

ALLIANCE CONTRACTING IN AUSTRALIA: NEXT STEPS

Project alliancing is a distinct, project-specific, form of relationship contracting.¹ Under an alliance contract, the parties agree to work cooperatively, on an open book basis, with commercial incentives (painshare/gainshare) based on project outcomes, controlled by a (joint, senior) project alliance board and alliance management team, and on a “no dispute” basis.

Origins

Graham Thomson, in perhaps the earliest substantive paper on project alliancing, entitled, “Project Alliances”, AMPLA Yearbook 1997², suggests the following “*Principles of Project Alliancing*”:

- (a) *a primary emphasis on the business outcomes for all parties;*
- (b) *clear understanding of individual and collective responsibilities and accountabilities;*
- (c) *an equitable balance of risk and reward for the parties;*
- (d) *encouragement of openness and co-operation between the parties;*
- (e) *encouragement to develop and apply innovative approaches and achieve continuous improvement;*
- (f) *access to and contribution by the expertise and skills of the parties; and*
- (g) *a commercial basis which offers the opportunity to achieve rewards commensurate with exceptional performance.*

The drivers in favour of this type of project delivery were perceived, then and now, as including:

1. improved performance through commercial joint risk/reward incentives
2. avoids draconian contract terms/lack of trust/lack of co-operation
3. parties focus on project outcome (“win-win”), rather than individual claim entitlements

Since that time, in Australia, there has been a substantial number, and substantial contract value, of alliance contracts that have followed, and a large number of academic papers produced³.

During the last decade, in Australia, the government agencies have voted with their feet. Public sector alliance contracts in Australia rose, dramatically, from a steady total contract value of around \$1 billion, up to the years 2004-2005, to a steady total contract value of around \$10 billion, from the years 2004-2005 to the present date, as depicted in Figure 2.4 below, from the seminal Report entitled, “In Pursuit of Additional Value: A benchmarking study into alliancing in the Australian Public Sector”, by Dr Colin Duffield and Evans & Peck⁴.

The substantive recent take-up in the public sector of this form of project delivery speaks volumes. Though Duffield et al, correctly, identify the VFM drawbacks in the alliancing model, alliancing will

¹ Graham Thomson, ‘Alliance Partnering as a Tool for Project Delivery’ (paper presented at the Building for Growth Innovation Forum, Sydney, 4-5 May 1998).

² Thomson, G. (1997) ‘Project Alliances’, Australian Mining and Petroleum Law Association Yearbook (AMPLA), 127-146

³ See, for example, the listing of research in Clifton, C., Duffield, C., Tang, W., McMullan, J., Beck, P. & Morgan, P., 2002 (updated A Vaccari 2009), “Alliance Contracting - A Resource and Research Bibliography”, Department of Civil and Environmental Engineering Research Report RR/091/02. The University of Melbourne.

⁴ Report commissioned in October 2009 by the Department of Treasury and Finance Victoria, entitled, “In Pursuit of Additional Value: A benchmarking study into alliancing in the Australian Public Sector”, by Dr Colin Duffield and Evans & Pec

be likely to remain the model of choice when factors relating to technical or commercial complexity, and/or the need for early commencement, rate higher on a particular project than cost outcome alone.

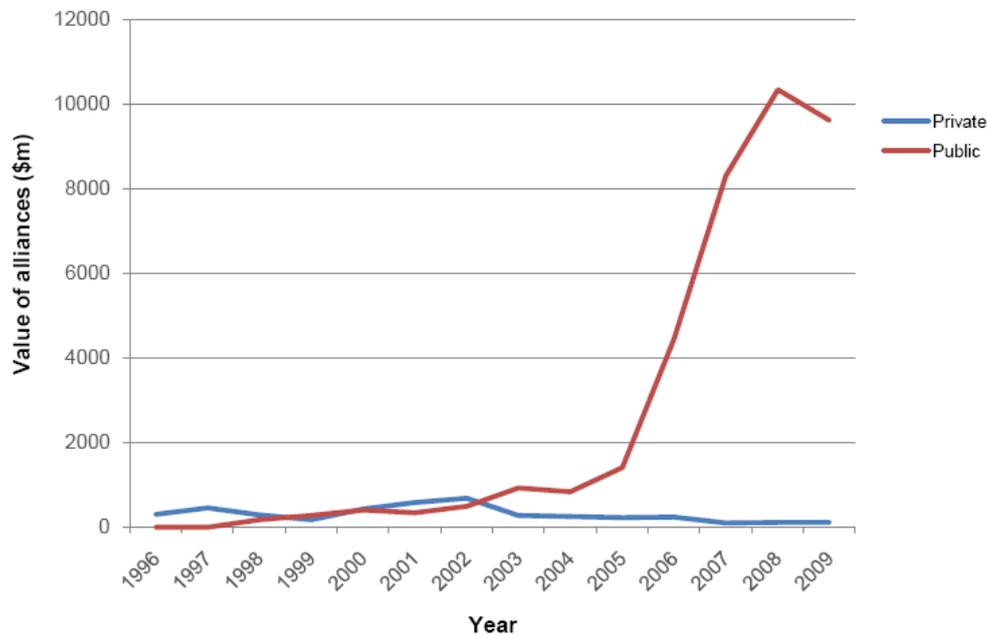


Figure 2.4: The use of alliancing in public and private sectors ⁴

The source data for 'private' in Figure 2.4 has been adjusted to reflect two major private sector projects that have been delayed or cancelled since the information was collected.

Features of Alliance Contracts

The key drivers in relation to alliance contracts are based on relationship contracting, rather than the parties having their separate contractual rights based on their original commercial bargain. The parties agree to work cooperatively, on an open book basis, with commercial incentives (painshare/gainshare) based on project outcomes, controlled by a (joint, senior) project alliance board and alliance management team, and on a “no dispute” basis. The substantive aim is for a win-win (or lose-lose) project outcome.

Alliance contracts, typically, have the following features:

1. work sharing according to “best person for the job” selection criteria
2. management by alliance board/alliance management team
3. open book contracting
4. commercial risk/reward incentives based on project outcomes
5. no dispute

Thomson⁵, in 1997, set out the following *points to consider in relation to a development/construction contract, including:*

- *defining direct costs*
- *agreeing overheads*
- *agreeing forecast costs*
- *agreeing risk/reward regime*

⁵ See note 3 above.

- *agreeing key performance indicators*
- *audit provisions (Open-book nature of alliancing)*
- *consequential loss: limitation of liability*
- *“no dispute”*
- *design (especially state of completion)*
- *variations*
- *extensions of time*
- *force majeure*
- *remedial work and defects liability*
- *insurances and indemnities*
- *dispute resolution*
- *termination*

Those commercial checklist items are relevant, still, 20 years later. Modern alliance contracts typically include provisions as follows:

- Project Objectives/Mission
- Project Alliance Principles/Charter
- Project Alliance Board
- Project Alliance Management Team
- Performance of the Work
- Payment
- Variation to TOC
- Extension of time
- Performance Payments: Painshare/Gainshare
- Insurances
- Securities
- Indemnities/Limitation of Liability
- Intellectual Property
- Confidentiality
- No Dispute/Resolution of Internal Disputes

Separately, the public sector procurement methods have been driven progressively by pre-contract requirements of government, typically including;

1. preparation of the Business Case
2. tender selection, generally on non-price criteria
3. joint development by the Owner and the preferred Non-Owner Participants (NOP) of the Target Outturn Cost (TOC)⁶
4. execution of Project Alliance Agreement

Ultimately, the parties will each derive a higher return depending upon the Actual Outturn Cost (AOC) relative to the TOC, and the actual completion date relative to the Project Schedule.

The documents and processes, correctly, vary project to project, and evolve with time. It seems, however, that the key features of alliance contracts have not moved in any substantive way over the last 20 years⁷.

⁶ On some projects, the owner has proceeded to TOC stage with 2 short-listed tenderers, seeking a price competitive benefit, then selecting between those tenderers on predominantly price criteria.

⁷ The fact that the substantive features of alliance contracts have not changed over that period is, perhaps, a positive indication in relation to user satisfaction?

Future of Alliance contracts in Australia

The key area in which alliance contracts are least attractive as a project delivery tool is price certainty/value for money (VfM).

Duffield et al, in their *In Pursuit of Additional Value*⁸ make a number of key findings, including :

1. *Business cases often did not clearly define the project VfM proposition to the rigour required for investment decision making.*
2. *Generally NOPs have a strong preference for alliancing over other traditional delivery methods. Additionally, NOPs have a strong preference for non-price selection approach over price selection approach.*
3. *Often physical works commenced prior to finalising the commercial arrangements with the NOPs.*
4. *In general the agreed (initial) TOC was higher than the business case cost estimate. The average increase was of the order of 35-45%.*
5. *A variety of commercial terms and conditions were found in the PAAs. In particular:*
 - *NOP corporate overhead and profit: Generally fixed upon agreement of the TOC, often variable as a percentage of actual costs.*
 - *No blame clause: Generally unconditional; little indication of modified clauses.*
 - *Dispute resolution: Generally silent; little indication of express provisions for resolution beyond the Alliance Leadership Team (ALT) (outside the alliance).*
 - *Incentive/penalty arrangements on time: Generally included; often not.*
 - *Owner reserved powers: Often reserved powers stated; sometimes not.*
 - *Performance security by NOPs: Little indication that security was required; generally not.*
6. *In general, Owner representatives (regardless of approach to selecting NOPs) rated their alliance's performance in all areas of non-price objectives as above expectations or game breaking.*
7. *The project's physical works were able to be commenced many months in advance of what would have been possible using traditional delivery methods (as noted elsewhere) leading to a commensurate earlier completion date.*
8. *The majority of projects met the Owners' target completion dates as set out in the business case.*
9. *There were no indications of any disputes between the Owner and the NOPs that needed to be resolved outside the alliance.*
10. *In general there was an increase from agreed (initial) TOC to adjusted (final) TOC. The average increase was of the order of 5-10%.*
11. *In general, the AOC was less than the adjusted (final) TOC. The average saving was of the order of 0.5%.*

Duffield et al conclude, among other things, that:

*....As a collaborative delivery method, **alliancing has demonstrated its ability to avoid disputes, improve non-cost outcomes and commence projects earlier** than by traditional methods.*

but that:

*To extract the optimum VfM from alliancing, **changes must be made at both the alliance and whole of government levels.***

This is surely the key issue for alliance contracting in Australia today. There is little doubt that public sector owners choose alliance contracting as a valid project delivery model on a substantial (vast) number and contract value of projects today.

⁸ See note 5 above.

The drivers for this selection by public sector owners seems obvious:

1. early commencement of projects (often, before clear technical and commercial details have been finally resolved);
2. the ability to promote non-cost objectives highly valued by the public sector (eg environmental values, community stakeholder values,);
3. no disputes.

Despite these attributes, it is also clear that public sector owners are driven by public interests committed to improving the value for money proposition (this can be seen by the substantial number of Guides/studies published by various state government Departments of Treasury around Australia⁹). This will be the next challenge for alliance contracting in Australia. Perhaps improved VfM is to be obtained from any further enhancements/improvements that might be dragged out of the following types of area, already highly advanced:

- competitive tendering up to TOC stage
- project alliance board/alliance management team methods
- enhanced painshare/gainshare models

Around 2000, I commented¹⁰ that the traditional Anglo/USA confrontational style of contracting in international BOT projects in East Asia was dominant, even though many countries in that region were more culturally attuned to some form of co-operative form of transacting. Appelbaum¹¹, for example, argued that the rise of the East Asian economies, especially China, might lead to the decline of North American and European global economic dominance and its associated legal forms, and reasoned that Confucianism (with its hostility to lawyers and confrontation) and communism (with its emphasis on party rule) afforded cultural barriers to the adoption of western legal practices in China and Hong Kong. He commented that the Chinese culture of *guanxi* is substantially embedded in those markets. Accordingly, he suggested, we would be more likely to observe, over time, legal practices dominated by regimes of “flexible accommodation....(which) would seem to have an affinity for the informality and personal networks long associated with Chinese businesses“.

In my view, the nature of alliance contracting has overtones of such cultural preferences: towards relationship contracting, away from traditional Anglo/US confrontational contracting.

J McMullan
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⁹ See, for example, the following, cited in *In Pursuit of Additional Value*: Department of Treasury and Finance, Victoria, 2006. Project Alliancing Practitioners’ Guide. State Government of Victoria; Department of Treasury and Finance, Victoria, 2008. Investment Lifecycle Guidelines. State Government of Victoria; Department of Treasury and Finance - Commercial Division, Victoria, 2009, Guidance Note No. 1 - Language in Alliance Contracting: A Short Analysis of Common Terminology. Guidance Note No. 2 - Insurance in Alliance Contracting: Selling Insurable Risks. Guidance Note No 4: The reporting of VfM outcomes in alliance contracting. State Government of Victoria; Department of Treasury and Finance, Victoria, 2009. Good Practice Guidelines: Developing a State Purchase Contract Business Case. State Government of Victoria; Department of Treasury and Finance, Western Australia, 2002. Partnerships for Growth, Policies and Guidelines for Public Private Partnerships in Western Australia. ISBN 0 7307 4507 4. Government of Western Australia; Department of Treasury and Finance, Western Australia, 2009. Review of Alliance Contracting (Draft). Government of Western Australia

¹⁰ J McMullan, “Globalising Trends in BOT Projects in East Asia”, 27 Asia Business Law Review, January 2000

¹¹ Appelbaum R, “The Future of Law in a Global Economy”, Social and Legal Studies Vol 7 (2), p 171.