PRAISE LOUDLY, BLAME SOFTLY—NO BLAME EXCEPT IN THE CASE OF WILFUL DEFAULT

Andrew Chew, Special Counsel

Geoff Wood, Partner

Franco Aversa, Solicitor

Mallesons Stephen Jaques, Sydney

INTRODUCTION

There is an increasing trend in Australia towards the use of project alliancing. This trend has arguably been driven by the perceived disadvantages of the adversarial nature of the traditional procurement models, the increased focus on 'value for money' and contractors' increased bargaining power in a market which allows them to insist on less risk. A principal feature of these project alliances is a 'no blame, no disputes' regime. This regime generally provides that the project participants agree to resolve disputes within the alliance (rather than through the use litigation or arbitration) and that no party will have any liability to the other, except in the case of wilful default. This article primarily focuses on the 'no blame' regime.

This article initially looks at the 'pros' and 'cons' of a no blame regime and examines the meaning of the 'wilful default exception'.. This article then briefly looks at the following legal and practical issues which surround a no blame regime in a project alliance:

(a) the fact that parties cannot exclude all their liability even if that is their commercial intention (i.e. liability to third parties and arising from statute);

(b) issues with obtaining professional indemnity insurance; and

(c) whether a no blame regime can be construed as a legally ineffective ouster of the courts' jurisdiction.

CONCEPT OF NO LIABILITY EXCEPT FOR WILFUL DEFAULT

'Pros' and 'cons' of a no blame regime

The vast majority of proponents of alliancing strongly maintain that unless an arrangement enshrines a no–blame culture, there is no true alliance. Such proponents argue that a no blame regime in a project alliance:

• focuses the parties on solutions rather than on who is to blame;

• fosters and encourages innovation;

• enables the parties to focus efforts on a performance based remuneration regime thereby aligning the commercial interests of owners and contractors; and

• lessens the likelihood of contractors over–inflating prices with contingency for risks that are difficult to measure, thereby providing owners with a good 'value for money' alternative for highly complex projects.

Notwithstanding the above advantages of a no blame culture, a project alliance encompassing a no blame regime is not, however, without its disadvantages. Listed below are some disadvantages for consideration:

• from the owners' perspective, why should a contractor be relieved from liability for its own negligence? If a contractor innocently but negligently designs a project, and the building collapses, why should the owner have to wear that risk?;

• from the owners' perspective, it is the owner who pays the contractor to carry out the work and bears the risk (other than for wilful default) of cost and time overruns;

• it is difficult sometimes to prove that a wilful default has in fact occurred, particularly where the term is defined by the parties in a very narrow sense (see discussion at section 2.2 below);

• it is not possible for the parties to exclude all liability even if that is the commercial intention; and

• in certain circumstances, a no blame regimes makes it difficult for the parties to obtain professional indemnity insurance.

Ultimately, project participants must weigh up these advantages and disadvantages both when selecting to proceed with a project alliance and when negotiating the relative scope of the no blame regime. This is discussed in more detail in the section below.

The exception is the rule: the meaning of wilful default

A no blame regime generally excludes all liability except for a party's 'wilful default'. But what does the term 'wilful default' actually mean? Unfortunately, the answer to this question is the classical lawyer answer 'it depends'. At common law (in the context of breach of trust cases) for a party to have committed a 'wilful default', that party needs to have committed a deliberate default with a particular consciousness, knowledge and state of mind (see Wolfe J's judgment in the Supreme Court case of *Wilkinson and Ors v Feldworth Financial Services Pty Ltd* (1998) 29 ACSR 642 for a good discussion on the common law meaning of wilful default).

However, parties to project alliances are not restricted by the common law definition and can include a broader (or narrower) list of acts which they expressly agree each constitute a 'wilful default' for the purposes of their alliance. Principals are increasingly seeking a 'broader' definition, whereas contractors will seek a more limited or 'pure' definition. The position ultimately adopted by the parties will often depend on the parties' individual negotiating power. In the purest of alliances, the meaning of 'wilful default' will often mirror the more narrow common law position, whereas, in hybrid alliances, the definition is more likely to capture acts additional to those committed with deliberate intent.

Extracted below are some definitions of 'wilful default' from some more recent project alliances, which, as one can see, all vary in terms of scope:

... an intentional act or omission to cause harmful and avoidable consequences ...

... a wanton or reckless act or omission as amounts to a wilful and utter disregard for the harmful and avoidable consequences of the act or omission (but not including any errors of judgment, mistake or act or omission, whether negligent or not, made in good faith by an Alliance Participant) ...

... (a) a repudiation by one of us of our Alliance Agreement, but does not otherwise include any error of judgment; (b) an intentional or wanton or reckless act or omission by one of us carried out with disregard to its harmful and avoidable consequences (but not including any errors of judgment, mistake or act or omission, whether negligent or not, made in good faith by an Alliance Participant); (c) a failure by one of us to pay another of us money it owes to the other within ten Business Days of a written demand which specifies that it is being made for the purposes of this paragraph; or (d) an Alliance Participant becomes insolvent ..

LEGAL AND PRACTICAL ISSUES OF NO BLAME REGIMES

Can't contract out of all liability

It is important to note that project participants can't exclude all liabilities by contract even if that is their commercial intention. This is because there are some things for which it is just not legally possible to exclude liability by contract under Australian law. For example, it is not possible to contract out of the *Trade Practices Act 1974* (Cth) or the *Building and Construction Security of Payment Act 1999* (NSW) and some acts such as the *Protection of the Environment Operations Act 1997* (NSW) and the *Occupational Health and Safety Act 2000* (NSW) impose criminal sanctions upon persons for certain breaches.

Furthermore, an alliance contract (like any other contract) can only bind the parties to that contract. So whilst the project agreement can largely regulate the liability as between the project participants, it cannot fetter the rights of third parties, who may wish to bring a claim against one or more of the parties. Effecting insurance in respect of such claims, including the sharing of deductibles in such cases, often goes some way towards mitigating this third party risk but it is a risk which must be addressed separately from the 'no blame regime'.

Insurance issues

The presence of most no blame regimes in project alliances create issues for the parties, particularly owner participants, in respect of having conventional professional indemnity insurance polices respond to certain events. This is because parties to project alliances are generally not liable for any losses (except for losses caused by their wilful default). Given that conventional professional indemnity insurance generally only triggers upon the existence of a liability (and such policies do not cover 'wilful default'), such policies will often not respond.

Notwithstanding the issue with conventional professional indemnity insurance polices, parties entering a project alliance do have certain options available to them to address the issue of conventional professional indemnity insurances being ineffective. These are briefly summarised below:

- parties may be required to amend the scope of the no blame regime to create liabilities for actions other than wilful default to ensure insurance will be available;
- the parties may wish to self insure. Although this may be an acceptable solution in certain circumstances it is important to note that such an option is often undesirable for Governments. Self insurance options do not tend to adequately address the issue of latent defects after, say, final completion; and
- parties may wish to effect and maintain 'first party insurance'. Such insurance allows for 'first party' claims to be initiated by the alliance itself, as opposed to one party initiating a claim against the other. Therefore there is no need for blame to be assigned. The way this is done is that the insurance policy names all the project participants as insured parties rather than just the contractor. Whilst a highly effective solution to the issue, it comes at a high price in terms of the premiums payable.

No litigation: An ouster of courts' jurisdiction?

Valid or void?

The willingness of project participants to attempt to avert dispute resolution through the courts is driven by perceived disadvantages of the adversarial nature of the court process and the long, often costly and drawn out process it usually involves. The contractual structure of project alliances, therefore, through the no blame regime is set up to limit the parties' exposure to the court process in circumstances of wilful default only.

Another consideration therefore having regard to the no blame regime found in project alliances is whether such a regime can be argued as an ouster of the court's jurisdiction given that it purports to prevent the parties litigating the matter for a breach of contract or other legal wrong associated with the project which does not comprise an act of 'wilful default'. It is said that a contract which purports to oust the jurisdiction of the courts is against public policy and is either void or unenforceable (*Lieberman v Morris* (1944) 69 CLR 69 at 84). Rich, Dixon Evatt and McTiernan JJ in *Dobbs v National Bank of Australasia Ltd* (1935) 53 CLR 643 (at p652) stated the following prohibition in respect of parties attempting to oust the courts jurisdiction:

It is not possible for a contract to create rights and at the same time to deny to the other party in whom they vest the right to invoke the jurisdiction of the courts to enforce them.

No blame regimes often contain an undertaking (express or implied) by each party not to sue any other party for breach of contract, or upon some other available cause of action arising out of the parties' legal relationship, unless the default on which the suit is based is within the wilful default definition. Viewed in this way, this type of no disputation clause may arguably be found void insofar as it purports to preclude litigation in relation to breaches which do not constitute wilful default. If this is so, failure to perform an obligation or to discharge a duty would be able to be litigated at the suit of the wronged party even where 'wilful default' is not involved. There is therefore a real question whether a no disputation clause in this frequently encountered form is legally effective to implement the project participants' commercial intentions.

Drafting suggestions

The position would be different if, rather than forbidding litigation in relation to all defaults other than those constituting wilful default, the contract made it clear that there was no breach except for wilful default. The problem with this is that it may be impossible, in any practical sense, to frame a substantive obligation which incorporates this qualification and, at the same time, remains meaningful. A promise to execute works only in such a way and only to such a standard as are consistent with absence of wanton or reckless disregard by the contractor for harmful and avoidable consequences is unlikely to be satisfactory from the principal's viewpoint.

An alternative drafting approach to this issue we believe overcomes the problems canvassed above is to avoid reference to 'no litigation', and the risk of a legally ineffective ouster of the court's jurisdiction, and simply exclude all liability (via a well drafted exclusion clause) for breaches not involving wilful default (other than such monetary disbenefit as the defaulting party may suffer through application of the alliance contract's KPI/ gainshare arrangements).

CONCLUSION

This article has canvassed some of the legal and practical issues which surround a no blame regime in a project alliance. However, notwithstanding these and other issues, much can be said for the benefits that a 'no blame culture' provides willing participants to a project alliance. Whilst the particular characteristics of each no blame regime will always differ from project to project (depending on parties' commercial intentions and respective bargaining positions), a no–blame culture in principle is an important aspect of any project alliance. The greatest challenge for any such regime is putting it into practice—praise loudly, blame softly is the name of the game!