations of good faith and the representations made may give rise to action outside the contract which would not be barred by the no blame, no dispute.

From the owners point of view, a development using an Alliance Contract can transfer power to the contractor and designer more than under a standard contract.

The great advantage however is that the parties are all working together. There are no disputes between the Alliance participants regarding the Alliance project and in practice, Alliance Contracting has been successful.

18 February 2009

CONSIDERING JOINT VENTURES AND ALLIANCE PARTICIPANTS IN RESPECT TO PREFERRED DELIVERY METHODS FOR COMMERCIAL BUILDING, CIVIL AND INFRASTRUCTURE PROJECTS

Robin Lonergan
Partner

5th Annual Queensland Construction Law Masterclass – 18 February 2009

1. Introduction

Particularly in the current economic climate, parties are looking at new structures to enable development of buildings and infrastructure projects to proceed. Investors are more risk averse; the banks have less cash to lend, governments are looking to encourage construction.

The Federal Government's package for commercial property and the use of Future Fund is to be used for providing funding to existing commercial property where foreign bank funding has been withdrawn rather than for assisting new construction projects¹. Westpac and ANZ asked the government to avoid creating the impression that the commercial property fund was aimed at new construction. Westpac noted that the loans to projects under development would only be on "an exceptional basis" and even then without any intention "to take on construction risk". This scheme will see the government put in \$2 billion and the big four banks \$500 million each to create the commercial property facility with capacity to lend up to \$30 billion if necessary to be financed by the issue of government bonds.

¹ Australian Newspaper 27.01.2009

The players (including landowners, contractors, consultants and financiers) are looking for structures which will allow them to continue to develop construction buildings and infrastructure projects.

2. Risk Adverse

In the past, the construction industry has been seen as lacking in trust between the participants and accordingly with each party defending itself against the others². Poor relationships between the principal, contractor and sub-contractors lead to problems that affect time, cost and quality as well as damaging long term relationships between the parties according to a study in the Northwest UK carried out about how people worked in the construction industry. The participants were asked about issues such as trust and why it is important, some of the issues were:-

- (a) Honest Communications – the parties should be open and willing to share important information with the rest of the team and be honest giving information that reflects the real situation.
- (b) Reliance – the parties should be able to rely on the information that is given and to rely that when people say they will say something that they will do it – that promises will be kept. In construction there may be many specialist trades and not everyone will have expertise to understand what is being done and therefore will have to rely on the other person's experience and expertise.
- (c) Reputation - trust tends to be given to people rather than companies or organisations and will rely on individuals rather than an organisation. Despite this, organisations can build reputations which impact on whether people feel comfortable working with them in projects.

The benefit of trust is that the construction industry is uncertain and if the information is clear and accurate then other people can rely on it. Where parties are reliable, there is more likely to be repeat business so that trust can increase profit both on an individual project and in the long term. Generally it is easier to build the personal relationships on smaller projects but by changing the culture within organisations, trust can be built on larger projects. Joint ventures and alliance contracting are two methodologies which have developed to bring "trust" into projects.

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A number of structures have been developed to minimise the confrontational nature of the relationships between the parties in the projects, to improve the trust between the parties and to establish a more collaborative approach.

Despite the various attempts at creating a new construction paradigm, the basic outcome sought is:

- a reasonable profit for each participant including the owner, contractor, subcontractor and consultant;
- completion of the project in a timely manner;
- to satisfy the social responsibility of the participants; and
- to minimise long term costs for the operation of the building/infrastructure project.

The weighting of these goals depends on the nature of the project and the nature of the participation of the parties.

Where the parties anticipate that the project will be on-sold quickly with short term profit for the developer, long term maintenance costs may be considered to be less important. With an infrastructure project such as a road, the government or the concessionaire will consider that the maintenance costs are as important as the original construction cost and that a designer may utilise techniques or materials which have a higher initial cost but will substantially reduce long term maintenance.

Some participants may have strong commitments to social responsibility for example ethical investment funds, churches and governments. Such principals may be willing to accept a greater cost for a project by having regard to the long term cost to society for issues such as being conscious of the source of materials, reducing long term energy costs, use of renewable or recyclable materials refusal, to use rainforest timbers etc. Many public companies have a social responsibility charter and reports relevant to that charter will be presented at the annual general meeting with as much importance as reports on financial performance.

3. Joint Venture/Alliance Contract

I will consider the two delivery methods of joint venture and alliance contracting for projects.

Diagram 1 – Alliance Contract

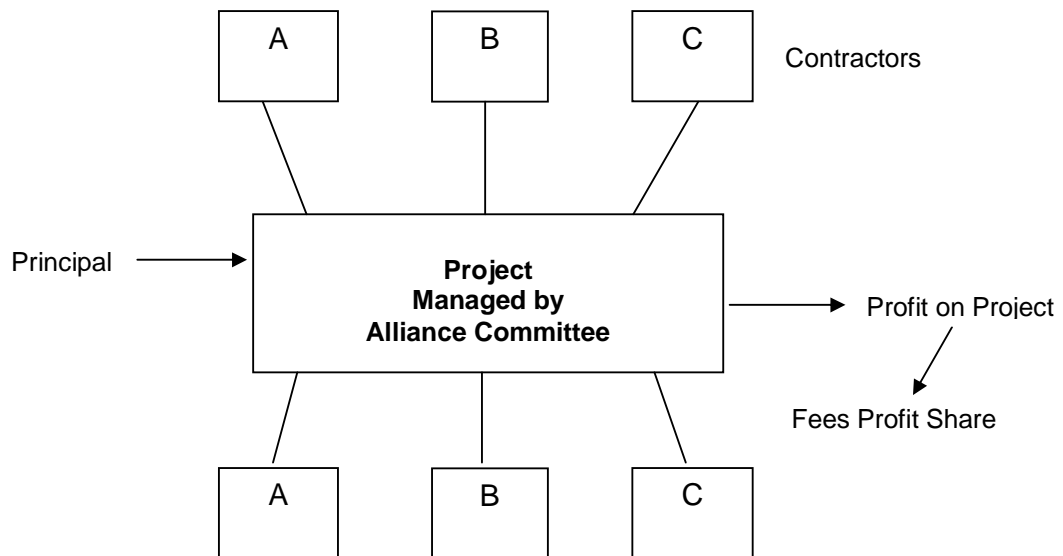
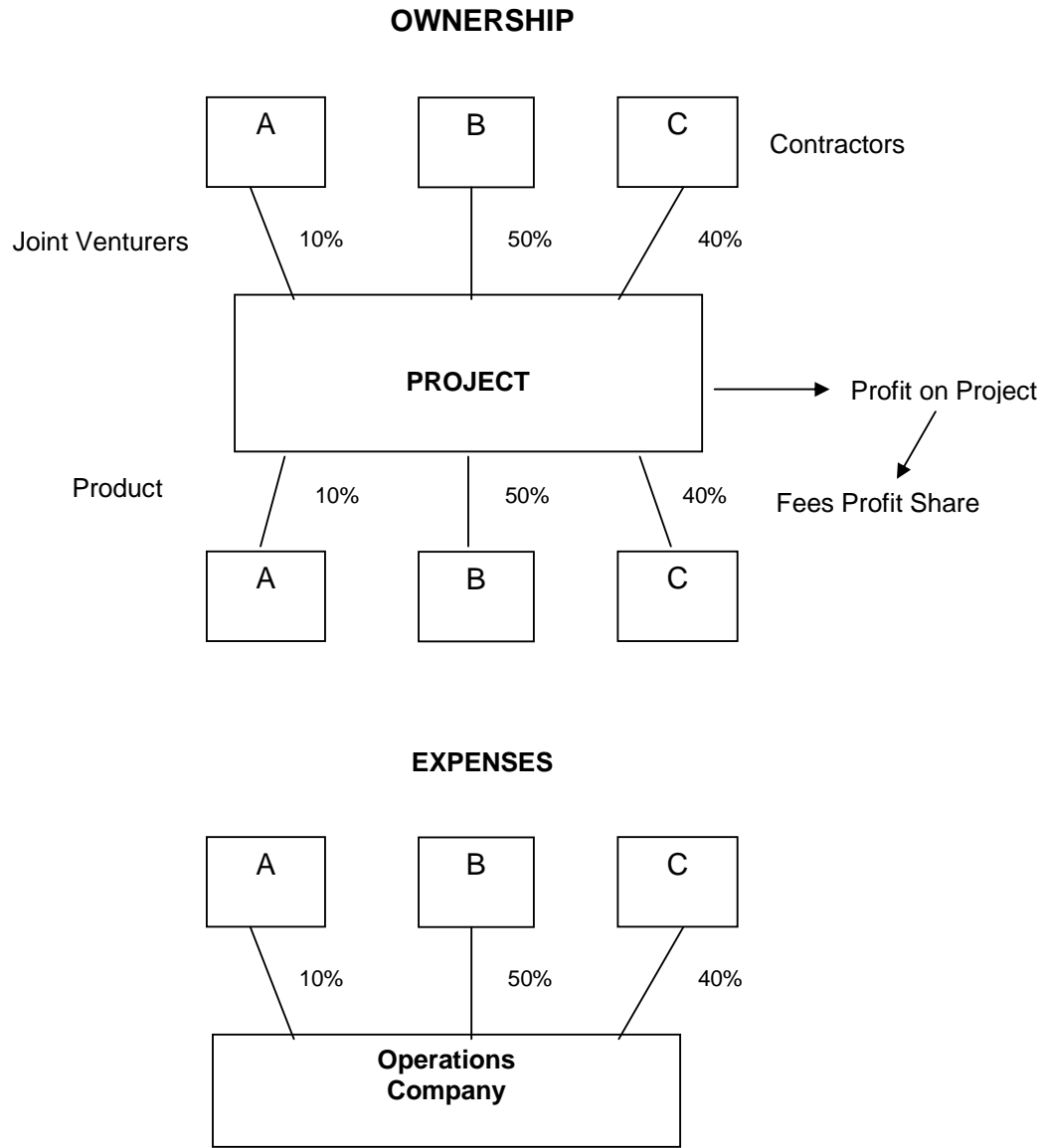


Diagram 2 – Joint Venture



Both of these delivery methods have the aim of ensuring that the participants share in the outcome – share the pain and the gain.

The unincorporated joint venture has been used for many years particularly in mining projects as a means of participating jointly without creating a new legal entity and without sharing liability. Traditionally it was developed as a tax effective means of carrying out the project. As it was developed in answer to tax matters, it can still be seen by the tax office as having an element of tax minimisation and therefore may have greater scrutiny than other structures.

The Australian Tax Office contract has been developed more from a culture of reducing risk and increasing trust between the participants. It requires greater cultural change within the participants and is usually not drive by tax considerations.

4. Joint Venture

4.1 What is a Joint Venture

The Australian Tax Office³ considers that a joint venture is characterised by the following:

- In Sharing of product outcome rather than the proceeds of sale or profits.
- Contractual agreement between the participants.
- Joint control.
- A specific economic project.
- Cost sharing.

Of these, the most important aspect is the sharing of the product of the outcome. In a mining joint venture, this may mean that the coal, iron ore etc which is extracted from the mine is taken to be owned by the participants in the joint venture in their respective percentages. In a joint venture operating a toll way concession, the participants own the concession revenue in their respective percentages. An arrangement which shares profit will be a partnership and not a joint venture.

The fundamental difference between an unincorporated joint venture and a partnership is that the joint venturers are only severally liable in the participation percentage and not jointly liable for the debts of the enterprise.

The other indication of a joint venture is that it is for a specific economic project rather than a continuous business. If there is continuous business, for example a number of different developments, then it is more likely to be characterised as a partnership. The ongoing operation of one project would not be characterised as a continuous business.

³ GSTR 2004/2 Goods and Services Tax: What is a Joint Venture for GST Purposes

The traditional view was that a syndicate which comes into existence for a limited period or purpose would not be a partnership for income tax purposes. For example construction of residential buildings which were divided equally between the venturers after construction is not a partnership either at general law or for income tax purposes⁴. There are various provisions which may require a limited partnership to be treated as a company for tax purposes.

For GST purposes, the parties may enter into an approved joint venture as a "GST joint venture", which means that the operator of the joint venture is responsible for the GST liabilities and entitlements arising from the operators dealing on behalf of the venture participants. The payments by the venturers to the operator are not considered to be a taxable supply for the purposes of the GST law. These joint venture provisions are similar to the GST group rules on the basis that it is operating in a similar way to a group by an unlimited basis. The GST joint venture is not treated as a single body for all GST purposes.

A GST joint venture will only be approved if:

- the venture is for an approved purpose;
- the venture is not a partnership, that is the income is not received jointly;
- each entity satisfies the participation requirements; and
- the application nominates an entity to be the joint venture operator, which need not be a party to the joint venture agreement.

The approved purposes reflect the common purposes for a joint venture including exploration or exploitation of mineral deposits, research and development, agriculture, generating transmission distribution of electricity etc. It can also specifically include the design, building or maintenance of residential/commercial premises subject to the counter-measures put in place to prevent exploitation of the margin rules.

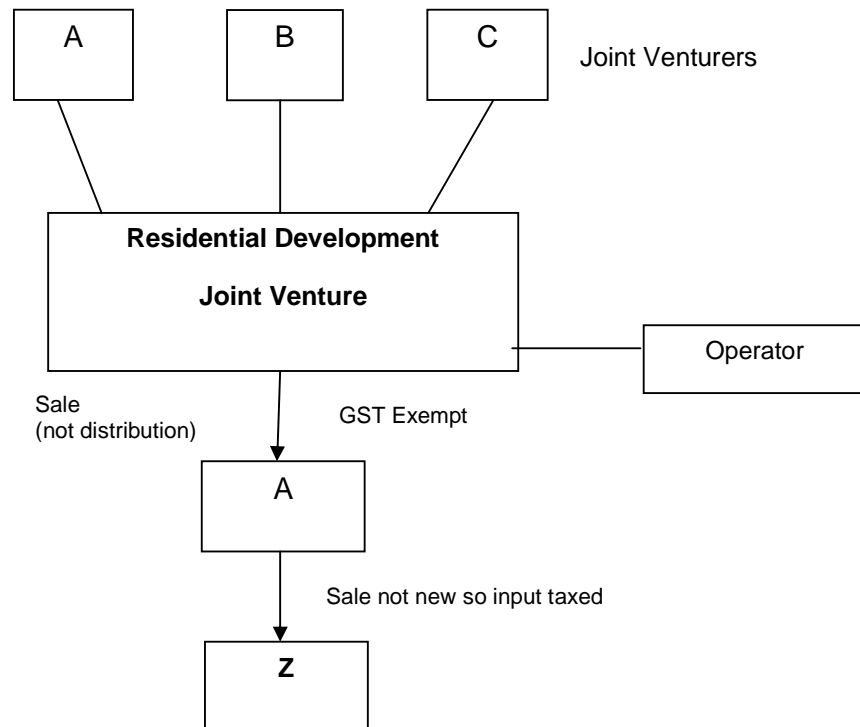
The participation requirements are that the entity:

- must participate or intend to participate in the joint venture;
- must be a party to the joint venture agreement;
- must be registered for GST purposes; and
- must account on the same basis as the other participants.

⁴ ARN Constructions 87atc 4790

GSTR 2004/3⁵ deals with avoidance of GST on the sale of new residential premises. Its purpose was to prevent avoidance of GST through entry into a scheme under which the parties purported formed a joint venture for the construction and sale of residential premises. The operator purports to sell the completed premises to a participant in the joint venture. It is argued that the sale is not a taxable supply under s.51-30(2) which provides that the supply made by the joint venture operator of a GST joint venture, to a joint venture participant is not a taxable supply if the participant acquires the things supplied for consumption, use or supply in the course of the activities for which the joint venture was entered into.

Diagram 3



The purpose of the scheme was to convert premises which were built from being "new residential premises" upon which GST would be payable to being a subsequent supply which is input taxed. The scheme relies on the transfer of the residential property from the operator to the participant as a GST exempt transaction on the basis that it is a supply within the joint venture. The proceeds for the sale of the residential premises to the third party is distributed amongst the participants as the participant pays for the residential premises to the operator the amount which the participant receives from the third party.

⁵ GSTR 2004/3 – 7 April 2004

The ATO has rejected the scheme in the ruling. It states that the sale by the joint venture operator to the participant is a taxable supply and that Section 51-30(2) does not apply because either:-

- the arrangement is not a joint venture for GST purposes; or
- the participant does not acquire the premises for consumption or use of the supply in the course of the activities for which the joint venture was entered into.

This ruling has caused some developers to be wary of using a joint venture vehicle for development. This should not be the case as the ruling has limited effect to prevent an unlawful scheme. On reviewing the structure of the scheme, the transfer from the operator to the participant is outside the joint venture purpose – it is not a payment between the participants and the operator to carry out the purpose of the joint venture. Under the nature of a joint venture, the participants own the product of the joint venture and therefore the product does not need to be sold by the operator to a participant.

Where the joint venture is properly (and lawfully) structured, the participant should be able to receive the product of the joint venture tax-free for on-sale. Where that product is residential premises, the participant would be entitled to keep those premises for its own use or to on-sell the premises with GST payable on the on-sale.

Another tax issue to consider are the Capital Gain Tax status of the land used in the Venture, particularly for any premises sold by the contractor.

4.2 Structure of Joint Venture

An infrastructure or property joint venture can link the participants commercially in a way to minimise disputes. For example, the participants may be:-

- landowner;
- principal contractor;
- designer;
- significant subcontractor;

In this type of structure, the parties would enter into a joint venture arrangement under which they would agree of their participation in the joint venture, the joint venture may appoint an

operator who would act as the project co-ordinator or that role may be undertaken by one of the participants (usually the contractor).

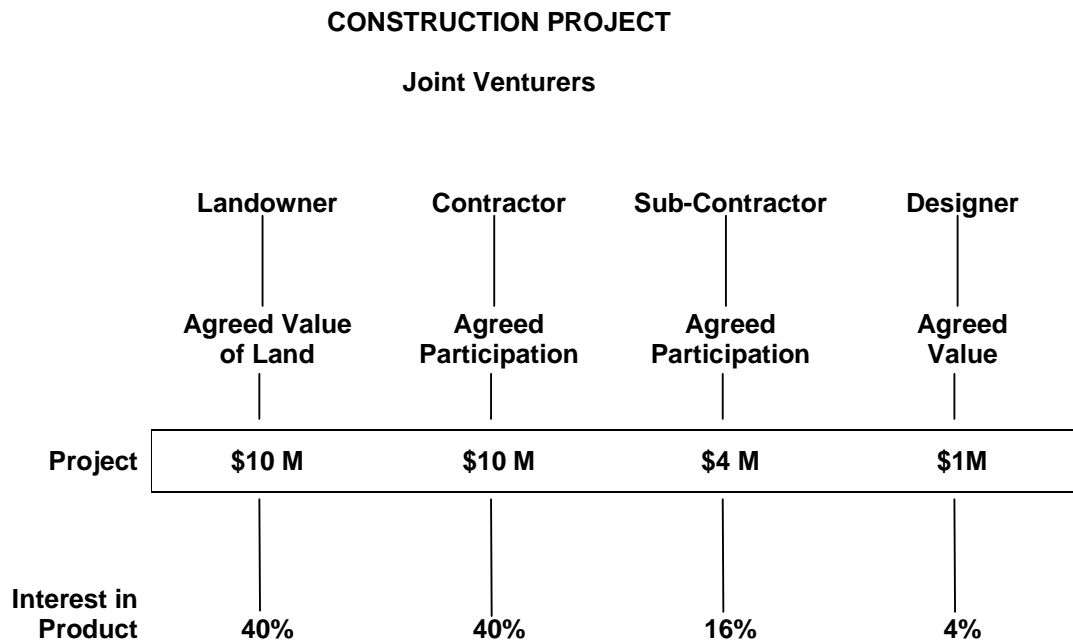
The benefit of the use of the joint venture is that the parties are commercially committed to each other and have a commercial reason to complete the project on time and within budget.

The joint venture agreement would need to identify the participation interests. It is easy to value the contribution by the principal as an agreed valuation of the land can be used.

The valuation of the contribution by the other participants is often more difficult. It may be necessary to have final drawings to be able to value the work by the other participants and any change to those agreed drawings/contracts would require the approval of all participants.

Another structure is for each participant to contribute its labour up to an agreed level.

Diagram 4



Under this scenario, the cost of construction in excess of the agreed participation by the contractor and sub-contractor would need to be paid by the joint venture participants in their participation percentage. Often the value of the designers work will be determined at the commencement of the project. The participation by the contractor and sub-contractor however

will be subject to a standard construction contract (upon which GST may not be payable if it can be structured to comply with Section 51-30(2) as a supplier within the joint venture).

The difficulty arises where there are variations during the project. The relationship between the contractor and the joint venture remains the same as the relationship between the contractor and the principal. Irrespective of the structure of the joint venture, the contractor/participant will still be seeking to maximise profit from the building contract potentially at the expense of the other participants. Where the joint venture engages an independent project manager to negotiate issues such as variations to time and cost, the joint venture may be able to provide that the decision of the Project Manager is final.

4.3 Advantage of Joint Venture

The main advantage of the joint venture is the high degree of co-operation and participation required to negotiate and administer a joint venture. This high degree of co-operation is likely to increase the trust between the parties, there are more likely to be regular meetings to discuss issues and to resolve problems and because of the contractual relationship under the joint venture agreement, the parties may have a less adversarial approach to each other.

It is a relatively simple structure that can be used on small projects.

5. Alliance Contract

5.1 What is an Alliance Contract

An Alliance Contract or relationship contract has developed as other forms of contracts such as engineering engineering, procurement, construction (EPC) contracts have lost popularity. The traditional EPC contract transferred risk from the developer to the contractor; the contractor would accept this risk (and often pass it on to sub-contractors) in exchange for a profit which is sufficiently large to fund that risk. The traditional contract worked where the market was buoyant enough that the contractor could include this profit margin in the tendered price.

As profit levels reduce in the current economic circumstances and as technology in the construction industry develops to potentially provide cost savings through the use of new technology other construction models have developed.

The Alliance Contract is an extension of a partnering arrangement. It codifies the relationship between the parties and generally covers:-

- (a) the parties are bound by the Alliance Contract;
- (b) the parties including the owner, contractor, designer, subcontractors form part of the Alliance team;
- (c) costs are 100% reimbursed;

- (d) the parties agree to share in profit or loss based on defined performance goals;
- (e) disputes are to be resolved within the Alliance Contract usually by the Alliance Committee;
- (f) no disputes can be brought outside the Alliance Agreement;
- (g) decisions of the Alliance Committee are binding and unanimous; and
- (h) the participants develop and commit to a set of Alliance principles setting out the key goals of the project.

According to the "Project Alliance and Practitioners Guide"⁶ :-

"Project Alliancing is about providing better value for money and improved project outcomes through a more integrated approach between the public and private sectors in the delivery of infrastructure projects."

The major advantage in the Alliance model is to shift risk so there is no allocation of risk to an individual party but risk is managed collaboratively through the Alliance Committee.

Various government bodies including the Queensland Department of Main Roads and Sydney Water have published statistics comparing Alliance Contracts to traditional contracts which show much better performance under the Alliance Contract. Projects came in at a lower cost, ahead of schedule and exceeding the expectations of the parties.

5.2 Alliance Structure

Generally an Alliance Contract will identify:-

- The Alliance Committee or board;
- Clarify the development of the integrated team; and
- establish the commercial arrangement.

5.3 Alliance Committee

The Alliance Committee comprises representatives of each of the Alliance participants. It has the primary role of administering the Alliance Project. Usually the partners will be the designer, the contractor and the owner. Each partner will have one vote and there is no provision for a casting vote. All decisions must be unanimous and there is no deadlock provision.

The structure of the Alliance Committee means that the owner does not have a final say in how the project will proceed and generally has no veto powers.

Some contracts will allocate some reserve power to the owner. For example, particularly where the owner is government, there may be overriding considerations such as national security which have to be considered. This may arise where the Alliance Contract deals with defence or IT matters which go to the heart of government.

The owner may also reserve a power to change fundamental aspects of the contract such as to prevent a change in scope of work greater than a certain percentage or to approve a variation to the contract in excess of a certain percentage or amount.

Reserve powers may also relate to long term potential liability for the owner particularly issues such as environmental concerns or the long term maintainability of the project where the Alliance is not continuing for the long term.

The problem with reserve powers is that it cuts across the nature of the Alliance relationship – instead of each of the Alliance partners being equal and having an equal say in the project, the owner has a superior position and a right of veto in a number of areas. If the owner exercises that veto power, there may be implications to the cost or profit which will impact on the sharing of the pain and gain.

The nature of the Alliance Committee is intended to take away the hierarchy of traditional contracts.

5.4 Integrated Development Team

The Alliance method is intended to minimise the confrontational nature of the traditional construction structure.

There is a change of philosophy and often prior to signing of the Alliance Contract, the parties will be involved in Alliance workshops, facilitated meetings between the various parties, employees and there may be ongoing involvement of the Alliance facilitator.

The intention of the structure is to break down the traditional silos on the workplace. One psychological method of doing this is for the alliance to have separate premises and often to work in a special alliance uniform logo etc so that the Alliance has a separate identity from the participants.

The lines of hierarchy within each of the participants blurs with the alliance having a separate hierarchy. While the relationship between the parties may become collegiate, other legal relationships will remain in place. For example, the employees of each of the participants remain employees of that party for tax and WH&S purposes. This can create complex contractual relationships where the employee of one organisation is required to take direction from the employee of another organisation.

⁶ State of Victoria Treasury 2006

On a long term basis, employees can lose the sense of identify with their employer and identify with the alliance. While this is the intention of the Alliance Contract, it can cause problems within the employer organisation when the alliance finishes. Does the employee lose his/sense of engagement with the employer.

5.5 No Disputes/No Blame

Fundamental to the concept of the Alliance Contract is that there is no blame and no disputes between the parties and each party releases the others from all liability. Some Alliance Contracts except wilful default from the general exclusion from liability. This of course leaves open what is intended by "wilful default". Generally the parties cannot claim against the other for negligence of any degree.

The philosophy is that if there is no blame and no disputes between the parties then the parties have no incentive to hide information.

As there is no blame and no disputes, the parties do not need to be concerned about issues such as extensions of time, liquidated damages or variations. These matters will be discussed in an open manner in the Alliance Committee where decisions can be made in the best interest of the project.

Because there is no blame, the design can be more innovative, the parties can incorporate new technology. If the project is delayed, the parties can discuss at the Alliance Committee methods to make up the time. As there is no blame, none of the parties need to maintain a critical path and no one owns the time float and workers can be used where they are most effective.

5.6 Profit

While the philosophical basis of the Alliance Contract creates a trusting environment, there needs to be an economic imperative to ensure that the parties abide by the arrangement even without blame or dispute.

Most Alliance Contracts provide for the contractor and the designer being reimbursed for their costs and then incentives for bringing the project in on or before time and on or under budget.

In negotiating the "cost" for the contractor and designer, the Alliance Contract needs to identify the nature of costs. Fore example, does it include an allowance for off-site overheads such as office expenses; can it include profit from subcontractors which are related parties. How do the parties negotiate for sub-contractors.

While an Alliance Contract is intended to be a risk sharing agreement, by ensuring that the contractor and designer are reimbursed their costs, the contract can become a "cost plus"

contract where the risk is shifted too the owner. The contractor and designer know that at the minimum they will be reimbursed their costs – they will not be out of pocket.

From a financing point of view, the owner needs to ensure that its financiers are satisfied with this arrangement.

6. Due Diligence

Prior to entering into an Alliance Contract or any type of relationship contract it is important that each participant undertakes complete due diligence on the other to understand the business culture of the other participants to check if they have a business culture which is conducive to the Alliance system, whether the people who will be engaged on the project day to day have the personality to participate in an Alliance situation and whether there is a genuine commitment by all participants to the Alliance concept.

The use of an Alliance Contract or other relationship contracting does not diminish the need to carry out extensive engineering/technical due diligence. It is often more important in negotiating an Alliance Contract to consider the interfaces between various subcontractors, a realistic cost plan and a realistic time schedule.

The Alliance Contract only applies between the Alliance partners. It is likely that all subcontractors will be engaged by the contractor or the Alliance under traditional contracts which would be entered into with the consent of the Alliance Committee.

As part of the due diligence, the participants need to consider insurance carefully. As there is no blame, a traditional professional indemnity insurance of the designer will not be effective. The designer will have no loss for its error therefore cannot claim under the policy. The owner may suffer loss because of the cost to redo work, the owner would not have an interest under the professional indemnity insurance. Often the Alliance participants would take out separate cover for their various interests under the Alliance Contract.

7. Obligation of Good Faith

The relationship under a joint venture or Alliance Contract creates a new set of relationships and legal obligations between the participants. In a traditional construction contract, the parties have an obligation not to commit fraud or misrepresentation, but there is no positive obligation of good faith. There is no restriction on one party taking advantage of its bargaining position or superior knowledge when dealing with the other. There is generally no obligation of general disclosure of information known about the project.

In a joint venture or Alliance Contract, the relationship is much closer.

In a joint venture, the participants may have fiduciary obligations in some aspects of the venture. For example, if a participant discovered information about the venture, such as that the coal seam extended further than the current mining lease, the participant may have a fiduciary obligation to advise the other joint venturers and if the participant took out a mining lease over the extended area in its own name, it is likely that it would be holding that mining lease on trust for the joint venture. The information relating to the extension of the mining lease is so intimately related to the mine that that information should be made known to the joint venturer as a whole.

Other aspects of the relationship do not carry fiduciary duty. For example joint venturers would not be required to act in good faith considering the impact on the other venturers in exercising a contractual right such as an assignment or consent to assignment of the contract.

The leading case dealing with this obligation of good faith is *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd*⁷. The facts of that case were that Placer was the operator for a joint venture of a number of mines in Western Australia. It had engaged Thiess to carry out the mining operations. Initially the contract was on the basis of a schedule of rates contract but because of the expense which had been incurred, Placer had proposed a partner in contract under which Thiess would be paid its costs plus an agreed percentage profit. The contract had a provision which allowed Placer to terminate the contract for its convenience without penalty other than payment of the demobilisation of costs. Following various discussions with Thiess, Placer decided to terminate the existing contract and to put the work to tender. Thiess tendered at a significantly lower rate.

Thiess brought an action against Placer claiming damages for loss of profits it would have earned had the contracts not been terminated. It was a claim for breach of fiduciary duty and misleading and deceptive conduct. Placer defended on the basis that it had an unqualified right to terminate the contracts and, during discovery, Placer became aware of material facts and claimed that Thiess had made material and fraudulent misrepresentations which induced Placer to enter into the contracts. Placer argued that Thiess had acted in bad faith.

The judge in the first instance, Mr Justice Templeton, reviewed the evidence in detail (the decision is almost 250 pages).

He held that Placer had an unfettered right to terminate. This was one of the aspects of the partnering agreement which did not attract any fiduciary obligations.

Most of the decision however was considering the surrounding circumstances to the parties entering into the partnering agreement. This is relevant in determining the percentage profit which was paid to Thiess. The analysis of the relationships which arose from this negotiation is

⁷ [2000] WA SCA 102
(2003) 77 ALJR 776 (on Appeal)

directly relevant to the payments under an Alliance Contract where the contractor and designer are usually entitled to be paid their "cost" but the profit is risk.

During negotiations between Thiess and Placer, it was proposed that the rates would be derived from an open book system from Haul Profiles, Cycle Times, ownership costs and operating costs plus a profit margin. The base rates were the rates in dollars per bank cubic metre ("BCM"). The rates were to be used by places to determine whether it was better to use Thiess to operate the mine or for Placer to operate the mine itself which it had done previously.

In addition to profit, Thiess would be entitled to claim overheads which would include head office charges. It was agreed that no profit would apply to those charges.

During the negotiations, there was discussion about repairs and accidental damage. Thiess advised Placer that Thiess had an internal plant department which obtained, services and repaired plant and equipment and then hired it to various operating departments. The objective was for the plant department to break even. The evidence given by a representative for Placer was that he had been told by Thiess that Placer would be charged the plant department rates, that is the internal hire rate by Thiess without profit. During disclosure, Placer discovered that Thiess had charged more than its internal plant rates. Thiess provides Placer with various costs for its internal plant rates. The impression given to Placer was that a 5% profit was being charged. In fact the profit was 10.87%. Placer was not told that the plant rates in the submission were not the internal plant rates which they appeared to be and which had been indicated to them.

The trial judge held that:-

"I accept entirely that Messrs Jukes, Trio and Parsons (senior staff at Thiess) derived no personal gain from the misrepresentations. I think that their conduct was motivated by loyalty to Thiess and the desire to ensure that it retained an important contract.

"They were in an invidious position. The 1989 contract had been very profitable for Thiess and it was anxious to retain Placer as a client. But Placer would accept only a 5% profit margin which was far below the level required by Thiess's business plan.

"... I am satisfied that Thiess's conduct was deceitful".⁸

In his conclusion the trial judge found that the Granny Smith contract imposed on Thiess the obligation of formulating in good faith equipment operating costs based on historical data. This was in the nature of the fiduciary obligation. Thiess was in breach of the contract because it inflated the equipment operating costs based on historical data for the purpose of deriving additional profit. Placer was entitled to damages for breach of contract in the sum of

⁸ Page 83

\$4,253,000.00. While the decision was overturned at the first instance, the High Court reinstated that order.

The Placer (Granny Smith) case is important on a number of issues:-

1. It confirms that the parties to a partnering agreement can have fiduciary obligations in some respects but other contractual rights (such as the right to terminate for convenience) do not have to be exercised having regard to the effect on the other party.
2. There are fiduciary obligations, obligations of good faith, arising from the relationship.

It highlights the importance of full disclosure but also the discussion by the trial judge of the evidence particularly of the senior management from Thiess indicates the pressure on the parties (particularly in the current economic climate) to justify the entry into the contract, the need to produce the required profit.

8. Representations

In the negotiation of a joint venture or an Alliance Contract, any other forms of relationship contracting, there are significant negotiations about the method that the project will proceed and the intentions of the parties. Under a traditional design and construct or EPC contract, the contract itself will set out the standard of skill, cost, variation procedures etc. The contract stands alone.

With a relationship contract, the pre-contractual negotiations will become more important. As was seen in the Placer (Granny Smith) case, the negotiations about the partnering agreement were vital to the interpretation of the final contract. Representations made about the methodology used to calculate cost could be relied upon in interpreting the intention of the final contract even though Placer had not specifically asked for a breakdown of the costs in that final contract.

Costs is only one aspect of a relationship contract. Representations can be made about other aspects which are less tangible which may affect the outcome of the project. These may include the commitment of a party to the Alliance concept.

While the Alliance Agreement will contain a provision dealing with no blame and no dispute, that waiver of liability will only relate to disputes or blame arising within the Alliance Contract itself. Where the misrepresentation arose to induce the party to enter into the Alliance Contract, the waiver will not apply.

Summary

The use of the joint venture or an Alliance Contract provides advantages for the construction of larger projects including significant buildings and infrastructure. These structures ensure that the participants share in the pain and the gain, that the participants have a vested interest in close dialogue, avoiding blame and looking for results and maximising the return on the project.

While these structures do not create partnerships, there are obligations of good faith between the participants. Each participant must ensure that it does not obtain an advantage from the other participants and is open in all dealings with them.

Issues can also arise about representations made during negotiations, meetings prior to the Alliance Agreement being signed which may have induced one of the participants to enter into the Agreement.

The existence of the obligations of good faith and the representations made may give rise to action outside the contract which would not be barred by the no blame, no dispute.

From the owners point of view, a development using an Alliance Contract can transfer power to the contractor and designer more than under a standard contract.

The great advantage however is that the parties are all working together. There are no disputes between the Alliance participants regarding the Alliance project and in practice, Alliance Contracting has been successful.

18 February 2009

CONSIDERING JOINT VENTURES AND ALLIANCE PARTICIPANTS IN RESPECT TO PREFERRED DELIVERY METHODS FOR COMMERCIAL BUILDING, CIVIL AND INFRASTRUCTURE PROJECTS

Robin Lonergan
Partner

5th Annual Queensland Construction Law Masterclass – 18 February 2009

1. Introduction

Particularly in the current economic climate, parties are looking at new structures to enable development of buildings and infrastructure projects to proceed. Investors are more risk averse; the banks have less cash to lend, governments are looking to encourage construction.

The Federal Government's package for commercial property and the use of Future Fund is to be used for providing funding to existing commercial property where foreign bank funding has been withdrawn rather than for assisting new construction projects¹. Westpac and ANZ asked the government to avoid creating the impression that the commercial property fund was aimed at new construction. Westpac noted that the loans to projects under development would only be on "an exceptional basis" and even then without any intention "to take on construction risk". This scheme will see the government put in \$2 billion and the big four banks \$500 million each to create the commercial property facility with capacity to lend up to \$30 billion if necessary to be financed by the issue of government bonds.

¹ Australian Newspaper 27.01.2009

The players (including landowners, contractors, consultants and financiers) are looking for structures which will allow them to continue to develop construction buildings and infrastructure projects.

2. Risk Adverse

In the past, the construction industry has been seen as lacking in trust between the participants and accordingly with each party defending itself against the others². Poor relationships between the principal, contractor and sub-contractors lead to problems that affect time, cost and quality as well as damaging long term relationships between the parties according to a study in the Northwest UK carried out about how people worked in the construction industry. The participants were asked about issues such as trust and why it is important, some of the issues were:-

- (a) Honest Communications – the parties should be open and willing to share important information with the rest of the team and be honest giving information that reflects the real situation.
- (b) Reliance – the parties should be able to rely on the information that is given and to rely that when people say they will say something that they will do it – that promises will be kept. In construction there may be many specialist trades and not everyone will have expertise to understand what is being done and therefore will have to rely on the other person's experience and expertise.
- (c) Reputation - trust tends to be given to people rather than companies or organisations and will rely on individuals rather than an organisation. Despite this, organisations can build reputations which impact on whether people feel comfortable working with them in projects.

The benefit of trust is that the construction industry is uncertain and if the information is clear and accurate then other people can rely on it. Where parties are reliable, there is more likely to be repeat business so that trust can increase profit both on an individual project and in the long term. Generally it is easier to build the personal relationships on smaller projects but by changing the culture within organisations, trust can be built on larger projects. Joint ventures and alliance contracting are two methodologies which have developed to bring "trust" into projects.

The culture of blame has lead to inefficiencies as each party seeks to "cover its back" and to shift risk. The risk is shifted to the party which is in the weakest negotiating position within the contracts. It is often shifted to a party who has the least control over minimising the risk and the least ability to prevent the events occurring.

² Trust in Construction – Achieving Cultural Change (Centre for Construction Innovation in the North West (UK) 01.2002

A number of structures have been developed to minimise the confrontational nature of the relationships between the parties in the projects, to improve the trust between the parties and to establish a more collaborative approach.

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The weighting of these goals depends on the nature of the project and the nature of the participation of the parties.

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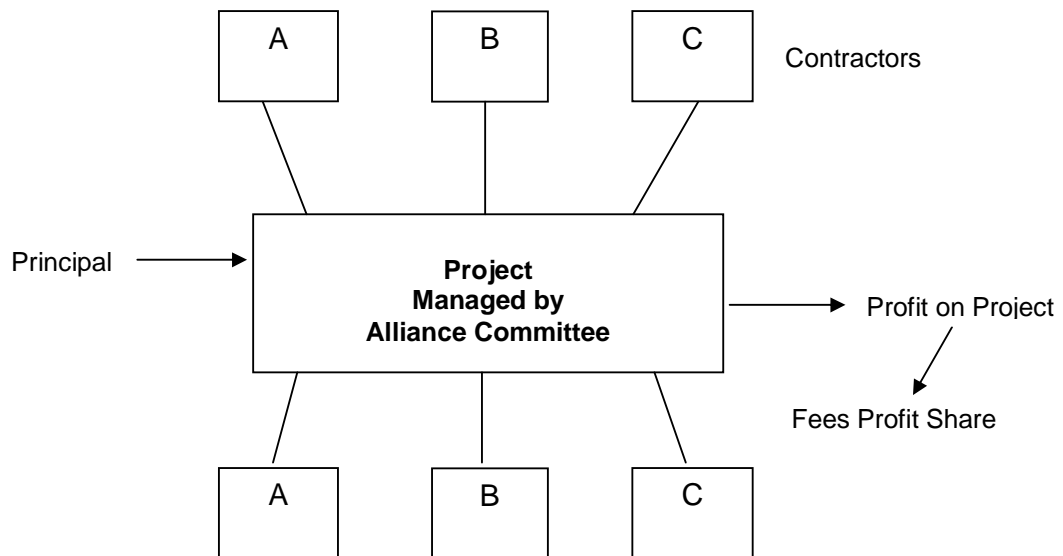
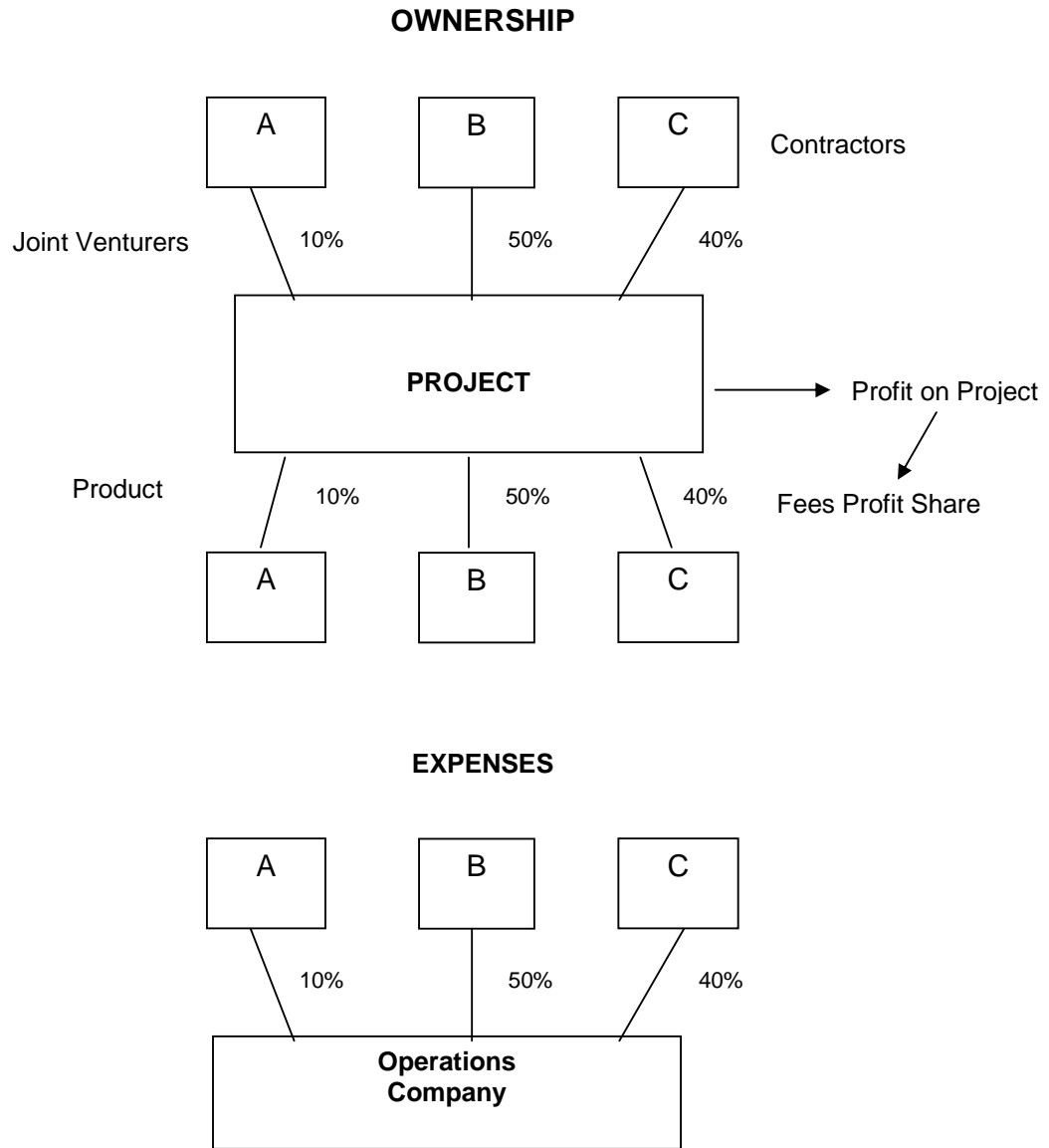


Diagram 2 – Joint Venture



Both of these delivery methods have the aim of ensuring that the participants share in the outcome – share the pain and the gain.

The unincorporated joint venture has been used for many years particularly in mining projects as a means of participating jointly without creating a new legal entity and without sharing liability. Traditionally it was developed as a tax effective means of carrying out the project. As it was developed in answer to tax matters, it can still be seen by the tax office as having an element of tax minimisation and therefore may have greater scrutiny than other structures.

The Australian Tax Office contract has been developed more from a culture of reducing risk and increasing trust between the participants. It requires greater cultural change within the participants and is usually not drive by tax considerations.

4. Joint Venture

4.1 What is a Joint Venture

The Australian Tax Office³ considers that a joint venture is characterised by the following:

- In Sharing of product outcome rather than the proceeds of sale or profits.
- Contractual agreement between the participants.
- Joint control.
- A specific economic project.
- Cost sharing.

Of these, the most important aspect is the sharing of the product of the outcome. In a mining joint venture, this may mean that the coal, iron ore etc which is extracted from the mine is taken to be owned by the participants in the joint venture in their respective percentages. In a joint venture operating a toll way concession, the participants own the concession revenue in their respective percentages. An arrangement which shares profit will be a partnership and not a joint venture.

The fundamental difference between an unincorporated joint venture and a partnership is that the joint venturers are only severally liable in the participation percentage and not jointly liable for the debts of the enterprise.

The other indication of a joint venture is that it is for a specific economic project rather than a continuous business. If there is continuous business, for example a number of different developments, then it is more likely to be characterised as a partnership. The ongoing operation of one project would not be characterised as a continuous business.

³ GSTR 2004/2 Goods and Services Tax: What is a Joint Venture for GST Purposes

The traditional view was that a syndicate which comes into existence for a limited period or purpose would not be a partnership for income tax purposes. For example construction of residential buildings which were divided equally between the venturers after construction is not a partnership either at general law or for income tax purposes⁴. There are various provisions which may require a limited partnership to be treated as a company for tax purposes.

For GST purposes, the parties may enter into an approved joint venture as a "GST joint venture", which means that the operator of the joint venture is responsible for the GST liabilities and entitlements arising from the operators dealing on behalf of the venture participants. The payments by the venturers to the operator are not considered to be a taxable supply for the purposes of the GST law. These joint venture provisions are similar to the GST group rules on the basis that it is operating in a similar way to a group by an unlimited basis. The GST joint venture is not treated as a single body for all GST purposes.

A GST joint venture will only be approved if:

- the venture is for an approved purpose;
- the venture is not a partnership, that is the income is not received jointly;
- each entity satisfies the participation requirements; and
- the application nominates an entity to be the joint venture operator, which need not be a party to the joint venture agreement.

The approved purposes reflect the common purposes for a joint venture including exploration or exploitation of mineral deposits, research and development, agriculture, generating transmission distribution of electricity etc. It can also specifically include the design, building or maintenance of residential/commercial premises subject to the counter-measures put in place to prevent exploitation of the margin rules.

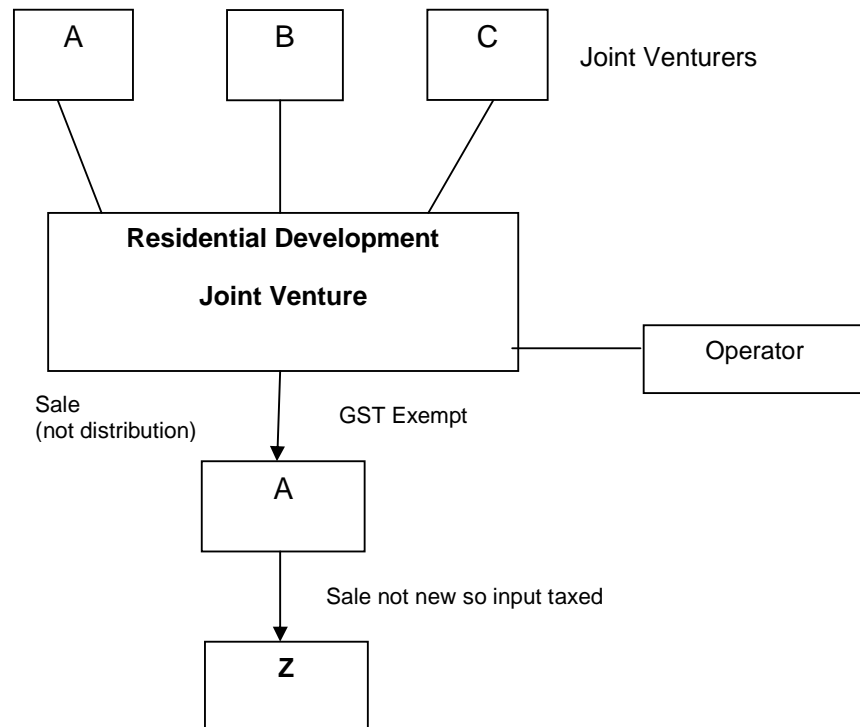
The participation requirements are that the entity:

- must participate or intend to participate in the joint venture;
- must be a party to the joint venture agreement;
- must be registered for GST purposes; and
- must account on the same basis as the other participants.

⁴ ARN Constructions 87atc 4790

GSTR 2004/3⁵ deals with avoidance of GST on the sale of new residential premises. Its purpose was to prevent avoidance of GST through entry into a scheme under which the parties purported formed a joint venture for the construction and sale of residential premises. The operator purports to sell the completed premises to a participant in the joint venture. It is argued that the sale is not a taxable supply under s.51-30(2) which provides that the supply made by the joint venture operator of a GST joint venture, to a joint venture participant is not a taxable supply if the participant acquires the things supplied for consumption, use or supply in the course of the activities for which the joint venture was entered into.

Diagram 3



The purpose of the scheme was to convert premises which were built from being "new residential premises" upon which GST would be payable to being a subsequent supply which is input taxed. The scheme relies on the transfer of the residential property from the operator to the participant as a GST exempt transaction on the basis that it is a supply within the joint venture. The proceeds for the sale of the residential premises to the third party is distributed amongst the participants as the participant pays for the residential premises to the operator the amount which the participant receives from the third party.

⁵ GSTR 2004/3 – 7 April 2004

The ATO has rejected the scheme in the ruling. It states that the sale by the joint venture operator to the participant is a taxable supply and that Section 51-30(2) does not apply because either:-

- the arrangement is not a joint venture for GST purposes; or
- the participant does not acquire the premises for consumption or use of the supply in the course of the activities for which the joint venture was entered into.

This ruling has caused some developers to be wary of using a joint venture vehicle for development. This should not be the case as the ruling has limited effect to prevent an unlawful scheme. On reviewing the structure of the scheme, the transfer from the operator to the participant is outside the joint venture purpose – it is not a payment between the participants and the operator to carry out the purpose of the joint venture. Under the nature of a joint venture, the participants own the product of the joint venture and therefore the product does not need to be sold by the operator to a participant.

Where the joint venture is properly (and lawfully) structured, the participant should be able to receive the product of the joint venture tax-free for on-sale. Where that product is residential premises, the participant would be entitled to keep those premises for its own use or to on-sell the premises with GST payable on the on-sale.

Another tax issue to consider are the Capital Gain Tax status of the land used in the Venture, particularly for any premises sold by the contractor.

4.2 Structure of Joint Venture

An infrastructure or property joint venture can link the participants commercially in a way to minimise disputes. For example, the participants may be:-

- landowner;
- principal contractor;
- designer;
- significant subcontractor;

In this type of structure, the parties would enter into a joint venture arrangement under which they would agree of their participation in the joint venture, the joint venture may appoint an

operator who would act as the project co-ordinator or that role may be undertaken by one of the participants (usually the contractor).

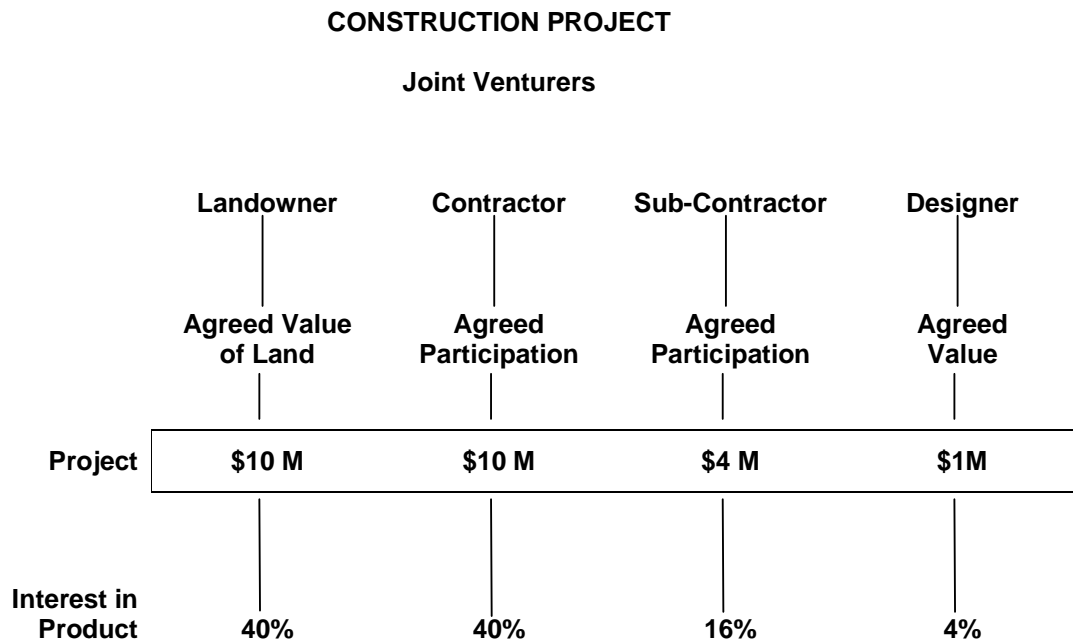
The benefit of the use of the joint venture is that the parties are commercially committed to each other and have a commercial reason to complete the project on time and within budget.

The joint venture agreement would need to identify the participation interests. It is easy to value the contribution by the principal as an agreed valuation of the land can be used.

The valuation of the contribution by the other participants is often more difficult. It may be necessary to have final drawings to be able to value the work by the other participants and any change to those agreed drawings/contracts would require the approval of all participants.

Another structure is for each participant to contribute its labour up to an agreed level.

Diagram 4



Under this scenario, the cost of construction in excess of the agreed participation by the contractor and sub-contractor would need to be paid by the joint venture participants in their participation percentage. Often the value of the designers work will be determined at the commencement of the project. The participation by the contractor and sub-contractor however

will be subject to a standard construction contract (upon which GST may not be payable if it can be structured to comply with Section 51-30(2) as a supplier within the joint venture).

The difficulty arises where there are variations during the project. The relationship between the contractor and the joint venture remains the same as the relationship between the contractor and the principal. Irrespective of the structure of the joint venture, the contractor/participant will still be seeking to maximise profit from the building contract potentially at the expense of the other participants. Where the joint venture engages an independent project manager to negotiate issues such as variations to time and cost, the joint venture may be able to provide that the decision of the Project Manager is final.

4.3 Advantage of Joint Venture

The main advantage of the joint venture is the high degree of co-operation and participation required to negotiate and administer a joint venture. This high degree of co-operation is likely to increase the trust between the parties, there are more likely to be regular meetings to discuss issues and to resolve problems and because of the contractual relationship under the joint venture agreement, the parties may have a less adversarial approach to each other.

It is a relatively simple structure that can be used on small projects.

5. Alliance Contract

5.1 What is an Alliance Contract

An Alliance Contract or relationship contract has developed as other forms of contracts such as engineering engineering, procurement, construction (EPC) contracts have lost popularity. The traditional EPC contract transferred risk from the developer to the contractor; the contractor would accept this risk (and often pass it on to sub-contractors) in exchange for a profit which is sufficiently large to fund that risk. The traditional contract worked where the market was buoyant enough that the contractor could include this profit margin in the tendered price.

As profit levels reduce in the current economic circumstances and as technology in the construction industry develops to potentially provide cost savings through the use of new technology other construction models have developed.

The Alliance Contract is an extension of a partnering arrangement. It codifies the relationship between the parties and generally covers:-

- (a) the parties are bound by the Alliance Contract;
- (b) the parties including the owner, contractor, designer, subcontractors form part of the Alliance team;
- (c) costs are 100% reimbursed;

- (d) the parties agree to share in profit or loss based on defined performance goals;
- (e) disputes are to be resolved within the Alliance Contract usually by the Alliance Committee;
- (f) no disputes can be brought outside the Alliance Agreement;
- (g) decisions of the Alliance Committee are binding and unanimous; and
- (h) the participants develop and commit to a set of Alliance principles setting out the key goals of the project.

According to the "Project Alliance and Practitioners Guide"⁶ :-

"Project Alliancing is about providing better value for money and improved project outcomes through a more integrated approach between the public and private sectors in the delivery of infrastructure projects."

The major advantage in the Alliance model is to shift risk so there is no allocation of risk to an individual party but risk is managed collaboratively through the Alliance Committee.

Various government bodies including the Queensland Department of Main Roads and Sydney Water have published statistics comparing Alliance Contracts to traditional contracts which show much better performance under the Alliance Contract. Projects came in at a lower cost, ahead of schedule and exceeding the expectations of the parties.

5.2 Alliance Structure

Generally an Alliance Contract will identify:-

- The Alliance Committee or board;
- Clarify the development of the integrated team; and
- establish the commercial arrangement.

5.3 Alliance Committee

The Alliance Committee comprises representatives of each of the Alliance participants. It has the primary role of administering the Alliance Project. Usually the partners will be the designer, the contractor and the owner. Each partner will have one vote and there is no provision for a casting vote. All decisions must be unanimous and there is no deadlock provision.

The structure of the Alliance Committee means that the owner does not have a final say in how the project will proceed and generally has no veto powers.

Some contracts will allocate some reserve power to the owner. For example, particularly where the owner is government, there may be overriding considerations such as national security which have to be considered. This may arise where the Alliance Contract deals with defence or IT matters which go to the heart of government.

The owner may also reserve a power to change fundamental aspects of the contract such as to prevent a change in scope of work greater than a certain percentage or to approve a variation to the contract in excess of a certain percentage or amount.

Reserve powers may also relate to long term potential liability for the owner particularly issues such as environmental concerns or the long term maintainability of the project where the Alliance is not continuing for the long term.

The problem with reserve powers is that it cuts across the nature of the Alliance relationship – instead of each of the Alliance partners being equal and having an equal say in the project, the owner has a superior position and a right of veto in a number of areas. If the owner exercises that veto power, there may be implications to the cost or profit which will impact on the sharing of the pain and gain.

The nature of the Alliance Committee is intended to take away the hierarchy of traditional contracts.

5.4 Integrated Development Team

The Alliance method is intended to minimise the confrontational nature of the traditional construction structure.

There is a change of philosophy and often prior to signing of the Alliance Contract, the parties will be involved in Alliance workshops, facilitated meetings between the various parties, employees and there may be ongoing involvement of the Alliance facilitator.

The intention of the structure is to break down the traditional silos on the workplace. One psychological method of doing this is for the alliance to have separate premises and often to work in a special alliance uniform logo etc so that the Alliance has a separate identity from the participants.

The lines of hierarchy within each of the participants blurs with the alliance having a separate hierarchy. While the relationship between the parties may become collegiate, other legal relationships will remain in place. For example, the employees of each of the participants remain employees of that party for tax and WH&S purposes. This can create complex contractual relationships where the employee of one organisation is required to take direction from the employee of another organisation.

⁶ State of Victoria Treasury 2006

On a long term basis, employees can lose the sense of identify with their employer and identify with the alliance. While this is the intention of the Alliance Contract, it can cause problems within the employer organisation when the alliance finishes. Does the employee lose his/sense of engagement with the employer.

5.5 No Disputes/No Blame

Fundamental to the concept of the Alliance Contract is that there is no blame and no disputes between the parties and each party releases the others from all liability. Some Alliance Contracts except wilful default from the general exclusion from liability. This of course leaves open what is intended by "wilful default". Generally the parties cannot claim against the other for negligence of any degree.

The philosophy is that if there is no blame and no disputes between the parties then the parties have no incentive to hide information.

As there is no blame and no disputes, the parties do not need to be concerned about issues such as extensions of time, liquidated damages or variations. These matters will be discussed in an open manner in the Alliance Committee where decisions can be made in the best interest of the project.

Because there is no blame, the design can be more innovative, the parties can incorporate new technology. If the project is delayed, the parties can discuss at the Alliance Committee methods to make up the time. As there is no blame, none of the parties need to maintain a critical path and no one owns the time float and workers can be used where they are most effective.

5.6 Profit

While the philosophical basis of the Alliance Contract creates a trusting environment, there needs to be an economic imperative to ensure that the parties abide by the arrangement even without blame or dispute.

Most Alliance Contracts provide for the contractor and the designer being reimbursed for their costs and then incentives for bringing the project in on or before time and on or under budget.

In negotiating the "cost" for the contractor and designer, the Alliance Contract needs to identify the nature of costs. Fore example, does it include an allowance for off-site overheads such as office expenses; can it include profit from subcontractors which are related parties. How do the parties negotiate for sub-contractors.

While an Alliance Contract is intended to be a risk sharing agreement, by ensuring that the contractor and designer are reimbursed their costs, the contract can become a "cost plus"

contract where the risk is shifted too the owner. The contractor and designer know that at the minimum they will be reimbursed their costs – they will not be out of pocket.

From a financing point of view, the owner needs to ensure that its financiers are satisfied with this arrangement.

6. Due Diligence

Prior to entering into an Alliance Contract or any type of relationship contract it is important that each participant undertakes complete due diligence on the other to understand the business culture of the other participants to check if they have a business culture which is conducive to the Alliance system, whether the people who will be engaged on the project day to day have the personality to participate in an Alliance situation and whether there is a genuine commitment by all participants to the Alliance concept.

The use of an Alliance Contract or other relationship contracting does not diminish the need to carry out extensive engineering/technical due diligence. It is often more important in negotiating an Alliance Contract to consider the interfaces between various subcontractors, a realistic cost plan and a realistic time schedule.

The Alliance Contract only applies between the Alliance partners. It is likely that all subcontractors will be engaged by the contractor or the Alliance under traditional contracts which would be entered into with the consent of the Alliance Committee.

As part of the due diligence, the participants need to consider insurance carefully. As there is no blame, a traditional professional indemnity insurance of the designer will not be effective. The designer will have no loss for its error therefore cannot claim under the policy. The owner may suffer loss because of the cost to redo work, the owner would not have an interest under the professional indemnity insurance. Often the Alliance participants would take out separate cover for their various interests under the Alliance Contract.

7. Obligation of Good Faith

The relationship under a joint venture or Alliance Contract creates a new set of relationships and legal obligations between the participants. In a traditional construction contract, the parties have an obligation not to commit fraud or misrepresentation, but there is no positive obligation of good faith. There is no restriction on one party taking advantage of its bargaining position or superior knowledge when dealing with the other. There is generally no obligation of general disclosure of information known about the project.

In a joint venture or Alliance Contract, the relationship is much closer.

In a joint venture, the participants may have fiduciary obligations in some aspects of the venture. For example, if a participant discovered information about the venture, such as that the coal seam extended further than the current mining lease, the participant may have a fiduciary obligation to advise the other joint venturers and if the participant took out a mining lease over the extended area in its own name, it is likely that it would be holding that mining lease on trust for the joint venture. The information relating to the extension of the mining lease is so intimately related to the mine that that information should be made known to the joint venturer as a whole.

Other aspects of the relationship do not carry fiduciary duty. For example joint venturers would not be required to act in good faith considering the impact on the other venturers in exercising a contractual right such as an assignment or consent to assignment of the contract.

The leading case dealing with this obligation of good faith is *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd*⁷. The facts of that case were that Placer was the operator for a joint venture of a number of mines in Western Australia. It had engaged Thiess to carry out the mining operations. Initially the contract was on the basis of a schedule of rates contract but because of the expense which had been incurred, Placer had proposed a partner in contract under which Thiess would be paid its costs plus an agreed percentage profit. The contract had a provision which allowed Placer to terminate the contract for its convenience without penalty other than payment of the demobilisation of costs. Following various discussions with Thiess, Placer decided to terminate the existing contract and to put the work to tender. Thiess tendered at a significantly lower rate.

Thiess brought an action against Placer claiming damages for loss of profits it would have earned had the contracts not been terminated. It was a claim for breach of fiduciary duty and misleading and deceptive conduct. Placer defended on the basis that it had an unqualified right to terminate the contracts and, during discovery, Placer became aware of material facts and claimed that Thiess had made material and fraudulent misrepresentations which induced Placer to enter into the contracts. Placer argued that Thiess had acted in bad faith.

The judge in the first instance, Mr Justice Templeton, reviewed the evidence in detail (the decision is almost 250 pages).

He held that Placer had an unfettered right to terminate. This was one of the aspects of the partnering agreement which did not attract any fiduciary obligations.

Most of the decision however was considering the surrounding circumstances to the parties entering into the partnering agreement. This is relevant in determining the percentage profit which was paid to Thiess. The analysis of the relationships which arose from this negotiation is

⁷ [2000] WA SCA 102
(2003) 77 ALJR 776 (on Appeal)

directly relevant to the payments under an Alliance Contract where the contractor and designer are usually entitled to be paid their "cost" but the profit is risk.

During negotiations between Thiess and Placer, it was proposed that the rates would be derived from an open book system from Haul Profiles, Cycle Times, ownership costs and operating costs plus a profit margin. The base rates were the rates in dollars per bank cubic metre ("BCM"). The rates were to be used by places to determine whether it was better to use Thiess to operate the mine or for Placer to operate the mine itself which it had done previously.

In addition to profit, Thiess would be entitled to claim overheads which would include head office charges. It was agreed that no profit would apply to those charges.

During the negotiations, there was discussion about repairs and accidental damage. Thiess advised Placer that Thiess had an internal plant department which obtained, services and repaired plant and equipment and then hired it to various operating departments. The objective was for the plant department to break even. The evidence given by a representative for Placer was that he had been told by Thiess that Placer would be charged the plant department rates, that is the internal hire rate by Thiess without profit. During disclosure, Placer discovered that Thiess had charged more than its internal plant rates. Thiess provides Placer with various costs for its internal plant rates. The impression given to Placer was that a 5% profit was being charged. In fact the profit was 10.87%. Placer was not told that the plant rates in the submission were not the internal plant rates which they appeared to be and which had been indicated to them.

The trial judge held that:-

"I accept entirely that Messrs Jukes, Trio and Parsons (senior staff at Thiess) derived no personal gain from the misrepresentations. I think that their conduct was motivated by loyalty to Thiess and the desire to ensure that it retained an important contract.

"They were in an invidious position. The 1989 contract had been very profitable for Thiess and it was anxious to retain Placer as a client. But Placer would accept only a 5% profit margin which was far below the level required by Thiess's business plan.

"... I am satisfied that Thiess's conduct was deceitful".⁸

In his conclusion the trial judge found that the Granny Smith contract imposed on Thiess the obligation of formulating in good faith equipment operating costs based on historical data. This was in the nature of the fiduciary obligation. Thiess was in breach of the contract because it inflated the equipment operating costs based on historical data for the purpose of deriving additional profit. Placer was entitled to damages for breach of contract in the sum of

⁸ Page 83

\$4,253,000.00. While the decision was overturned at the first instance, the High Court reinstated that order.

The Placer (Granny Smith) case is important on a number of issues:-

1. It confirms that the parties to a partnering agreement can have fiduciary obligations in some respects but other contractual rights (such as the right to terminate for convenience) do not have to be exercised having regard to the effect on the other party.
2. There are fiduciary obligations, obligations of good faith, arising from the relationship.

It highlights the importance of full disclosure but also the discussion by the trial judge of the evidence particularly of the senior management from Thiess indicates the pressure on the parties (particularly in the current economic climate) to justify the entry into the contract, the need to produce the required profit.

8. Representations

In the negotiation of a joint venture or an Alliance Contract, any other forms of relationship contracting, there are significant negotiations about the method that the project will proceed and the intentions of the parties. Under a traditional design and construct or EPC contract, the contract itself will set out the standard of skill, cost, variation procedures etc. The contract stands alone.

With a relationship contract, the pre-contractual negotiations will become more important. As was seen in the Placer (Granny Smith) case, the negotiations about the partnering agreement were vital to the interpretation of the final contract. Representations made about the methodology used to calculate cost could be relied upon in interpreting the intention of the final contract even though Placer had not specifically asked for a breakdown of the costs in that final contract.

Costs is only one aspect of a relationship contract. Representations can be made about other aspects which are less tangible which may affect the outcome of the project. These may include the commitment of a party to the Alliance concept.

While the Alliance Agreement will contain a provision dealing with no blame and no dispute, that waiver of liability will only relate to disputes or blame arising within the Alliance Contract itself. Where the misrepresentation arose to induce the party to enter into the Alliance Contract, the waiver will not apply.

Summary

The use of the joint venture or an Alliance Contract provides advantages for the construction of larger projects including significant buildings and infrastructure. These structures ensure that the participants share in the pain and the gain, that the participants have a vested interest in close dialogue, avoiding blame and looking for results and maximising the return on the project.

While these structures do not create partnerships, there are obligations of good faith between the participants. Each participant must ensure that it does not obtain an advantage from the other participants and is open in all dealings with them.

Issues can also arise about representations made during negotiations, meetings prior to the Alliance Agreement being signed which may have induced one of the participants to enter into the Agreement.

The existence of the obligations of good faith and the representations made may give rise to action outside the contract which would not be barred by the no blame, no dispute.

From the owners point of view, a development using an Alliance Contract can transfer power to the contractor and designer more than under a standard contract.

The great advantage however is that the parties are all working together. There are no disputes between the Alliance participants regarding the Alliance project and in practice, Alliance Contracting has been successful.

18 February 2009

CONSIDERING JOINT VENTURES AND ALLIANCE PARTICIPANTS IN RESPECT TO PREFERRED DELIVERY METHODS FOR COMMERCIAL BUILDING, CIVIL AND INFRASTRUCTURE PROJECTS

**Robin Lonergan
Partner**

5th Annual Queensland Construction Law Masterclass – 18 February 2009

1. Introduction

Particularly in the current economic climate, parties are looking at new structures to enable development of buildings and infrastructure projects to proceed. Investors are more risk averse; the banks have less cash to lend, governments are looking to encourage construction.

The Federal Government's package for commercial property and the use of Future Fund is to be used for providing funding to existing commercial property where foreign bank funding has been withdrawn rather than for assisting new construction projects¹. Westpac and ANZ asked the government to avoid creating the impression that the commercial property fund was aimed at new construction. Westpac noted that the loans to projects under development would only be on "an exceptional basis" and even then without any intention "to take on construction risk". This scheme will see the government put in \$2 billion and the big four banks \$500 million each to create the commercial property facility with capacity to lend up to \$30 billion if necessary to be financed by the issue of government bonds.

¹ Australian Newspaper 27.01.2009

The players (including landowners, contractors, consultants and financiers) are looking for structures which will allow them to continue to develop construction buildings and infrastructure projects.

2. Risk Adverse

In the past, the construction industry has been seen as lacking in trust between the participants and accordingly with each party defending itself against the others². Poor relationships between the principal, contractor and sub-contractors lead to problems that affect time, cost and quality as well as damaging long term relationships between the parties according to a study in the Northwest UK carried out about how people worked in the construction industry. The participants were asked about issues such as trust and why it is important, some of the issues were:-

- (a) Honest Communications – the parties should be open and willing to share important information with the rest of the team and be honest giving information that reflects the real situation.
- (b) Reliance – the parties should be able to rely on the information that is given and to rely that when people say they will say something that they will do it – that promises will be kept. In construction there may be many specialist trades and not everyone will have expertise to understand what is being done and therefore will have to rely on the other person's experience and expertise.
- (c) Reputation - trust tends to be given to people rather than companies or organisations and will rely on individuals rather than an organisation. Despite this, organisations can build reputations which impact on whether people feel comfortable working with them in projects.

The benefit of trust is that the construction industry is uncertain and if the information is clear and accurate then other people can rely on it. Where parties are reliable, there is more likely to be repeat business so that trust can increase profit both on an individual project and in the long term. Generally it is easier to build the personal relationships on smaller projects but by changing the culture within organisations, trust can be built on larger projects. Joint ventures and alliance contracting are two methodologies which have developed to bring "trust" into projects.

The culture of blame has lead to inefficiencies as each party seeks to "cover its back" and to shift risk. The risk is shifted to the party which is in the weakest negotiating position within the contracts. It is often shifted to a party who has the least control over minimising the risk and the least ability to prevent the events occurring.

² Trust in Construction – Achieving Cultural Change (Centre for Construction Innovation in the North West (UK) 01.2002

A number of structures have been developed to minimise the confrontational nature of the relationships between the parties in the projects, to improve the trust between the parties and to establish a more collaborative approach.

Despite the various attempts at creating a new construction paradigm, the basic outcome sought is:

- a reasonable profit for each participant including the owner, contractor, subcontractor and consultant;
- completion of the project in a timely manner;
- to satisfy the social responsibility of the participants; and
- to minimise long term costs for the operation of the building/infrastructure project.

The weighting of these goals depends on the nature of the project and the nature of the participation of the parties.

Where the parties anticipate that the project will be on-sold quickly with short term profit for the developer, long term maintenance costs may be considered to be less important. With an infrastructure project such as a road, the government or the concessionaire will consider that the maintenance costs are as important as the original construction cost and that a designer may utilise techniques or materials which have a higher initial cost but will substantially reduce long term maintenance.

Some participants may have strong commitments to social responsibility for example ethical investment funds, churches and governments. Such principals may be willing to accept a greater cost for a project by having regard to the long term cost to society for issues such as being conscious of the source of materials, reducing long term energy costs, use of renewable or recyclable materials refusal, to use rainforest timbers etc. Many public companies have a social responsibility charter and reports relevant to that charter will be presented at the annual general meeting with as much importance as reports on financial performance.

3. Joint Venture/Alliance Contract

I will consider the two delivery methods of joint venture and alliance contracting for projects.

Diagram 1 – Alliance Contract

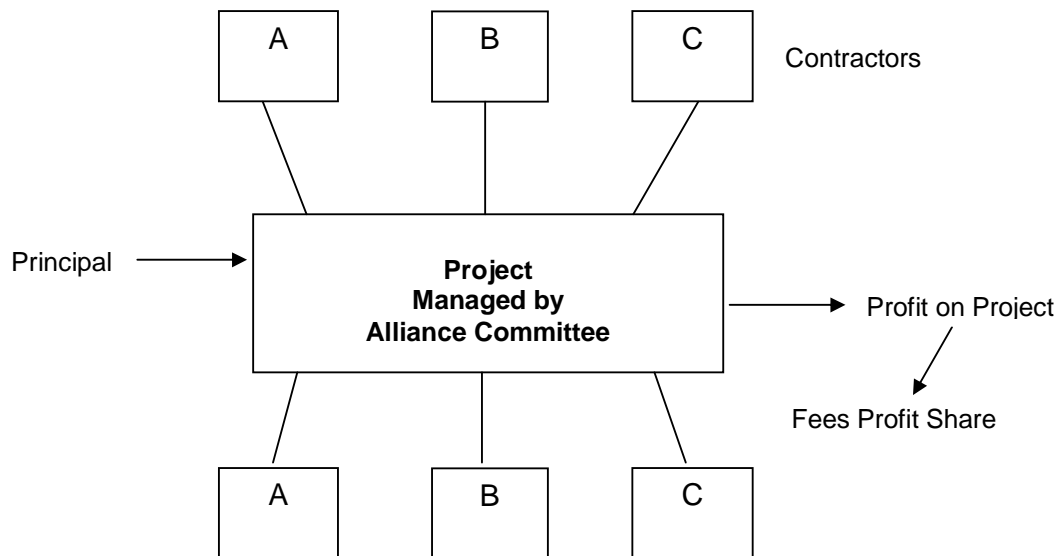
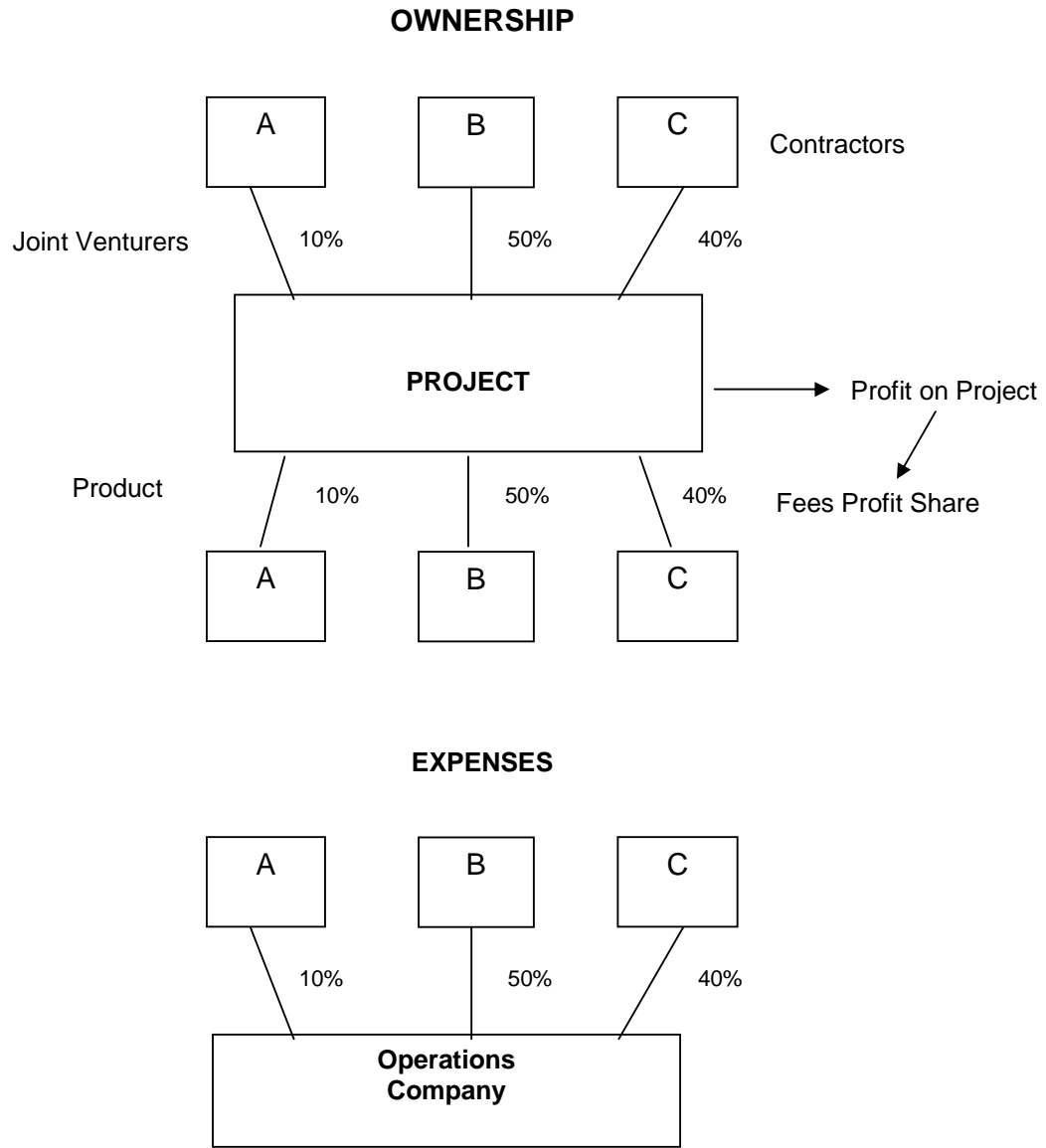


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- Cost sharing.

Of these, the most important aspect is the sharing of the product of the outcome. In a mining joint venture, this may mean that the coal, iron ore etc which is extracted from the mine is taken to be owned by the participants in the joint venture in their respective percentages. In a joint venture operating a toll way concession, the participants own the concession revenue in their respective percentages. An arrangement which shares profit will be a partnership and not a joint venture.

The fundamental difference between an unincorporated joint venture and a partnership is that the joint venturers are only severally liable in the participation percentage and not jointly liable for the debts of the enterprise.

The other indication of a joint venture is that it is for a specific economic project rather than a continuous business. If there is continuous business, for example a number of different developments, then it is more likely to be characterised as a partnership. The ongoing operation of one project would not be characterised as a continuous business.

³ GSTR 2004/2 Goods and Services Tax: What is a Joint Venture for GST Purposes

The traditional view was that a syndicate which comes into existence for a limited period or purpose would not be a partnership for income tax purposes. For example construction of residential buildings which were divided equally between the venturers after construction is not a partnership either at general law or for income tax purposes⁴. There are various provisions which may require a limited partnership to be treated as a company for tax purposes.

For GST purposes, the parties may enter into an approved joint venture as a "GST joint venture", which means that the operator of the joint venture is responsible for the GST liabilities and entitlements arising from the operators dealing on behalf of the venture participants. The payments by the venturers to the operator are not considered to be a taxable supply for the purposes of the GST law. These joint venture provisions are similar to the GST group rules on the basis that it is operating in a similar way to a group by an unlimited basis. The GST joint venture is not treated as a single body for all GST purposes.

A GST joint venture will only be approved if:

- the venture is for an approved purpose;
- the venture is not a partnership, that is the income is not received jointly;
- each entity satisfies the participation requirements; and
- the application nominates an entity to be the joint venture operator, which need not be a party to the joint venture agreement.

The approved purposes reflect the common purposes for a joint venture including exploration or exploitation of mineral deposits, research and development, agriculture, generating transmission distribution of electricity etc. It can also specifically include the design, building or maintenance of residential/commercial premises subject to the counter-measures put in place to prevent exploitation of the margin rules.

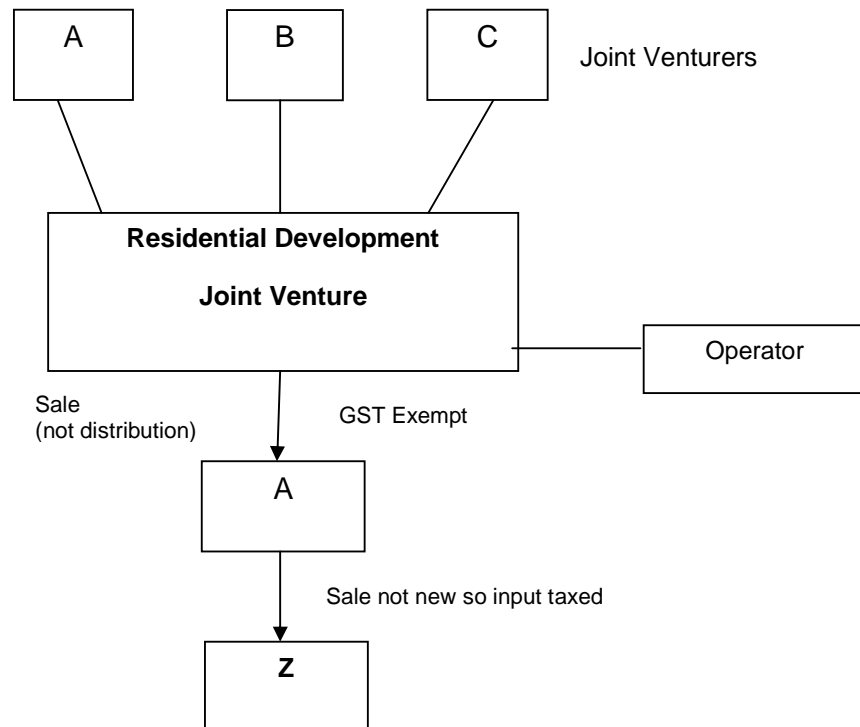
The participation requirements are that the entity:

- must participate or intend to participate in the joint venture;
- must be a party to the joint venture agreement;
- must be registered for GST purposes; and
- must account on the same basis as the other participants.

⁴ ARN Constructions 87atc 4790

GSTR 2004/3⁵ deals with avoidance of GST on the sale of new residential premises. Its purpose was to prevent avoidance of GST through entry into a scheme under which the parties purported formed a joint venture for the construction and sale of residential premises. The operator purports to sell the completed premises to a participant in the joint venture. It is argued that the sale is not a taxable supply under s.51-30(2) which provides that the supply made by the joint venture operator of a GST joint venture, to a joint venture participant is not a taxable supply if the participant acquires the things supplied for consumption, use or supply in the course of the activities for which the joint venture was entered into.

Diagram 3



The purpose of the scheme was to convert premises which were built from being "new residential premises" upon which GST would be payable to being a subsequent supply which is input taxed. The scheme relies on the transfer of the residential property from the operator to the participant as a GST exempt transaction on the basis that it is a supply within the joint venture. The proceeds for the sale of the residential premises to the third party is distributed amongst the participants as the participant pays for the residential premises to the operator the amount which the participant receives from the third party.

⁵ GSTR 2004/3 – 7 April 2004

The ATO has rejected the scheme in the ruling. It states that the sale by the joint venture operator to the participant is a taxable supply and that Section 51-30(2) does not apply because either:-

- the arrangement is not a joint venture for GST purposes; or
- the participant does not acquire the premises for consumption or use of the supply in the course of the activities for which the joint venture was entered into.

This ruling has caused some developers to be wary of using a joint venture vehicle for development. This should not be the case as the ruling has limited effect to prevent an unlawful scheme. On reviewing the structure of the scheme, the transfer from the operator to the participant is outside the joint venture purpose – it is not a payment between the participants and the operator to carry out the purpose of the joint venture. Under the nature of a joint venture, the participants own the product of the joint venture and therefore the product does not need to be sold by the operator to a participant.

Where the joint venture is properly (and lawfully) structured, the participant should be able to receive the product of the joint venture tax-free for on-sale. Where that product is residential premises, the participant would be entitled to keep those premises for its own use or to on-sell the premises with GST payable on the on-sale.

Another tax issue to consider are the Capital Gain Tax status of the land used in the Venture, particularly for any premises sold by the contractor.

4.2 Structure of Joint Venture

An infrastructure or property joint venture can link the participants commercially in a way to minimise disputes. For example, the participants may be:-

- landowner;
- principal contractor;
- designer;
- significant subcontractor;

In this type of structure, the parties would enter into a joint venture arrangement under which they would agree of their participation in the joint venture, the joint venture may appoint an

operator who would act as the project co-ordinator or that role may be undertaken by one of the participants (usually the contractor).

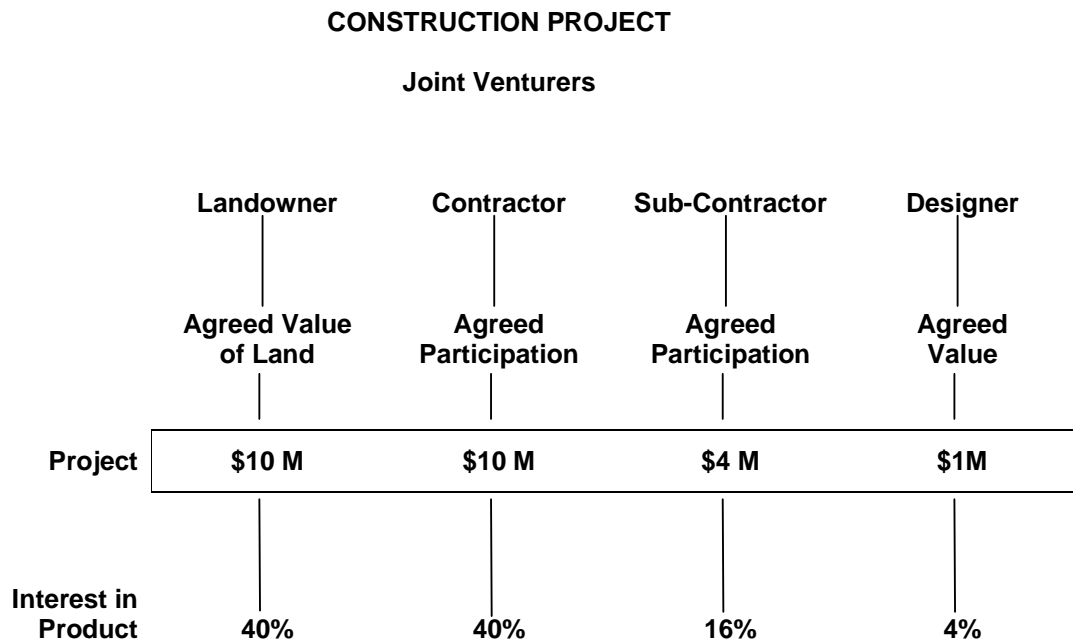
The benefit of the use of the joint venture is that the parties are commercially committed to each other and have a commercial reason to complete the project on time and within budget.

The joint venture agreement would need to identify the participation interests. It is easy to value the contribution by the principal as an agreed valuation of the land can be used.

The valuation of the contribution by the other participants is often more difficult. It may be necessary to have final drawings to be able to value the work by the other participants and any change to those agreed drawings/contracts would require the approval of all participants.

Another structure is for each participant to contribute its labour up to an agreed level.

Diagram 4



Under this scenario, the cost of construction in excess of the agreed participation by the contractor and sub-contractor would need to be paid by the joint venture participants in their participation percentage. Often the value of the designers work will be determined at the commencement of the project. The participation by the contractor and sub-contractor however

will be subject to a standard construction contract (upon which GST may not be payable if it can be structured to comply with Section 51-30(2) as a supplier within the joint venture).

The difficulty arises where there are variations during the project. The relationship between the contractor and the joint venture remains the same as the relationship between the contractor and the principal. Irrespective of the structure of the joint venture, the contractor/participant will still be seeking to maximise profit from the building contract potentially at the expense of the other participants. Where the joint venture engages an independent project manager to negotiate issues such as variations to time and cost, the joint venture may be able to provide that the decision of the Project Manager is final.

4.3 Advantage of Joint Venture

The main advantage of the joint venture is the high degree of co-operation and participation required to negotiate and administer a joint venture. This high degree of co-operation is likely to increase the trust between the parties, there are more likely to be regular meetings to discuss issues and to resolve problems and because of the contractual relationship under the joint venture agreement, the parties may have a less adversarial approach to each other.

It is a relatively simple structure that can be used on small projects.

5. Alliance Contract

5.1 What is an Alliance Contract

An Alliance Contract or relationship contract has developed as other forms of contracts such as engineering engineering, procurement, construction (EPC) contracts have lost popularity. The traditional EPC contract transferred risk from the developer to the contractor; the contractor would accept this risk (and often pass it on to sub-contractors) in exchange for a profit which is sufficiently large to fund that risk. The traditional contract worked where the market was buoyant enough that the contractor could include this profit margin in the tendered price.

As profit levels reduce in the current economic circumstances and as technology in the construction industry develops to potentially provide cost savings through the use of new technology other construction models have developed.

The Alliance Contract is an extension of a partnering arrangement. It codifies the relationship between the parties and generally covers:-

- (a) the parties are bound by the Alliance Contract;
- (b) the parties including the owner, contractor, designer, subcontractors form part of the Alliance team;
- (c) costs are 100% reimbursed;

- (d) the parties agree to share in profit or loss based on defined performance goals;
- (e) disputes are to be resolved within the Alliance Contract usually by the Alliance Committee;
- (f) no disputes can be brought outside the Alliance Agreement;
- (g) decisions of the Alliance Committee are binding and unanimous; and
- (h) the participants develop and commit to a set of Alliance principles setting out the key goals of the project.

According to the "Project Alliance and Practitioners Guide"⁶ :-

"Project Alliancing is about providing better value for money and improved project outcomes through a more integrated approach between the public and private sectors in the delivery of infrastructure projects."

The major advantage in the Alliance model is to shift risk so there is no allocation of risk to an individual party but risk is managed collaboratively through the Alliance Committee.

Various government bodies including the Queensland Department of Main Roads and Sydney Water have published statistics comparing Alliance Contracts to traditional contracts which show much better performance under the Alliance Contract. Projects came in at a lower cost, ahead of schedule and exceeding the expectations of the parties.

5.2 Alliance Structure

Generally an Alliance Contract will identify:-

- The Alliance Committee or board;
- Clarify the development of the integrated team; and
- establish the commercial arrangement.

5.3 Alliance Committee

The Alliance Committee comprises representatives of each of the Alliance participants. It has the primary role of administering the Alliance Project. Usually the partners will be the designer, the contractor and the owner. Each partner will have one vote and there is no provision for a casting vote. All decisions must be unanimous and there is no deadlock provision.

The structure of the Alliance Committee means that the owner does not have a final say in how the project will proceed and generally has no veto powers.

Some contracts will allocate some reserve power to the owner. For example, particularly where the owner is government, there may be overriding considerations such as national security which have to be considered. This may arise where the Alliance Contract deals with defence or IT matters which go to the heart of government.

The owner may also reserve a power to change fundamental aspects of the contract such as to prevent a change in scope of work greater than a certain percentage or to approve a variation to the contract in excess of a certain percentage or amount.

Reserve powers may also relate to long term potential liability for the owner particularly issues such as environmental concerns or the long term maintainability of the project where the Alliance is not continuing for the long term.

The problem with reserve powers is that it cuts across the nature of the Alliance relationship – instead of each of the Alliance partners being equal and having an equal say in the project, the owner has a superior position and a right of veto in a number of areas. If the owner exercises that veto power, there may be implications to the cost or profit which will impact on the sharing of the pain and gain.

The nature of the Alliance Committee is intended to take away the hierarchy of traditional contracts.

5.4 Integrated Development Team

The Alliance method is intended to minimise the confrontational nature of the traditional construction structure.

There is a change of philosophy and often prior to signing of the Alliance Contract, the parties will be involved in Alliance workshops, facilitated meetings between the various parties, employees and there may be ongoing involvement of the Alliance facilitator.

The intention of the structure is to break down the traditional silos on the workplace. One psychological method of doing this is for the alliance to have separate premises and often to work in a special alliance uniform logo etc so that the Alliance has a separate identity from the participants.

The lines of hierarchy within each of the participants blurs with the alliance having a separate hierarchy. While the relationship between the parties may become collegiate, other legal relationships will remain in place. For example, the employees of each of the participants remain employees of that party for tax and WH&S purposes. This can create complex contractual relationships where the employee of one organisation is required to take direction from the employee of another organisation.

⁶ State of Victoria Treasury 2006

On a long term basis, employees can lose the sense of identify with their employer and identify with the alliance. While this is the intention of the Alliance Contract, it can cause problems within the employer organisation when the alliance finishes. Does the employee lose his/sense of engagement with the employer.

5.5 No Disputes/No Blame

Fundamental to the concept of the Alliance Contract is that there is no blame and no disputes between the parties and each party releases the others from all liability. Some Alliance Contracts except wilful default from the general exclusion from liability. This of course leaves open what is intended by "wilful default". Generally the parties cannot claim against the other for negligence of any degree.

The philosophy is that if there is no blame and no disputes between the parties then the parties have no incentive to hide information.

As there is no blame and no disputes, the parties do not need to be concerned about issues such as extensions of time, liquidated damages or variations. These matters will be discussed in an open manner in the Alliance Committee where decisions can be made in the best interest of the project.

Because there is no blame, the design can be more innovative, the parties can incorporate new technology. If the project is delayed, the parties can discuss at the Alliance Committee methods to make up the time. As there is no blame, none of the parties need to maintain a critical path and no one owns the time float and workers can be used where they are most effective.

5.6 Profit

While the philosophical basis of the Alliance Contract creates a trusting environment, there needs to be an economic imperative to ensure that the parties abide by the arrangement even without blame or dispute.

Most Alliance Contracts provide for the contractor and the designer being reimbursed for their costs and then incentives for bringing the project in on or before time and on or under budget.

In negotiating the "cost" for the contractor and designer, the Alliance Contract needs to identify the nature of costs. Fore example, does it include an allowance for off-site overheads such as office expenses; can it include profit from subcontractors which are related parties. How do the parties negotiate for sub-contractors.

While an Alliance Contract is intended to be a risk sharing agreement, by ensuring that the contractor and designer are reimbursed their costs, the contract can become a "cost plus"

contract where the risk is shifted too the owner. The contractor and designer know that at the minimum they will be reimbursed their costs – they will not be out of pocket.

From a financing point of view, the owner needs to ensure that its financiers are satisfied with this arrangement.

6. Due Diligence

Prior to entering into an Alliance Contract or any type of relationship contract it is important that each participant undertakes complete due diligence on the other to understand the business culture of the other participants to check if they have a business culture which is conducive to the Alliance system, whether the people who will be engaged on the project day to day have the personality to participate in an Alliance situation and whether there is a genuine commitment by all participants to the Alliance concept.

The use of an Alliance Contract or other relationship contracting does not diminish the need to carry out extensive engineering/technical due diligence. It is often more important in negotiating an Alliance Contract to consider the interfaces between various subcontractors, a realistic cost plan and a realistic time schedule.

The Alliance Contract only applies between the Alliance partners. It is likely that all subcontractors will be engaged by the contractor or the Alliance under traditional contracts which would be entered into with the consent of the Alliance Committee.

As part of the due diligence, the participants need to consider insurance carefully. As there is no blame, a traditional professional indemnity insurance of the designer will not be effective. The designer will have no loss for its error therefore cannot claim under the policy. The owner may suffer loss because of the cost to redo work, the owner would not have an interest under the professional indemnity insurance. Often the Alliance participants would take out separate cover for their various interests under the Alliance Contract.

7. Obligation of Good Faith

The relationship under a joint venture or Alliance Contract creates a new set of relationships and legal obligations between the participants. In a traditional construction contract, the parties have an obligation not to commit fraud or misrepresentation, but there is no positive obligation of good faith. There is no restriction on one party taking advantage of its bargaining position or superior knowledge when dealing with the other. There is generally no obligation of general disclosure of information known about the project.

In a joint venture or Alliance Contract, the relationship is much closer.

In a joint venture, the participants may have fiduciary obligations in some aspects of the venture. For example, if a participant discovered information about the venture, such as that the coal seam extended further than the current mining lease, the participant may have a fiduciary obligation to advise the other joint venturers and if the participant took out a mining lease over the extended area in its own name, it is likely that it would be holding that mining lease on trust for the joint venture. The information relating to the extension of the mining lease is so intimately related to the mine that that information should be made known to the joint venturer as a whole.

Other aspects of the relationship do not carry fiduciary duty. For example joint venturers would not be required to act in good faith considering the impact on the other venturers in exercising a contractual right such as an assignment or consent to assignment of the contract.

The leading case dealing with this obligation of good faith is *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd*⁷. The facts of that case were that Placer was the operator for a joint venture of a number of mines in Western Australia. It had engaged Thiess to carry out the mining operations. Initially the contract was on the basis of a schedule of rates contract but because of the expense which had been incurred, Placer had proposed a partner in contract under which Thiess would be paid its costs plus an agreed percentage profit. The contract had a provision which allowed Placer to terminate the contract for its convenience without penalty other than payment of the demobilisation of costs. Following various discussions with Thiess, Placer decided to terminate the existing contract and to put the work to tender. Thiess tendered at a significantly lower rate.

Thiess brought an action against Placer claiming damages for loss of profits it would have earned had the contracts not been terminated. It was a claim for breach of fiduciary duty and misleading and deceptive conduct. Placer defended on the basis that it had an unqualified right to terminate the contracts and, during discovery, Placer became aware of material facts and claimed that Thiess had made material and fraudulent misrepresentations which induced Placer to enter into the contracts. Placer argued that Thiess had acted in bad faith.

The judge in the first instance, Mr Justice Templeton, reviewed the evidence in detail (the decision is almost 250 pages).

He held that Placer had an unfettered right to terminate. This was one of the aspects of the partnering agreement which did not attract any fiduciary obligations.

Most of the decision however was considering the surrounding circumstances to the parties entering into the partnering agreement. This is relevant in determining the percentage profit which was paid to Thiess. The analysis of the relationships which arose from this negotiation is

⁷ [2000] WA SCA 102
(2003) 77 ALJR 776 (on Appeal)

directly relevant to the payments under an Alliance Contract where the contractor and designer are usually entitled to be paid their "cost" but the profit is risk.

During negotiations between Thiess and Placer, it was proposed that the rates would be derived from an open book system from Haul Profiles, Cycle Times, ownership costs and operating costs plus a profit margin. The base rates were the rates in dollars per bank cubic metre ("BCM"). The rates were to be used by places to determine whether it was better to use Thiess to operate the mine or for Placer to operate the mine itself which it had done previously.

In addition to profit, Thiess would be entitled to claim overheads which would include head office charges. It was agreed that no profit would apply to those charges.

During the negotiations, there was discussion about repairs and accidental damage. Thiess advised Placer that Thiess had an internal plant department which obtained, services and repaired plant and equipment and then hired it to various operating departments. The objective was for the plant department to break even. The evidence given by a representative for Placer was that he had been told by Thiess that Placer would be charged the plant department rates, that is the internal hire rate by Thiess without profit. During disclosure, Placer discovered that Thiess had charged more than its internal plant rates. Thiess provides Placer with various costs for its internal plant rates. The impression given to Placer was that a 5% profit was being charged. In fact the profit was 10.87%. Placer was not told that the plant rates in the submission were not the internal plant rates which they appeared to be and which had been indicated to them.

The trial judge held that:-

"I accept entirely that Messrs Jukes, Trio and Parsons (senior staff at Thiess) derived no personal gain from the misrepresentations. I think that their conduct was motivated by loyalty to Thiess and the desire to ensure that it retained an important contract.

"They were in an invidious position. The 1989 contract had been very profitable for Thiess and it was anxious to retain Placer as a client. But Placer would accept only a 5% profit margin which was far below the level required by Thiess's business plan.

"... I am satisfied that Thiess's conduct was deceitful".⁸

In his conclusion the trial judge found that the Granny Smith contract imposed on Thiess the obligation of formulating in good faith equipment operating costs based on historical data. This was in the nature of the fiduciary obligation. Thiess was in breach of the contract because it inflated the equipment operating costs based on historical data for the purpose of deriving additional profit. Placer was entitled to damages for breach of contract in the sum of

⁸ Page 83

\$4,253,000.00. While the decision was overturned at the first instance, the High Court reinstated that order.

The Placer (Granny Smith) case is important on a number of issues:-

1. It confirms that the parties to a partnering agreement can have fiduciary obligations in some respects but other contractual rights (such as the right to terminate for convenience) do not have to be exercised having regard to the effect on the other party.
2. There are fiduciary obligations, obligations of good faith, arising from the relationship.

It highlights the importance of full disclosure but also the discussion by the trial judge of the evidence particularly of the senior management from Thiess indicates the pressure on the parties (particularly in the current economic climate) to justify the entry into the contract, the need to produce the required profit.

8. Representations

In the negotiation of a joint venture or an Alliance Contract, any other forms of relationship contracting, there are significant negotiations about the method that the project will proceed and the intentions of the parties. Under a traditional design and construct or EPC contract, the contract itself will set out the standard of skill, cost, variation procedures etc. The contract stands alone.

With a relationship contract, the pre-contractual negotiations will become more important. As was seen in the Placer (Granny Smith) case, the negotiations about the partnering agreement were vital to the interpretation of the final contract. Representations made about the methodology used to calculate cost could be relied upon in interpreting the intention of the final contract even though Placer had not specifically asked for a breakdown of the costs in that final contract.

Costs is only one aspect of a relationship contract. Representations can be made about other aspects which are less tangible which may affect the outcome of the project. These may include the commitment of a party to the Alliance concept.

While the Alliance Agreement will contain a provision dealing with no blame and no dispute, that waiver of liability will only relate to disputes or blame arising within the Alliance Contract itself. Where the misrepresentation arose to induce the party to enter into the Alliance Contract, the waiver will not apply.

Summary

The use of the joint venture or an Alliance Contract provides advantages for the construction of larger projects including significant buildings and infrastructure. These structures ensure that the participants share in the pain and the gain, that the participants have a vested interest in close dialogue, avoiding blame and looking for results and maximising the return on the project.

While these structures do not create partnerships, there are obligations of good faith between the participants. Each participant must ensure that it does not obtain an advantage from the other participants and is open in all dealings with them.

Issues can also arise about representations made during negotiations, meetings prior to the Alliance Agreement being signed which may have induced one of the participants to enter into the Agreement.

The existence of the obligations of good faith and the representations made may give rise to action outside the contract which would not be barred by the no blame, no dispute.

From the owners point of view, a development using an Alliance Contract can transfer power to the contractor and designer more than under a standard contract.

The great advantage however is that the parties are all working together. There are no disputes between the Alliance participants regarding the Alliance project and in practice, Alliance Contracting has been successful.