

ALLIANCING CONTRACTS

A panacea to all that ails construction and infrastructure development?

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There is a clear connection between the pressure points experienced by industry participants in the early phases of a project and the issues that continue to arise throughout its life and which become the subject of disputes ... The future success of projects in Australia's construction industry requires adequate scoping at the outset, as well as adopting the procurement model best suited to the project, with an appropriate allocation of risk between the project participants. Investing time and money to get these issues right up front will produce positive returns for all parties involved.

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Scope for Improvement –
A Survey of Pressure Points in
Australian Construction and Infrastructure Projects
[2007] 1 ICLR 36 at p 54

1. Introduction

Like *déjà vu*, with every new tender comes at least one proposal for an alliance or collaborative working arrangement.

Colourful PowerPoint presentations show value plotted against risk and the presenters talk bafflingly of *high performance teams, business outcomes, peer relationships* and *equitable sharing*. All alliance projects are apparently “on time and within budget”; with no one unkind enough to point out the elephant in the room; that it all rather depends on the budget and the timeframe.

Like presentations from Amway representatives in the days of yore, there is only so much good news you can take before you start wondering about the specifics. All too often, there seem to be pitifully few of them.

2. Traditional Structures

To understand the core principles of alliancing arrangements, it is important to understand where they fit in the spectrum of available and commonly used contracting structures.

Traditionally, the owner would engage a design consultant; a brief would be prepared and agreed, and the designer would then proceed to prepare outline then definitive and tender designs and specifications. The designer would then call for tenders based on a reasonably detailed design. Ideally this design would define the project sufficiently for the builder to price the work, and complete it within that price.

This relatively straightforward arrangement reflected the strengths the parties brought to the project, and usually followed a sensible allocation of risk. It is also fair to say that the traditional approach has also resulted in a level of dissatisfaction with cost overrun, delay and dispute.

Perhaps in recognition of the relative technical in experience of owners, or the increased role of funders, in the late 1980s, early 1990s, there came a concerted move towards single point of responsibility contracts, in the form of design and construct and turnkey. These had the benefit of increased price certainty and the early utilisation of the contractor's skills, albeit at the increased risk of dispute if best practice is not followed.

With more creative funding structures and the growth of capital markets, PPP projects, and their cousins the DBO, DBFO and BOT, increasingly pushed funding, operations and other typical owners' risks on to contractors. The owners were becoming less involved in the day to day operational aspects of their projects, funders were becoming increasingly more assertive.

There was also recognition in the 1990s that successful projects clearly benefit from good working relationships at project management level. Partnering charters, providing for good faith behaviour, open sharing of information and increased communication (as used for the construction of *Te Papa*) became increasingly popular. These charters did not substitute traditional contractual arrangements, but supplemented them by outlining how the parties would behave under the contract.

In each case, the roles of the parties, and the allocation of risk changed significantly.

On a continuum, with traditional employer design and contractor construct at one end and the more imaginative PPP structures at the other, with design and construct somewhere in the middle, it is easy to see risk and responsibility progressively pushed from the owners to the contractor. Alliances do not easily fit into this continuum.

3. **The need for change**

In the survey conducted in Australia in 2006 referred to in the quote at the head of this article, a number of causes for project disputes were identified (almost always turning on cost overrun and/or delay). First and foremost was a shortage of skilled resources, followed by inadequate scoping, the use of inappropriate delivery methods, inequitable risk allocation and unrealistic time and cost objectives. Sir Michael Latham's report on contracting in the UK (*Constructing the Team*) in 1994 reached similar conclusions, focusing as it did on best practice.

The traditional procurement strategies compound these problems in a number of ways, principally by laying the ground work for dispute by promoting an adversarial relationship during the competitive tender process and the tendency to provide inadequate or incomplete information to bidders during the tender process, and to use the tender process to pass increasingly unmanageable and inappropriate risks on to contractors. While this may give the initial appearance of providing greater project certainty, the certainty doesn't come without the cost of an increased risk of claim and dispute.

When disputes do arise, the parties show a reluctance to engage early and to deal with the issues in the best interests of the project before legal positions become entrenched.

Somewhat surprisingly, owners and their advisers also continue to opt for contracts and delivery methods they are familiar with, rather than those which suit the particular needs of the project.

4. **Alliances and Collaborative Working Arrangements**

Conversely, the alliance model proposes more cooperative relationships, with its less legalistic approach.

The core elements of the alliance model are:

- (a) the project is controlled by the *Alliance Board*, made up of representatives of the owner, the contractor and often the designer. All decisions of the board are to be unanimous and are to be in the interests of the project,
- (b) the project is undertaken on an open book basis with a fixed return by an *integrated development team*, comprising relevant expertise from all parties preferably located together at the site,
- (c) the legal relationship avoids blame (the use of the word *default* not used), with a contractual ban on disputes, no warranties, clear limitations on liability and a pain share/gain share arrangement on project outturn cost.

Target outturn cost is established based on actual net cost (Limb 1), which is cost reimbursable, and an agreed margin (Limb 2), which is fixed, but at risk through the painshare/gainshare arrangements. Typically, this will mean that any savings will be shared under an agreed percentage, which can be adjusted based on agreed *key performance indicators*, like safety, community involvement, consent compliance or timely delivery.

Conversely, pain, measured by the amount by which the actual outturn cost exceeds the target outturn cost, is shared by a different percentage up to the contractor's profit on the project (Limb 2).

One curious consequence to this model is that no warranties are provided, and similarly there is no talk of liability for defects. The main focus is on actually rectifying defects properly. This is more problematic where the defects arise after the relatively limited defects correction period has expired (eg latent defects). While the project or the project designers will carry professional indemnity insurance, where neither the designer nor the contractor are *liable* in the traditional sense of the word (save for wilful default), there is considerable doubt about whether or not the owner would get the benefit of such cover.

It seems to be the hallmark of alliance contracts that considerable risks, not least cost control, get transferred to the owner.

5. Implications for Project Risk

In the majority of projects, where risks can be identified and properly managed through traditional contracting arrangements, alliancing arrangements will give little benefit and potentially significant costs.

However, where it is difficult to allocate risks sensibly or where there are complex issues which are difficult to manage, alliance arrangements between competent parties have much to offer. When successfully implemented, the integrated project team focuses on project delivery and high performance, rather than their exposure under the contract. By guaranteeing payment of the cost of the works, and putting the contractor's return at risk, the rationale is that the contractor is then incentivised to deliver the project as quickly and with as many savings as possible.

The down sides are that most, if not all, of the concerns raised in both the recent Australian survey and the Latham report can be addressed by selecting an appropriate contract structure, and amending it as necessary, without such a significant transfer of risk to the owner. Selecting and negotiating with only high performing project teams, and investing time in defining the scope and the cost goes a long way towards reducing project risk.

For contractors, the alliancing model can be very attractive. The payment of cost (Limb 1) is assured, with only the contractor's margin (Limb 2) being at risk. Further, when painshare/gainshare is measured against achievement of key performance indicators, contractors can become more focused on maximising the KPI score than on achieving project completion, achieving the underlying KPI measure, or controlling project cost.

Typically, the owner's responsibility is to pay for the works. While it has become common to speak of the owner "owning" some of the project risks, the reality is that such ownership simply means payment. Regardless of who "owns" the risks, it is the contractor who is in the best position to identify, avoid, manage and mitigate the effects of any risk. All the owner can do is to pay.

Under an alliance, the owner is in the project team with the contractor and the designer, where arguably it has little to add under a traditional allocation of risk.

6. Conclusion

There are considerable difficulties with traditional contracting practices, not least a reluctance to be imaginative and flexible in dealing with project risk.

Alliancing arrangements go a considerable way to dealing with those difficulties. However, guaranteeing payment for all project costs provides little incentive for keeping costs under control; particularly when relatively modest contractor's margin is at risk.

However, where there are complex project risks, many alliancing concepts are useful. To my mind, there are few, if any project risks which cannot be managed by appropriate allocations of risk under more traditional contracting structures.