

BEING HELD TO RANSOM OR “WIELDING THE WHIP OR THE ROD”¹

HOW UNSCRUPULOUS DEALING, ILLEGITIMATE PRESSURE AND TOUGH NEGOTIATING TACTICS CAN BE OVERCOME BY THE LEGAL REMEDY OF ECONOMIC DURESS

PHILIP LOOTS² AND DR DONALD CHARRETT³

INTRODUCTION

This paper looks at the legal doctrine of economic duress in the Anglo-Australian context of construction contracts on large resource projects. Employers on large projects are sometimes put in a position where, to obtain timely completion, there seems to be no alternative but to renegotiate the commercial terms of a construction contract with a non performing contractor (and inevitably on terms that are more favourable to the contractor). Redress may however be possible by seeking curial intervention on the grounds of economic duress, to avoid the consequences of having acceded to undue pressure.

Economic duress is an action for restitution of property or money extracted under duress and the avoidance of any contract that is induced by it. It is a common law doctrine that is part of the law of contract and unjust enrichment and is closely related to the equitable doctrine of undue pressure⁴. It is not, in and of itself, a species of tort⁵. Economic duress is a factor which may render a contract voidable⁶.

¹ *Smith v William Charlick Ltd* [1924] HCA 13; (1924) 34 CLR 38, per Isaacs J at 56: “Refusal to relieve from business difficulties is not the creation of those difficulties. It is not the same thing as wielding the whip or the rod.”

² Counsel, Wheatstone Project; Adjunct Professor, Centre for Mining, Energy and Resources Law, University of Western Australia; past counsel, Gorgon Project.

³ Melbourne TEC Chambers.

⁴ *Electricity Generation Corporation t/as Verve Energy Ltd v Woodside Energy Ltd* [2013] WASCA 36 at paragraph 23, per McLure P.

⁵ *Id.* at paragraph 150, per Murphy J.

⁶ *Pao On v Lau Yiu Long* (PC) [1980] AC 614 at 636, per Lord Scarman.

Economic duress has long been acknowledged in the US⁷. However, it was not until 1976⁸ that the English common law recognised economic duress as an acceptable ground to avoid an agreement⁹.

A party engaged in a commercial transaction normally and acceptably engages in robust negotiations in its own self-interest. To what extent can such a party go to tip the balance in its favour before it “crosses the line”¹⁰ between acceptable commercial behaviour and illegitimate economic duress?

LEGAL RECOGNITION OF ECONOMIC DURESS – WHERE IS THE LINE FOR ECONOMIC DURESS, AND WHEN IS IT CROSSED?

Economic duress is an acceptable legal ground to avoid an agreement. In order to establish economic duress it is necessary to show illegitimate pressure. The questions are “where is the line?” and “what does it take to cross the line from legitimate to illegitimate pressure?”. The line that divides robust commercial negotiation from illegitimate pressure or duress is a fine one¹¹. Conduct amounting to illegitimate pressure cannot be set out in an all-encompassing list. The cases referred to below are not exhaustive but are of interest because they represent fairly commonplace situations in business, and set out the criteria as they have evolved and been defined and applied by the courts in determining where that line is and when the line is crossed. Most importantly for the construction industry, these cases show that, in certain circumstances, there may be a remedy that allows the work to be completed and the contract that was entered into under illegitimate pressure to be set aside later.

The tests for economic duress

The English case of *DSND Subsea Ltd v Petroleum Geo-Services ASA* succinctly stated the ingredients of actionable duress to be that there must be pressure: (a) whose practical effect is that there is compulsion on, or a lack of practical

⁷ J Dawson, “Economic Duress — An Essay in Perspective” (1947) 45(3) *Mich L Rev* 253; J Dalzell, “Duress and Economic Pressure” (1942) 20 *NC L Rev* 237.

⁸ H Lal, “Commercial Exploitation in Construction Contracts: The Role of Economic Duress and Unjust Enrichment” [2005] 21(8) *Const LJ* 590 at 592.

⁹ *Occidental Worldwide Investment Corp v Skrips (The Sibeon and the Sibotre)* [1976] 1 Lloyd’s Rep 293.

¹⁰ An expression used for a penalty infringement in the game of polo. Most fouls and penalty shots are related to players exerting illegitimate pressure by improperly and dangerously crossing the line of the ball or the right of way.

¹¹ *Atlas Express Ltd v Kafco Ltd (Importers & Distributors) Ltd* [1989] QB 333.

choice for, the victim; (b) which is illegitimate; and (c) which is a significant cause inducing the claimant to enter into a contract¹².

To similar effect is the recent Australian formulation by the WA Court of Appeal:

“[24] ... There are two material facts of the cause of action in economic duress being (1) that illegitimate pressure was applied which (2) induced the victim to enter into the contract (or make a non-contractual payment); the illegitimate pressure does not have to be the sole reason for the victim entering into the contract, it is sufficient if it is one of the reasons.

[25] If the pressure involves an actual or threatened unlawful act, it is prima facie illegitimate. If the pressure is lawful, it may be illegitimate if there is no reasonable or justifiable connection between the pressure being applied and the demand which that pressure supports.

[26] An actual or threatened breach of contract is unlawful conduct for the purposes of the economic duress doctrine.”¹³ [Citations omitted.]

Illegitimate pressure

Applied economic pressure must be illegitimate:

“... economic pressure may be sufficient to amount to duress ... provided at least that the economic pressure may be characterised as illegitimate and has constituted a significant cause inducing the plaintiff to enter into the relevant contract.”¹⁴

In *DSND Subsea*, Dyson J said that in determining whether there has been illegitimate pressure, the court takes into account a range of factors. These include: whether there had been an actual or threatened breach of contract; whether the person allegedly exerting the pressure had acted in good or bad faith; whether the victim had any realistic practical alternative but to submit to the pressure; whether the victim protested at the time; and whether he affirmed and sought to rely on the contract. These are all relevant factors. Illegitimate pressure must be distinguished from the rough and tumble of the pressures of normal commercial bargaining¹⁵.

In the NSW Court of Appeal in *Crescendo Management*, McHugh JA said that the proper approach is to ask first, whether any applied pressure in fact induced the victim to enter into the contract, and, if so, whether that pressure went beyond what the law treats as legitimate. If there has been no applied pressure, it is unnecessary to make further inquiry as to whether it has a subjective effect on the conduct of the plaintiff. If there has been

¹² *DSND Subsea Ltd v Petroleum Geo-Services ASA* [2000] BLR 530, per Dyson J, referring to *Universe Tankships Inc of Monrovia v International Transport Workers' Federation (The Universe Sentinel)* (HL) [1983] 1 AC 366 at 400B–E; and *Dimskal Shipping Co SA v International Transport Workers' Federation (The Evia Luck)* (HL) [1992] 2 AC 152 at 165G.

¹³ *Electricity Generation Corporation t/as Verve Energy Ltd v Woodside Energy Ltd* [2013] WASCA 36, per McLure P.

¹⁴ *Dimskal Shipping Co SA v International Transport Workers' Federation (The Evia Luck)* (HL) [1992] 2 AC 152 at paragraph 168.

¹⁵ *DSND Subsea Ltd v Petroleum Geo-Services ASA* [2000] BLR 530, per Dyson J.

applied pressure, the critical question then becomes: “What pressure does the law regard as illegitimate?” His Honour explained:

“Pressure will be illegitimate if it consists of unlawful threats or amounts to unconscionable conduct. The categories are not closed. Even overwhelming pressure, not amounting to unconscionable or unlawful conduct, however, will not necessarily constitute economic duress.”¹⁶

This analysis was recently adopted by Murphy JA in the WA Court of Appeal¹⁷. McHugh JA also found that the illegitimate pressure applied must be one of the reasons for the victim entering into the agreement, but does not need to be the sole cause¹⁸.

Unlawful conduct involving non-performance of contractual obligations is usually regarded by courts as illegitimate pressure¹⁹. However, the threat does not need to be unlawful to be illegitimate:

“... the legitimacy of the pressure must be examined from two aspects; first, the nature of the pressure and secondly, the nature of the demand which the pressure is applied to support. Generally speaking the threat of any form of unlawful action will be regarded as illegitimate. On the other hand, the fact that the threat is lawful does not necessarily make the pressure legitimate.”²⁰ [Citations omitted.]

The case of *Progress Bulk Carriers Ltd v Tube City*²¹ illustrates the fine line between bargaining and exerting illegitimate pressure. In this case, the court found that the conduct of one party following its repudiatory breach of contract and refusal to comply with previous undertakings had left the other party without any option but to accept the agreement proffered. The refusal of the first party to honour its prior agreements unless the other party waived its rights amounted to illegitimate pressure.

Thus, the question is “not whether the conduct is lawful but whether it is morally and socially unacceptable”:

“I also readily accept that the fact that the defendants have used lawful means does not by itself remove the case from the scope of the doctrine of economic duress ... And there are a number of cases where English courts had accepted that a threat may be illegitimate when coupled with a demand for payment even if a threat is one of lawful action. On the other hand, *Goff and Jones Law of Restitution* (3rd Edition, 1986) observed that English courts have wisely not accepted any general principle that a threat not to contract with another, except on certain terms, may amount to duress.”²² [Citations omitted.]

¹⁶ *Crescendo Management Pty Ltd v Westpac Banking Corporation* (1988) 19 NSWLR 40 at 46.

¹⁷ *Electricity Generating Corporation t/as Verve Energy v Woodside Energy Ltd* [2013] WASCA 36 at 179, per Murphy JA.

¹⁸ *Crescendo Management Pty Ltd v Westpac Banking Corporation* (1988) 19 NSWLR 40 at 46.

¹⁹ See e.g., *Nixon v Furphy* (1925) 25 SR (NSW) 151 at 158–160 (affirmed in *Furphy v Nixon* [1925] HCA 34; (1925) 37 CLR 161; *White Rose Flour Milling Co Pty Ltd v Australian Wheat Board* (1944) 18 ALJR 324 at 326–327; *Re Hooper & Grass' Contract* [1949] VLR 269 at 271–272; *TA Sundell & Sons Pty Ltd v Emm Yannoulatos (Overseas) Pty Ltd* [1956] SR (NSW) 323 at 328; and *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd (The Atlantic Baron)* [1979] 1 QB 705).

²⁰ *R v Attorney General for England and Wales* (PC) [2003] UKPC 22, per Lord Hoffmann.

²¹ *Progress Bulk Carriers Ltd v Tube City IMS LLC* [2012] EWHC 273 (Comm).

²² *CTN Cash & Carry Ltd v Gallagher Ltd* (CA) [1994] 4 All ER 714 at 718E–719B, per Steyn LJ.

As noted by McHugh JA, lawful but unconscionable conduct in negotiations is one species of illegitimate pressure²³.

Illegitimate pressure must be “applied”

Economic duress not only involves illegitimate pressure, but that pressure must be “applied” to induce the victim to enter into the contract or make a non-contractual payment.²⁴

“[179] Further, the defendant’s conduct must put the plaintiff under ‘pressure’ in the ordinary sense of that word. Evidentiary matters relevant to the question of whether the plaintiff was put under ‘pressure’ may overlap with the question of causation, but the two are conceptually distinct and it remains necessary for the plaintiffs to prove that they actually succumbed to the pressure under which they were placed.

[180] In determining whether there has been applied pressure, the words and conduct of the party against whom duress is alleged are to be judged as a matter of substance and reality, and not mere form. Accordingly, in considering whether pressure has been applied, a threat may be veiled, even if there is no specific demand.”²⁵ [Citations omitted.]

Pressure must be an inducement

Commercial pressure without coercion is insufficient to constitute economic duress. A threat to repudiate or an unfair use of a dominant bargaining position is insufficient to invalidate the consideration for the agreement²⁶.

However, no express threat need be made; conduct or the creation of a set of circumstances by the defendant can equally constitute coercion and convey a threat of duress²⁷. Where a contracting party has no practical alternative than to accede to threats in breach of the terms of the contract made without justification, the pressure constitutes the necessary “inducement”²⁸.

A contract entered into as a result of such conduct will be voidable only where the party had no commercial option but to submit²⁹.

²³ See also, R McKeand, “Economic Duress — Wearing the Clothes of Unconscionable Conduct” (2001) 17 *JCL* 1; RA Conti QC, “Economic Duress” (1985) 1 *Aust Bar Rev* 106; LR Halston, “Opportunism, Economic Duress and Contractual Modifications” (1991) 107 *LQR* 649 at 656; R C Nicholls, “Conduct after Breach: The Position of the Party in Breach – Pt 2” (1991) 3 *JCL* 163 at 170; A Phang, “Economic Duress – Uncertainty Confirmed” (1992) 5 *JCL* 147; and M P Sidone, “The Doctrine of Economic Duress” (1996) 14 *Aust Bar Rev* 34 at 114.

²⁴ *Electricity Generation Corporation t/as Verve Energy Ltd v Woodside Energy Ltd* [2013] WASCA 36 at paragraph 24, per McLure P.

²⁵ *Electricity Generation Corporation t/as Verve Energy Ltd v Woodside Energy Ltd* per Murphy JA.

²⁶ *Pao On v Lau Yiu Long* [1980] AC 614; *Crescendo Management Pty Ltd v Westpac Banking Corporation* (1988) 19 NSWLR 40; *Hawker Pacific Pty Ltd v Helicopter Charter Pty Ltd* (1991) 22 NSWLR 298.

²⁷ In *Hawker Pacific Pty Ltd v Helicopter Charter Pty Ltd* (1991) 22 NSWLR 298, the defendant by not returning a helicopter to the plaintiff in the knowledge that the plaintiff urgently required a helicopter to satisfy important business contracts, was found to have made a threat by conduct.

²⁸ *Carillion Construction Ltd v Felix (UK) Ltd* [2001] BLR 1; (2001) 74 ConLR 144, per Dyson J.

²⁹ *Crescendo Management Pty Ltd v Westpac Banking Corporation* (1988) 19 NSWLR 40 at 46, per McHugh JA.

Robust commercial bargaining or illegitimate pressure?

Cases of economic duress must be decided on the facts, and while the authorities are of interest, “it is necessary to focus on the distinctive features of this case, and then ask whether it amounts to a case for duress”³⁰.

Given the difficulties of distinguishing between legitimate commercial pressure and illegitimate economic duress, and the criteria referred to, economic duress is not easily proved. Further, there are dangers in making a remedy for economic duress too readily available to parties with equal bargaining power, particularly if they are substantial businesses with access to legal and managerial skills of a high order³¹. (See below as to the balance of power in negotiation.)

A threat to cease supply may be sufficient to cross the line from what can be regarded as the rough and tumble of the pressures of normal, robust commercial bargaining³². Illegitimate pressure has been recognised by the courts as including threats of violence to the person³³. “No person can insist on a settlement procured by intimidation”³⁴.

However, a threat to repudiate a pre-existing contractual obligation or an unfair use of a dominant bargaining position in itself may be insufficient without coercion³⁵. In *Huyton v Cremer*³⁶ Mance J took the view that a threatened breach of contract may not represent illegitimate pressure if there was a reasonable commercial basis for the threat.

A contract procured by economic duress is not void, but may be voidable

The earlier view was that an agreement made under duress in the form of illegitimate economic pressure amounts to coercion or overbearing of will and thereby vitiates consent³⁷. Thus: “the consent is treated in law as revocable unless approbated either expressly or by implication after the illegitimate pressure has ceased to operate on his mind”³⁸. “[T]he classic case of duress is ... not the lack of will to submit but the victim’s intentional

³⁰ *Adam Opel GmbH v Mitras Automotive (UK) Ltd* (2008) CILL 2561 per Steyn LJ.

³¹ *Equiticorp Finance Ltd (in liquidation) v Bank of New Zealand* (1993) 32 NSWLR 50 at 108–109; 11 ACLC 952, per Kirby P.

³² *Adam Opel GmbH v Mitras Automotive (UK) Ltd* [2007] EWHC 3481 (QB); [2008] CILL 2561.

³³ *Barton v Armstrong* [1976] AC 104; [1975] 2 All ER 465 and *Friedeberg-Seeley v Klass* (1957) 101 SJ 275.

³⁴ *D & C Builders Ltd v Rees* (CA) [1966] 2 QB 617 at 625, per Lord Denning.

³⁵ *Pao On v Lau Yiu Long* (PC) [1980] AC 614 at 635, per Lord Scarman.

³⁶ [1999] 1 Lloyd’s Reports 620 at 637.

³⁷ *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd (The Atlantic Baron)* [1979] 1 QB 705. See also, *Pao On v Lau Yiu Long* (PC) [1980] AC 614 at 635; *Universe Tankships Inc of Monrovia v International Transport Workers’ Federation* (HL) [1983] 1 AC 366 at 384, 400; and *Dimskal Shipping Co SA v International Transport Workers’ Federation (The Evia Luck)* (HL) [1992] 2 AC 152 at 165.

³⁸ *Universe Tankships Inc of Monrovia v International Transport Workers’ Federation (The Universe Sentinel)* (HL) [1983] 1 AC 366 at 400, per Lord Diplock.

submission arising from the realisation that there is no other practical choice open to him”³⁹.

The modern view is that duress operates to deflect the will of the party rather than to vitiate consent. The effect of a finding of duress is therefore always to make the contract voidable, not void⁴⁰. Pressure is illegitimate where it amounts to unlawful threats or unconscionable conduct, but a contract entered into as a result of unlawful threats or unconscionable conduct will be voidable only when the party had no commercial option but to submit⁴¹.

However, even if a contract has been rendered voidable by the application of illegitimate pressure, the victim of economic duress must take active steps to avoid the contract; an affirmation of the contract will nullify any claim for restitution⁴².

“[201] Finally, mention should be made of the topic of rescission or avoidance. Binding agreements vitiated by duress of this kind are merely voidable, and not void. A claim in restitution in respect of money paid pursuant to a binding agreement resulting from such duress requires rescission of the agreement. This accords with the principle that generally restitution does not operate in respect of an effective contract.

[202] Also, even where a plaintiff claims money paid under a contract where the consideration has wholly failed, the plaintiff should elect to be entitled to recover the payment. The election may be made by the institution of proceedings to recover the money.”⁴³ [Citations omitted.]

Duress is determined in accordance with the proper law of the contract

When the pressure takes place in a location that is different from the place of the governing law of the contract, the jurisdiction of the governing law of the contract is applicable in determining whether the pressure amounts to economic duress⁴⁴.

Rescission or affirmation?

A party seeking redress should raise the economic duress argument as soon as it is free from the alleged illegitimate pressure. The effect of duress is to render the contract voidable at the option of the coerced party, who will be entitled to exercise that right by notice to the offending party, unless prevented from doing so by one of the “bars to rescission”, such as the

³⁹ *Universe Tankships Inc of Monrovia v International Transport Workers’ Federation (The Universe Sentinel)* (HL) [1983] 1 AC 366 at 400, per Lord Scarman.

⁴⁰ *IFR Ltd v Federal Trade Spa* [2001] EWHC 519 (Comm).

⁴¹ *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd (The Atlantic Baron)* [1979] 1 QB 705; (CA) [1978] 3 All ER 1170; *Hawker Pacific Pty Ltd v Helicopter Charter Pty Ltd* (1991) 22 NSWLR 298.

⁴² *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd (The Atlantic Baron)* [1979] 1 QB 705.

⁴³ *Electricity Generation Corporation t/as Verve Energy v Woodside Energy Ltd* per Murphy JA.

⁴⁴ *Dimskal Shipping Co SA v International Transport Workers’ Federation (The Evia Luck)* (HL) [1992] 2 AC 152 at paragraph 168.

contract being affirmed. Until the right of avoidance is exercised, the contract is valid.

However, if a party does not act quickly when it considers that it has the right to avoid a contract on grounds of economic duress, it will be taken to have affirmed the contract resulting in the loss of the right to have the contract set aside⁴⁵. There might be a slight divergence between the English approach which seems to require a prompt protest once duress has passed, while Australian doctrine seems to require election or estoppel and some unequivocal conduct inconsistent with any claim for relief from the duress. Nevertheless, it would be prudent for the party claiming duress to err on the conservative side and protest at the earliest opportunity.

If strict restitution of the parties to their pre-contractual position is no longer possible because some benefits have passed under the contract, the assistance of the court in the form of an order setting aside a contract, and associated orders for the adjustment of the parties' position so as to achieve a just result will be required. If money has been paid over, it may be recovered on a "money had and received" count⁴⁶.

Where contracts have been performed, rescission normally involves a consideration of *restitutio in integrum*⁴⁷. However, it has recently been established that the fact that one party cannot offer the other party substantial *restitutio in integrum* on rescission of the contract does not preclude the avoidance of a contract procured by duress⁴⁸. It can also be argued that in equity's concurrent jurisdiction, counter-restitution is unnecessary⁴⁹.

Case study

*North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd (The Atlantic Baron)*⁵⁰ is a striking example of compulsion amounting to economic duress that nevertheless left the plaintiff without a remedy. A shipbuilding company refused to honour a fixed price contract to build a tanker for ship

⁴⁵ In *DSND Subsea Ltd v Petroleum Geo-Services ASA* [2000] BLR 530, Dyson J considered that PGS had affirmed the amended contract because PGS did not raise the argument of economic duress as soon as it was free of the economic pressure, but only after it raised the breach of the amended contract. Cf, in failing to seek to avoid the contract after the duress has been lifted, the party does not ipso facto affirm the contract: *Hawker Pacific Pty Ltd v Helicopter Charter Pty Ltd* (1991) 22 NSWLR 298.

⁴⁶ See e.g., *Universe Tankships Inc of Monrovia v International Transport Workers' Federation (The Universe Sentinel)* (HL) [1983] 1 AC 366.

⁴⁷ R Meagher, W Gummow and J Lehane, *Meagher, Gummow and Lehane's Equity: Doctrines & Remedies*, 2002, 4th Edition, [24-040].

⁴⁸ *Halpern v Halpern (No 2)* (CA) [2007] EWCA Civ 291; [2007] 2 Lloyd's Rep 56; [2008] QB 195; [2007] 3 WLR 849; [2007] 3 All ER 478.

⁴⁹ *Electricity Generation Corporation t/as Verve Energy v Woodside Energy Ltd* [2013] WASC 36 at paragraph 205, per Murphy JA who referred to authorities such as *Hulton v Hulton* [1917] 1 KB 813 at 821 and *Allason v Campbell* (CA) [1998] ECWA Civ 363 at 226–229, discussed in D O'Sullivan, S Elliott and R Zakrzewski, *The Law of Rescission*, (2008) [18.42]–[18.44].

⁵⁰ [1979] 1 QB 705 (CA) [1978] 3 All ER 1170.

owners unless payments were increased to lessen the effect of a devaluation in exchange rates.

The ship owners were at the same time negotiating a very lucrative contract for the charter of the tanker to Shell. The ship owners, fearing the loss of the charter if the vessel was delivered late, replied that although they were under no obligation to make additional payments, they would do so “without prejudice” to their rights, and requested that the shipbuilding company arrange for corresponding increases in the letter of credit. The shipbuilding company agreed to do so in June 1973, and the ship owners remitted the remaining instalments, including the 10% increase, without protest. The tanker was delivered to the ship owners in November 1974 but it was not until July 1975 that the ship owners claimed the return of the extra 10% paid on four instalments, with interest.

The matter was referred to arbitration. The arbitrators stated a special case for the opinion of the court on a question of law. On the question of whether the ship owners had entered into the agreement under duress, the court held that the shipbuilding company’s threat to break the contract without any legal justification unless the ship owners increased their payments by 10% did amount to duress in the form of economic pressure. Accordingly, the agreement of June 1973 was a voidable contract that the ship owners could either affirm or avoid. Mocatta J stated: “compulsion may take the form of ‘economic duress’ if the necessary facts are proved. A threat to break a contract may amount to such ‘economic duress’.” However, since there was no likelihood that the shipbuilding company would resile from the contract to build the tanker at the time she was due for delivery, the ship owners, by making the final payments without protest and also by its delay from November 1974 until July 1975 before making a claim for the return of the extra payments, had so conducted themselves as to affirm the contract. Accordingly, their claim failed. Had the ship owners protested at the time and not delayed in making the claim, they would most likely have succeeded in their claim.

Practical issues in the application of the doctrine of economic duress in construction contracts

Commercial realities

In reality, the resolution of claims requires considerable patience and perseverance; can be a very time-consuming and be very expensive⁵¹.

As time progresses and the contracts move to practical completion, management’s focus shifts to operations and production, and away from construction. The importance of resolving remaining claims is overtaken by more pressing priorities. Particularly in the EPCM (Engineering, Procurement and Construction Management) structure, decision-making

⁵¹ See e.g., *McAlpine Humberoak Ltd v McDermott International Inc* (CA) (1992) 58 BLR 1.

may be cumbersome. Teams may be inadequately resourced, disbanded prematurely or assigned different tasks. External assistance with no background of the project might be sought. “Global settlements” will be proposed. It is at this critical time that a contractor’s threat to withhold delivery, a “go-slow” or circumstances contrived to disadvantage the employer may emerge. Much may be conceded by the employer to achieve a satisfactory outcome. Pressure exerted in this way combined with hard positional bargaining may yield a result for the contractor far beyond merit and their expectation. However, even if such negotiating tactics may be lawful, they may be considered to be morally and socially unacceptable, and the agreement brought about by such illegitimate pressure may be set aside. For the contractor who plays to the employer’s weaknesses, the known consequences of its conduct in refusing to hand over work may be so dramatic as to render threats and demands superfluous. Senior management may not be aware of the legal remedy of economic duress, or may choose to ignore it. Conduct and inaction may affirm the contract, denying the employer the right to recover the amounts paid and concessions made under economic duress.

There may also be an individual at a more senior level who is sympathetic to the contractor’s version of events and receptive to “offline discussions”; who wishes to foster amicable relationships and is inclined to soft, positional bargaining. For the aggressor, the key is to identify that person.

“Many people recognise the high costs of hard positional bargaining, particularly on the parties and their relationship. They hope to avoid them by following a more gentle style of negotiating. Instead of seeing the other side as adversaries, they prefer to see them as friends. Rather than emphasising a goal of victory, they emphasise the necessity of reaching agreement. In a soft negotiating game the standard moves are to make offers and concessions, to trust the other side, to be friendly, and to yield as necessary to avoid confrontation ... The soft negotiating game emphasises the importance of building and maintaining a relationship ... Pursuing a soft and friendly form of positional bargaining makes you vulnerable to someone who plays a hard game of positional bargaining. In positional bargaining, a hard game dominates a soft one. If the hard bargainer insists on concessions and makes threats while the soft bargainer yields in order to avoid confrontation and insists on agreement, the negotiating game is biased in favour of the hard player. The process will produce an agreement, although it may not be a wise one. It will certainly be more favourable to the hard positional bargainer than to the soft one. If your response to sustained, hard positional bargaining is soft positional bargaining, you will probably lose your shirt ...⁵² The answer to the question of whether to use soft positional bargaining or hard is ‘neither’. Change the game.”⁵³

⁵² The accuracy of this advice in a construction context is demonstrated repeatedly in practice.

⁵³ At the Harvard Negotiation Project an alternative to positional bargaining was developed: a method of negotiation explicitly designed to produce wise outcomes efficiently and amicably. This method, called “principled negotiation” or “negotiation on the merits”, relies on four basic points: people — separate the people from the problem; interests — focus on interests, not positions; options — generate a variety of possibilities before deciding what to do; and criteria — insist that the result is to be based on some objective standard. See R Fisher, W Ury and B Patton, *Getting to Yes*, 2nd Edition, Random House Business Books, 1991, pp. 8–11.

Another insightful observation is that: “No matter how many people are involved in the negotiation, important decisions are typically made when no more than two people are in the room.”⁵⁴ While this is true, if disagreements arise later as to what was agreed are not resolved, the “two people in the room” may well find themselves being called upon as witnesses to give evidence. Construction contracts usually require communications to be in writing, but this does not mean that oral communications have no legal consequences. Without appropriate safeguards, conversations may be asserted or denied later in litigation causing detriment to the employer and embarrassment to the individual.

Guidelines and support for management on this topic in advance of any major project can be invaluable. It should not be imagined that the remedy of economic duress will salvage what has simply been a bad negotiation. Whether management of the employer themselves wish to exert pressure in the rough and tumble of commercial negotiation⁵⁵ or find themselves “in a corner”, they should be able to judge for themselves where the line is and be aware of the consequences of crossing it.

All parties to construction contracts are equally susceptible to illegitimate pressure, and needless to say, the same principles apply.

The balance of power in negotiation

It is tempting to simply assume that large international companies entering into a construction contract as employer hold a stronger bargaining position than the contractor, and are therefore unlikely to be subject to economic duress. Due to their significant resources and assets, access to legal and managerial skills and the attraction to contractors and suppliers of their repeat business, senior management in major international resource companies might be forgiven for assuming that their negotiating power is unquestionably the strongest in any dealings they have with contractors and suppliers. This is not always the case. As will be seen, a general assumption as to who is more powerful may be a serious misjudgment.

An incorrect assumption of negotiating power coupled with an absence of sound legal advice and preparedness may prove extremely costly. It is the circumstances, not the size of the employer or the strength of its balance sheet, that will determine who is in the strongest bargaining position in any given situation. In the context of major construction projects, factors such as the employer’s own organisational capability, construction experience, negotiating skills, responsiveness, preparedness, speed of decision-making and appetite for risk in carrying out or managing the work itself which may become significant factors. A larger organisation may have a policy and culture of integrative bargaining.

⁵⁴ Cited above, fn. 53, p. 37.

⁵⁵ *DSND Subsea Ltd v Petroleum Geo-Services ASA* [2000] BLR 530 at 545.

A smaller contracting organisation may well be in a much stronger bargaining position than a large multi-national organisation because of the circumstances, its agility, its relatively low profile and its ability to act opportunistically. The threat of litigation and the attendant adverse publicity might have a much greater potential for reputational damage to the large multinational than to the smaller organisation. It is therefore important not to make assumptions, but to look at the overall situation and make an assessment of strengths and weaknesses before negotiations are started.

There is little congruence between the business culture of an employer and its contractors. The drivers for the employer (in addition to generating profits), are likely to be safety, getting into production, enhancing its reputation and delivering its projects on schedule. The contractor is less likely to be influenced by such factors; its sales are not necessarily repetitive in nature, its short-term drivers most likely being cash-flow, profit and survival. These differences will lead the parties naturally down the path of distributive bargaining, unless active intervention steers them on a different course. This is where the establishment of a Dispute Board at the outset can make a big difference in driving behaviour towards integrative bargaining.

As R Fisher, W Ury and B Patton say in their well-known publication, *Getting to Yes*.⁵⁶

“Negotiating power is the ability to persuade someone to do something ... Whether your resources give you negotiating power will depend on the context, on who are you trying to persuade, and what you want them to do ... Trying to estimate whether you or your counterparts are more ‘powerful’ is risky ... Whatever you conclude will not help you figure out how best to proceed. In fact, a great deal can be done to enhance your negotiation power even when the resource balance is one-sided. Of course there will be negotiations where — at least in the short term — the best cards are held by the other side. But in this increasingly interdependent world, there are almost always resources and potential allies that a skilled and persistent negotiator can exploit, at least to move the fulcrum, if not ultimately to tip the balance of power the other way. You won’t find out unless you try ... The more you try for, the more you are likely to get ...”

The question, then, is how far can you go to tip the balance in your favour before you “cross the line”?

Bargaining: Negotiating tactics, behaviour and economic pressure

Distributive bargaining may include deliberate strategies such as open disregard for the contract, threats of adverse publicity, refusal to follow written instructions, elevating issues by breaching lines of communication for the principal purpose of disturbing established relationships, targeting those of the adversary’s personnel most likely to pose a threat so as to damage their credibility and so neutralise them, and spreading ambiguous

⁵⁶ Cited above fn. 53.

and misleading information calculated to erode the confidence of the employer’s own senior management in the competence of its own execution team. All of these factors should be recognised as potentially part of a planned strategy, and treated on their merits.

In crisis bargaining, issues raised need not be rational, are likely to be chosen for their sensitivity to the other party, and are frequently without substance. The strategy will be to divert attention and resources away from the true priorities, and to unsettle the opponent. The message that management lacks confidence and is questioning the team’s competence undermines commitment and motivation. Large, successful organisations are often impatient for results and generally have a very low tolerance for ambiguity.

Practical choices – the Employer’s Contractual Remedies

When difficulties arise, the first place to look for relief is usually the contract.

Contractors and suppliers are aware that an employer for which they carry out work has deadlines to deliver product, failing which very large sums of money are at risk for breach of sales agreements. An employer’s potential vulnerability to illegitimate pressure should be taken into account in risk assessment in selecting the most appropriate project delivery model and in appointing the most suitable contractor. The sheer size and complexity of EPC (Engineering, Procurement and Construction) and EPCM⁵⁷ (Engineering, Procurement and Construction Management) work packages being awarded today⁵⁸ are such that the replacement of a non-performing contractor is not a simple matter and may cause even more delay and increased cost than continuing with an underperforming contractor (if a substitute contractor can be found at all). The highly complex and interrelated nature of the supply chain⁵⁹ can make it very difficult for the employer to exercise the traditional legal remedies for breach of contract.

Early warning signs of contractual distress include: failure by the contractor to provide bank guarantees, failure to comply with the mobilisation plan, failure to provide a baseline schedule, failure to provide waivers and releases evidencing payment of sub-contractors and suppliers, and failure to achieve milestone dates. These warning signs should be acted on promptly, because the employer’s alternatives may diminish as time passes. Being aware of the

⁵⁷ P Loots and N Henchie, “Worlds Apart: EPC and EPCM Contracts: Risk Issues and Allocation” [2007] 24 ICLR 252.

⁵⁸ Some recent Australian contracts include the US\$57 billion Gorgon LNG Project, the US \$43 billion Ichthys Project, the US\$35 billion Wheatstone LNG Project, the US\$34 billion Curtis LNG Project, the US\$33 billion Kearsley Project, and the US\$30 billion GLNG Project.

⁵⁹ For example, cutting-edge technologies in deep-water pipe laying, subsea installation and well completion require precise coordination with other contractors carrying out related work, extensive planning and the highest technical expertise.

potential for illegitimate pressure is as important as recognising early signs of distress.

Contractual remedies for the employer include: cancellation of the contract; reducing the scope of work; calling the contractor's bank guarantee, letter of credit, or parent company guarantee; or exercising other legal remedies under statute, in tort or in equity. The remedies should be explored and although they may be available, they may still not provide the employer with a satisfactory practical solution to achieving completion safely, on time and within budget. The omission of parts of the work may not be legally or practically feasible. When sub-contractors and suppliers have not been paid by a delinquent contractor, they will be unlikely to cooperate in the assignment of their contracts to the employer unless the payment backlog is made good and the terms and conditions of contract are modified in their favour.

The courts are unlikely to assist with an order for specific performance even if the contract includes a "reasonable endeavours" obligation, because of the difficulties presented in overseeing the execution of such an order. In reality, the employer may find itself in the position where it must unwillingly accept the possibility of assisting the contractor which is in financial difficulties, rewarding bad behaviour by easing cash flow constraints, assisting with unpaid debts to sub-contractors and suppliers, settling large current commitments for the contractor's and sub-contractors' employee wages and other financial obligations, and waiving liquidated damages. In any event, the urgency with which such relief by way of specific performance will be forthcoming might be uncertain⁶⁰.

Replacement contractors will be unlikely to assume liability for partially completed work; safety, quality compliance and certification issues may prove to be major obstacles; and insurance, approvals and licences, confidentiality in and reliance on another contractors' designs, contractors' process patents, know-how and specialist equipment, and the existence of charterparties for purpose-built construction vessels may make any such a transition impractical. The lead time to access alternative specialist equipment and marine construction vessels may be very long (if they are available at all); when modules are being fabricated in low-cost foreign jurisdictions with different legal systems, issues such as liens and title to the unfinished goods are likely to arise. The options for the employer may be extremely limited. Illegitimate pressure is most likely to be applied when the contractor is entrenched but a significant amount of work remains to be done, and later when physical delivery of goods and services becomes of critical importance. Once the work and services are delivered the contractor

⁶⁰ See e.g., *Electricity Generation Corporation t/as Verve Energy v Woodside Energy Ltd* [2013] WASCA 36 at 183, per Murphy JA.

is in a weaker bargaining position. The initial award of the contact to the contractor may be effectively the point of no return for the employer⁶¹.

Other practical choices – Looking for alternatives

Assessing alternatives can be time-consuming. When confronted with a contractor or supplier which is applying illegitimate commercial pressure, the employer should have a pre-prepared plan which may include: a review of the status of the work; an analysis of the employer’s own strengths and weaknesses in each of the alternatives available to it; a review of the status of the sub-contractors and suppliers; and legal advice on each of its options.

At the same time it would be advisable to continue to work with the contractor with a view to changing behaviour and developing a recovery plan. Whether the contractor can be assisted by splitting milestones to enable earlier interim payments should be investigated, as well as whether changes and claims can be processed more quickly and whether neutral funding can be introduced. Records of what has been done to assist the contractor should be kept, and rights must be preserved. Resolution of change requests should be reviewed, contractual breaches recorded and appropriate notices sent.

Any constraints imposed by “own company breaches” should be acknowledged internally under legal professional privilege, and provided for in the plan. Limitations in operational capability of the employer should be recognised and resolved and alternative contractors should be evaluated. The schedule should be reviewed. Payments to sub-contractors and suppliers should be audited. Appropriate communication channels should be enforced, discipline maintained and the execution team’s confidence built up and alignment ensured. The focus on progressing the work should be maintained by way of daily status updates. The impact and consequences of delays to other contracts should be considered and possible mitigation strategies developed.

The loss of time-sensitive subcontracts, such as charterparties, and skilled workers should be avoided. All fixed-time commitments, such as the vessel call-down windows, should be identified. Direct payment to sub-contractors and suppliers, and opportunities for taking assignment of specialist equipment and vessel charterparties should be examined. The time required to obtain approvals for amended plans should be factored in. The management of new and changed interfaces will be critical. The plan should be to adjust the level of resources to match the work-scope and

⁶¹ For major construction contracts in general, the preparatory and bid process to the finalisation of the terms and conditions of the contract and award of the contract can take in excess of a year. Permits, safety cases, work methods and complex calculations have to be undertaken. In marine construction, especially in deep water, extreme caution, planning and diligence is required. In any given situation, there will always be tensions as to time, cost and safety. In the oil and gas industry, safety takes priority above all else.

schedule and to deal with the contractual disputes in parallel. Conversion to a cost-reimbursable form of payment may be the only alternative. The establishment of a Dispute Board allows for disagreements to be dealt with without distraction from the task of completing the work. Dispute Boards have a demonstrated track record in producing greater co-operation between the parties and generate more positive behaviour⁶².

Whether the availability of an injunction or an adjudication were practical alternatives in such a situation was considered in *Carillion Construction*⁶³.

Bending to pressure – Is the illegitimate pressure a significant cause?

The employer may suffer reputational damage and be prejudiced in its standing as operator among its joint venture partners if it is incapable of delivering the project safely, on time and on budget.

Curiously, in some cases, the worse the contractor's performance, the better its bargaining position. Liabilities for late or non-performance are frequently capped at a certain percentage of the contract price. Having reached this cap, the contractor may deliberately minimise expenditure and reallocate its resources to other contracts with greater financial benefit or strategic value, slowing progress even further to the detriment of the employer.

A well-recognised negotiation strategy for the party in the weakest position is to precipitate a crisis on any pretext in order to establish a power base. From this position it can attract the necessary attention from the opposing party to start negotiations (crisis bargaining). It should therefore not come as a surprise to the employer when a contractor in difficulty gives notice of numerous spurious claims, ignores its own failure to perform and pleads an inability to complete the work unless an adjustment to schedule and price is conceded, or indeed refuses to complete or deliver the work unless its demands are met. The way in which the message may be communicated may range from unspoken or unwritten lawful conduct to an illegal threat. As stated by Fisher, Ury and Patton:⁶⁴

“Pressure can take many forms: a bribe, a threat, a manipulative appeal to trust, or a simple refusal to budge. In all these cases, the principled response is the same: invite them to state their reasoning, suggest objective criteria you think apply, and refuse to budge except on this basis. Never yield to pressure, only to principle.”

With the exception of a bribe, there will be situations in which there is no option but to yield to pressure in order to “get the job done”. Fisher, Ury and Patton acknowledge that if there is no give in the opponent's position

⁶² P Loots and D Charrett, *Practical Guide to Engineering and Construction Contracts*, CCH Australia Ltd, 2009, p. 312. See also, The Dispute Resolution Board Foundation at <http://www.drb.org/concepts.htm> (last accessed 10/02/14).

⁶³ *Carillion Construction Ltd v Felix (UK) Ltd* [2001] BLR 1 at 9.

⁶⁴ Cited above, pp. 94–95.

and you find no principled basis for accepting it, you should assess what you might gain by accepting their unjustified position rather than going to your “best alternative”. However, it is important that in accepting the opponent’s unjustified position, you should do so with your eyes open. Protect yourself by taking the right action at the right time.

Redress for economic duress

If, despite its best endeavours to avoid it, an Employer has submitted to economic duress to get its project completed in a timely manner, it can seek to retrospectively “claw back” the economic penalty it has suffered through arbitration or litigation. Ultimate success in such proceedings will depend on whether there is sufficient evidence that economic duress was applied in accordance with the applicable law of the contract, and that the Employer has not lost its cause of action through affirmation of the relevant contract.

Consistent with the Anglo-Australian case law cited above, an employer will need evidence to prove:

- the contractor’s conduct “crossed the line” of robust commercial negotiation and comprised illegitimate pressure;
- the contractor applied the illegitimate pressure to achieve a new or modified contract or a non-contractual financial advantage;
- the employer had no practical commercial alternative but to succumb to the pressure;
- the employer did not, by its subsequent conduct, affirm the offending contract or contractual modification.

Strict contract administration and proper record keeping of meetings and relevant conversations as detailed above is essential; oral evidence of recollected conversations that occurred years earlier are unlikely to be as persuasive as written records. In the case of *DSND Subsea*,⁶⁵ the court considered that the absence of any suggestion of duress in any of the many written communications or the voluminous contemporaneous documents (including the claimant’s internal memoranda and the diary entries of its representatives) was sufficient evidence that illegitimate pressure had not been applied.

The cases show the importance of the victim of economic duress taking relevant action soon after that duress has ceased to operate. Continuing to fulfil its obligations in accordance with the contract without demur is likely to be construed as the employer’s affirmation of the contract, and relinquishment of any rights arising from economic duress.

Subject to legal advice as to the validity and strength of its case, an Employer that conceded to non-contractual payments under economic duress would be justified in subsequently withholding the amount of such

⁶⁵ *DSND Subsea Ltd v Petroleum Geo-Services ASA* [2000] BLR 530.

payments from the contractor; most construction contracts would provide a contractual mechanism for the recovery of such “overpayments”.

Avoiding economic duress

A contractor that seeks to renegotiate the contract terms or obtain additional payments for the consequences of delaying events needs to conduct itself in a way that does not “cross the line”. That is, it must ensure that it only engages in robust commercial negotiation (which it is entitled to do in its own self-interest), and does not exert illegitimate pressure.

The cases discussed above show that illegitimate pressure includes both unlawful conduct, as well as unconscionable conduct that is “morally and socially unacceptable”. A contractor would be well advised to “play a straight bat”, eschewing threats or implications of conduct in breach of contract or otherwise unlawful. Considering alternative courses of action under the contract, exhibiting a willingness to compromise, and avoiding “take it or leave it” proposals should be indicative of legitimate commercial negotiation that forthrightly advances the contractor’s commercial interests. Further, a contractor must be wary of taking advantage of circumstances in its favour that would make a threat unnecessary.

CONCLUSION

Each case will be judged on its merits, but even if lawful means are used, the critical inquiry will be whether the conduct is morally and socially unacceptable. The known circumstances of the conduct may make threats and demands superfluous. The employer should be alive to the tactics of those who abuse a position of necessity to secure an advantage.

Unfortunately it is not unusual for a contractor which finds itself in fundamental breach and in a weak bargaining position to disregard its own failure to perform and to plead or threaten inability to complete the work or to deliberately slow down the progress of work in the knowledge that the employer’s options are limited, and that its caps on liability have been reached. The contractor may call for significant adjustments to the time for completion, contract rates and prices, and cash flow.

From the cases cited, it will be apparent that recording at the time not only what took place, but the circumstances and the manner in which the communications were made, is of the utmost importance. Contemporaneous evidence of the behaviour of each of the parties at that time is likely to play a significant if not decisive part in determining the existence of duress or otherwise. The sophisticated commercial negotiator will be studious to avoid a clear repudiation of the contract,⁶⁶ and may merely hint at the

⁶⁶ *Heyman v Darwins Ltd* (HL) [1942] AC 356 at 378, 389.

consequences of failure to comply with a threat or simply take unscrupulous advantage of a situation of its own making.

It may be difficult to prove unspoken deliberate behaviour, such as intentionally slowing down or re-sequencing the work so as to apply pressure; to contrive a situation in which threats and demands are superfluous. In such circumstances there will be all the more reason to keep continuous and comprehensive records of the circumstances, including: pre-contractual representations; resources and productivity; constantly comparing the planned with the actual; and searching for the true reasons behind the pressure, and the failure to perform. Above all, lodging a formal protest and taking prompt action to rescind the contract as soon as the pressure has ceased are crucial.

At least it can be said that the law, and what is morally and socially acceptable, are aligned, and that there is a remedy against economic duress, if the “victim” is well prepared, and willing to use it.