

6TH WORLD CONGRESS ON TALL BUILDINGS AND URBAN HABITAT

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LABOUR AND MATERIALS: CONTRACTS

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1. CONTRACT FORMS

1.1 FORMS ADOPTED BY BUILDING OWNERS

There are a range of contract types which may be attractive on a particular building project.

Most major projects within the private sector do not employ standard form Conditions of Contract.

This may be due to a lack of confidence, by project lawyers, usually the Principal's lawyers, in those documents when the stakes are high. Alternatively, however, and more likely, it seems to me that the standard form of Conditions of Contract available, to date, have simply been unsuitable on very large projects, where a substantial amount of consultant advice, including legal advice, is usually taken prior to execution of the project documents.

For example, most of the standard form Conditions of Contract are based on the traditional principal/contractor relationship, with a Superintendent acting in the dual agent/independent certifier role. In recent years, however, many major projects have proceeded on the basis of a completely different project delivery system including, for example:-

Design and Construct

Warranted Maximum Price

Project Management

Construction Management

Turnkey

BOT (Build/Own/Transfer)

Each of these project delivery systems has been used, to my knowledge, on one or more major projects in Australia in the last five years. The standard form Conditions of Contract have, perhaps, not kept up with the emerging preference for such project delivery systems.

The choice of a particular style of project delivery system will nearly universally be made by the Owner, driven by factors such as:

- ease of design (buildings vs complex building projects);
- desire for design flexibility during construction;
- availability of suitable builders/project managers, and balance sheets of such builders;
- political considerations;
- budget constraints vs performance of completed project.

On major public sector projects, the use of standard form fixed-price contracts would be more prevalent than on similar scale private sector projects (though, in contrast, BOT projects are essentially public sector projects delivered by the private sector).

1. *Fixed Price Contracts*

The traditional form of construction contract has been a fixed price contract.

The general operation of this type of contract requires the Builder to tender on, and then take the risk in relation to, the price of the works. The Builder, irrespective of the actual cost of the works, will be entitled to be paid no more than and no less than the Contract Sum, as agreed between the parties prior to commencing the works.

In fact, for a number of reasons which are discussed elsewhere in this and related topics, a fixed price contract is rarely performed for exactly the amount of the originally agreed Contract Sum. For example, if the Owner delays the Builder in obtaining the site, the contract would usually provide for an increase in the Contract Sum.

The critical characteristic, however, of a fixed price contract, is that the Builder takes the risk as to the ultimate price, and that the parties agree to pay the Contract Sum (as adjusted pursuant to the provisions of the Contract).

2. *Cost Plus*

The critical characteristic of the cost plus contract is that there is no risk, as to cost, borne by the Builder.

The Builder and the Owner agree, at the time entering into the Contract, that the Builder will perform the works, and that the Owner will pay for those works, on the basis of the actual cost of the Works to the Builder, plus an agreed fee, usually an agreed percentage of that sum (or some other agreed incentive over and above the actual cost of the works).

A cost plus contract is, therefore, risk-free, as to cost, for the Builder.

This does not mean, however, that the Contractor is entitled to charge whatever he likes. The Contract will usually provide that the Builder has to verify and/or justify the cost of the works to be charged under the Contract. Further, one could envisage circumstances where, through negligence by the Builder or some other reason, the Builder would not be entitled to recover the full cost of those works.

There are flexibility reasons why such an arrangement may be attractive from time to time for a Owner.

For example, the Owner might have a strict budget to comply with, and may be in a position of being able to increase or reduce the Works as they are performed (for example, by deleting or adding parts of the Works, or by increasing or decreasing the quality of the selected materials) to ensure that the final cost of the Works remains within that strict budget. (In theory, this should be equally possible under a fixed-price contract. For the reasons referred to above, however, in certain instances the Contract Sum being able to be adjusted, a Cost Plus Contract, where the Works themselves are able to be changed during construction, might, conceivably, provide a more convenient method of ensuring that the cost stage within particular limits, albeit that the Works to be performed may change from that which was originally proposed.)

The nature of cost-plus contracting, therefore, is that the Builder agrees to perform the works but that the risk as to the final cost of those works is borne by the Owner, not the Builder (the reverse of the position under the fixed price contract).

3. *Design & Construct Contract*

A design & construct contract requires the Builder to tender on the works described in the Design Brief (prepared by the Owner), and tender not only for the construction of the works described in that Design Brief, but also for the completion of the detailed design, consistent with that Design Brief.

There are a number of construction reasons which suggest that the design & construct method of contracting has the potential to reduce the overall cost of construction to the Owner.

The nature of this type of contract is such that the Owner is able to enjoy the advantages of design efficiencies which Builders, through their contracting experience, may be able to incorporate into the design of the works, which may have the effect of reducing construction cost (this is discussed further below).

The Owner is still required to adequately specify (in the Design Brief) the works to be completed for the Contract Sum. The degree to which that work is specified, however, is less than that which would occur under a construction only contract. The accuracy of the Design Brief (which, again, is discussed further below), is critical to the Owner being able to rely on the design & construct contract.

4. ***Project Management Agreement***

A project management agreement is one in which the Owner contracts, not with a Builder who would perform the construction (or the design and construction) works, but with a person who would manage the project on behalf of the Owner, whether by performing the works in part or wholly himself, or by contracting out part or all of the works on behalf of the Owner, or a combination of all of the above.

There is an infinite variety of possible project management contract types (these are discussed further below).

The nature of a project management agreement, however, is that the Owner engages a person to manage the project on its behalf, rather than engaging a Builder to construct the Works. The functions typically performed by a Project Manager, therefore, are usually more extensive than those which might be performed by a Builder. Further, the risks borne by a project manager, under a project management agreement, are typically less than, or at least different to, those borne by a Builder.

The types of functions performed by a project manager, pursuant to a project management agreement, typically include the design, or procurement of the design on behalf of the Owner, the construction or procurement of the construction on behalf of the Owner, and, in particular instances, other activities including, for example, site selection, site acquisition, permit approvals, advertising of the project, leasing or pre-leasing of the project, and/or other activities which might otherwise need to be performed by the Owner.

The essential feature of the project management agreement is that the works to be performed pursuant to the agreement are the necessary management services rather than the contract construction works.

5. ***Construction Management Agreement***

A construction management agreement is similar in most respects to a project management agreement, except that, typically, the services to be provided by the Construction Manager are restricted to construction activities only (rather than, for example, design activities, site acquisition, leasing activities...).

Accordingly, construction management agreements are, typically, similar in structure to project management agreements.

The substantive functions to be performed by construction management, typically, include engaging trade builders on behalf of the Owner, and potentially, the provision of preliminaries for those trade builders.

The functions performed by the construction manager might include any or all of the functions set out in Schedule A¹.

¹ These functions are derived from the MBAA standard form Construction Management Agreement.

6. *Managing Builder Contract*

The Managing Builder might be characterised as a hybrid of a project management/cost-plus/fixed price contract.

Typically the features of such a contract would include:-

- the Managing Builder contracts with the Owner to manage the construction of the works on behalf of the Owner;
- the Managing Builder contracts with the Owner to provide, at a fixed price, or alternatively at a percentage of the total contract price, certain aspects of the works (for example, the preliminaries, including crane hire, site sheds, supervision services...);
- the Managing Builder may perform all or part of the design services for the Owner;
- the Managing Builder will arrange the trade packages, tender and enter into the trade contracts on behalf of the Owner and, potentially, itself perform some of the trade contract works;
- the Managing Builder will perform the usual supervision, reporting activities required on the project to keep the Owner informed of the progress of the works.

The attraction of the Managing Builder type of contract is its flexibility and the skills which the Managing Builder may be able to bring to bear in the procuring the Works, to assist the Owner.

7. *Warranted Maximum Price Contract*

A Warranted Maximum Price Contract is, in substance, a cost-plus contract between the Owner and the Builder, which, in turn, is subject to an upper limit (the Warranted Maximum Price), above which, subject to certain conditions, some of which are discussed below, the Builder will bear the risk as to costs.

Under a Warranted Maximum Price contract, the Builder is to be paid on a cost-plus basis up to a certain limit. Over and above that limit, the Builder is not entitled to any further payment. That limit, however, as in the case of the Contract Sum under a Fixed Price Contract, is subject to adjustment in certain circumstances (for example, where the Owner varies the works, or where the Owner causes delay and/or additional cost to the Builder).

The benefit of the Warranted Maximum Price contract is in giving some upper limit degree of comfort as to the total cost of works, provided those works are adequately described as to scope, yet allow the parties to enter into the contract on a cost-plus basis where that is an appropriate vehicle for them (this is discussed further below in paragraph 2.3.2).

8. *Build Own Operate Transfer (BOOT) Project*

In recent years, in Australia, there have been a substantial number of major construction projects which have been performed using the BOOT, or BOT vehicle.

The basic structure of a BOOT project is that the Builder agrees with the Owner not only to build the project but to arrange finance for the project, and then, using that finance, to build the project, to own the project for a limited period, to operate the project throughout that period, and then, at the end of that period, to transfer the project to the Owner.

Typically, this style of structure is employed on public infrastructure projects where, but for the intervention of private sector financing, the project might not proceed.

1.2 STANDARD FORMS

There are a number of standard form Conditions of Contract generally in use in Australia, particularly within the public sector. Those standard forms include:

AS2124/AS4000

JCC

NPWC3-1981

PropCon 1

AS2124/AS4000

AS2124 is the Standards Association of Australia produced General Conditions of Contract for construction projects.

The document was first published in 1952 and was then known as CA24. Since that time it has been reproduced in several editions, changing its designation in 1978 to AS2124. AS2124 was revised in 1978, 1981, 1986 and 1992.

The Standards Association of Australia has, in recent years at least, hoped to encourage universal use of AS2124 on building projects. In particular, in the 1986 revision, and again in the 1992 revision, SAA hoped to discourage the use of the alternative NPWC3-1981 General Conditions of Contract by the public sector in favour of AS2124. (In the 1986 revision, therefore, many of the features of NPWC3-1981 were incorporated.) This hope has only been partially successful, perhaps for some of the reasons suggested below.

There are, however, a number of unfortunate drafting errors in the 1992 revision of the document, attributable no doubt to the committee process of revision, which would need to be remedied before the document is suitable for use on major building projects.

In brief, those drafting flaws include:

- (i) The document, in its treatment of Bills of Quantities, places the risk of pricing the works with the Owner rather than the Builder (contrary to the recommendations contained in "No Dispute" which recommended the reverse).
- (ii) uncertain risk allocation in a number of important areas (e.g. default of selected Sub-builders);
- (iii) inadequate security/retention provisions, which disentitle the Owner from access to security or retention in the event of defective work removing the commercial equivalence of bank guarantees to cash;
- (iv) no provision of collateral contracts within the document (perhaps this is a reflection of the failure of the committee to follow the commercial trends);
- (v) complex logical difficulties relating to the conflicting roles of the Superintendent (as between his role as agent for the Owner and as an independent certifier);
- (vi) the document does not include an acceleration clause;
- (vii) the latent conditions clause is a subjective test likely to favour inexperienced Builders;
- (viii) the extension of time clause has a number of logical and commercial difficulties;
- (ix) the certificate of progress payments by the Superintendent requires the Superintendent to certify for claims, which may involve a legal judgment, and for claims, which may arise out of his own error, which are likely to result in challenges to the certificate by the Builder;
- (x) the dispute resolution clause does not constitute a binding arbitration agreement.

It seems that, irrespective of the worthy aims of Standards Association of Australia, the document is certain to be substantially amended by Owners prior to use on major projects, or not used at all.

AS4000 (until recently AS2124) is the Standards Association of Australia produced General Conditions of Contract for construction projects.

The document was first published in 1952 and was then known as CA24. Since that time it has been reproduced in several editions, changing its designation in 1978 to AS2124. AS2124 was revised in 1978, 1981, 1986 and 1992. AS4000 is the 1997 revision of this standard form.

The Standards Association of Australia has, in recent years at least, hoped to encourage universal use of AS4000/AS2124 on building projects. In particular, in the 1986 revision, and again in the 1992 revision, SAA hoped to discourage the use of the alternative NPWC3-1981 General Conditions of Contract by the public sector in favour of AS2124. (In the 1986 revision, therefore, many of the features of NPWC3-1981 were incorporated.)

This document, in both the AS2124-1992 and the AS4000-1995 revision, has drafting problems. Yet still, in my view, it should generally be adopted where possible, particularly on

lower value contracts, in the interest of universal use across the country eventually leading to lower tender prices.

There will be debate as to the extent to which the latest revision should be adopted in favour of the previous revision.

There will also be debate as to the extent to which the latest revision should be amended prior to using that document. I simply add my vote to the use of the AS2124 family, wherever possible, with as little amendment as possible (having regard to the size and complexity of the particular contract). It seems to me that, drafting problems accepted, the universal adoption of this family of contracts will ultimately increase the prospects of lower tender price.

JCC

The JCC family of contracts was first released in January 1985 in two documents:-

JCCA - 1985 Building Works Contract (with quantities)

JCCB - 1985 Building Works Contract (without quantities)

The document was prepared jointly by the Royal Australian Institute of Architects, the Master Builders Federation of Australia, and the Property Council of Australia (then BOMA). It effectively replaced the previous standard form conditions of contract which were in common use, the RAI A Edition 5b-1970 Conditions of Contract.

The contract was prepared by a committee comprised of representatives of those three organizations, hence the title JCC (Joint Contracts Committee). Recently the Joint Contracts Committee released two new versions of the document:-

JCCC - 1993 Building Works Contract (with quantities)

JCCD - 1993 Building Works Contract (without quantities)

Those editions were released in March 1993 and represent the present state of the JCC contract.

The JCC document, it may be fair to say, has, at least until recently when there have been a number of new options, become the most commonly used form of Conditions of Contract **amongst the various standard form conditions available.**

There may be, on some views, some difficulties with the document, however nothing which could not be remedied easily. Perhaps the following comments might be made of the JCC family of documents:-

- (i) the latent conditions clause might reasonably be limited to "material" and/or "substantial" differences in conditions, and could be amended to impose a positive obligation on the Builder to investigate the site and draw its own conclusions as to the site conditions likely to be encountered;
- (ii) the document, no doubt in the interest of risk/sharing in the hope of a more even contractual approach, introduces an option, in the Appendix, for the parties to insert a percentage of delay costs to be paid to the Builder in respect of a number of delays

not attributable to the Proprietor (the better view, for Proprietors, might be that the Builder is only to be entitled to delay costs where a delay is caused by the Proprietor);

- (iii) clause 12.09 is, in the view of some commentators, at best meaningless, and at worst, provides an unnecessary and illogical tactical advantage to both parties (but more so, it seems to me, to the Builder);
- (iv) the contract provides an arbitration clause which, even if arbitration is to be preferred, is unnecessarily procedurally complex.

Having said this, the document has many excellent features, in particular, a clear designation of the role of the Architect, on the one hand when acting as agent of the Proprietor, and on the other when acting as independent assessor. Further, it has the added attraction of being widely in use. Accordingly, this is a well understood standard form.

The recent editions have expanded the insurance clauses.

On balance, JCC remains a viable and popular option.

1.3 DEVELOPING RISK AREAS

The choice of any particular project delivery system is made at the commencement of the project. Historically, however, little, or inadequate, consideration is given to the many types of possible contract structure available for any particular project.

In fact, there is an unlimited number of potential project delivery systems based on the above, or a combination of any or all of the above, which might be suitable to any particular project.

The choice will usually depend on factors such as:-

- the need for strict cost control;
- the need for flexibility in what is to be constructed throughout the construction period;
- the complexity of what is to be constructed;
- the inhouse resources of the Owner;
- the expertise of the likely tenderers;
- particular budget constraints;
- financing considerations.

The above project delivery systems reflect a more complex style of project delivery.

FIXED PRICE?

In theory, a Fixed Price Contract is one in which the Owner contracts with the Builder to perform agreed works for a fixed price.

Accordingly, irrespective of whether the works actually cost more or less than the agreed Contract Sum, the Builder is entitled to receive no more than and no less than the Contract Sum at the end of the works.

In practice, however, there are a number of ways in which the Contract Sum can (and usually does) alter during the period of construction on the works, including, for example:-

- the Owner failing to deliver the site to the Builder on time;
- the Owner failing to deliver exclusive access of the site to the Builder at the agreed time;
- the Owner failing to provide the detailed contract drawings and/or specifications required of the Owner under the Builder by the agreed time;
- the drawings and/or specifications provided by the Owner having errors or omissions or being incomplete;
- the site having characteristics different from that which was described in the tender documents;
- material to be dealt with on the site being different from that which was anticipated under the tender documents;
- other reasons pursuant to which the Builder would reasonably be entitled to claim more or less than the Contract Sum on the basis that the works as ultimately performed were different to those works which were described in the tender documents.

In fact, as a matter of practice, a Fixed Price Contract is rarely performed for the exact amount of the original Contract Sum. This is not surprising when one considers the nature of a construction contract (in comparison, for example, with a Contract of Sale for land). The nature of a construction contract is such that works as generally described in detailed and complex contract documents are to be performed over an extended period of time, subject to a large number of variable conditions, which the parties need to anticipate and which may bear on the actual cost of construction.

1.4 TURNKEY CONTRACTS

The Fixed Price Contract is dramatically different to a true “turnkey” contract.

(Unhappily, the word “turnkey” is often used interchangeably with “fixed price contract”, or what are in fact fixed price contracts are wrongly called “turnkey” contracts on particular projects, thereby giving rise to the confusion.)

A turnkey contract is one in which the Owner and the Builder agree on a fixed Contract Sum to be paid upon completion of the works to a particular standard and/or performance criteria, and in relation to which the Owner does not participate in any way in the actual performance of the works but, at the end of the works, is invited to inspect the works and, subject to the works being adequately constructed and performing to the requisite criteria, the Owner then paying the full amount of the Contract Sum and taking over the works. (The Owner is said to simply hand over the cheque, turn the key and commence operation.)

In a fixed price contract, by comparison, the Contract Sum is adjusted throughout the contract period, (for the reasons set out above).

A true turnkey contract, therefore, is more akin to a purchase contract than to a construction contract.

1.5 COST CONTROL OF COST-PLUS CONTRACTS

The Owner may impose a number of cost controls in a cost-plus contract.

Capping

For example, there may be an overall cap on the Maximum Price (usually referred to as a Warranted Maximum Price Contract), subject to the following:-

- the Warranted Maximum Price is subject to the scope of the Works being adequately described;
- the Warranted Maximum Price as adjustable, just as the Contract Sum is adjustable under a fixed price contract.

Trade Contracts

Alternatively, the Builder, though himself on a cost-plus basis, may be required to procure all or an agreed part of the works through fixed price trade contracts, each of which is to be vetted and approved by the Owner.

The Owner would, with the assistance of the Project Manager, negotiate and enter into prime contracts with the five proposed Alliance Builders, the technology providers, and other major builders as are identified at the time of allocating work/supply contracts between the prime builders.

Wherever this project structure has been successful, however, the Owner has been protected from the possibility of unlimited cost overruns by incorporating all of the work (for example, 85% of the work) in fixed price trade contracts. The Owner enters into a cost-plus contract with the prime builder, the work is then contracted out by the prime builder on a fixed price basis, the prime builder being entitled to cost-plus reimbursement by the Owner for those trade contract prices. Effectively, therefore, the Owner has the benefit of fixed price contracting.

Features of the Trade Contracts

The Builder would be required to perform the works within a number of trade contracts.

There are a number of contractual protections (for the Owner) which should be incorporated into those trade contracts to ensure the time/cost targets are ultimately met on the project:-

- a) the trade contracts should be fixed price;
- b) the terms of the trade contracts, generally, should be agreed between the Owner and the Builder;
- c) the trade contracts should be put out to open tender;
- d) there should be an approval process whereby the Owner may review the proposed tender process, and shall have final approval of any particular trade contract (subject to, if necessary, such trade contracts having a value above a minimum trade contract value);
- e) the trade contracts should provide adequate security for the performance of the contract, and provisions for liquidated damages (in respect of both, later completion and underperformance) sufficient to compensate the Owner for its losses if necessary.

Subject to these protections, the Owner would have effective contractual remedies in respect of the works, should there be a failure to perform in accordance with the targets ultimately develop

Bonus/Penalty Provisions

Finally, the cost-plus contract would preferably include a regime of bonuses and penalties, and potentially a cap on the total cost, all of which would be subject to adjustment in appropriate circumstance.

The bonus/penalty targets would be developed by the Owner, assisted in some instances by the Builder, and incorporated into the cost-plus contract

2. DESIGN & CONSTRUCT CONTRACTS

The use of design and construct contracts on major building projects in Australia has developed substantially since the mid-eighties. In this respect, the Australian experience is consistent with the USA.²

There are a number of observations which might be made in relation to design and construct contracts generally:

2.1 Importance of Design Brief

The Design Brief is a document which is attached to the Design & Construct Contract. That document describes the works which are to be constructed for the Contract Sum.

The design brief is a technical document which includes some or all of the following:

- a) schematic drawings of the proposal;
- b) general specifications of the proposal and performance criteria for the works when complete;
- c) site information;
- d) any other technical details which impinge on the Works which are to be constructed.

The preparation of the Design Brief is a matter for the Owner. Usually that function will be performed by the Owner's design consultants. The Design Brief is not intended to be a detailed design, merely that it is sufficiently detailed to express exactly what it is that is to be designed and constructed by the Design & Construct Builder.

The Design & Construct Contract obliges the Design & Construct Builder to produce a detailed design, to comply with the requirements expressed in the Design Brief, and to obtain the approval of the Owner (usually the Owner's design consultants who prepared the Design Brief) prior to commencing construction. Claims usually arise, at this point, between the Owner (on the basis that the detailed design has produced is low quality, or does not adequately perform the function which is described in the design brief) and the Builder. It is critical, therefore, for the Design Brief to be adequate in describing the works which are to be constructed and the functions which they are to perform.

² See, for example, the discussion of this trend in Molenaar, K. et al (1999) 'Public-Sector Design/Build Evolution and Performance', Journal of Management in Engineering, March/April; Ndekugri, I. And A. Turner. (1994) 'Building Procurement by Design and Build Approach', Journal of Construction Engineering and Management, 120:2, 243-256; Potter, K. and V. Sanvido. (1995) 'Implementing a Design/Build Prequalification System', Journal of Management Engineering, May/June, 30-34; Songer, A. and K. Molenaar. (1996) 'Selecting Design-Build: Public and Private Sector Attitudes', Journal of Management in Engineering, November/December; Songer, A. and K. Molenaar. (1997) 'Project Characteristics for Successful Public-Sector Design-Build', Journal of Construction Engineering and Management, March.

The types of documents/technical information which might be expected on a building project would include any or all of the following:

- site information
- demographic information
- building quality/quantity inputs
- preferred (or permitted) treatment methods
- output criteria

The information to be included may seem, at first glance, to be reducing the design input which was being hoped for from the design and construct builder. The level of information provided to, and restrictions placed upon, will vary depending on the project. There will always be a minimum level of specification which will be necessary from, and in fact should be desired by, the Owner. Further, in some cases, there will be political restraints on a particular project.

Such matters are, contractually, necessary to be included in the Design Brief.

2.2 "Buildability"

The owner advantage of a design and construct contract is that it allows the construction builder to bring his construction expertise into the design process.

There is a view that the ability of the construction builder to design the works with the convenience of construction in mind will result in cost savings to the Owner at the time of tender.

The design and construction builder is able, in producing the detailed design, to incorporate certain design criteria which may suit the builder for ease of construction. Accordingly, the tender price is likely to be lower (taking into account the cost of the actual design work) than where a Construction Builder was pricing works which had been designed by others, with no regard to the "buildability" of that design.

It is yet to be seen whether this will be true in the building sector. It would have little relevance, for example, if the design complexities mean that construction builders simply engage or joint venture with pure design professionals.

Further, the capacity of any builder to incorporate notions of "buildability" into a particular project design is directly related to his previous experience in design and construction. It seems unlikely (at least initially) that local builders will have a great deal of experience in the building sector (compared to, for example, the construction of roads or buildings)?

Perhaps, therefore, we will now see the arrival of experienced large Australian and international builders at the same time as more complex project delivery systems (as occurred in the recent Sydney Civil building Board projects).

The incorporation of construction expertise in the design process is certain, it seems to me, to result in substantially more efficient designs and lower tender prices.

2.3 Single Point of Responsibility

There are a number of potential situations in traditional style contracts where the boundaries of the responsibility of the designer for design and the construction builder for construction may become unclear.

There is potential for dispute as to responsibility, where the works as constructed fail to perform in accordance with the specifications (for example, leaking, cracking, discolouration ...). In such instances, the Construction Builder might assert that the problems are a design flaw, whereas the designer might assert that the design was adequate but the works as constructed did not comply with that design. Where the Builder has responsibility for both the design and construction, this problem does not arise.

There are several such potential areas of overlapping responsibility. For example:

1. claims sometimes arise in traditional contracts (where the detailed design has been performed by the Owner prior to entering into the Contract) where the Builder is asserting that the design cannot (or cannot conveniently) be constructed;
2. where the Works, as constructed, do not perform the required function in accordance with the specifications, and/or are defective, a difficulty sometime arises where the Builder is asserting that the problem is a design fault, and the designer is asserting that the problem is a construction fault;
3. claims sometimes arise where the construction builder is delayed by the designer during the construction phase (for example, in waiting for asserted errors or ambiguities in the design documents to be resolved).

In each of those instances, the Owner would be faced with the designer and the construction builder blaming each other and denying liability to the Owner.

Builders often assert that the Owner and/or the Owner's design consultants have failed to take into account whether or not the works as designed by the Owner are able to be built, and whether construction cost savings could have been achieved if the design were other than as produced at the time of tender.

Usually such claims do not arise until after the execution of the Construction Contract (because they were not perceived until that time).

Where the Design & Construct Builder has responsibility to produce the detailed design, this type of claim will not arise.

2.4 Perceived fast tracking

There is a view that a Design & Construct Contract increases the possibility for "fast tracking" of the Project.

Some minor improvements in the programming of capital works can often be achieved through the Design & Construct model. The pre-tender phase is likely to be shorter than for a traditional contract (because it is only necessary to prepare the Design Brief, rather than the detailed design which would take substantially longer) prior to inviting tenders. The detailed design work is able to be performed after execution of the Design & Construct Contract, and during the early stages of construction, in a staged manner.

However, the timing benefits of this process may be illusory. At the point of commencing construction, at least the stage 1 building approval is required for the foundations. Accordingly, at that point, the design of the structural matters must be complete to the point where the foundation details are known. The detailed structural issues, and the architectural detail, may be able to be produced later to then obtain subsequent staged building approvals.

Further, in relation to capital works within the building sector, it is likely that the perceived advantages of fast tracking would be negligible for a number of reasons:

1. the lengthy lead times to acquire the site and/or obtain planning and EPA approvals make minor time improvements largely irrelevant;
2. the complexity of obtaining political support for a particular is, typically, a higher priority than minor time improvements, accordingly it is unlikely that an authority would be able, in any event, to substantially shorten the overall project implementation, to the point where, again, there is little to be gained in minor time improvements.

It seems to me that "fast tracking" is a minor (maybe irrelevant) factor in this respect.

2.5 Independent Design Review?

A question arises for the Owner, in the Owner's review of the detailed design, as to how far that review should be taken.

On the one hand, the Owner has a contractual remedy against the Builder if the detailed design is ultimately inadequate. On the other hand, the Owner has to review the detailed design in any event to ensure that it complies with the Design Brief. It may be convenient, and prudent, therefore, to have the detailed design reviewed by independent professional consultants to ensure that the design is adequate prior to construction.

In the building sector, significant community health issues arise. It seems likely to me that authorities will err on the side of independent design review. The cost of such review is likely, it seems to me, to be minor when weighed against this risk.

Contractually, presuming that the design and construct builder is substantial (and for the reasons set out above, it seems likely to me that major builders will ultimately dominate the procurement of future Victorian building projects) the Owner will be protected. In theory, therefore, independent design review is unnecessary. In practice, however, again, it seems to me that future building authorities will err on the side of independently reviewing designs prepared by the builder, rather than let the builder fall into error and then simply rely on the contract.

2.6 Contract Administration

Under the Design & Construct Contract, the parties may or may not have a third person in the role of Superintendent/Architect. (This is equally true of traditional contracts.)

Usually the person in the role of Superintendent under a traditional contract is also the designer. To the extent that the construction of the Works is not consistent with the original design philosophy, there is still some control able to be exercised over the construction Builder. Under a Design & Construct Contract, there would still be a Superintendent, he is merely not the (detail) designer.

For the same reasons that a building authority is likely to err on the side of conservatism in assessing whether to have the builder's detailed design independently reviewed, it seems to me that the Owner would usually insist on a comprehensive administration of the builder's obligations under the contract. Accordingly, I would expect to see the use of a superintendent on such projects.

2.7 Potential for Dispute

The unique area for dispute arising in design & construct contracts, rather than traditional contracts, arises at the time of the proprietor's review of the builder's detailed design.

The Builder must design the Works in accordance with the requirements of the Design Brief. By definition, however, the Design Brief will be descriptive rather than detailed and will rely, in most instances, on defining function and performance criteria, rather than specific design elements.

The Builder will, naturally, be inclined to use lesser quality materials to reduce cost (the Contract Sum having already been agreed). The Owner, on the other hand, would usually have a higher impression of the degree of quality which was intended within the Design Brief.

Accordingly, there is always a possibility (in practice, it seems a probability) of substantial dispute as to the exact materials and/or construction criteria which are required pursuant to the Design Brief.

Further, in many instances, the dispute will be a technically esoteric dispute as to the likely performance of materials and/or workmanship which have not yet been incorporated into the Works.

To the extent that a proprietor does not adequately describe, in the Design Brief, the materials and/or workmanship which is to be performed under the Contract, there is potential for this type of dispute.

This is likely to be a critical issue for the building sector.

The Design Brief is complex on any project. On building treatment projects it is likely to be particularly complex for a number of reasons:

1. the technical complexity of input data of building quality and quantity, and the desired output quality, will be hard to adequately specify, and hard to contractually enforce (in a traditional the difficulty is still present, but the Owner and/or the design consultant design the plant and the builder merely constructs whatever is described in the plans and specifications);
2. the design Brief may necessarily include matters which go beyond mere technical criteria (for example, political constraints);
3. the Design Brief may sometimes be based on "in principle" planning/EPA approvals, resulting in "final" approvals being necessary on completion of the detailed design (accordingly, the detailed design may need to be subjected to a final approval by third parties on grounds other than mere compliance with the Design Brief).

This complexity is probably warranted on bigger projects, where the "buildability" advantages are likely to be worthwhile. The preparation of the Design Brief on building projects, however, is likely to be a non-trivial task.

2.8 Potential Design Conflict

A potential conflict for the builder may arise in designing the Works under a Design & Construct Contract.

The Builder, having contracted to construct the Works for the Contract Sum, and to the extent not expressly prescribed within the Design Brief, will be required, as any designer must, to make a number of design decisions.

On the one hand, the Contract Sum having been agreed, the Builder will be inclined to keep costs to a minimum. On the other hand, the Builder, also being the designer, would wish the materials and/or workmanship to result in a constructed product which performs adequately (at least in accordance with the Design Brief).

For example, in designing the Works, a Builder might be inclined (remembering that the Contract Sum has already been agreed) to use lower quality materials (where they have not been specified in the Design Brief) irrespective of the design life of those materials. The Design & Construct Builder may conclude that his contractual obligations cease at the end of the Defects Liability Period (this is not strictly correct, however problems of proof may make this practically so) and, therefore, there is no reason for the Design & Construct Builder to prefer more expensive materials to less expensive materials, provided that the less expensive materials would last at least to the end of that Defects Liability Period. The Owner, on the other hand, would prefer the more expensive materials in order to reduce long-term maintenance costs.

(This is an example of the type of detail which should be included in the Design Brief.)

This issue would usually arise at the stage of approval, by the Owner, of the detailed design as prepared by the Builder. The issue will turn on what has or has not been specified in the Design Brief (there is some limited opportunity to assert implied terms, but difficulties in relation to the implication of terms, generally, limit the practical effect of implying terms into the Contract).

Accordingly, the Builder in performing his design role, will have a conflict between the proper performance of that design role and the desire to keep costs to a minimum.

In the financial analysis of proposed capital works in the building sector, the operating costs are far more critical to the viability of the proposal than, for example, on buildings.

There will be difficulties in tender assessment. An authority would want tenderers to take the competing capital cost/operating cost issues into account when submitting their design proposals in their tenders. The assessment of such tenders will be more complex, the more flexible the Design Brief.

There will be further difficulties at the time of approval by the Owner of the builder's detailed design. At that point, the Owner and the builder (the Contract Sum already being agreed) will have competing interests in relation to the operating and maintenance costs of the Works as designed, the only reference being the matters set out in the Design Brief.

2.9 Choice/Quality of Designer

The design & construct tenderer, when bidding on the tender documents, will usually be required to disclose the identity of the detail designer. The Owner will usually wish to have some control over the choice of designer (whether the Owner has a particular preference or whether the Owner is merely interested to have a suitably competent designer).

On complex projects, the Owner may require the engagement by the Builder of a suitable firm of professional design consultants. In this manner, the Owner will have remedies against the Builder in contract and/or against the professional consultants in negligence should the (detailed) design ultimately prove to be inadequate. (The Owner will also wish to ensure, in that instance, that the particular design consultants have adequate professional indemnity insurance.)

(A possible method of addressing this issue is to require the successful Design & Construct Builder to "novate" the Owner's existing professional services contract with the original designers. This form of "novation" contract has other consequences which should be considered, beyond this short discussion of Design & Construct. In any event, however, it is probably unnecessary for the Owner to insist on the choice of one particular firm of design consultants over another, especially if, in fact, that would result in higher tender prices).

The perceived disadvantage as to choice of designer, when weighed against issues of "buildability" and single point of design responsibility, may be illusory.

2.10 Contract Administration not by Original Designer

There is a perceived disadvantage in having the administration of the construction contract performed by a person other than the original designer.

It is correct that the original design philosophy is likely to be more adequately addressed by the original designer, in the administration of the construction contract, than by a professional who did not perform the ultimate design. It may be, however, that, again, this disadvantage is illusory. The likelihood is that, subject to the choice of a suitable person for

the role, any professional contract administrator would have regard to the design philosophy in superintending the construction of the works.

It seems to me, in the building sector, that it will be the Owner or a professional building superintendent, rather than the designer per se.

2.11 Risk Allocation under the Design & Contract Builder

The allocation of risk under a Design & Construct Contract is slightly more complex than under a traditional contract.

Under a traditional contract, the adequacy of the design (with all of the consequences which flow from inadequate design in respect of both the Works, and/or delay or additional costs caused to the Builder) rests with the Owner. The Owner may or may not have adequate remedies against the original designer pursuant to their (separate) professional engagement agreement.

This is likely to be a major factor (in favour of using the design/construct model) for building authorities.

Unlike the traditional contracts, the responsibility for detailed design rests with the Builder. There are a number of risk areas for the Builder in this role:

- (i) compliance with the Design Brief;
- (ii) adequacy of the design generally;
- (iii) design approval by the relevant building authorities.

Each of these matters need to be properly addressed in the Design & Construct document.

In addition, there should be a process whereby the detailed design is ultimately submitted to the Owner for the Owner's approval prior to construction. Again, this is a risk area for the Builder, and also for the Owner. This is the point at which major dispute as to the adequacy of the detailed design will usually arise. This area of risk is not present in a traditional contract.

In all other respects the risk allocation under a Design & Contract is similar to that which one might find under a traditional contract. It is a matter for the parties to negotiate the allocation of those risks.

3. SECURITIES PROVIDED BY THE BUILDER

3.1 FORM OF THE SECURITY

On major building projects, the Builder will universally be required to provide security for the performance of its obligations under the Contract.

That security, traditionally, was provided by cash retention. The Owner would deduct an amount (usually of the order of 5% of the value of the works completed) from each progressive progress claim from the commencement of the works up until practical completion. At practical completion, usually, part of that cash retention would be returned to the Builder if it was not required for any reason under the Contract). Typically, the Owner would retain, say, 2.5% of the total Contract sum throughout the Defects Liability Period.

In recent years, an alternative style of security has tended to be preferred by Builders, namely the provision of bank guarantees in lieu of cash retention.

The attraction of providing a bank guarantee, for the Contract, is that (providing the Builder has security at its bank for the relevant amount) the cost of the bank guarantee to the Builder (typically of the order of 0-2% of the sum involved) is negligible in comparison with having the access to the relevant amount of cash flow.

The amount usually provided by way of bank guarantee should mirror the amount which would otherwise be provided by way of cash retention. For example, it is a typical amount to be provided by way of bank guarantee for amount equal to 2.5% of the Contract sum provided at commencement of the works, a second bank guarantee for 2.5% of the Contract sum provided half way through the completion of the works, the first bank guarantee being returned at practical completion, the second bank guarantee being returned at the end of the Defects Liability Period.

The purpose of the Builder providing this security is to put the Owner in the position, at all times, of being able to step in and complete all or part of the works, as necessary, where the Builder fails to do so under the Contract.

The critical issue in relation to the form of a bank guarantee is that the bank guarantee (so far as the Owner is concerned) be as good as cash. (We refer to the ability to convert the bank guarantee to cash in Topic 7.4 below.)

Security by Owner?

The convention has always been to require the Builder to provide security to the Owner.

In fact, the Owner always has the advantage of the Builder having completed part of the works prior to becoming entitled to receive payment for that work. (For example, where the Contract commences at the start of month one, submits its progress claim at the end of that month one, receives that progress

payment towards the end of month two, then, at all times, the Builder has completed at least 1-2 months of work for which he has not yet been paid.)

From time to time, however, the Owner has been required to give security to the Builder.

This is not usual. (In fact, the annexure to AS2124 includes a place for the parties to indicate whether the Owner is to provide security or not.)

Where the Owner is to provide security, again, that security will usually be provided by way of bank guarantee.

One could envisage circumstances in which the Owner might provide security where, for example:-

- the company with which the Builder was contracting was not the registered proprietor of the land.

Alternatively, there may be some issue about the financial security of the Owner. Alternatively, the Owner might be a foreign corporation and there may be concerns as to the ability of the Builder to obtain payment where enforcement proceedings ultimately became necessary.

The convention, however, is that the Owner does not usually provide security to the Builder.

Protection for Owner

The Owner has substantial security under the Contract to protect it from any failure to complete the works by the Builder.

That security consists of any or all of the following:-

- the value of the works completed by the Builder, for which the Builder has not yet been paid (this will, typically, at any time, be of the order of 1-2 months of works completed by the Builder);
- the value of any cash retention or bank guarantee provided by way of security by the Builder to the Owner.

Accordingly, at any time, if the Builder fails to complete the works, the Owner will have a substantial amount of money with which to step into the shoes of the Builder and complete the works.

Such circumstances might arise when, for example:-

- the Builder goes into liquidation during the progress of the works;
- the Builder, because of a contractual dispute with the Owner, terminates the Builder and leaves the site;
- the Builder, for reasons of the Owner, is terminated by the Owner.

In each of these circumstances, irrespective of the Builder's right to sue for damages if it has a claim against the Owner, the Builder will in fact typically be holding sufficient funds to re-start the work with another Builder and complete the works at the Builders expense.

Security to Remedy Defective Work

The Owner, at any time, is holding substantial security to enforce the rectification of defective work..

Where the Builder performs defective work, and fails upon the Owners or the Superintendents instruction to rectify that defective work, at some point the Owner will become entitled to step into the shoes of the Builder, rectify that defective work at the Builder's expense, and deduct the cost of that rectification from monies otherwise due to the Builder.

Accordingly, where defective works is not remedied by the Builder, the Owner will usually deduct the cost of that rectification from the next progress payment or, failing that, from subsequent progress payments and any cash retention or bank guarantee security as presently held by the Owner.

3.2 CONVERSION OF SECURITIES

The rationale for providing security to the Owner is to put the Owner in the position where, irrespective of any contractual entitlement, it can complete the works if necessary, or rectify defective works if necessary, using funds provided by the Builder.

The recent use of bank guarantees as an alternative to cash retention should have simply substituted a form of security which was equivalent to cash for that cash retention. For various reasons, however, the form of bank guarantee has tended to include, on occasion, certain restrictions on the Owner's ability to present that bank guarantee and convert it to cash.

For example, typical conditions might include:

- notification of the Builder with sufficient time, if necessary, for the Builder to be able to commence Court proceedings to restrain the presentation of the guarantee;
- the need to obtain a judgment from a Court or an Arbitrator entitling the Owner to convert the bank guarantee to cash.

These conditions will, potentially, have the effect of removing the efficacy on the bank guarantee altogether.

The obligation to give notice of ones intention to present a bank guarantee could, conceivably, be seen as preventing a mad scramble to the Courts by a Builder where it simply guest that the bank guarantee was to be presented. Accordingly, one could possibly justify the inclusion of a condition requiring formal notice to be given a certain number of days prior to presentation of a bank guarantee. Even that, however, will seemingly introduce the additional legal hurdle of, in appropriate circumstances, having to defend a Supreme Court injunction application prior to the Owner's ability to complete the project using the Builders security monies.

The second condition, however completely removes the advantage of the security. The obligation to obtain a judgment from a Court or an Arbitrator will, typically, involve the Owner in many months of protracted and expensive litigation as a pre-condition to being able to complete the works using the Builder's money. This seems an unnecessarily expensive condition to impose on the security to be provided by the Builder to the Owner.

In fact, the more common convention is that where cash retention is not to be provided by the Builder, the form of bank guarantee is to be a condition-free irrevocable direction to the bank requiring the bank to pay the funds to the Owner without reference to the Builder.

Right to Convert to Cash

The Owner will, under the Contract, become entitled to take the cash retention monies and/or convert a bank guarantee to cash and use those funds in limited circumstances only.

Such circumstances might include:-

- the Builder failing to comply with a notice to rectify defective work and the Owner taking those defective works out of the hands of the Builder;
- the Builder having the whole of the works remaining to be performed under the Contract taking out of its hands, and the Owner completing those works;
- the Owner becoming entitled to claim, as a debt due, from the Builder, sums of money relating to the Builders failure to complete the works by the Date for Practical Completion (including, where provided, the deduction of liquidated damages).

Typically, the Contract will expressly provide those circumstances in which the Owner may have recourse to the security including the conversion of bank guarantees to cash.

Injunction to Restrain Presentation of Guarantee

The presentation of a bank guarantee at a Builders bank is a serious financial step for the Builder.

Accordingly, where the Builder becomes concerned that the Owner is about to present such a bank guarantee at the Builder's bank, the Builder will consider whether it would be in his interest to attempt to have the Courts restrain the Owner from presenting the bank guarantee, by way of injunction.

The Owner, in theory, in holding the bank guarantee, is in the same position as if it were holding cash. In theory, the Owner merely needed to present the bank guarantee at the bank named on the guarantee and the bank, without contacting the Builder, will simply exchange the bank guarantee for the relevant amount of cash.

In practice, however, the Builder has, from time to time disputed the right of the Owner to convert the bank guarantee to cash under the Contract (for example, the Builder and the Owner may be in dispute as to whether the Owner has wrongfully terminated the Contract).

On one view, the Builder should usually be successful in an injunction application where it can establish a prima face case to be argued in the Courts and a lack of commercial inconvenience being caused to the Owner if the injunction is granted (typically, the Builder will be required to give an undertaking as to damages should the Builder ultimately fail in any proceedings against the Owner and the Owner suffer loss as a result of being restrained from presenting the bank guarantee).

On balance, however, the Owner will usually be inconvenienced by being able to have recourse to the cash (for example, it will need to arrange alternative funds).

The Courts have tended to decide such applications on the balance of convenience. Contract disputes can be complex and the rights of the parties are not always clear at first (they will be necessarily subjected to substantial pre-trial preparation on the documents and the facts relied upon by the parties will often vary). In those circumstances, where the Builder is prepared to provide an undertaking as to damages, and where the Owner will not in fact be substantially inconvenienced by the inability to have recourse to the security (for the present), the Builder will typically obtain an injunction, at least for a short period, restraining the Owner from presenting the bank guarantee while the issues are sorted out in the proceedings.

For this reason, where the Builder becomes concerned that the Owner is about to present the bank guarantee, there is often a mad scramble to the Courts to obtain that injunction before the Owner in fact presents the bank guarantee at the Builder's bank.

4. DISPUTE TRENDS

4.1 DISPUTE RESOLUTION MECHANISMS

Disputes occur on major building contracts on a regular basis. There have several developments in Australia, over the past few years, in the resolution of disputes in the building sector. All have, in my view, been positive. This brief paper is intended to identify those developments, and to anticipate possible future improvements in the disposal of such disputes.

The usual type of dispute is one in which the Builder claims to be entitled to additional payment or an extension of time because of:

- delays on the part of the owner (for example, in providing the Contract drawings)
- performing work which the Builder believes was not included in the original tender documents
- performing work which, though including the Contract documents, is more difficult or under different circumstances to that described in the Contract documents (for example, the Builder expected to have a clear site but arrived to find a number of other trade builders working on the site)
- the owner requesting additional work or deleting work from the work described in the original tender documents

In each of these and other circumstances, the Builder may be entitled to additional payment and/or an extension of time if he is correct in his claim.

Most building contract disputes are reassessments of determinations made by the Superintendent.

Where the Builder is entitled, or believes he is entitled, to make a claim, that claim will usually be submitted to the Superintendent for determination. The Superintendent will make a determination in respect of the claim, whether or not to allow the claim at all, and if so to what extent the Contract Sum should be adjusted and/or an extension of time given. Where the Builder disagrees with that determination, a dispute has arisen under the Contract.

The Contract will usually expressly provide a procedure for determining such disputes. Such dispute resolution provisions might include any or all of the following:

- negotiations between the parties
- negotiations between chief executives of the parties
- mediation
- referral to a particular form mediation/dispute resolution (for example, the Australian Commercial Dispute Centre)
- arbitration
- litigation.

The Contract could, of course, provide no such mechanism, in which case the parties are free to take the dispute to any forum they believe appropriate. Where the Contract provides such a dispute resolution procedure, that will usually oblige the parties to comply with that procedure. In recent years, however, (we refer to this further below in relation to the topic of commercial arbitration) legislation and/or the Courts have intervened to some extent.

Filtering of the Disputes

The modern trend in dispute resolution on major building contracts is to attempt to remove a number of the disputes by filtering out those disputes which are able to be resolved by negotiation.

Such contracts typically provide, as a pre-requisite to any party taking a dispute to Court, or to arbitration, that the dispute be referred to structured negotiations between:

- the parties;
- the Chief Executives of the parties
- the parties within a structured dispute resolution mechanism such as, for example, ACDC

The purpose of imposing that that process, which, in effect, merely obliges the parties to negotiate but does not bind the parties to any outcome decided by that process, is to attempt to reduce the total number of disputes, by removing those disputes able to be resolved through negotiation.

Such processes, are by nature, non-binding.

Accordingly, if a party, for any reason, did not wish to comply with such a process (for example, did not wish to refer the dispute to a panel) then they would merely have to go through the process but not agree with the outcome of that process.

Nevertheless, it has become the trend in modern major contracts to impose that process in the hope that it will have the effect of substantially reducing the number of disputes which proceed all the way to arbitration or litigation.

The trend on major projects is to then refer disputes to a dispute panel, appointed by the parties at the time of creating the Contract.

It appears, from empirical evidence (though in relation to mediation there may be even more substantive evidence) that this filter process is extremely successful in reducing the number of matters which proceed from a mere dispute to litigation.

PROJECT CLAIMS PANELS

We have seen on a number of projects in Australia in the last 3-5 years the inclusion of a Project Claims Panel to resolve disputes as they arise throughout the duration of the project.

In the mid to late 1980's, it was a common occurrence on major property developments which were being operated by a joint venture proprietor for there to be a project control group. The purpose of that group was to perform the normal management functions of a owner, having regard to the respective degrees of participation in the joint venture of all of the participants.

In recent years, similar panels have been set up, to operate during the life of the project, solely for the purpose of resolving any disputes which arise between the two parties to the construction contract.

Empirical evidence from mega-projects overseas suggests that the dispute panel filters out a substantial proportion of disputes before they become litigious.

REFERENCES OUT OF COURT

In the last 5-10 years, the Supreme Courts in Sydney and Melbourne have regularly adopted the practice of "referring out" technical questions to Special Referees.

The process involves the Building Cases Judge agreeing to refer certain questions of a technical nature to a technically qualified Special Referee. That application is usually made by one or more of the parties,

but the agreement of all parties is **not** a pre-requisite. To date, such special referees have, typically, been senior arbitrators.

One difference between references out and arbitration is that arbitration is restricted to those matters agreed between the parties (in most cases at the time of entering into the construction contract). By definition, parties will only be participants in an arbitration where, usually at the time of entering into the contract, they have agreed to refer such matters to arbitration rather than litigation. The type of issue which will be referred to arbitration has, historically therefore, been a commercial contract dispute.

The modern development of sending technical issues out to a Special Referee, arising out of Supreme Court litigation, has the (unintended?) effect of expanding the type of disputes being referred to non-judicial adjudicators to include, for example, negligence actions. Previously, such issues would rarely, if ever, be dealt with other than in a Court.

The basis of the special reference system is that a case at all times remains within the jurisdiction of the Building Cases List Judge. In theory, the action returns from the Special Referee (the questions having been answered by the Referee) for the ultimate disposal of the action at trial by the trial judge. Accordingly, it is open to the parties to challenge the report of the Referee at the subsequent trial.

In fact, however, the procedure having been in operation in Sydney for many years, the New South Wales Court of Appeal has now had an opportunity to review the special referee procedure and recently handed down a decision which effectively discourages trial Judges from overturning the technical questions answered by the Referee.

These procedural changes unquestionably improve the efficiency of the disposal of building/construction disputes.

LITIGATION OR ARBITRATION?

In the last 10-20 years, commercial arbitration on major building contracts has risen and declined.

Commercial arbitration became popular in the 19th Century. Originally, the process of arbitration envisaged a technical expert, who may or may not hear from the parties, resolving a dispute referred to him by those two parties, as an alternative to litigation through the Courts.

In recent years, however, commercial arbitration has become a mirror image of litigation, with certain key exceptions:

- the arbitration process is conducted in private (the proceedings are not open to the public)
- the arbitration process allows the parties to the dispute to select (and pay) the person to whom they will refer the dispute

In all other respects, at least in Australia, the commercial arbitration process has been mirroring the litigation process.

It seems fair to say that the number of actions being referred to commercial arbitration in the last five years, in Australia, have substantially declined. This may be due to a number of factors including, perhaps, a perception as to the quality of commercial arbitrators in Australia outside the top commercial arbitrators.

Irrespective of the reasoning for this decline, there are a number of differences between commercial arbitration and litigation which encourage parties or not to refer matters to arbitration rather than litigation. Those differences include:

1. Proceedings in Court are open to the public, whereas proceedings in commercial arbitration are private, accordingly the parties who wish to preserve their commercial secrets may prefer commercial arbitration.
2. The commercial arbitration process permits (though, again, for different reasons this is often not made advantage of) the parties to select their arbitrator, rather than take pot luck in the Courts.
3. The arbitration process is slightly more expensive in that the parties are obliged to pay for the arbitrator and matters such as room hire (the Court process, once the initiating fees have been paid, are basically free).
4. The process of the arbitration (namely, the pre-trial steps and the time table for those pre-trial steps) are essentially a matter for the parties. In recent times, however, the Supreme Courts and lower Courts in Melbourne and Sydney, at least, have included specialist building lists. Accordingly, the distinction between the pre-trial steps in Court, and the timing of those pre-trial steps, has largely disappeared.
5. Commercial arbitration is a critical method for international contracts. Court judgments contained in a particular country are not necessarily enforceable in other countries. Commercial arbitration awards, however, are enforceable in other countries which are parties to the New York Convention 1958 (effectively, all major commercial countries are parties to that convention). Effectively, therefore, for international contracts where parties may or may not wish to enforce adjustments obtained in one country against companies whose assets reside in another country, will usually refer, in their contracts, all disputes to commercial arbitration rather than to litigation.

It was said for some time that arbitration was cheaper and more efficient than litigation. Whether this was true in the past (and this was debatable) that distinction appears to have disappeared altogether now having regard to the tendency to use similar legal representation in arbitration as was previously occurring in litigation, and having regard to substantial increases in efficiency in the Court processes in Australia.

In Sydney and Melbourne, there are specialist building and building cases lists in the Supreme Court. An action will usually proceed through all of the pre-trial steps, in those lists, in 6-12 months, depending on the numbers of parties.

TREND TOWARDS ADR?

Alternative dispute resolutions (ADR) has not changed much in the last few years; it has simply become more respectable. Interestingly, in contrast to my views some years ago, arbitration has declined substantially in Australia in favour of mediation. In particular:

1. the number of arbitrations referred to the Institute of Arbitrators Australia (for example) has declined dramatically over the last few years (though this is also true, perhaps, of disputes in court);
2. some very prominent retired judges have, in recent years, commenced to perform mediations on a regular basis;
3. many commercial organisations have publicly (I can recall a particularly prominent series of advertisements by ACDC) and privately confirmed their distaste for prolonged litigation in favour of mediation (in one form or another);
4. there is a trend among cases in the Victorian Supreme Court Building Cases List to mediation, and, as occurred in the County Court Building Cases List earlier, the success rate of settling such cases has been extremely high;
5. a number of major projects in Australia have incorporated, as a first step in the dispute resolution procedure, a requirement to refer the dispute to the organisation heads of the respective disputants;
6. a number of major USA projects have successfully adopted a disputes panel procedure on the project (I am not aware of this occurring on an Australian project yet, though this is inevitable);
7. the use of **partnering** techniques is (perhaps inexplicably?) having undoubted effects in reducing disputes.

These indicators, though substantially anecdotal, all suggest that arbitration is decreasing in Australia in favour of mediation or some other form of ADR.

In addition to the above, it is apparent that on most (perhaps all) major projects being negotiated in Australia over the last 2-3 years, the additional step of having any dispute referred to the Chief Executive and/or Managing Director of the parties as a pre-condition to taking any steps to either arbitration or litigation of any disputes is being included.

This suggests a major change in attitude in commercial parties to major contracts, namely that there is a genuine preference for a negotiated settlement rather than a strategic battle.

4.2 NON-CONTRACT REMEDIES UNDER ENGINEERING CONTRACTS

TRADE PRACTICES REMEDIES

The *Trade Practices Act* ("TPA") was passed by the Commonwealth Parliament in 1974. At the time it was a fairly novel piece of legislation purporting to regulate dealings with consumers. Constitutional limitations of the Federal Parliament generally limited the application of the Act to corporations under the Federal corporations power. Each State has now passed legislation with provisions similar to those found in the TPA which deal with misleading and deceptive conduct. In Victoria the *Fair Trading Act* ("FTA") was passed in 1985. Section 11 is based on Section 52 of the TPA, however it is expressed to apply to all persons not just corporations. Section 52 provides, so far as relevant, as follows:-

Misleading or Deceptive Conduct -

(1) A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

The three key concepts in Section 52 TPA and Section 38 FTA are as follows:

(i) *"in trade or commerce"*

In **Re Kuringai Co-Operative Building Society (No.12) Limited** (1978) 36 FLR 134 at page 167 His Honour Mr Justice Dean said:-

"The terms trade and commerce are not terms of art. They are expressions of fact and terms of common knowledge."

This has been the basis for the interpretation of the phrase "in trade or commerce". Those terms encompass many activities. In the same case His Honour the Chief Justice of the Federal Court Mr Justice Bowen said at page 139:-

"The terms trade and commerce are ordinary terms which describe all the mutual communings, negotiations, verbal and by correspondence, the bargain, the transport and the delivery which comprise commercial arrangements... The word trade is used with its accepted English meaning: traffic by way of sale or exchange or commercial dealing".

There are a number of examples. In **Larmer v. Power Machinery Pty Ltd** (1978) 20 FLR 490 the display of a brochure in the foyer of the defendant company was held to constitute a representation in trade or commerce. In **Bevanere Pty Ltd v. Lubidineuse** (1985) 7 FCR 325 the Federal Court held that the sale of a cosmetic clinic by a company which was not engaged in the business of selling such capital assets was nevertheless a transaction in trade or commerce. In **Menhaden Pty Ltd v. Citibank NA** (1984) 1 FCR 542 the Federal Court held that if the provision of information or advice by a corporation was shown to have been in trade and commerce and to have been misleading or deceptive, the mere fact that the information or advice was provided gratuitously would provide no defence to a claim based on a breach of Section 52.

In the construction industry representations are often made which do not become part of the contract. For example:

- the owner often provides geotechnical reports which give:
 - a factual report of what was encountered on investigation;
 - an extrapolation from such information as to the ground conditions likely to be encountered.
- bills of quantities "measure" the building work to be performed.
- other advice at pre-tender meetings which relates to a wide range of issues which may dictate how the work can be performed.

If these are wrong, and the builder has no contractual right to an adjustment, he may be able to obtain a remedy under Section 52.

(ii) *"engage in conduct"*

"Engaging in conduct" is defined in Section 4(2) of the TPA and includes:

- (a) doing or refusing to do any act;
- (b) giving effect to a provision of a contract or arrangement; and
- (c) arriving at or giving effect to an understanding.

The person alleged to have been in breach of section 52 must have been engaging in conduct which was misleading or deceptive.

The word "conduct" is defined in Section 4 of the Act. It has been held to include a wide variety of activities including representations, silence, providing advice and passing off.

There is a limitation on the concept of "engaging in conduct" in that innocent third parties may avoid liability for false representations which they unwittingly pass on. In **Gardam v. George Wells & Co. Limited** (1988) 82 ALR 415 Mr Justice French in the Federal Court said:

"The innocent carriage of a false representation from one person to another in circumstances where the carrier is and is seen to be a mere conduit, does not involve him in making their representation."

His Honour qualified this by going on to say:

"When, however a representation is conveyed in circumstances in which the carrier would be regarded by the relevant section of the public as adopting it, then he makes that representation."

If, therefore, advice is passed on by a third party, that third party will only be liable if that third party has adopted" the advice. For example, if an architect passes on the advice of a quantity surveyor to his

owner, without more than a with compliments slip or a short covering letter, the architect may be said not to have adopted the advice. If, however, the architect provides his own comments in relation to the advice or represents that it is correct, the architect may be liable under section 52 (if the advice is misleading or deceptive).

(iii) *"Misleading or deceptive or likely to mislead or deceive"*

The word "mislead" has been interpreted to mean to lead into error an ordinary member of the public likely to read the statement or to be influenced by it: **Keehn v. Medical Benefits Fund** (1977) ATPR 40-047. Similarly, the word "deceive" means to cause to believe what is false, to lead into error, etc. The broad interpretation of these words, as developed in the cases, has resulted in a wide range of activities being within the scope of the consumer protection legislation.

An injured party need not show that the person alleged to have misled or deceived him **intended** to do so. Section 52 can be breached through unintentional or inadvertent conduct which misleads or deceives.

In determining whether specific conduct is misleading or deceptive, the Court must consider the class of persons who are misled or deceived, or who are likely to be misled or deceived. The relevant persons considered are those who are exposed to the conduct in question and who are prospective purchasers of the goods or services to which the conduct relates. Thus, if the statements about a particular product are made on a television broadcast which is televised in the Melbourne district, the class of persons will be the prospective purchasers of the product in the Melbourne district.

In **Parkdale Custom Built Furniture Pty. Ltd. v. Puxu Pty. Ltd.** (1982) ATPR 40-307, the Chief Justice Mr Justice Gibbs examined the stages involved in determining whether the conduct is prohibited. His Honour said that while ordinarily the class of customers considered may include the inexperienced as well as the experienced, and the gullible as well as the astute, whether the conduct is misleading or deceptive will be determined by its presumed effect on reasonable members of the class exposed to the conduct.

Puxu had manufactured a distinctive range of lounge suites under the name "Post and Rail". It had advertised its furniture extensively and was noted for its distinctive design. Parkdale manufactured a range of furniture which was of a closely similar design to that of Puxu's, but Parkdale's furniture was labelled so as to dispel any confusion between the suites. Puxu commenced proceedings against Parkdale for an injunction to restrain Parkdale from selling its furniture on the basis that its conduct was misleading or deceptive. Puxu brought evidence to show that consumers had purchased Parkdale's furniture with its label removed, mistakenly believing it to be "Post and Rail" furniture.

Puxu was ultimately unsuccessful. Some of the important features of the High Court judgment were:-

- (a) the words "likely to mislead or deceive" add little to the section, their major effect is to make it clear that evidence that the conduct in question actually deceived or misled persons is not necessary for a successful application;
- (b) in order to prove a contravention of the legislation, it is not sufficient to prove that the conduct complained of was confusing or caused people to wonder whether the two products had the same source;

- (c) the Court must decide **objectively** whether the conduct is misleading, evidence that relevant members of the public had been misled is not conclusive; and
- (d) if an article is properly labelled as to who the name of the manufacturer or the source of the article, its close resemblance to another article will not mislead an ordinary reasonable member of the public.

There are circumstances in which silence may constitute conduct which is misleading or deceptive. A statement may be untrue because of what it fails to say as well as because of what it says directly.

A difficulty may also arise because a word may have a meaning which is known to one group of people but not others. For instance, it may have a particular technical meaning amongst persons with a special knowledge in that area, but if the word is used in statements made to persons outside of that group, it may be misleading because the persons exposed to the statements are not aware of its technical meaning. Thus a statement which is otherwise not misleading may become misleading to persons lacking the special knowledge.

The failure of the person to whom the conduct is directed to check the accuracy of a statement or conduct will not prevent the conduct or statement from being misleading or deceptive. It follows from this that it is unnecessary to prove that any person has suffered loss or damage as a result of the misleading or deceptive statement or conduct. However, evidence of such loss will be relevant in determining the amount of damages, if any, the Court may award.

The Courts originally found it difficult to determine whether a promise made or prediction given was misleading or deceptive without undertaking an investigation of the mind of the person giving such promise or prediction. Section 51A of the Trade Practices Act was introduced in 1986 to overcome this difficulty. That section deems a representation as to a future matter misleading unless the corporation has reasonable grounds for making it. The corporation must prove the existence of reasonable grounds for making the statement in order to avoid the representation being misleading. An equivalent provision is made in section 37 of the FTA, expressed to apply to persons rather than corporations.

A contravention of the legislation may occur from giving a misleading general impression, even though the statement itself is true. Mr Justice Stephen in the **Hornsby Building Information Centre** case (1978) ATPR 40-067 (at page 17,690) reasoned:

"To announce an opera as one in which a named famous prima donna will appear and then to produce an unknown young lady bearing by change that name will clearly be to mislead and deceive. The announcement will be literally true but nonetheless deceptive, and this because it conveyed to others something more than the literal meaning which the words spelled out."

An overall misleading or deceptive impression may not be overcome by the use of fine print qualifications or fine print terms and conditions. It is the impression gained by a reasonable person in the class of the public exposed to this statement or conduct which is to be considered.

Causal link between conduct and loss

The person alleging a loss or damage must show a causal link between the conduct and the loss suffered.

For example, in **Bond Corporation Pty. Limited v. Thiess Builders Pty. Ltd. & Ors.** (1987) 71 ALR 615, Bond Corporation engaged a firm to act as consulting and supervising engineers for road, earth and drainage works. Following the calling of tenders, and acting on the advice of the consulting engineers, Bond engaged a builder to carry out the works. Bond brought an action against the consulting engineer, alleging that the firm misrepresented its experience and expertise in the design and supervision of the works, and its ability to provide competent engineers with sufficient experience and to provide accurate estimates of work and subdivisional costs. Bond claimed that as a result of it relying on the consulting engineer's advice it would have to pay more than \$5.4M in excess of the estimated total cost of the development.

It was held by the Court that section 52 of the Trade Practices Act was applicable to the giving of professional advice by a consulting engineer. The provision of professional advice for reward fell within the class of conduct as it was engaged in "trade or commerce". The consulting engineer was found to have misrepresented its experience and expertise. However, Bond failed to establish a causal link between the misleading conduct and the damage.

ESTOPPEL

This paper is not the convenient forum to deal with the complex paper of estoppel. It may be helpful here, however, to attempt to put estoppel in context in dealing with liabilities outside the contract.³ The Australian High Court has considered estoppel, in its various forms, in three significant recent judgments.⁴

In **Waltons Stores (Interstate) Ltd v Maher**, the High Court ultimately found in favour of a party to an Agreement to Lease which had not been finally executed, not on the basis of contract (a contract had **not** been formed) but on the basis of "promissory estoppel" arising out of the **conduct** of the parties.

The conduct consisted of correspondence leading the other party to believe that the Agreement to Lease would ultimately be executed, failure to take steps to prevent the other party from acting on the basis of a concluded contract...standing by in silence when it must have known that the other party was proceeding on the basis that the agreement had been concluded. A further factor was the urgency of the required works and the tenor of the correspondence from the solicitors for the other party suggesting that exchange would be a mere formality.

The High Court first rejected the doctrine that estoppel acted only ever as a shield and never as a sword:-

³ A detailed discussion of estoppel in Australia is provided by A. Leopold in his excellent article, " *The Elements of Estoppel*", (1991) 7 BCL 248.

⁴ The cases were **Waltons Stores (Interstate) Ltd v. Maher** (1988) 164 CLR 387; **Foran v. Wight** (1989) 88 ALR 413; **The Commonwealth of Australia v. Verwayen** (1990) 95 ALR 321.

*"...there has been for many years a reluctance to allow promissory estoppel to become the vehicle for the positive enforcement of a representation by a party that he would do something in the future. Promissory estoppel, it has been said, is a defensive equity...and the traditional notion has been that estoppel could only be relied upon defensively as a shield and not as a sword...but this does not mean that a Plaintiff cannot rely on an estoppel. Even according to traditional orthodoxy, a Plaintiff may rely on an estoppel if he has an independent cause of action where in the words of Denning LJ in **Comb v. Combe**...the estoppel 'may be part of a cause of action, but not a cause of action in itself'".⁵*

[emphasis added]

The Court was willing to find a remedy in the absence of a contractual relationship:-

"...but the Respondents ask us to drive promissory estoppel one step further by enforcing directly in the absence of a pre-existing relationship of any kind a non-contractual promise on which the representee has relied to his detriment...the principle objection to the enforcement of such a promise is that it would outflank the principles of the law of contract..."⁶

The Court considered a number of cases and sets of circumstances relating to varying kinds of "estoppel". The basis for its ultimate conclusion was the nature of equitable remedies per se:-

"...one may therefore discern in the cases a common thread which links them together, namely, the principle that equity will come to the relief of a Plaintiff who has acted to his detriment on the basis of a basic assumption in relation to which the other party to the transaction has "played such a part in the adoption of the assumption that it would be unfair or unjust if he were left free to ignore it"...equity comes to the relief of such a Plaintiff on the footing that it would be unconscionable conduct on the part of the other party to ignore the assumption".⁷ [emphasis added]

The issue of estoppel came again before the High Court two years later in **Foran v. Wight**. In that case, the purchasers of a \$75,000 property had made settlement on 22 June 1983 an essential term and required the Vendor to register a plan containing a right-of-way affecting the property. On 20 June 1983, two days before the date fixed for completion, the solicitor for the purchasers telephoned the solicitor for the vendors and were advised that the right-of-way had not been registered. The purchasers' solicitor advised that he would seek instructions. Nothing occurred on the day of settlement. Two days later the purchasers served a Notice of Rescission and the dispute went all the way to the High Court. The High Court concluded, inter alia, that the purchasers were entitled to rescind and to obtain a return of their deposit.

Deane and Dawson JJ concluded that the vendors were estopped from asserting that the purchasers had failed to tender on the date for completion (because the purchasers had been induced by the vendors into believing that this would not be necessary).

⁵ per Mason CJ & Wilson J at pages 520-521.

⁶ Ibid; at page 521.

⁷ per Mason CJ and Wilson J, at page 524.

Deane J said, at page 448:-

*"...in **Walton Stores (Interstate) Ltd v. Maher**...I explained in detail the reasons which lead me to conclude that the assumed state of affairs under an estoppel by conduct can provide the factual foundation of a cause of action and that estoppel by conduct (in its emanation commonly described as "promissory estoppel") may preclude departure from a represented or assumed future "state of affairs" in at least certain categories of case. A case such as the present which involves a representation between parties and a pre-existing contractual relationship that one party is dispensed from strict performance of the contract clearly falls within one such category of case...In any event, I am now prepared to take the step which I refrained from taking in **Walton Stores**... and to accept the doctrine of estoppel by conduct extends, as a matter of general principle, to a representation or induced "assumption of fact or law, present or future"...Once it is recognised that promissory estoppel is probably to be seen as no more than an instance of the general doctrine of estoppel by conduct (see **Walton Stores**....) there remains no valid reason in principle why that general doctrine should not apply to a representation of future facts".*

[emphasis added]

The High Court considered estoppel again in **Commonwealth Australia v. Verwayen**. In that case, Mr Verwayen had been a member of the Royal Australian Navy on HMAS Voyager when their ship had collided with HMAS Melbourne in 1964. He issued proceedings in November 1984 claiming damages. In its Defence, the Commonwealth admitted liability and did not plead the Limitation of Actions Act defence, nor did it plead that it owed no duty of care to the Respondent. The Commonwealth had repeatedly stated that it had adopted a policy not to contest liability and not to plead the Act in similar cases. The Commonwealth reconsidered that policy in November 1985 and ultimately raised both defences. The High Court concluded 4:3 that the Commonwealth was estopped from disputing liability to the Respondent for damages on the basis that it was estopped by its conduct.

The Court was uniform in its reasoning to the effect that the central principle of the doctrine of estoppel by conduct was that the law would not permit an unconscionable departure by one party from the subject matter of an assumption which had been adopted by the party as a basis of some relationship, course of conduct, act or omission which would operate to the other party's detriment if the assumption were not adhered to for the purposes of the litigation. The judgments differed, however, in assessing whether in fact the Respondent had suffered any detriment related to the unconscionable conduct. Importantly, the High Court seemed to be moving towards uniformity in the general doctrine of estoppel. At page 330, Mason CJ said:-

"...that brings me to estoppel, a label which covers a complex array of rules spanning various categories. There are the divisions between common law and equitable estoppel, between estoppel by conduct and estoppel by representation, and the distinction between present and future facts. There are titles such as promissory estoppel, proprietary estoppel and estoppel by acquiescence. Yet all of these categories and distinctions are intended to serve the same fundamental purpose, namely "protection against the detriment which would flow from a party's

change of position if the assumption (or expectation) that lead to it were deserted)" (emphasis added).

And at page 331:-

*"In conformity with the fundamental purpose of all estoppels to afford protection against the detriment which would flow from party's change or position if the assumption that lead to it were deserted, these developments have brought a greater underlying unity to the various categories of estoppel. **Indeed, the consistent trend in the modern decisions points inexorably towards the emergence of one overarching doctrine of estoppel rather than a series of independent rules...**" [emphasis added]*

In combination with restitution, estoppel may provide remedies where the contract fails to do so.

UNCONSCIONABLE CONDUCT

A more complex area, again, arises in the area of "unconscionable" conduct. The old cases recognize that an unconscionable contract might be set aside. The modern type of unconscionable contract case, however, is potentially, extremely far-reaching as to the conduct of parties.

In **Commercial Bank of Australia Ltd v. Amadio** (1983) 151 CLR 447 a bank agreed to reopen the company account of the plaintiffs' son on condition that the overdraft was secured by a mortgage on property owned by the plaintiffs. The plaintiffs were old and had only a limited knowledge of written English. The company became insolvent and the plaintiffs sought to be released from the deed. On appeal to the High Court, it was held that the bank was guilty of unconscionable conduct in failing to properly advise the plaintiffs in view of their disadvantage. The Court allowed the contract to be set aside.

The effect of the High Court **Amadio** decision has been dramatic. (For example, lending contracts, now, usually require independent legal advice to be obtained by a person in a position of Mrs Amadio.) The critical factor in the **Amadio** decision, and no doubt in future cases, will be the inequality of bargaining power between the parties.

This is a major example of the development of contract beyond "black letter contract law" in recent times, based upon the conduct of the parties rather than the strict enforcement of the original agreement.

More recently, amendments to the **Trade Practices Act** have created express rights to bring a civil action where there is "unconscionable conduct".