Chapter 1

The Australian legal system

This chapter describes the legal landscape in which construction law and projects operate in Australia today. Its primary focus is upon the development and key features today of the two main sources which make up the landscape: enacted law (legislation) and judge-made law (case law). As will be seen, the "Australian legal system" may more accurately be described as nine legal systems, not one: legislation and case law is made within nine separate (though interrelated) State, Territory and Federal systems.

LAW AND LEGAL SYSTEMS

[1.1] Almost every aspect of life in Australia is regulated or influenced by the legal system. Most people living and doing business in Australia are, however, either unaware, or have little understanding, of law and justice, the sources of law or the common law system. More would be familiar with the creation of law by legislation and court decisions and most people would recognise that courts and parliaments are the main legal institutions.

As the law increasingly impinges on the activities of citizens, it is important that they be familiar with the legal system and how it operates. Participants in the construction industry, particularly, need to be aware of the legal system because of the degree to which it controls and regulates their activities.

Nature and definition of law

[1.2] Use of the term "law" will vary according to user and context. The law of the land is the sum total of all of the rules by which the legal system regulates society. In a more general context, the law refers to the whole legal system including institutions, machinery, rules and the personnel who operate them. The use made of the term "law" in this text will vary, although, as the title "Construction Law in Australia" suggests, it will be mostly concerned with those rules created within the legal system, and the parts of the system which apply to the processes of, and participants in, the construction industry.

The nature, origin and role of law in any community are dependent upon its socio-political system. In general, the law is an expression of the community's guidelines for acceptable behaviour. The law is a system of rules imposed by a supreme authority in a politically-organised society, and recognised by the members of that society as governing or regulating their conduct and intercourse, one with another.

Although our society expects the law to operate in a just and fair way, it does not follow that every application of the rules will produce justice. The legal system will always be able to reach a conclusion in a case presented to it for judgment but the decision will only rest on the applicable legal principles in each case. This may not be in accordance with what each litigant, or any outsider, sees as the justice of the situation. The law is concerned with justice, but it would be impossible to simultaneously satisfy everyone's concept of justice in every situation.

Legal systems

[1.3] Legal systems in modern societies of European origin derive from one of two distinct origins: English law and Roman law. Where Roman law applies, the jurisdiction is called a "civil law" country. There, the fundamental source of law is in the written code of laws to which the decisions of judges provide a gloss or overlay, but not a binding interpretation. Court procedure in civil law jurisdictions is described as inquisitorial, with the judge controlling the progress of a case, calling and examining witnesses, actively investigating the circumstances to find the truth. Most European countries have civil law systems, as do the countries across the world which developed under disparate European influences.

The English legal system is referred to as a "common law" system, and has been adopted in countries having historical ties with England. The fundamental concept of a common law jurisdiction is the "doctrine of precedent", by which a judge's decision will determine or influence the decisions of judges in later cases and inferior courts. The function of a judge during a case is to oversee the adversarial or accusatory nature of the proceedings, and to determine those proceedings. The decision is only about those issues before the court, and the judge's role is more like that of an umpire reaching a decision based on the relevant merits of the evidence and the arguments put before the court.

In a common law system, there are two sources of law:

1. *case law*, which consists of the laws evolved through judicial decisions; and
2. *statute law*, which is that created by Parliament by means of legislation passed directly, and by "delegated" legislation.

In that Australia inherited its legal system from England, it is a common law system. As with any development in isolation, however, differences have emerged as Australian legislatures and judiciaries assert their independence.

The Torrens system of land title by registration, and the strata title system of title to air space (both of which are discussed in Chapter 7) are significant innovations developed in Australia; as was the system of settling industrial disputes by conciliation and arbitration (see Chapter 13). Yet the ties to other jurisdictions are strong, both with the principles of English law and with the law of other jurisdictions in which they are applicable, mainly other nations of the former British Commonwealth.

In this text, references will not only be made to Federal-level Australian cases, but also to cases from all States and Territories of Australia, and to those from jurisdictions such as the United Kingdom, New Zealand and Canada. All of these have an influence upon construction law as it applies in the various parts of Australia: for example, a Western Australian Court of Appeal decision will generally bind a trial judge in Victoria. Further, the Australian courts will often look to foreign jurisdictions for guidance where relevant and appropriate within the doctrine of precedent (see [1.19]).

Bearing in mind that, generally, a statute can only apply within the jurisdiction in which it was enacted, a great deal of Australia's legislation is duplicated across the States and Territories. However, far from revealing a coherent picture of regulation, the national legislative blanket is all too often a patchwork displaying pointless and frustrating inconsistency.[1]

LAW IN AUSTRALIA TODAY

[1.4] The applicable law in Australia today is a complex mixture from a number of sources. The original source and still the basis of our law is the law of England. A body of case law principles and statute law was transported to Australia along with the convicts and settlers. The British Parliament declared in 1828 that all the laws in force in England at that time (statute and case law) which were applicable to the conditions in the colonies should apply to New South Wales and Van Diemen's Land. The other colonies and the Territories similarly "received" the law of England and established court systems to administer the law with the Judicial Committee of the Privy Council in England as the head of each court system.

As a result, some ancient statutes and principles of English law still apply today. Since the reception of English law, the Australian legal system has developed its own body of case law principles determined by judicial decisions in the State and Federal Courts and its own statutes passed by colonial, then by State, Territory and Commonwealth, legislatures.

Enacted law – legislation

[1.5] Legislation is law made by Parliaments and persons or bodies acting under the authority of Parliament. This definition points to the two

1 See, especially, the discussion on "security of payment" at [3.5].

branches of enacted law: Acts of Parliament (which are called "statutes") and regulations of legislative authority (called "subordinate" or "delegated" legislation).[2] Legislation created in Australia emanates from the Commonwealth Parliament, one of the six State Parliaments, or from the Australian Capital Territory or Northern Territory Legislative Assemblies.[3]

Colonial Parliaments were created by the English Parliament, and in their constitutions each was charged with making laws for the "peace, welfare, and good government" (or similar) of the colonies. From 1865, all colonial Parliaments could legislate independently of English laws, although all legislation was, and still is, subject to Royal Assent from the Governor (see below). Theoretically, the British Parliament still could pass legislation validly applicable to Australian States until 1986, when, by agreement of each State, the Commonwealth and the United Kingdom, independence was achieved.

In 1901, the colonies federated to form the Commonwealth of Australia, to which they ceded certain legislative powers. As States, they retained residual legislative authority over matters other than those specifically granted to the Commonwealth. It is not uncommon for the constitutional validity of a statute to be challenged in the courts. If the legislation lies within the competence of the legislature enacting it, then it is binding and cannot be altered except by the same legislature. If Parliament has gone outside its powers in making a law, it can be declared void in whole or in part. In those matters where both State and Federal Parliaments may legislate, to the extent to which a State law is inconsistent with a Federal law, the State law is inoperative.

The Commonwealth of Australia was created with the power to make laws on a specified range of subjects enumerated in s 51 of the Commonwealth *Constitution*, itself an Act of the British Parliament. Legislative independence from Britain was guaranteed by the *Statute of Westminster 1931* (Imp), but all legislation must have "Royal Assent" from the Governor-General (in the case of the States the State Governors or, for the Northern Territory, the Administrator; there is no equivalent office-holder in the Australian Capital Territory, where Bills come into force when they are "notified" in the Legislation Register by the authorisation of the Chief Minister). In practice, as is the case with the giving of Assent to legislation in the UK by the Queen, such a step is nowadays a mere formality in practice, though it has important and abiding historical significance.

Some powers are exercised exclusively by the Commonwealth, but most are exercised jointly or concurrently with the States and Territories. Many of these exclusive Commonwealth heads of power under the *Constitution* cover

2 See, further, [1.8]-[1.9].

3 Unless otherwise stated, references to Australia's "Territories" in this text are to the Australian Capital Territory and Northern Territory, not to the various "external" Territories (including the Australian Antarctic Territory, Christmas Island and Norfolk Island).

subjects which would clearly be the responsibility of a national Government, such as overseas trade, defence, foreign affairs, immigration, currency and interstate trade. The Commonwealth may also legislate over areas such as marriage and divorce, social welfare allowances, bankruptcy and insurance.

Since 1901, the Commonwealth has been able to extend its jurisdiction beyond the specific legislative powers in various ways. Interpretation of the Australian *Constitution* by the High Court has often been favourable to greater Commonwealth power, for example, over industrial matters, or by the use of the foreign affairs powers in *The Tasmanian Dams Case*.[4] Recent Commonwealth legislation based on the "corporations" and "interstate trade" powers under the *Constitution* has expanded the intervention into areas previously regarded as within the province of the States (for example, the 2005 and 2010 industrial relations workplace reforms).[5] This process is likely to expand and, in the interest of consistency, might be encouraged.

On the other hand, the *Constitution* may be formally altered by referendum, though Australians have rarely voted to accept such change to the extent required under the amendment mechanism: this requires that a majority of electors in a majority of States vote in favour of the amendment, and that overall there is a majority in favour across the nation (including those voting in the Territories).[6] The States may also agree to transfer their powers (as occurred with the power to raise income taxes during World War II), or to pass uniform legislation modelled on Commonwealth Acts, or through agreement to pass uniform legislation: for example, the application of the *Building Code of Australia*[7] and the recently-introduced reforms of occupational health and safety law and consumer law.

Through the allocation of funds in the budget, the Commonwealth may also extend its control into areas otherwise the preserve of the States, for example, education, health and public works capital expenditure. The Northern Territory and the Australian Capital Territory now have power to make statute law, albeit limited, reducing the sphere of Commonwealth power.

Harmonisation – Uniformity

[1.6] To encourage the development of consistency in national and State/Territory legislation, the Council of Australian Governments (COAG), has established working groups to ensure consistency and the saving of costs for commerce. The Standing Committee of Attorneys-General (SCAG) has similar objectives, though they are rarely achieved. There are a number of aspects of the law which impact upon the construction industry which

4 *Commonwealth v Tasmania* (1983).

5 See [3.23].

6 *Constitution* s 128.

7 See, primarily, [3.11].

require some attention by these bodies, including proportionate liability and security of payment.

The parliamentary system

[1.7] Legislation in Australia is made by, or with the authority of, Parliaments. Parliaments are an expression of the democratic form of government practised in this country, which also has the distinguishing features of being a federation and, currently, a constitutional monarchy. Australia follows a Westminster style of government with ministerial responsibility (meaning that Ministers, including the Prime Minister, must be elected to Parliament and answerable to it),[8] and to some extent a separation of the legislative, executive and judicial functions of government.

Australia remains a constitutional monarchy. This means, somewhat anachronistically, that the monarch for the time being of the United Kingdom is also the Head of State of Australia (as she is of several other former British Dominions). The Queen or King does not, however, have absolute power. The monarch reigns, but governs only with the advice and consent of Parliament. However, as was noted above, all legislation in Australia must obtain the "rubber stamp" of Royal Assent from the Queen, through her Vice-Regal representatives (the Governor-General, State Governors or Northern Territory Administrator), before it becomes effective.[9]

Houses of Parliament. Australia has a Federal Parliament, six State Parliaments and two Territory legislatures. Most Parliaments are bicameral, having an "upper" and "lower" house. At Federal level these are the Senate and the House of Representatives. The Senate was designed as a States' house with equal representation from each State, and now also representation from the Territories. The House of Representatives is elected from single member constituencies on a direct franchise. Legislatures at the State level consist, with the exception of Queensland, of a Legislative Council which acts as a house of review, and a Legislative Assembly or House of Assembly. Members of upper houses are appointed or elected; the lower houses are elected either by direct or proportional representation. The Territory legislatures, and that of Queensland, are unicameral.

The government. When elections are held, the party (or a coalition of parties commanding a majority of seats) will be asked by the Queen's representative to form a government. The leader of that party becomes the Prime Minister, Premier or Chief Minister. The policies of the majority party (or, where a party is unable to command a majority in its own right, as happened at Federal level in 2010, those of the party which has the support of sufficient

8 *Constitution* s 64.

9 As to the ACT, see [1.5] above.

minor party and independent members) will form the basis of legislation enacted during the life of the Parliament.

The Cabinet and Ministers. From the ranks of elected representatives of both the Upper and Lower Houses, the leader of the majority party appoints Ministers of the Crown, who are placed in charge of government departments, and forms a Cabinet, comprising some or all Ministers. Individual Ministers are responsible to the Parliament for the operation of their portfolio, that is, answerable for their actions and those of their public servants. A major administrative function of a department is to prepare legislation for the Parliament, and the delegated legislation, the detail of regulations necessary to execute the broad outlines of legislation created by Parliament.

Creation of statutes

[1.8] A statute usually implements Government policy, determined by Cabinet and based on the party policy and departmental advice. Public and media pressure may lead to legislative change, or it may follow recommendations of law reform commissions or other inquiries. An individual member of Parliament may also propose a "private member's Bill". This has rarely happened in recent years. It occurs more often where neither major party has a majority and the Government controls the "hung" Parliament with the support of minor parties and independent members (such as occurred at Federal level from late 2010).

The procedure for creating a statute is essentially the same in both the Federal and State Parliaments and in the Territory Legislative Assemblies. Once Cabinet decides on a proposed law, the relevant Minister is responsible for drafting the Bill. This is done by parliamentary drafters, with advice from the department and, where appropriate, community consultation. The Bill is drafted in the form of numbered clauses and schedules.

The Minister introduces the Bill, usually to the Lower House of Parliament, where it must undergo three "readings" and where it is debated and may be amended by the legislature. When the Bill has passed the two houses (or single house, in the case of the Australian Capital Territory, Northern Territory and Queensland), it is submitted (other than in the ACT – see [1.5]) to the Governor-General, Governor or Administrator for Royal Assent. Once assented to (or, in the ACT, "notified"), the Bill becomes an Act, the clauses become "sections" and statute law has been created.

Delegated legislation

[1.9] Whilst legislation enacted by Parliament is an important and ever increasing source of law in the Australian legal system, a more voluminous source is subordinate or delegated legislation. The names by which such legislation is known will vary, and include Ordinances, Regulations, By-laws, Schemes, Rules and Orders-in-Council. In practice, the construction industry

is significantly influenced by delegated legislation, for among the activities controlled by it are building regulations, including the *Building Code of Australia* (BCA), construction safety regulations, traffic regulations and offences, industrial awards governing conditions of employment, and the activities controlled by local government. Much of the law applicable to the construction industry, both in what may be built and where, and the manner in which it is built, is to be found in delegated legislation.

The validity of delegated legislation will depend upon the authority granted by Parliament to the particular council, Minister, department, commission or body from which the regulations emanate, and whether the legislation is within the powers of the body creating it or if it is *ultra vires* or outside the body's powers.

Whatever the form, the creation of delegated legislation must begin with the grant by a legislature to a competent authority of the power to make regulations within some defined scope. Usually, power is given to the Governor- (or Governor-General)-in-Council, and to Ministers of the Crown, government departments, local government councils and other statutory authorities. If delegated legislation is made within the limits of the powers granted, it is as effective in law as laws passed by Parliament.

Procedures for making delegated legislation will vary with its source, although some general approaches are followed. Consultation with the citizens who will be affected by the regulations often occurs, and indeed some Acts make this procedure essential. Regulations concerning industrial arbitration or conditions in shops, factories or on building sites are usually made in consultation with both employer and employee organisations. Industrial awards are forms of delegated legislation, and they are made only after hearings involving the parties to the award. Town and country planning schemes or local environmental plans generally will become effective only after a process of publicity, lodging of objections and review, involving interested parties.

Consultation with experts is also a major source of the contents of regulations. There may be advisory committees or boards whose functions are to assist and make recommendations to the regulation-making authority, for example the Australian Building Codes Board (ABCB), which since 1994 has had national responsibility for maintaining consistency in the application of the BCA across Australia. One initiative of COAG is the proposed introduction of a National Building Code based on the BCA.

Delegated legislation may incorporate other documents by reference, a procedure frequently used for codes of practice established by non-government bodies, or standards approved or adopted by a designated body. Examples applicable to the construction industry are the standards published by Standards Australia which are incorporated into the BCA.

The process of bringing delegated legislation into effect will vary. All Australian jurisdictions have procedures whereby delegated legislation is tabled or laid before each House of Parliament, which may then disallow any

of the regulations. In practice, the level of scrutiny varies between legislatures and depends upon the type of delegated legislation involved. Parliaments do not always take careful interest in this method of law making, although committees to review regulations exist within some legislatures. Publication of the new delegated legislation is usually effected by printing in the *Government Gazette*.

Local government

[1.10] The third tier of government in Australia is the local council, of a city, county, town, municipality, shire or district. Local government does not have a separate constitutional foundation or autonomy; each council is created by a statute of State or Territory Parliament and an elected council may be dismissed by the Local Government Minister. The exception to this is the Australian Capital Territory, in which the Territory government is responsible not only for Territory-wide functions but also for those which elsewhere are devolved to local government, such as waste disposal.

In Australia, local government generally does not play as important a role in government as does its English counterpart, on which it was modelled. Australian local government has no authority over police, education or the provision of housing, for example, but in both countries has wide responsibilities for the local area, particularly in planning and environmental matters. Many of the functions of local government directly affect the building and construction industry. Almost all councils are required or permitted to provide health and sanitary services, maintain public works and services (roads, drainage, recreation facilities, car parking), and to administer town and environmental planning, including development approvals, sub-divisions, zoning and some pollution controls.

With the exception of New South Wales, where Ordinances are made at departmental level and issued by the Governor, most Local Government Acts give local councils power to make their own by-laws, though these may require authorisation by the Governor-in-Council. This means that councils are empowered to make delegated legislation. The legal consequences of this position are that councils must follow the procedures laid down by the Act for making by-laws, and must operate only within the field specified by statute or risk challenge in the courts as to the validity of their regulations. Practical consequences make understanding local government law a cumbersome operation, as one must wade through and apply an intricate web of law contained within the Local Government Act and the by-laws for a particular council area, usually lengthy, frequently amended, infrequently published and subject to interpretation in a multitude of judicial and administrative decisions.

There are about 700 local councils in Australia. All are representative bodies, elected by local residents and ratepayers. The day-to-day administration of the council is carried on by a permanent staff of officers, including

that it is not in itself a taxpayer (although the partners will pay tax on the distributed profits). The firm will be liable for payroll tax, sales tax and stamp duty arising from its business operations.

Dissolution

[4.20] Partnerships may be dissolved or terminated in a number of different ways. In the absence of a special agreement, a partnership ceases on the death, bankruptcy or retirement of one of the partners. The agreement may provide for the firm to be carried on in such circumstances by the surviving or remaining partners. The partnership may also be dissolved by the lapse of time if made initially only for a limited period, or on the completion of the enterprise for which it was formed.

Where provision is made in the partnership constitution for the retirement, replacement or addition of a partner, the business of the firm may continue, but it will be a different firm from the original. The *Partnership Act* accordingly requires that such changes be publicised. Contracts entered into prior to the dissolution will continue to bind the partners unless provision is made for release.

Dissolution is the first step to the winding up of a partnership. The partners' authority and obligations may continue thereafter only for the purposes of winding up and to complete existing contracts. The partnership agreement should make provision for such things as the valuation of goodwill where the business is to continue, and the distribution of assets on final settlement after the payment of creditors.

Chapter 5

Law of contract

The law of contract pervades all aspects of construction projects. Not only does it define and determine the nature of the relationships among principals, superintendents, contractors, consultants, suppliers, sub-contractors, financiers and others as parties to their various contracts, it is also relevant to a wide range of activities and relationships incidental to the main focus of the project.

The law of contract applies to the main construction contract, sub-contracts for specific work, employer/employee relationships, insurance, sale of goods and land, hire purchase, corporations, partnerships and myriad other arrangements all of which impinge on the project in legal terms. An understanding of the law of contract is, therefore, essential to the understanding of construction law.

This chapter considers how the general principles of contract law – primarily formation, interpretation, enforceability, discharge and remedies – apply in the context of construction projects. Specific issues arising under construction contracts, such as variations, payment and obligations as to progress and completion, are discussed in Chapter 9.

THE NATURE OF CONTRACT LAW

[5.1] In Australia, the law of contract is founded principally in the common law, so the focus is upon judgments of decided cases from the courts. Courts are generally reluctant to interfere with the terms of an agreement, although the uninhibited freedom to contract of a laissez-faire economy no longer exists. For example, at common law, terms may be implied in certain types of contracts, contracts may be rendered void for misrepresentation or other "vitiating factors", and certain categories of persons, for example, children and persons lacking the requisite mental capacity, may be restricted in their ability to contract. There are also, as will be seen from other chapters, important interventions upon the common law via statute, for example unfair contract terms and security of payment legislation (see, respectively, [3.15] and [3.5]).

Fundamentally, the law of contract concerns the *legal* enforceability of promises. A promise is legally binding only if it complies with the principles derived from the case law of contract, primarily the elements of formation discussed below. The contract involves an agreement which gives rise to rights and obligations which can both be enforced at law. For this reason, in the eyes of the law, a "contract" refers to the bargain or agreement itself, though in everyday terms most people see the "contract" as being the documentation which records it (or in any case purports to do so).

Basic to the nature of a contract, therefore, is the concept of agreement, or bargain, with each side contributing something to make it binding. In Australia, generally speaking, the law will enforce an agreement only if the parties intended to create legal relations, reached real agreement about the terms on which they will be bound, offered reciprocal promises, acts or the relinquishment of something of value, known as "consideration", and were capable at law of entering such an agreement. Those requirements for enforcement are referred to as the "elements of formation".

Where contracts are in fact formed, the courts may be asked to consider the terms on which they are made, their relative importance and operation, and any terms which may be implied. Rules exist on which contract documents are construed or interpreted.

Further, a contract may otherwise be valid according to the elements of formation, yet be unenforceable at law; for example, where it is to carry out an illegal act or under residential building contracts when the contractor is not licensed.

Contracts may be discharged, that is, the parties being released from their obligations. This is usually by performance however, parties may seek remedies in the event of non-fulfilment by any other party of an undertaking. In addition, statutes place limitations on the time within which an action may be brought to enforce a contract or bring an action for breach of a contract.

FORMATION OF CONTRACTS

[5.2] In order to be legally enforceable, a "simple" contract (being a bargain between the parties with mutually-supporting promises)[1] must satisfy certain technical legal requirements concerning its formation. For a contract to exist, there must be at least two parties who have achieved sufficiently certain agreement as to their respective rights and obligations, and who contemplate that such agreement will be protected, and if need be, enforced, by the law.

To establish the existence of a contract, courts typically look to a number of essential elements of formation. These are categorised in this text, as discussed below, as:

1 See [5.20] below as to unilateral undertakings and other contracts entered into by way of deeds.

- intention to create *legal* relations
- offer and acceptance
- consideration
- capacity to contract.

Having said that, commentators, lawyers and parties often frame the elements in different ways; for example, certainty is sometimes seen as a separate element. Whichever mode of categorisation is used, however, the fundamental exercise is to analyse whether the parties have in fact agreed to contract with one another.

Intention to create legal relations

[5.3] Not all agreements are intended by the parties to create legally-binding obligations. In many informal situations, a party will exchange promises or benefits with an honest intention to be personally bound to perform the promise, yet lack any intention to impose a legal obligation on either party to perform. Despite the existence of all other elements required for a legally-enforceable contract, in this case the parties will not be legally bound.

Therefore, the parties to a contract must, expressly or impliedly, show an intention to create a legally binding relationship. Whilst this is rarely an issue in construction projects, where most arrangements are commercial in nature, it can be important where, for example, friends or family members have an informal arrangement to carry out work. In such a case, the existence or absence of an actual or imputed intention to create legal relations could be crucial to whether the parties look to the law of contract to settle any disputes or have to fall back on extra-contractual legal principles.

Presumptions as to intent

[5.4] Traditionally, the law has applied "presumptions" to decide whether there is the required intention to create legal relations. In personal or family relationships, the presumption is that there is no such intention; conversely, in commercial relationships, the intention is presumed. However, such presumptions can be "rebutted" by evidence in particular circumstances. Furthermore, the High Court has indicated that a presumptions-based approach may be inappropriate in many cases, especially where the relationship sits somewhere between the "personal" and "commercial".[2] Nevertheless, presumption remains a useful starting point for analysis in most cases.

2 *Ermogenous v Greek Orthodox Community of SA Inc* (2002). More recently, Pembroke J in the NSW Supreme Court case of *Tadrous v Tadrous* (2010) has noted that "reference to a presumption may serve only to distract attention from the more basic and important proposition, namely whether the plaintiff has satisfied the onus of demonstrating that there was a contract, including that the parties intended to create legal relations".

Family agreements traditionally have been presumed to be mere social arrangements.[3] However, the presumption can be overcome by evidence that the parties intended to affect their legal position, notwithstanding the domestic or social setting. Where the agreement anticipates substantial reliance by one party upon the other, this will often be an important factor in deciding to overcome the presumption that the contract is not binding.[4]

The circumstances under which the agreement was made provides evidence of the intention of the parties, such as protracted discussions, seeking legal advice, and formal recording of promises. Even if the presumption is not overcome and therefore there is no contract, reliance may form the basis for raising an estoppel binding the defendant to his or her promise (see [5.54]).

In business or commercial arrangements, the contrary presumption, that there *is* an intention to create legal relations, applies. This can often be crucial in construction projects where, for example, there might be a dispute in the future about whether a "letter of intent" is binding upon the parties. Whilst the answer will usually come down to the words used in the document, a party seeking to assert that an agreement entered into in a commercial setting is not contractually-binding upon it will face the difficulty of bearing the burden of proof. In *Banque Brussels Lambert SA v ANI Limited* (1989), for example, the New South Wales Supreme Court held that the party asserting that no legal effect was intended in a "letter of comfort" had the onus of setting aside the prima facie presumption.

This presumption may also be rebutted by a sufficiently strong inference drawn in all the circumstances of the case; from the conduct of the parties; or as is more common, by an express condition that the parties do not intend to be legally bound. This occurs in gambling activities, for example, where the coupon will state that there is no enforceable contract and that the parties are bound in honour only.[5]

"Subject to contract"

[5.5] It is not uncommon for parties to indicate that their agreement is "subject to contract" or a like expression. The High Court considered the legal effect of such words in the case of *Masters v Cameron* (1954) and pointed to the underlying need to ascertain whether the parties intended immediately to be bound by the contract. Thus, depending upon the circumstances, "subject to contract" (and similar expressions) could mean that:

3 See, eg, *Balfour v Balfour* (1919), where a wife could not enforce a promise of her husband to give her money while they were forced by his work to live apart.

4 For example, in *Todd v Nicol* (1957), the plaintiffs moved from Scotland to Australia on the strength of a promise by the defendant to leave her house to them if they provided company for her.

5 See, eg, *Jones v Vernon Pools Limited* (1938).

1. the parties simply want to have their terms restated in a fuller or more precise form in a written contract
2. the obligation to *perform* one or more terms depends (as a so-called "condition precedent") upon execution of the formal documents
3. the parties do not wish to be bound at all unless and until they execute such a document.

In the first two categories, there is a binding contract despite no formal document having been executed, but in the third there is not.

A possible fourth category was suggested in *Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd* (1986) and has been taken up in subsequent cases. This contemplates that the parties intend to be bound "immediately and exclusively" to the terms they have agreed but expect to make a further contract, containing additional terms, in the future and that this will replace their current agreement.

The inevitable difficulty is determining which of these categories applies in the circumstances means that it is impossible, in the abstract, to give a "yes" or "no" answer to the question of whether a "letter of intent" or similar device forms a binding contract.[6] In other words, assuming that the other elements of formation are fulfilled, the answer depends upon the objective determination of the parties' intention at the relevant time.

Offer and acceptance

General principles

[5.6] To find out whether two parties have reached agreement in the formation of a contract, the courts will look for two complementary aspects: an "offer" by one party (the "offeror") and an "acceptance" by the other party (the "offeree").

The offer and acceptance do not have to be formally expressed in precisely identical terms. Inferences can be drawn from the conduct of the parties that they have a similar understanding of the nature of their promises such that a consensus "*ad idem*" (or "meeting of the minds") exists and that they agree to be bound in those terms. There are many situations where conduct alone indicates an intention to be bound.

Agreement may also be explicit in a document signed by the parties, acknowledging the terms offered and accepted, hence, in the vast majority of written and signed contracts occurring in construction projects, it will not be an issue whether there has been offer and acceptance.

Whether the agreement arises from express or implied offer and acceptance, there are well-established legal rules which apply. The offer must be a definite promise to be bound on specific terms. It may be to a particular

6 For an example of such difficulties in practice, see *PRA Electrical Pty Ltd v Perseverance Exploration Pty Ltd* (2006).

person, to a particular class of persons or to the world at large. The general principle is that any person to whom the offer was made may accept it.[7]

The offer must be communicated, that is, brought to the attention of the person to whom it is made. There can be no acceptance and no contract unless the person purporting to accept was aware of the offer at the time when the alleged act of acceptance was made. For example, where a reward is offered for the return of a lost article, a person returning the article who does so without knowledge of the reward would not be able to claim the reward later upon becoming aware of it. The relevant principles are discussed by the High Court in *R v Clarke* (1927).

Where an offeror has promised to keep an offer open for a specified period, such a promise will only be binding if the person to whom the promise is made has given some consideration for that promise; in the absence of such consideration, the offeror may withdraw their offer at any time prior to its acceptance. This rule is important with respect to tenders, and the right of a tenderer to withdraw their tender prior to acceptance.[8]

There are situations which, whilst similar to offers, are not in fact offers. For example, an "option" is an arrangement whereby an owner of specific property, real or personal, agrees with a prospective purchaser, who pays a sum to the owner, that the purchaser has the sole legal right to purchase the property for a stipulated price within a nominated period of time. The effect of such a transaction is that the owner is not free to sell to anyone else within the specified period, and will be liable to the option holder for damages for breach of the option contract if he or she does so.

Invitations to treat and tenders

[5.7] Another important distinction is between offers and invitations to make offers, often called "invitations to treat". The most common such invitation is the display of goods in a shop. In contractual terms,[9] no contract of sale exists until the customer has "offered" to purchase by taking or handing their selection to a cashier, who "accepts" by indicating the total price and taking the purchaser's money. In other words, as far as contract law is concerned, the price indicated on a price tag (and, for that matter, any representation that an item on a shelf is available for sale at all) is an unenforceable "invitation to treat". In practice, this contractual situation has now been substantially modified by fair trading legislation, effectively meaning that merchants are bound to sell at the advertised price.

Traditionally, the advertisement and calling of tenders, for example, for the construction of a building, have been regarded as no more than an

7 *Carlill v Carbolic Smoke Ball Company* (1893).
8 See [9.5].
9 See *Pharmaceutical Society of Great Britain v Boots Cash Chemists Ltd* (1953).

invitation to treat.[10] In other words, tenders lodged will be offers capable of acceptance by the party calling tenders and the contract will be formed when the acceptance of a particular tender is made by the owner; conversely, no contractual obligations will arise in respect of conduct of the tender process.

This situation has changed substantially in recent years with the recognition that a separate "process" contract may arise where a conforming tender is submitted.[11] In other words, an invitor may be contractually bound, to each tenderer which submits a tender conforming with the request for tender, to conduct the tender process according to the advertised procedure. As an example of the way courts approach the issue of the obligations imposed under process contracts, see *Ipex ITG Pty Ltd (in liq) v State of Victoria* (2010).

Standing offers

[5.8] Standing offers are also common arrangements in construction contracting. These are agreements to supply goods or services at a particular rate and as per agreed terms as and when required.[12] Each order produces a separate contract. A standing offer can be revoked at any time, but only as to future orders.

Defects in acceptance

[5.9] Acceptance must be a complete and unqualified acceptance of the terms of the offer. A conditional acceptance or a counter-offer may constitute a rejection of the original offer which may not later be able to be accepted. However, such a conditional or counter offer may itself be accepted by the original offeror.

Alternatively, it may be that the offeree's response is not in fact a counter-offer and therefore rejection of the original offer but merely an enquiry about the offer. This is a distinction that has great importance as to the contractual effect of the statement but often may be difficult to work out in practice as it will come down to the intention of the parties as manifest through their words and conduct. For example, if a sub-contractor offers to undertake work for $100,000 and the head contractor replies that they will accept their tender if it is for $90,000, this is likely to be a counter-offer; on the other hand, if the head contractor replies, "Could you do the work for $90,000?", this could be seen as simply an enquiry which leaves the original offer open for acceptance.

An acceptance "subject to contract" is generally not an acceptance at all. However, as discussed in [5.5] above in relation to intention to be bound, the

10 For discussion on tendering generally, see [9.1] and following.
11 The ground-breaking case in Australia was *Hughes Aircraft Systems International v Airservices Australia (No 3)* (1997). See, generally, Bell M, "From an Invitation to Treat to an Invitation to Tread... Warily" (2003) 19 *Building and Construction Law* 89 and, as to subsequent cases, Levin D, "The unsuccessful tenderer – legal rights and remedies" (2010) 26 *Building and Construction Law* 324.
12 See, generally, *Synergy Protection Agency Pty Ltd v North Sydney Leagues' Club Ltd* (2009).

use of particular forms of wording may not be the end of the story. Thus, where the language used by the parties discloses an intention in the parties to be immediately bound by the terms they have agreed upon whilst also intending that those terms will be reduced into a formal document, a binding contract exists immediately between the parties. This is often the case in a building contract where the execution of the formal document does not take place until well after the work has commenced.

Problems may arise where parties intending to be bound are in fact not in agreement as to the precise terms of their apparent contract. The tendency for such issues is inherent in construction projects, which involve highly complex obligations and activities yet the agreements are often documented in a shorthand manner. Provided that the parties have agreed upon the terms essential for their contract to operate, this will generally be sufficient for the formation of an enforceable contract; in turn, terms may be implied to fill in any gaps, even as to very important issues like the time within which matters must be undertaken.[13]

Where a tender is conditional, but the acceptance and the formal executed contract do not include the proposed conditions, the contractor generally will not be able to rely on the conditional terms of the tender. It may be that the conditional acceptance constitutes a counter-offer in different terms which may be accepted. The resolution of the "battle of the forms" is generally a question of construction but may be resolved by examination of the offer/counter-offer process.[14]

In the extreme situation where no agreement is eventually reached, or where the Court is unable to find an agreement, there will be no contract. However a party who has carried out work in reliance on the non-existent or unenforceable, contract may, if it is able to convince the court that justice in the circumstances requires that such a remedy be granted, be entitled to a *quantum meruit* (that is, a reasonable sum for the work done).[15]

Time when acceptance effective

[5.10] Acceptance is usually not effective – that is, it does not form a contract – until received by the offeror. A special method of acceptance may be imposed, although an equally expeditious method may be effective. Where no method of acceptance is prescribed, the court will look to the nature of the offer and the circumstances in which it was made in order to determine the appropriate method of acceptance. As a general rule, silence cannot be made a method of acceptance (for example, a statement in the offer along the lines "In the absence of advice to the contrary I will assume

13 See, eg, *Trollope & Colls Limited v Atomic Power Constructions Limited* (1963) and, further, [5.15] and [9.14].

14 See *White Industries Limited v Piling Contractors Pty Limited* (1986), and *Butler Machine Tool Company Limited v Ex-Cell-O Corporation Eng (Limited)* (1979).

15 See the detailed discussion at [5.52].

acceptance").[16] The offeree must indicate acceptance positively by words or conduct.

Where the offeror contemplates and intends that acceptance is to be communicated by post, it will be effective (and a contract is formed) when the letter is posted.[17] Where instantaneous communications, for example fax, are used, the position is different. The acceptance will generally be effective from when it is received, and importantly, the contract will be made at the place where acceptance is received.[18]

Electronic communications, such as email, pose particular issues, especially as to when an email is "received" by the offeree. Whilst the law has been slow to catch up with the detailed implications for contracts of such communications, default positions are set by the *Electronic Transactions Acts* in force in each jurisdiction. Essentially, for example, if an electronic information system has been designated for the purpose of receiving communications, communication is effective once it enters that system but, if it has not been so designated, the communication needs to come to the attention of the addressee in order to be effective.[19]

By contrast with acceptance, *revocation* of an offer will only be effective, meaning that the offer can no longer be accepted to form a contract, when it is *actually* received by the offeree. So long as the offeree learns of the revocation by some reliable means, it will be effective. A revocation by a tenderer communicated to a representative of the principal, for example, the superintendent, will normally be effective and a principal cannot purport to accept on the grounds that the advice was not received personally. See also [9.5] as to the withdrawal of tenders.

Consideration

[5.11] The third essential element in the formation of a simple contract in common law countries like Australia is the presence of "consideration". This is the value or benefit given or promised by one party in return for the other party's promise. Common forms of consideration in construction contracts include the payment of money, the supply of goods and the performance of work.

When asked to enforce an agreement, a court has to determine that something of value has been given which is sufficient in law to support a

16 But see *Empirnall Holdings Pty Limited v Machon Paull Partners Pty Limited* (1988) where a party who had refused to sign a set of conditions was nevertheless found to be bound by them.

17 *Tallerman & Co Pty Ltd v Nathan's Merchandise (Vic) Pty Ltd* (1957).

18 *Entores Limited v Miles Far East Corp* (1955); *Reese Bros Plastics Ltd v Hamon-Sobelco Australia Pty Ltd* (1988).

19 See, generally, Mik E, "The Effectiveness of Acceptances Communicated by Electronic Means, or Does the Postal Acceptance Rule Apply to Email?" (2009) 26 *Journal of Contract Law* 68.

Chapter 9

Key issues in construction contracts

The purpose of this chapter is to examine the special principles, mainly derived from the common law, applying to construction contracts, in a sequence approximating their execution. These special principles often arise as a result of the interpretation of the general form that the contracts take and the methods adopted for the execution and administration of the contracts. The various standard forms of contract are generally described in Chapter 10 and commentary on the detailed provisions of the standard forms is set out in the companion book to this text, *Understanding Australian Construction Contracts* (2008).

TENDERS

[9.1] A tender process is one by which a party invites offers from the market for a contract and then enters into the contract with the tenderer whose offer is preferred. Most construction contracts are concluded after such a tender process. Alternatively, the parties may directly negotiate the price, the conditions and the type of contract: even then it may be, for example, that the head contractor lets its sub-contracts by way of tenders.

The tendering process may be public (that is, it is open for any interested contractor to bid) or the tenders may be selective, in which case the principal invites tenders from a selected group of contractors. Tenderers may be selected by various means; one being the simple preparation of the list by the principal and consultants, and another by selection from those contractors who have responded to a public invitation to register as tenderers.

Most governments (at Federal, State, Territory and local level) also have their own codes and guidelines applicable to tendering. Many of these are in mandatory terms, such that tenderers will not have their tenders considered unless they comply with the relevant provisions. In addition, Standards Australia publishes a Code of Tendering (AS 4190-1994) which sets out the ethics and obligations of the principals and tenderers in the construction industry.

Apart from the requirement to comply with the various codes referred to above, certain practices are prohibited or controlled by statutory provisions. Collusive tendering may amount to a restrictive practice in breach of Pt IV of the *Competition and Consumer Act 2010* (Cth) (which incorporates the previous Pt IV of the *Trade Practices Act* and relevant State-based provisions, such as those of the *Fair Trading Acts* and the *Collusive Practices Act 1965* (Vic)).

Tender documents

[9.2] Typically, the documents issued for the calling of tenders comprise, at least:

- Notices to Tenderers
- Conditions of Tendering
- the Form of Tender document
- the applicable General Conditions of Contract
- the specification and drawings and (if applicable) any bill of quantities.

Ultimately, however, it may be that some only of these documents are included in the contract documentation which is signed. Where a tender is submitted on certain conditions, it is important that the agreement finally signed by the parties incorporates those conditions for them to be effective.[1]

The tender documents should supply a complete set of information necessary for preparation of tenders; however, a common clause in both conditions of tendering and standard form contracts requires the contractor to have inspected the site and examined all information having an effect on the tender.[2] In this situation, tenderers are deemed to have satisfied themselves with regard to the circumstances of their offer and so should exercise care in making inquiries. The principal may owe a duty of care to the contractor and be liable for misleading tender information relied upon by the contractor.[3]

Apart from this potential liability for negligent misstatement if errors or mis-descriptions were contained in tender documents, a contractor relying upon them may also have an action for a breach of s 18 of the *Australian Consumer Law*.[4]

1 See *Cable (1956) Ltd v Hutcherson Bros Pty Ltd* (1969) where a "basis of tender" clause requiring a guaranteed operation of the works could not be relied upon because it was not adequately incorporated into the agreement.

2 See, eg, AS 2124-1992 cl 12.

3 See *Morrison-Knudsen International Co Inc v Commonwealth* (1972). Contrast *Dillingham Constructions Pty Ltd v Downs* (1972) where the principal was not liable on the basis that the contractor had accepted the risk.

4 For cases in relation to s 18's predecessor, *Trade Practices Act 1974* (Cth) s 52, see, eg, *Dockpride Pty Ltd v Subiaco Redevelopment Authority* (2005); *Noor Al Houda Islamic College Pty Ltd v Bankstown Airport Limited* (2005).

Invitations to tender and "tender process contracts"

[9.3] Traditionally, an invitation to tender has, in contractual terms, been regarded as nothing more than an "invitation to treat" (that is, an invitation to submit an offer).[5] In turn, tenders submitted in response are offers capable of acceptance, and only after the principal has accepted one tender will a binding contract for the building works (or other activities the subject of the contract) be formed.

This traditional analysis is now subject to the possibility that a "process contract" might be formed which binds the parties – both the principal inviting tenders and those who submit a conforming tender in response to it – to follow the procedures advertised in the tender documents. Over the past 30 years, courts in New Zealand, Canada, the UK and Australia have found that principals can be liable to unsuccessful tenderers as a result of failing to comply with the procedure prescribed in the tender documents.[6]

The case of *Hughes Aircraft Systems International v Air Services Australia (No 3)* (1997) remains the starting point for process contract analysis in Australia, illustrating both that a process contract might arise where the requisite formation elements apply and the applicable terms of the process contract. More recent cases which illustrate how the principles apply include *Dockpride Pty Ltd v Subiaco Redevelopment Authority* (2005) and *Ipex ITG Pty Ltd (in liq) v State of Victoria* (2010). In practice, the element of intention to create legal relations can be of particular importance, especially where one party (usually the principal) disclaims an intention to create such a relationship via the tender documentation.

Another ongoing area for development in this area of the law is the terms of the process contract (crucial, for example, where it is claimed by a tenderer that the principal has failed to take into account an advertised evaluation criterion). Whilst *Hughes* confirmed that the express terms of the process contract are those which appear in the request for tender documentation, it also raised the possibility of terms being implied into process contracts, where the relevant tests for implication are satisfied (see [5.15]), including a term of fair dealing in public sector tender process contracts.

Recently, there has also been detailed consideration of the extent to which liability arising from a tender process contract can validly be excluded by a term of that contract: see, for example, the discussion by the Supreme Court of Canada in *Tercon Contractors Ltd v British Columbia (Transportation and Highways)* (2010).

5 See, further, [5.7].

6 The relevant cases have recently been summarised by David Levin QC in "The unsuccessful tenderer – legal rights and remedies" (2010) 26 *Building and Construction Law Journal* 324, by Professor Anthony Lavers in "Tender contract developments give hope to the disgruntled" (2010) 5(2) and 5(3) *Construction Law International* and by Bill Napier in "Process contracts in government commercial tendering" (2011) 27 *Journal of Contract Law* 171.

The tender process contract analysis is, in terms of classic contracting theory, a significant development. Quite apart from the possibility that a tender process contract analysis might be used by a disgruntled tenderer in order to claim against the principal, it may also provide grounds for a tenderer to gain access (albeit with appropriate restrictions as to use) to competitors' commercially-sensitive information.[7]

Tenders

[9.4] Tenders submitted should comply strictly with the form and detail requirements of the conditions of tendering. Even a minor failure to comply with the strict requirements, for example, as to the time of submission of tenders, can lead to the exclusion of an otherwise conforming tender. For example, in *Smith and Wilson v British Columbia Hydro Authority* (1997), a tender which was submitted one minute late was found to be unacceptable because to consider the late tender would have been a breach of the "bid contract". Similarly, in *J B Leadbitter & Co Limited v Devon County Council* (2009), the principal was found to have validly excluded a tender from consideration where part of it was submitted in time but some parts of it arrived about half an hour after the deadline.

On the other hand, tenderers may sometimes find themselves being able to have a disregarded bid considered where they can show that the principal has failed to comply with the tender process. It is well established that an erroneous failure to consider a conforming tender may amount to a breach of the tender process contract: see, generally, *Blackpool and Fylde Aero Club Limited v Blackpool Borough Council* (1990). In *Electricity Retail Corporation t/as Synergy v Western Australia* (2008), the principal set aside a tender which apparently arrived 34 minutes late but, due to an ambiguity as to whether standard or daylight savings time applied, the Court ordered the principal to consider the tender.

A conforming tender may include alternative proposals and, in fact, the conditions of tendering may call for alternatives. Generally speaking, and subject to any relevant terms in the tender documentation, so long as the conforming tender was capable of acceptance, there is no reason why an agreement could not be reached on the basis of an alternative proposal.

Proposals submitted by intending contractors sometimes may be referred to as an "estimate" or a "quote". However, the deliberate or inadvertent description of a tender in a submission by a contractor as an estimate may not prevent such an offer from being accepted by the principal. Accordingly, care should be exercised in proffering estimates to ensure that they do not constitute offers capable of acceptance.[8]

7 See, eg, *Griffin Energy Pty Ltd v Western Power Corporation* (2006) where the Court allowed an unsuccessful tenderer to inspect the tender of the successful tenderer in order to ascertain whether it had a cause of action against the principal.

8 See *Crowshaw v Pritchard* (1899) where a contractor gave an "estimate" in response to an invitation to tender which was held to be an offer, and see also *Cana Construction Co v The Queen* (1973).

Tenders may be submitted for the supply of work or materials over a period. In such cases, the tender offer should make it clear whether the offer is merely a standing offer capable of acceptance at any time, or any number of times during the period, or if it is a definite offer that, once accepted, leads to obligations to do or supply a definite specified amount of work or material.[9] If it is merely a standing offer, the tender may be revoked (unless the offeror has agreed to keep it open) prior to the expiration of the period.[10] Maintenance and repair contracts are often drafted in such a form.

Withdrawal of tender

[9.5] A tenderer may revoke or withdraw a tender at any time prior to acceptance, provided that consideration has not been given to maintain the offer (see below). In line with general contract theory (see [5.10]), if a tender is subject to revocation or withdrawal, such action is not effective until actually communicated to the principal. A contractor must act promptly should it be possible and desirable to withdraw, lest the principal accept it in the meantime.

Various limits and restrictions can be placed on the tenderer's capacity to withdraw. The most effective is by means of a preliminary contract supported by a consideration (for example, via a promise by the principal, acknowledged by the tenderer in the tender form, to pay a nominal amount (say, $1.00)) in which the tenderer agrees to keep the offer open. In the absence of such a preliminary agreement, a person who has acted on an offer will have no right to recover damages in contract or in tort where the offer is withdrawn prior to acceptance.[11]

The conditions of tendering may require a security deposit to be submitted with a tender, the security deposit being forfeited if the tender is withdrawn within a specific period. Such a condition does not, of itself, prevent the withdrawal of tender, but provides a disincentive against which the tenderer wanting to withdraw must weigh the loss that may be suffered if the offer is maintained.

Acceptance of tender

[9.6] In line with general contract principles (see [5.9]), an acceptance of a tender must be unqualified. Any conditions which the principal seeks to impose may cause the acceptance to be considered as a counter-offer. In contractual terms, therefore, the situation frequently encountered where the

9 See *Jarvis v Pitt Limited* (1935).

10 See also [5.8].

11 See *Holman Construction v Delta Timber Co* (1972) where a contractor was unsuccessful in an action against a sub-contractor who withdrew a tender offer after the main contract tender was accepted.

principal negotiates the terms of the preferred tenderer's (or tenderers') tender is, in effect, a series of counter-offers leading to final contract formation when all the terms are agreed.

Having said that, it is not unusual for parties to be in general agreement about the conditions on which they will be bound and to proceed on that basis for a long period prior to executing a formal document. Such delay in signing the contract should, however, be avoided to ensure that there is no doubt as to the conditions on which the parties have agreed.[12]

The conditions of tendering and the conditions of contract may make provision for preliminary agreements.[13] Acceptances made "subject to contract" are not binding where the parties have not reached agreement on essential terms.[14] Where the parties have in fact reached agreement, even if the contract details are only settled after work commenced, there is a contract applying retrospectively to the commencement of work.[15] It follows that there may be acceptance by conduct, that is, the intention to accept may be indicated by instructions to proceed with the execution of work the subject of the tender.

Letters of intent

[9.7] Often principals in the construction industry issue what is referred to as a "letter of intent". The consequence of such a document and the actual intention may be that the letter is regarded as an acceptance rather than a mere indication of an intention to enter into a binding contract at some future date.[16]

In many instances, such a letter is intended to operate as an acceptance, particularly where the parties know precisely the conditions on which they are to be bound and are merely attempting to acknowledge that a formal execution of the contract documents is to follow. On the other hand, there will be circumstances where it is intended to operate as nothing more than a preliminary step in the formation of an agreement and part of the negotiation process, in which case there may be no contract. The contractor may nevertheless be entitled to recover any costs incurred in anticipation of the formation of a contract on a restitutionary basis (see below).

Recalling tenders

[9.8] Even the lowest tender submitted may prove to be beyond the expectations of the principal and the estimates of the consultants, in which case

12 See, eg, *Cox Constructions Pty Ltd v Decor Ceilings Pty Ltd (No 2)* (2005).
13 See, eg, AS 2124-1992 cl 6.1 and AS 4000-1997 cl 6.
14 See *Masters v Cameron* (1954) and *Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd* (1986) and the discussion at [5.5].
15 See *City of Box Hill v E W Tauschke Pty Ltd* (1974).
16 See *ERDC Group Ltd v Brunel University* (2006).

the principal may wish to recall tenders and cancel the tender process. Most conditions of tender will, therefore, include a term to the effect that the principal is not obliged to accept the lowest or any tender. The principal may use such a provision to instigate amendments to the design and documents (in order, for example, to seek a lower price) and recall tenders. However, this process may lead to difficulties given that the reductions may constitute a lowering of the general standard required but not necessarily the principal's expectations.

Costs of tendering

[9.9] Tendering costs represent a significant overhead expense for the construction industry: in a major infrastructure project, they may run to hundreds of thousands or even millions of dollars. Even for a small job, tendering can be a time-consuming and costly exercise for an organisation's management and staff. Whilst, occasionally, principals will offer to reimburse all or part of unsuccessful tenderers' costs, as a general rule they are not recoverable.

Various attempts have been made to recover these costs by other means, but they are rarely successful and may amount to a prohibited practice under the various tendering codes referred to above. In New South Wales, for example, a practice developed whereby tenderers agreed to include within their tenders a predetermined amount to be distributed by the successful tenderer to the other unsuccessful tenderers. This practice was held to be illegal and the amount included in the contract sum was recoverable by the principal.[17]

If, however, the tenderer is asked by the principal to carry out preparatory work beyond the mere calculation of tenders, then an entitlement to a claim on a restitutionary basis (see [5.52]) might arise.[18] A claim by a tenderer for preparatory work was accepted in England in *Marston Construction Co Ltd v Kigass Ltd* (1989), but was rejected in *Regalian Properties plc v London Docklands Development Corp* (1995).

Alternatives to tenders

[9.10] Whilst tendering is the norm in the construction industry, it may be that in particular circumstances, the contract can be more efficiently entered into by way of direct negotiation. This is especially the case where the procurement method is not lump sum (though it is entirely possible, and usual, for competitive tender processes to be set up for other means, including

17 *New South Wales v McCloy Hutcherson Pty Ltd* (1993).
18 See *Sabemo Pty Limited v North Sydney Municipal Council* (1977) which was a claim involving preparation of plans and documents concerning a proposed development for the Council.

the reimbursement basis of construction management – see [8.13]) or where the principal has an established relationship with a particular contractor.

Many organisations seek to combine the competitive tension of the tender process with expedited procurement arrangements by establishing, by tender, panels of contractors or consultants: once pre-qualified in this way, panel members can be engaged by an expedited process.

CONTRACT DOCUMENTS

[9.11] Most building contracts are fully comprised in writing, but there is no reason, in general, why they cannot be oral. Some contracts are, however, required to be in writing to be enforceable by the contractor, particularly contracts for domestic or residential building work.[19] Depending on the terms of the legislation, the contractor may nevertheless be able to recover payment for work performed under the unenforceable contract on the basis of unjust enrichment.[20]

Even where a contract is in writing, problems of interpretation or construction may still arise. It is therefore important to understand the various documents which generally comprise building contracts and the role which they each perform. Clearly it is critical to identify all of the documents which are to form part of the contract, particularly where the documents, such as correspondence, would not normally or necessarily comprise the contract.

Contract documents usually comprise the following:

- *Agreement:* the instrument of agreement signed by the principal and contractor (or, in the case of a sub-contract, the (head) contractor and sub-contractor). This often sets out certain contract-specific information such as the date of signing, the parties, the contract works and the name of the superintendent or contract administrator. It may also identify and list the Conditions of Contract document, the drawings, specification, bill of quantities (if any) and all other documents forming part of the contract. Such information may otherwise be found in a "*contract particulars*" section preceding or following the Conditions of Contract (for example, in the AS 2124-1992 form, this is referred to as "Appendix Part A").
- *Conditions of Contract:* the detailed conditions covering the execution of the contract and the procedures to be adopted during the execution of the contract; these may include amendments to a standard form of conditions or a separate set of special conditions.
- *Drawings:* prepared on behalf of the principal (for example, by an architect or engineering firm) and showing the extent and detail of the works to be executed. The extent and level of finality of such drawings depends upon the procurement method and range from preliminary (or no) design in design and construct arrangements through to full documentation in construct-only contracts (see Chapter 8).
- *Specification:* also prepared on behalf of the principal describing in detail the work to be done, standard or level of workmanship to be provided and the materials to be used. In design and construct contracts, this will usually be by way of a "design brief" setting out the key parameters to be achieved by the project.
- *Schedule of rates:* a schedule detailing a list of items (for example, particular types of materials and labour/trades) and applicable contract rates for each item. In a lump sum contract, such schedules are typically part of the tender submission and, once negotiated with the principal, included in the contract documents and used to value variations.
- *Other documents:* these *may* include correspondence, tendering information, tender documents, post-tender negotiations, bills of quantities and so forth. The parties need always to be mindful, however, that the inclusion of such materials may tend to override the contractual position which they have otherwise negotiated: for example, it may be that the tenderer included in its tender submission a statement that it is not prepared to accept liability for consequential loss yet the conditions of contract include a limitation of liability clause which is in quite different terms. For this reason, it is essential that the contractual documents, read as a whole, tell a coherent story (see [5.22]). In any case, it is essential that the agreement state expressly which documents are incorporated (preferably, such documents should be physically bound in with and signed along with the other documents) and their exact contractual status, in order to prevent disagreement in the future as to the exact terms of the contract.

It is often necessary to determine precisely what documents and conditions were to apply due to a failure or refusal by one party to execute a printed or consolidated form of contract. Here, the court is required to determine from all of the circumstances of dealings between the parties what was their intention and whether a particular set of conditions was to apply.[21] Further, standard forms of conditions might be incorporated into an agreement by reference notwithstanding that there was no executed bundle of the actual conditions.

19 See *Home Building Act 1989* (NSW) s 7(1); *Domestic Building Contracts Act 1995* (Vic) s 31; *Domestic Building Contracts Act 2000* (Qld) s 26 (in addition, s 67G of the *Queensland Building Services Authority Act 1991* (Qld) requires most commercial building contracts to be in writing); *Building Act* (NT) s 48B (along with *Building Regulations* (NT) regs 41F-41J); *Building Work Contractors Act 1995* (SA) s 28; and *Home Building Contracts Act 1991* (WA) s 4.

20 See [5.52].

21 See *Empirnall Holdings Pty Ltd v Machon Paull Partners Pty Ltd* (1988) and *PRA Electrical Pty Ltd v Perseverance Exploration Pty Ltd* (2007).

Professional indemnity insurance policies are usually what are described as "claims made" or "claims made and notified" cover.[60] Such policies require notification of a claim when made to the insured. They typically exclude cover where the insured person became aware of circumstances of a potential claim prior to the inception of the policy. However, s 40(3) of the *Insurance Contracts Act 1984* (Cth) provides that if, before the expiry of the policy, an insured party gives written notice to an insurer of facts that may give rise to a claim, then that insurer must provide cover even though the claim itself may have been made after the expiry of the policy.

The entitlement to indemnity will usually arise under the policy in place when the claim or the circumstances are notified, notwithstanding that the pursuit of the claim against the insured is commenced in a later period of cover. It is essential, when initially seeking insurance or renewal of cover, that full disclosure is made of circumstances known to the insured and material to the insurer's decision whether to issue a policy and, if so, on what terms. Indemnity might be declined if a claim ultimately arises from a situation that was known and not disclosed.

Another aspect of professional indemnity insurance is the exclusion that is frequently included for contractually acquired liability. It is possible that professionals who agree, under conditions of engagement to exclude the "benefit" of proportionate liability, may not be entitled to an indemnity for the additional liability acquired thereby.

60 See *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd* (2001).

Chapter 12

Dispute avoidance, management and resolution

This chapter considers the means by which parties to construction contracts may manage conflicts and resolve disputes without recourse to the adversarial procedures of litigation and arbitration analysed in Chapter 13.

INTRODUCTION

[12.1] The risks associated with participating in conventional dispute resolution processes – primarily, costs and uncertainty as to outcome – are matters which parties should identify and address as they do all other risks (see [8.2]). Taking into account these risks, along with the fact that approximately 95 per cent of disputes are resolved by agreement, usually after significant costs have been expended, it seems somewhat strange that the development of contractually-based management of conflicts and avoidance of disputes has not been given more attention.

The issue has been partially addressed by the introduction in standard form contracts of tiered resolution processes with some acknowledgement of the fact that combative contract management and administration can be the source of problems. This chapter analyses dispute avoidance and management processes which can be used by parties during the course of construction, as well as the more commonly recognised alternative dispute resolution procedures.

see *Understanding Australian Construction Contracts*, **ch 32**

DISPUTE AVOIDANCE AND MANAGEMENT

[12.2] Society has, over time, become very familiar and comfortable with the concept of preventative medicine: it is better and cheaper to look after yourself and have regular check-ups than to treat an illness once it has taken hold.

Contractual dispute management by way of Dispute Avoidance Processes (DAPs) is the legal equivalent of preventative medicine. As Figure 12.1 below demonstrates, DAPs are designed to act as circuit breakers, preventing the escalation of construction conflicts into disputes, whereas alternative/appropriate dispute resolution (ADR) generally operates as a circuit breaker only after a dispute has matured.

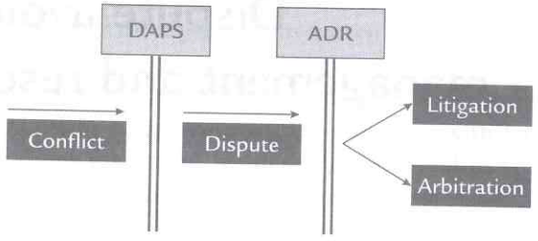

Figure 12.1: Interrupting the Conflict-Dispute-Litigation Continuum[1]

The initial investment in setting up a DAP may be recovered many times over in savings that flow from more harmonious on-site relations, a reduction in conflicts and disputes, and early resolution of those that do occur.[2]

A welcome development in the administration and management of construction contracts in recent years has, therefore, been the recognition that early identification of potential conflicts between the parties, and the implementation of procedures to address such issues, are a necessary incident of modern contracting.[3] However, in Australia, standard form contracts do not, as a general rule, provide models for non-combative administration and management of conflicts. The adoption of a separate contractual dispute management and contract administration protocol is one way in which the parties might overcome this shortfall in the standard form contracts (see [12.12]).

The development of early recognition and management of disputes under contracts has been driven not so much by a change in human nature but more as a consequence of economic imperatives. The reality is that the pursuit of disputes through conventional adversarial procedures is costly and rarely produces outcomes which the parties are happy with. Many in the industry now recognise the wisdom of the proverb, "if we don't change the direction we are going, we are likely to end up where we are heading".

1 Gerber P and Ong B, "DAPs: When will Australia Jump on Board?" (2011) 27(1) *Building and Construction Law Journal* 4, at p 8.

2 Gerber P, "Dispute Avoidance Procedures ('DAPs') - The Changing Face of Construction Dispute Management" [2001] *International Construction Law Review* 122.

3 Indicative of the importance of this aspect of practice in the construction industry is the publication of the *Guide to Leading Practice for Dispute Avoidance and Resolution* (2009) by the Cooperative Research Centre for Construction Innovation based at QUT in Brisbane.

There are a number of DAPs which have been developed and are employed in the construction industry.[4] This chapter looks at three DAP models; namely, Dispute Resolution Advisors (DRAs), Dispute Review Boards (DRBs) and Dispute Adjudication Boards (DABs). These processes are not found in any Australian standard form contract, however, the general form of the processes, and terms for them, are generally available, and it is also possible for the parties to agree upon their own bespoke procedure.[5]

A distinctive and welcome feature of DAPs is that they are employed at project commencement and designed to remain in place throughout the life of a construction project. In the event that parties are not successful in avoiding or managing conflict, and it escalates into a dispute, the dispute will be commonly resolved by way of an on-site dispute resolution system. Failing the on-site resolution of the dispute, there are various forms of ADR available. However, as noted above, ADR is generally only employed after completion of the project, whereas DAPs are used during the course of construction. Thus, it can be said that DAPs are about *prevention*, whereas ADR is about *cure*.[6]

A common feature of most DAPs and ADR is the appointment of an independent person (or persons) to assist the parties to manage or resolve their conflict or dispute. These persons can perform a variety of different roles ranging from a mere adviser through to a decision-maker empowered to make final and binding determinations. The parties have the freedom to tailor the process to account for the complexity and value of the project as well as the nature of issues that may potentially escalate into disputes. The parties decide for themselves the extent of the involvement of the independent party, or panel, and their jurisdiction, as well as the consequences of any determinations they may make (for example, non-binding recommendation or binding decision). The evidence is clear that, regardless of the model adopted, early intervention by an agreed neutral, even in a mere advisory capacity, produces economic benefits for all parties.

Dispute Resolution Adviser

[12.3] The Dispute Resolution Adviser (DRA) model was developed in Hong Kong by Professor Colin Wall, and was first used on the Queen Mary Hospital project.[7] It involves a two tiered system:

- first, an informal dispute avoidance approach through partnering and site visits and familiarisation meetings with the DRA; and

4 Gerber and Ong, above n 1, at p 8.

5 Ong B and Gerber P, "Dispute Boards: Is there a role for lawyers?" (2010) 5(4) *Construction Law International* 7, at p 9.

6 Ibid.

7 Wall C, "The Dispute Resolution Adviser in the Construction Industry" (1993) 21 *Building Research & Information* 122.

- secondly, a system of dispute resolution which commences with maximum party control and then introduces a series of steps, each one becoming more interventionist, with final resolution, if necessary, by short-form arbitration.[8]

The parties, as part of the construction contract, sign a partnering charter (see [8.15]) and appoint a DRA. The DRA attends the site on a monthly basis, their brief being to assist parties to settle their disputes. As the name suggests, the role of the DRA is to *advise* parties on how to resolve their conflicts, rather than to actually determine them. Thus, at these site visits, the DRA engages in pro-active processes to try and identify potential problems and take measures to overcome them.

Typically, the parties have 28 days to challenge any decision, certificate or evaluation made under the contract. Failure to do so renders the decision final and binding. If the decision, evaluation or certificate is challenged, the parties must first attempt to resolve the matter by good faith negotiations. If this is not successful in resolving the dispute, a formal notice of dispute is served and the DRA becomes involved. The DRA is free to choose the most appropriate ADR technique, be that mediation, mini-trial or expert determination.[9]

If the dispute remains unresolved, the DRA prepares a report which is submitted to senior staff of both the contractor and principal. The report contains an analysis of the dispute and why settlement attempts have failed. The report may also include a recommendation for resolution. The underlying theory is that involving senior staff who were not involved in the day-to-day management of the project brings a non-confrontational perspective to the dispute.

Under the DRA model, if the dispute remains unresolved 14 days after the report is submitted to senior staff, a short-form arbitration is convened before a neutral arbitrator. The rules for the short form arbitration are set out in the contract. Key elements include that it:

- only involves one claim or issue;
- is to be conducted and concluded within one day;
- allows each party an opportunity to present their arguments (the arbitrator is to allocate time fairly between the parties); and
- concludes with the arbitrator making a written report (including reasons) within seven days of the hearing.

Significantly, the arbitrator's decision is final and binding subject to very limited rights of appeal.

8 Gerber, above n 2, at p 123.

9 Wall C, "The Genesis, Development and Future use of the Dispute Resolution Adviser System" (Paper delivered for the Society of Construction Law Hong Kong (Hong Kong, 17 Nov 2004)) pp 1–25.

If the dispute concerns quantum, a procedure called a "final offer system" is implemented. In this, each party writes down its settlement figure and the arbitrator picks whichever one he or she considers the most reasonable. This system provides an incentive for the parties not to exaggerate their position.

The DRA procedure has been employed in many government contracts in Hong Kong and is regarded as a highly successful procedure.[10] Since 2009, a truncated version of the initial DRA procedure has been included in major civil engineering projects. Since 2007, the American Institute of Architects *General Conditions of the Contract for Construction* (Document A201-2007) has, similarly, included in Article 15 a procedure for the conduct of claims and disputes by the use of an Initial Decision Maker. The process is, in part, a recognition of the wisdom of having an early independent assessment of claims and disputes. In many respects it is similar to the DRA process referred to above. The Decision Maker is independent from the Architect. The parties may proceed to mediation or ultimately arbitration if the claim or dispute is not resolved at some step in the procedure.

There is little which would prevent the adaptation of the DRA procedure in Australia. It is a DAP model which exemplifies early recognition of issues and proceeds through a timely series of rational non-combative steps to a final and binding determination of unresolved disputes without submitting the parties to the time and costs of conventional adversarial dispute resolution.

Dispute Review Boards

[12.4] Dispute Review Boards (DRBs) were first developed in the United States in the 1970s for use on heavy engineering projects.[11] They have since been used all around the world, and through to the end of 2006, DRBs had been used on over 2,000 international construction projects, worth over US$100 billion.[12] In Australia, the picture regarding DRBs is not so rosy, with only 21 projects having used a DRB up to the end of 2010.[13] However, this may soon change, with DRBs now being actively promoted in this country by the Dispute Resolution Board Australasia Inc (www.drba.com.au).

A DRB typically comprises three independent persons who are selected by the contracting parties. The unique feature of the DRB, and probably the reason that it has been so successful, is that it is established at the commencement of the project. Moreover, by undertaking regular site visits, the DRB is

10 Ibid.

11 Harmon K, "A Case Study as to the Effectiveness of Dispute Review Boards on the Central Artery/Tunnel Project" (2009) (1)1 *Journal of Professional Issues in Engineering Education & Practice* 18, 19.

12 The Dispute Resolution Board Foundation, *Practices and Procedures* (2007) [1.3], <www.drb.org/manual.htm> at 3 February 2011.

13 Gerber P and Ong B, "21 Today!: Dispute Review Boards in Australia: Past Present and Future" (2011) 22 *Australasian Dispute Resolution Journal* 1.

actively involved throughout the construction process, becoming part of the project. It seems that the very presence, or shadow, of the DRB influences the attitudes and behaviour of those involved in the project, which in turns leads to fewer disputes.[14]

Although a DRB usually consists of three members, this is not mandatory. For example, a one-person DRB has been trialled in Queensland by the Townsville City Council, and the Channel Tunnel project had a five-person DRB. The Hong Kong Airport project undertaken in the early 1990s had a DRB consisting of six members, plus a convenor, to cover all the main contracts (about 20) awarded by the Hong Kong Airport Authority. Panels of one to three members were then selected, depending on the nature and complexity of the dispute. Thus, a DRB can have a moving membership to suit the various stages of the project or nature of the dispute; for example, engineers for technical matters, quantity surveyors for issues of quantum, and legal members to deal with matters such as interpretation of contract provisions.[15]

The most common method of appointing DRB members is for the contractor to nominate one member acceptable to the owner, the owner to nominate one member acceptable to the contractor, and those two members to appoint the third member who will be the chairperson. Although two of the DRB members are party nominations, all three are neutral and required to act impartially.[16]

Regular site visits enable the DRB members to become highly conversant with the project and observe problems on-site as they develop. Technical difficulties and their ramifications can be readily appreciated and, should the DRB be required to make a recommendation, the members' close knowledge of the project and issues permits quick, well-informed, even-handed and consistent responses. By contrast, judges, arbitrators and even mediators often experience great difficulty in trying to visualise factual circumstances that existed several years earlier merely by listening to others, or reading documents. Upon being asked to resolve a construction dispute, there is nothing quite so informative as having witnessed the technical and physical conditions prevailing at the time. Thus, DRBs avoid the difficulty inherent in reconstructing historical events.[17]

In order to have a DRB on a project, it is necessary to amend the construction contract to include clauses that set up the DRB and empower it to attend the site regularly and convene hearings. The cost of the DRB is generally borne equally by all parties.[18] This overcomes the problem of a contractor

14 Gerber P, "Construction Dispute Review Boards" (1999) 10 *Australasian Dispute Resolution Journal* 9.
15 Ong and Gerber, above n 5, at p 11.
16 Dispute Resolution Board Foundation, above n 12, at [2.2].
17 Gerber, above n 2, at p 125.
18 The DRB, as advocated by the DRBF and ICC, recommends that the contractor and principal split costs 50:50. Under FIDIC, the fees are paid by the contractor who can, in turn, claim 50 per cent back from the principal.

perceiving the engineer or superintendent as being biased because he or she is paid by the owner.

How expensive a DRB will be depends on the number and complexity of disputes that arise. According to the American Society of Civil Engineers, DRB costs range from .04 per cent to .51 per cent of the total contract costs, which is a fraction of the expenses typically associated with litigation or arbitration. Furthermore, these costs do not take into account the lower tender prices that are known to result when contractors prepare tenders for jobs with DRBs, as the tender does not have to be inflated to factor in the risk of injustice or delay that may occur without the DRB.[19]

The DRB members are kept informed of developments on site by being sent key reports and minutes in between their site visits, which generally take place every few months. Site visits provide the DRB with an opportunity to observe progress and talk to the parties about any potential disputes. It is often useful for the DRB to prepare a report at the conclusion of each site visit stating what occurred and making suggestions as to how matters of concern could be progressed to settlement.

When a dispute cannot be resolved by the parties themselves, it is referred to the DRB, which conducts a hearing at which each party has the opportunity to explain their position. The "hearing" is conducted more like a site meeting than a fully-fledged trial or arbitration. Lawyers are generally not present, and expert witnesses are not necessary as the DRB members have been selected for their expertise in the type of project being undertaken.[20]

After the hearing, the DRB sets about writing its decision. It is not uncommon for this to be done while the members are still on site. Some decisions may take longer, particularly if there is quantification of time or costs involved, but prompt resolution is the touchstone of the DRB process. It is preferable that the DRB acts as a single entity and gives a unanimous decision. Since the decision takes the form of a non-binding recommendation, the DRB must work hard to engender confidence of the parties in its decision, and unanimity assists with this.[21] The DRB's product is its written decision, and this should be drawn up carefully, with particular attention to ensuring that a party knows why it has failed on a point or issue.

To achieve maximum benefit from a DRB, the procedures adopted should be simple, easily understood, fair and efficient. To impose multiple steps of review and negotiation prior to the DRB hearing being conducted can lessen the likelihood of success by increasing confrontation.[22] Furthermore, the longer it takes to get an issue before the DRB, the greater the chance of a party's fantasy

19 Harmon K, "Dispute Review Boards Effects on Bid Prices" (2004) 46 *Cost Engineering Journal* 30.
20 Gerber, above n 14, at p 13.
21 Gerber, above n 2, at p 126.
22 Ibid.

turning into an expectation. The prompt attention of the DRB ensures that issues are isolated and contained, and not allowed to snowball into unmanageable proportions, such as those that arise under "global" or "total cost" claims.

Because of the proximity of the hearing to the actual dispute, greater certainty prevails and the parties are generally satisfied that all material germane to the issue has been revealed. The result is that even unfavourable decisions are likely to be accepted in good faith.[23]

It is clear from available figures that DRBs are highly effective at ensuring projects reach final practical completion with no outstanding or unresolved disputes.[24] This suggests that the parties believe that the "judgment" of the DRB is as good if not better than that which could have been obtained from an arbitrator or judge.

Dispute Adjudication Boards

[12.5] Dispute Adjudication Boards (DABs) first appeared in the late 1990s under the FIDIC standard form contract published by the International Federation of Consulting Engineers (see, generally, [10.3]). Prior to that, the World Bank was mandating the use of FIDIC standard form contracts on projects it was funding, but requiring that they be amended to include a DRB. FIDIC decided to address this by modifying its contracts to incorporate a DAB.[25]

The DAB mechanism differs from a DRB in the following respects:

- The parties are under an obligation to implement the decisions of the DAB; that is, it is immediately binding, whereas a DRB makes recommendations that the parties are free to accept or reject.
- The DAB procedure is more structured and formal; for example, a party is required to give notice within 28 days of the circumstances giving rise to the claim. Thus a claim before the DAB can be time-barred. This is not the case with DRBs.
- The DAB is required to give its decision within 84 days of receiving notice of the dispute. This is significantly slower than the DRB.[26]

Although the DRB and DAB have many similarities, the greater informality, flexibility and speed of the DRB gives it many advantages. The strict protocols set out in the FIDIC contract can significantly delay the involvement or decision of the DAB to the detriment of the project.[27]

23 Ibid.

24 Around the world, 98 per cent of projects which have used a DRB have achieved completion with no outstanding disputes. See, The Dispute Resolution Board Foundation, <www.drb.org/manual/Database_2005.xls> at 3 February 2011.

25 Gerber, above n 2, at p 127.

26 Clause 20.4 of the FIDIC Conditions of Contract for Construction for Building and Engineering Works Designed by the Employer.

27 Ibid.

ADR: ALTERNATIVE/APPROPRIATE DISPUTE RESOLUTION

[12.6] Throughout Australia, resolution of commercial construction disputes by ADR, alternative (or, as more recently referred to, "appropriate") dispute resolution, has made significant advances since the late 1980s. A number of factors, including dissatisfaction with the costs of arbitration and litigation, have provoked the construction industry to seek alternative ways of resolving their disputes.[28]

ADR processes, such as mediation and conciliation, have been used for some time and have been refined and developed with the increase in the use of ADR. Some commentators refer to arbitration as an ADR process; however, its adversarial character and the binding nature of its decisions align it more, in this respect, with litigation rather than ADR. The underlying philosophy of most ADR processes is consensual rather than combative and involves the parties deciding the outcome rather than having a decision imposed on them.

Mediation

[12.7] Mediation is the most popular form of ADR used in Australia. It is nothing more, and nothing less, than facilitated negotiations. The parties engage a neutral third party to help them negotiate a settlement of their dispute which is then recorded in a binding settlement agreement.

There are several organisations in Australia that specialise in providing accredited mediators and facilities for the conduct of mediations, including the Institute of Arbitrators and Mediators Australia (IAMA) and the Australian Commercial Disputes Centre (ACDC).

Parties with a dispute may end up in mediation via a variety of different pathways including that:

- the construction contract compels the parties to participate in a mediation before they can commence any legal proceedings (see, eg, Section P of the ABIC MW-2008 standard form contract);
- a court has ordered the parties to attend a mediation before their case will be set down for trial, see, for example, s 26 of the *Civil Procedure Act 2005* (NSW); or
- the parties have agreed to proceed to mediation to try and resolve their dispute.

Unlike litigation and arbitration, which are very formal and structured processes, mediation is informal and flexible. As such, there is no single model

28 Groton J, "Alternative Dispute Resolution in the Construction Industry" (1997) 52(3) *Dispute Resolution Journal* 48.

of mediation, and individual mediators have different approaches to how they conduct a mediation.[29] Furthermore, it can be difficult to obtain detailed information about the conduct of mediations since they are invariably held in private and subject to confidentiality agreements.

As a rule of thumb, however, most mediations begin with a joint session where the mediator explains how the mediation will be conducted and the parties (often through their lawyers) present an outline of their position. After all parties have made their presentations, some mediators will endeavour to identify any areas of agreement or common ground as a way of creating a positive atmosphere.

Thereafter, individual mediators' practices differ. Some will separate the parties into different rooms to speak with them confidentially about issues or concerns they may not want to talk about in front of the other party. It is permissible, indeed almost mandatory, that mediators speak with the parties separately. This is in stark contrast to litigation and arbitration where it is highly improper for a judge or arbitrator to meet a party in the absence of the other party. Other mediators like to keep the parties together and get them working jointly on setting an agenda that contains all the issues that need to be resolved, and then commence negotiations directly between the parties.

Every mediation involves exploring the issues, evaluating the settlement options, and attempting to negotiate a resolution. If an agreement is reached, it is reduced to writing and signed by all parties. This written agreement is a contract that binds the parties to the settlement they negotiated. If a party fails to comply with the terms of settlement the innocent party can commence litigation for breach of the contract signed at the mediation. If the parties cannot reach an overall settlement of their dispute at the mediation, the mediator should attempt to at least get the parties to agree on some issues so that the scope of the dispute is narrowed, thereby reducing the length and cost of any subsequent trial or arbitration.

Conciliation

[12.8] Precise definition of the conciliation process is more difficult than for other forms of ADR.[30] In some instances, the terms "conciliation" and "mediation" are used interchangeably. A conventional distinction between the processes is that a conciliator takes a more active role in the negotiation process and may propose solutions, whereas a mediator traditionally facilitates the process but does not comment on the strength of the parties' positions or suggest possible settlements. Thus, a conciliator may offer opinions as to the issues of factual or legal dispute between the parties, which is something

29 Sefton C, "No square pegs in round holes: What mediators want lawyers to do in mediation and how they get it" (2011) 22 *Australasian Dispute Resolution Journal* 22.

30 Wade J, "Mediation – The Terminology Debate" (1994) 5 *Australasian Dispute Resolution Journal* 204.

mediators tend to shy away from doing. IAMA has published Conciliation Rules (2006) with explanatory notes.[31]

Non-binding expert determination

[12.9] This procedure involves the reference of disputed claims to an expert appointed by the parties to make a determination. The use of an independent expert or assessor to assist parties to resolve their disputes traditionally involves the expert playing a non-binding role; that is, he or she makes a recommendation which the parties are free to accept or reject, as opposed to a final decision that binds the parties. However, there have also been occasions (and, indeed, this possibility is reflected in a number of the standard forms in common use in Australia) when parties have engaged an independent expert to make a binding decision, akin to a simplified form of arbitration.

The process of binding expert determination may resemble a simplified arbitration procedure, and in some respects it is preferable to define it as such, thereby reinforcing the enforceability of the expert's decision. Moreover, strictly speaking *binding* expert determination does not fall within the definition of ADR since it involves a binding decision being imposed on the parties, rather than the parties reaching a consensual settlement of their dispute. For this reason, only non-binding expert determination (sometimes also known as "expert evaluation") is considered in this chapter; binding expert determination is dealt with at [13.38].

Non-binding expert determination involves the parties appointing a neutral person to provide an appraisal on the merits of the dispute and recommend a resolution. The expert investigates the matters in dispute on the basis of the information provided by the parties and any further information sought by the expert. He or she then hands down a decision which the parties may accept or use as the basis for further negotiations.

While traditional forms of dispute resolution such as arbitration and litigation are governed by legislation that is not the case with expert determination. As with most forms of ADR, it is up to the parties to agree on the process for the expert determination. IAMA and the ACDC both have rules for the conduct of expert determinations, although these focus on binding, rather than non-binding, expert determination.[32]

Like mediation, expert determination is a flexible process that is controlled by the parties. Thus, they decide what procedures best suit the circumstances

31 The Institute of Arbitrators & Mediators Australia, *Conciliation Rules 2006*, <www.iama.org.au/pdf/ConciliationRules.pdf> at 3 February 2011.

32 The Institute of Arbitrators & Mediators, *Expert Determination Rules 2010* <www.iama.org.au/Expert%20Rules%202010.pdf> at 3 February 2011; Australian Commercial Disputes Centre, *Downloadable ADR Guidelines*, <https://www.acdcltd.com.au/adr-clauses-guidelines/guidelines> at 3 February 2011.

of their dispute. Expert determination tends to be best suited to disputes which are relatively simple in content or are essentially technical in nature. As the title of this form of ADR suggests, the parties select a person with appropriate qualifications and experience in the area of the dispute; that is, someone they respect and by whose opinion they are therefore likely to be swayed.

Expert evaluation tends to work if the expert's opinion is regarded as a *prediction* of the result that a binding procedure would generate rather than advice on the way in which the expert would *personally* decide the case. The parties need to be convinced that, even if they spend a lot more time and money preparing the case for trial or arbitration, the outcome is likely to be the same.

Even if both parties do not accept the determination of the independent expert, it can form a good basis for future settlement negotiations. It is for this reason that the parties should be required to wait a certain period (say, 45 days) after the expert gives his or her opinion before commencing litigation or arbitration. This "cooling off" period gives the parties time to digest the expert's evaluation and possibly pursue settlement negotiations based on the expert's written opinion.

Non-binding expert determination is an excellent way of providing a "reality check" to the parties. It is important that before too much money is spent on legal fees, and positions have become entrenched, the parties see their case, and that of their opponent, as others may see it.

Senior Executive Appraisal

[12.10] Senior Executive Appraisal (SEA) is an Australian adaptation of the American ADR process known as a "mini-trial".[33] SEA is a hybrid of other dispute settlement processes, in that it has aspects of both mediation and expert determination. In a SEA, both parties present their case in an abridged form to a panel that is made up of a senior executive from each party and a neutral third party. After the panel has heard the presentations of both parties they commence settlement negotiations, facilitated by the neutral third party who acts in many ways like a mediator. The rationale behind SEA is that senior business people, once they are fully appraised of all the relevant facts and arguments, are well placed to find a commercial solution to the dispute.

Having the top executives from the companies involved in the dispute, working together to reach a settlement, is likely to not only result in a commercial resolution (as opposed to a strictly legal one) but also to provide the disputing parties with the best chance of salvaging a working relationship. For example, it may be that the parties are able to negotiate a solution that involves them agreeing to work together again on future projects, which is something no court or arbitrator would have had the power to order.

33 Street L, "Senior Executive Appraisal" (1989) 6 *Australian Construction Law Newsletter* 9-11.

Procedure and enforceability

[12.11] If a contract includes provision for a DAP or ADR, the procedure and rules under which the process is to operate should be clearly defined. In order for these processes to be enforceable, there must be no uncertainty as to the procedures and documents associated with it including references to negotiations in good faith: see *United Group Rail Services Ltd v Rail Corporation of New South Wales* (2009).

Despite some early judicial disinclination to enforce ADR clauses by granting a stay of arbitration or litigation proceedings, it is now generally accepted that, so long as the process is clearly expressed, the courts will enforce ADR clauses.[34] As noted above, the ACDC and IAMA have prepared standard form clauses providing for a number of alternative dispute resolution processes, which include a definition of the rules and procedure which are required for the process to be enforceable.

Looking to the future

[12.12] The days of combative contract administration appear to be numbered, with parties increasingly inserting DAPs into their contractual arrangements to assist them to complete their projects with no outstanding disputes.[35] Moreover, if there are any unresolved issues remaining post practical completion, parties nowadays tend to prefer exploring ADR options first, in an effort to find a cost-efficient, non-adversarial means of resolving their disputes.

Increasingly, ADR is being supported, or even mandated, by the courts and law-makers.[36] Indeed, when introducing civil procedure reform legislation into Parliament in 2010, the then Victorian Attorney-General noted that "litigation should be a measure of last resort". Philosophies of this kind were also reflected in New South Wales by the introduction of Part 2A of the *Civil Procedure Act 2005* (NSW). These reforms introduced pre-action requirements for the adoption of ADR and the filing of dispute resolution statements by the parties. Similarly, the *Civil Dispute Resolution Bill 2010* (Cth) requires parties to provide a statement that they have taken "genuine steps" to resolve their dispute.

In Victoria, pre-action procedures were briefly in force by virtue of the *Civil Procedure Act 2010* (Vic). As first enacted, it required disputants in a range of civil disputes to undertake "reasonable steps" to either resolve their

34 See, eg, *Northbuild Construction Pty Ltd v Discovery Beach Project Pty Ltd* (2007), *1144 Nepean Highway Pty Ltd v Abnote Australasia Pty Ltd* (2009) and *Lipman Pty Limited v Emergency Services Superannuation Board* (2010) dealing with expert determination provisions.

35 Danuri M et al, "Growth of Dispute Avoidance Procedure in the Construction Industry: a Revisit and New Perspectives" (2010) 21 *Construction Law Journal* 349, at p 363.

36 See, generally, Sourdin T, "Making an attempt to resolve disputes before using courts: We all have obligations" (2010) 21 *Australasian Dispute Resolution Journal* 225.

dispute, or clarify and narrow the issues in dispute, as a pre-condition to commencing proceedings. However, following a change of government in Victoria in late 2010, the provisions of the Act making such steps compulsory were repealed.[37]

In light of this, the change of government in New South Wales in March 2011 and the fact that the Commonwealth Bill lapsed with the calling of the 2010 election, it cannot currently be predicted with confidence that mandatory pre-litigation measures will become an entrenched part of the Australian landscape for construction dispute resolution. Such procedures are, nonetheless, consistent with a growing trend among courts and tribunals in Australia and overseas to put in place "pre-action protocols" (PAPs).[38]

The most prominent construction law PAP is the "Pre-Action Protocol for Construction and Engineering Disputes", implemented in the UK in 2000, following the recommendations of Lord Woolf in his *Access to Justice 1996* report. In his 2010 *Review of Civil Litigation Costs*, Lord Justice Jackson found that such protocols serve a useful purpose, but that, in practice, they tended to drive counter-productive behaviours such as lawyers front-loading their costs into the pre-action phase. Thus, the UK experience provides both a general indication of the merits of reforms such as those currently being undertaken in Australia and lessons which can inform the implementation of those reforms.

All in all, though, a sea-change in attitudes and procedures is evident, making it less likely, but by no means impossible, that a judge might be called upon to decide a construction law dispute of a nature similar to the infamous case of *SMK Cabinets v Hili Modern Electrics Pty Ltd* (1984). In that case, in which less than $10,000 was in dispute, Brooking J recounted the "melancholy chronicle" of the process as follows:

> "The notice of dispute was followed by a preliminary hearing at which pleadings were directed; and points of claim led to defence and counterclaim, which itself provoked reply and defence. Then the hearing began, two of the pleadings being amended and a schedule of questions being agreed upon. The hearing, which included a view, lasted some six days. As if this was not enough, after the hearing each side resumed the offensive with written arguments, followed by written submissions in reply. The arbitrator rose to the occasion by making an award that ran into 108 pages. That was in August 1981, and that should have been enough. But by now the Juggernaut was quite out of control and it careered into the Practice Court on a motion to set the award aside. The Practice Court could not contain it, so off

37 By way of the *Civil Procedure and Legal Profession Amendment Act 2011* (Vic), which took effect on 30 March 2011.

38 Legg M and Boniface D, "Pre-action protocols in Australia" (2010) 20(1) *Journal of Judicial Administration* 39.

> it went to the miscellaneous causes list, where it was reinforced by a summons seeking leave to enforce the award. A reserved decision followed after a two day hearing, and four days after that decision still more argument was heard. Then an order was made setting aside part of the award and so, by way of remittal, the Juggernaut went rumbling back towards the arbitrator. It has now been deflected into this Court by way of application for leave to appeal. I for one am not in the least disposed to let it go on its way again if, consistently with legal principle, it can be finally restrained."

With DAPs, PAPs and ADR now all part of the dispute management smorgasbord, it is to be hoped that litigation sagas, like that described above, will one day become a thing of the past.