MinterEllison LAWYERS

# alliancing

## a glimpse of the real world view

Phillip Greenham

# About the author

**PHILLIP GREENHAM**
**Partner, Minter Ellison**
LLB, BSc

Phillip has over twenty years experience in the area of construction law and now heads the Construction, Engineering and Infrastructure Group in the Melbourne office of Minter Ellison. He has acquired a wealth of experience in all types of construction and infrastructure projects. He has been involved from project concept and structuring, through project management to the resolution of any disputes that might arise.

Phillip has a particular interest in procurement methodologies relevant to the construction industry and public sector procurement generally.

Phillip acts on behalf of government and public authorities as well as high profile public sector clients.

His experience covers a range of projects including the Mitcham Frankston Freeway (EastLink); Melbourne City Link Project; the Melbourne Sports and Aquatic Centre; the Melbourne Multipurpose Venue and the Ballarat Police and Courts Complex.

Phillip regularly presents at seminars to clients and industry organisations on topics that include alliancing, insurance law in the construction industry, competitive tendering, contract management and partnering, dispute avoidance and resolution.

He is member and former President of the Building Dispute Practitioner's Society; an Associate of the Institute of Arbitrators and Mediators and a member of the Law Council of Australia. Phillip is also a founding member of the Alliancing Association of Australasia. He has been named in The International Who's Who of Construction Lawyers and The International Who's Who of Business Lawyers.

# About Minter Ellison

Minter Ellison is an international law firm with a strong Asia Pacific focus. Established in 1827, we have built a legal group that is ranked the largest in the Asia Pacific and the 13th largest in the world.

With more than 1300 specialist lawyers through an integrated network of offices across Asia, Australia, New Zealand, the UK and the US, Minter Ellison supports both local business and international companies with a range of services.

In addition to being recognised as a market leader in the Asia Pacific and a key adviser to leading multinationals and Fortune 500 companies, our people have been independently recognised among the world's pre-eminent lawyers.

Our success is based on sticking to what we are good at – cross-border deals, big employment-related assignments, major infrastructure projects, capital markets/IPO transactions, energy and resources, and telecommunications and technology – and the values that drive our behaviour: integrity and trust; enduring relationships; balance; and excellence.

For more information about Minter Ellison please visit www.minterellison.com

# Contents

# 01
# The project

## Background

Alliance contracting has been in use in Australia for more than a decade. It is growing in popularity due to its potential to: limit disputes, work within resource limitations and thereby assist projects to be delivered on time and within budget.

Over the past two years, Minter Ellison, a recognised leader in the field of alliance contracting, conducted a number of seminar presentations on the subject of collaborative or relationship contracting generally.

During the course of these presentations it became apparent that while there is growing interest in alliance contracting there is still some pervading confusion regarding its practical application.

I have sought to address some of this confusion by undertaking an anecdotal research project through which I have pooled some of the knowledge, opinions and foresights of those directly involved in alliancing in Australia.

This paper will detail my findings into what is a "real world view" of alliancing in Australia.

## Methodology

Interviews were conducted with some 40 senior participants in the Construction, Engineering and Infrastructure industry throughout Australia. These included principals, contractors, financiers, insurers, designers, contract administrators and alliance consultants, all drawn from both public and private sectors.

I gratefully acknowledge the time and openness with which respondents shared their knowledge, experience and opinions.

# 02
# What is an alliance?

Alliancing is a project delivery methodology. It exists as one of a number of methodologies, including Construct Only, Design and Construct, Construction Management, Build Own Operate and Transfer.

Broadly there are two main types of alliancing:

(a) project alliancing; and

(b) strategic alliancing.

In a project alliance the alliance team is constituted for one specific project. The team is usually dissolved upon completion of the project. In this case, the project is typically (although not always) the delivery of some form of physical infrastructure, such as a road, a mineral processing plant or an engineering facility. This type of project alliance tends to be short term, with a duration of say 1 to 3 years.

However, in some situations, arrangements can become extended to cover the ultimate operation of the facility (such as operation of a toll road or a petroleum refinery), such that the alliance becomes extended over a period of time, perhaps 10 to 20 years. While still confined to a particular project, it begins to take on some the characteristics of a strategic alliance.

My research found that often a long term project alliance grows out of an arrangement that begins with a more traditional delivery methodology (such as a 3 year facilities management contract that is regularly renewed). In some cases this leads to the parties formally documenting an alliance agreement; in others, while there is no formal documentation, the behaviours become consistent with that of a formal alliance.

02

By contrast, a strategic alliance is formed to exploit a particular segment of the market (such as the various parties that may be involved in pine plantation farming and harvesting, or those concerned with the exploitation and marketing of a particular mineral).

At the inception of a strategic alliance, the number, nature, scope and duration of future projects may be unknown.

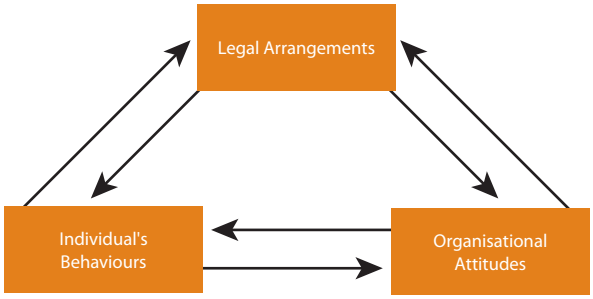
03

# The key characteristics of an alliance

There are two sets of characteristics within an alliance – those that pertain to legal arrangements and others that relate to behaviours. To fully understand an alliance both characteristics must be considered.

These legal and behavioural characteristics interact to form either a positive reinforcing pattern or a negative undermining pattern, depending on the early experiences. This interaction is depicted in Figure 1.

Figure 1 - Interaction of legal and behavioural characteristics




The key characteristics of the legal arrangements of an alliance are:

(a) absence of a fixed lump sum cost (the remuneration is primarily cost reimbursable);
(b) a sharing of all (or almost all) risk and responsibility;
(c) consequent on the sharing of all risk and responsibility, the absence of individual or several liability;
(d) connected with the sharing of all risk and responsibility, the presence of a financial risk sharing mechanism (the *gain share/pain share mechanism*); and
(e) an inability for any party to bring legal proceedings against any other party.

The key characteristics of the behaviours demonstrated under an alliance are:

(a) cooperation and collaboration;
(b) team work – often described as a 'virtual organisation';
(c) mutual support and respect;
(d) accountability, whilst maintaining the shared responsibility elements discussed above;
(e) outcome and problem resolution focus; and
(f) a 'best for project' focus.

There was a variance in the views of those I interviewed on which is the more critical of these two types of characteristics. It is my view that for the alliance to be successful, a blend of both legal and behavioural characteristics are essential.

Imposing the legal framework on a team that has not committed to, and is not capable of implementing the necessary alliance behaviours will not lead to success. On the other hand, if the team displays alliance behaviours they will probably enjoy a successful project whatever the legal framework.

The legal framework, which supports, and is supported by, the organisational framework, will assist those who are generally committed to alliance behaviours to remain focussed on such behaviours. For those who are unfamiliar with the alliance framework the legal framework will provide a roadmap for moving forward.

# 04
# The benefits of an alliance

There are two types of benefits which are the result of successful implementation of alliance projects. These are:

- benefits accruing to the project; and
- benefits accruing to the organisations and individuals involved in the project.

Those interviewed cited the following benefits for the project:

- innovation;
- better technical and quality outcomes;
- better value for money;
- timely delivery;
- generally 'better than business as usual' outcomes; and
- avoidance of the poisonous distraction of disputes.

The benefits accruing to organisations and individuals are said to include:

- greater job satisfaction and motivation;
- increased profitability; and
- the transference of alliance behaviours to non-alliance projects.

However, the perceived benefits will vary between individuals and projects. Some of those interviewed were more sceptical than others about the existence of some of these benefits. These, more cautious respondents, described their concerns with respect to:

- the cost reimbursable aspect of alliancing (effectively equating this methodology with an unconstrained 'cost plus' methodology);
- the sharing of risk and responsibility and the associated absence of legal accountability, with its consequent impact on final cost. They fear that this could lower the motivation to produce good quality workmanship or produce inappropriate trade-offs between quality and longevity. The result of this would be the transfer of cost from capital to maintenance.
- the difficulty of a principal becoming comfortable with the 'value for money' delivered by an alliance.

# 05
# Setting up the alliance process

Traditionally, the process for selecting participants in an alliance has been as follows:

(a) Invitations are extended in the usual way; (however it is not uncommon that invitees are selected rather than invitations being open);

(b) a short list is prepared from the responses. The criteria for being appointed to the short list usually includes: competitiveness of the bid in respect of the margin for profits and overheads, technical competence, financial and organisational capacity and compliance with any mandatory requirements;

(c) workshops are convened with each of the short listed candidates. The workshop might be half a day, its prime objective being to determine which of the candidates are likely to be amenable to participating in an alliance project;

(d) the short list is then reduced typically, to two final candidates; and

(e) a further, more lengthy workshop (of perhaps two days) is then conducted separately with each of the two final candidates. It is common that during this workshop a number of case studies or role plays are conducted with a view to observing how the candidates will behave in circumstances when the project is subject to stress.

Following the selection of the successful candidate the alliance agreement is entered into and work begins on settling the Target Outturn Cost ('TOC'). The TOC is the 'reference figure' against which financial performance is judged. It stands in place of a fixed contract sum.

# 06
# The gain share/pain share mechanism

The gain share/pain share mechanism is a key element of an alliance project. It is this mechanism which determines how much the owner pays for the project (in addition to reimbursement of cost) and how much compensation the 'Non Owner Party' (NOP) receives (in addition to reimbursement of cost).

Under a traditional contract the contract sum can be seen to comprise 4 elements. They are set out in Figure 2. Most gain share/pain share mechanisms recognise 5 elements to the total remuneration. They are set out in Figure 3.

Figure 2 – Four elements in a traditional fixed sum

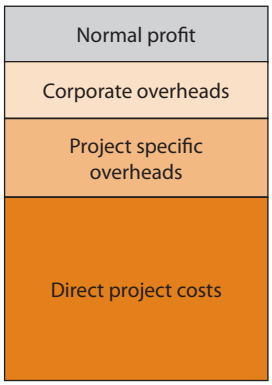
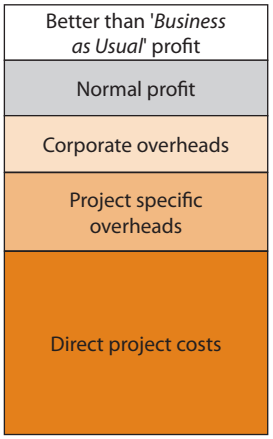



Figure 3 – Five elements in a Target Outturn Cost ('TOC')



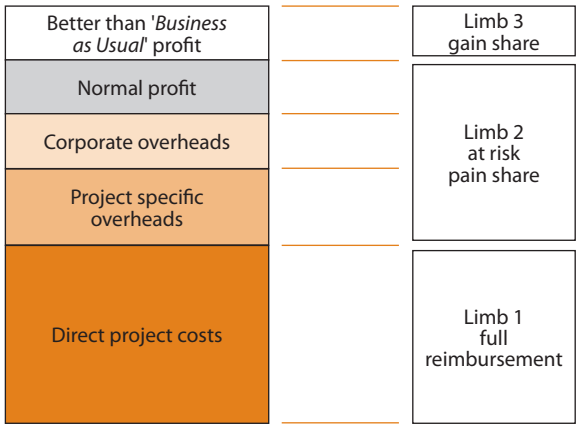

Source: The Department of Treasury and Finance, State of Victoria, 'Compensation framework', *Project Alliancing, Practitioners' Guide*, April 2006, p. 27.

Although Figure 3 is shown as greater than Figure 2 this merely reflects the way the figures are constructed rather than the actual circumstance.

The cost and remuneration elements of the TOC are seen to fall into three limbs. The *gain share/pain share* mechanism may be applied differently to each of these three limbs. The three limbs are shown in Figure 4.

The *gain share/pain share* mechanism is the formula by which the contractor is reimbursed for costs, overhead and profit, and the way in which any cost savings that the project might enjoy are distributed (that is the 'better than business as usual profit'. In respect of the Key Results Area of project cost, the reimbursement or distribution differs depending on whether the final project cost is more or less than the TOC, and by how much the actual project cost is more or less than the TOC.

Figure 4 – The three limbs of the TOC



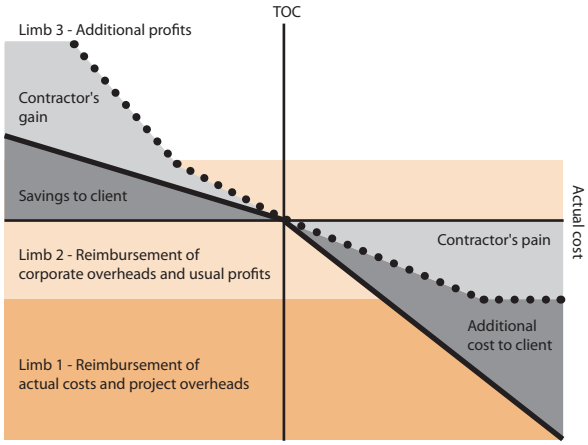

Source: The Department of Treasury and Finance, State of Victoria, 'Compensation framework', *Project Alliancing, Practitioners' Guide*, April 2006, p. 27.

An example of a *gain share/pain share* chart is set out in Figure 5. This mechanism has the following features:

(a) the TOC is within the Limb 2 range – that is the contractor would not obtain all of its 'usual profit' unless the actual cost was less than the TOC;

(b) the contractor's share of savings increases when any savings have exceeded the capacity for the contractor to earn all of its limb 2 'usual profit'.- that is the contractor can earn some 'premium profit' if the performance on cost is particularly good.

Figure 5 - Gain share/Pain share mechanism - Key Results Area is costs



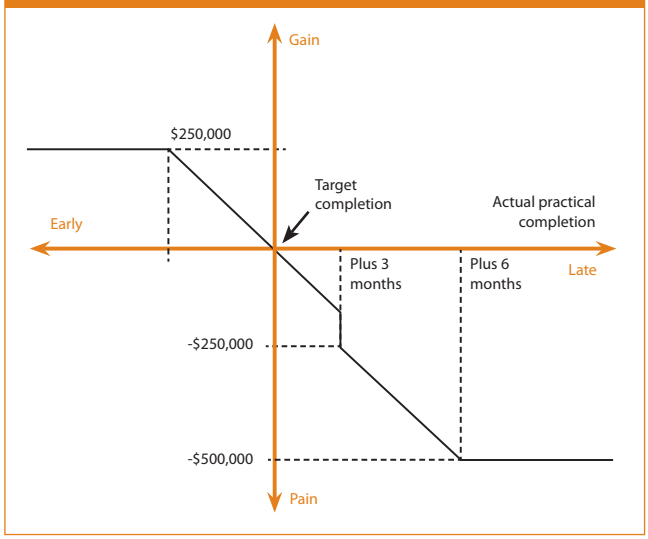

Sources: The Department of Treasury and Finance, State of Victoria, 'Compensation framework', *Project Alliancing, Practitioners' Guide*, April 2006, p. 27.

Australian Contractors Association, 'Relationship Contracting: The Fundamentals', *Relationship Contracting – Optimising Project Outcomes*, 1999, p. 19.

# 06

The *gain share/pain share* mechanism is most often depicted by reference to project costs. However a *gain share/pain share* mechanism can be depicted for any *Key Results Area* ('KRA'). A *gain share/pain share* mechanism in relation to time is depicted is Figure 6.

Figure 6 - Gain share/Pain share mechanism - Key Results Area is time




Source: Presentation by Mr David Stuart-Watt, Director Operations & Services, Road Traffic Authority, New South Wales, 2005.

# 07
# Hybrids

Alliancing is not always implemented in its pure form. Parties will often depart from the theoretical model to more precisely meet their needs. The departures typically relate to:

- whether the alliance is a single TOC or a dual TOC (competitive alliance) – this departure is discussed later in this paper;
- risk allocation; and
- the structure of the *gain share/pain share* mechanism.

There are some who consider targeted or several allocation of risk to be permissible and appropriate in an alliance context. Targeted or several allocation of risk involves excising a number of risks from the general pool of shared risks. One such risk might be the performance of subcontractors under the control of an alliance participant. This risk might be borne exclusively by the prime contractor participating in the alliance.

There are a variety of views on this issue. The purists see this approach as inconsistent with the philosophy of alliancing and a threat to the success of alliancing in the same way that they see competitive alliancing as a threat. Others consider that limited or rationed several allocation of risk is appropriate and does not violate the underlying alliance philosophy. Those people also acknowledge that excessive quarantining or excision of risk would be problematic in an alliance. Finally, there are those who consider that a decision can be made on a risk by risk basis and that anything short of wholesale several allocation of risk is compatible with an alliance framework.

Associated with this risk issue is the structure of the 'gain share/pain share' mechanism. Should all 'gains' and 'pains' be equally shared in the same ratios or should there be greater granularity with financial outcomes caused by particular events being treated differently to the general 'gain share/pain share' formula. The structuring of a 'segmented differential gain share/pain share' mechanism can easily be a Trojan horse for several allocation of risk.

A preference for 'non segmentation' of the 'gain share/pain share' mechanism does not necessarily extend to disinterest in a different approach being taken to the way in which the 'gain share/pain share' mechanism applies to the different limbs of recovery. The recovery of limb two financials (corporate overheads – project overheads) are typically included in the cost reimbursable element, whereas limb three financials (profit) can be treated differently by the

07

'gain share/pain share' mechanism. Indeed, displaying variability between these two limbs can secure even stronger performance from the industry participants.

The potential evolution of hybrid models is an important one. Many people considered that earlier attempts at collaborative or relationship contract, such as partnering, foundered on the hybrid rock. Those people considered that excessive dilution of the essential elements of an alliance contract would inevitably see alliancing flounder in the same way. This would leave the industry with the 'tried and true', but wearingly fallible, traditional methodologies.

The general view was that 'a tailored suit always fits best' and that the selection of the most appropriate core methodology, combined with the refinement of that methodology to suit the idiosyncrasies of the participants and the undulations of the project, will deliver the best results. In other words, if the motivations and behaviours are in tune, then alliancing will withstand hybridisation.

08

# Criteria and motivation for using alliancing

While a small number of those interviewed considered that alliancing principles could be applied to all projects, the vast majority believed that the alliance approach was not universally employable. However, it was a commonly held view that the focus on outcomes and collaboration, that are characteristic of alliancing, would benefits all projects.

There was consensus amongst those interviewed regarding the central criteria that a project should satisfy in order to be an appropriate candidate for an alliance. These relate to:

- risk;
- scope;
- timing;
- operating environment;
- relationships involved;
- size and cost; and
- technical solution

## Risk

The nature of the risk that is associated with a project was considered to be the most important criteria. Those projects which carried with them imponderable risks, risks that are difficult to define, explore or understand as well as projects that encompass a high level of technical or execution risks were regarded as ideal candidates. On the other hand, projects with a well understood risk profile, which participants felt familiar and comfortable with (such as a greenfields, vanilla road project) were not regarded as strongly benefiting from an alliance approach.

It is sometimes difficult to identify all of the key risks that might impact on a project or to assess the likelihood of those risks occurring, or the impact of those risks if they do occur.

In some instances the response to the difficulties of identifying all of the key risks that might impact on a project, assessing the likelihood of those risks occurring or the impact of those risks if they do occur, is for the Owner to seek to pass all of the risks to the Contractor. Many would consider such an approach to be inconsistent with appropriate principles of risk management. Many would also be of the view that attempts to transfer imponderable or difficult to assess risks is ultimately ineffective. The contract documents might appear to be successful in transferring such risks, however, the stresses and behaviour which become manifest if such a risk eventuates, and the disputes which are then likely to follow, (with all the cost and uncertainty that is associated with such disputes), often negate the protection which the Contract sought to secure. There is also a view that the transferring of such risks is often economically inefficient – the Contractor builds in a premium to cover the risk and the premium is paid, whether or not the risk eventuates.

Alliance contracting is considered by many to be an appropriate methodology when such risks are associated with a project. The Owner does not pay the risk premium in circumstances where the risk does not eventuate. If a risk does eventuate then, as a result of the shared exposure to the consequences of the risk eventuating, there is a collective focus on minimising the impact of the risk.

08

## Scope

Projects in which the technical solution or the scope is not sufficiently understood at the commencement were often described as ideal candidates for alliancing. Many considered that, in these cases, the benefits of alliancing are twofold. It can allow for maximisation of innovation (thus providing the best possible technical solution) as well as permitting the parties who deliver the physical project, maximum involvement in the definition of the scope and provision of that technical solution. This has the prospect of reducing costs.

Some of those interviewed were, however, cautious about this approach. They believed that the principal would be better served by delaying the project commencement until the scope could be more fully and precisely defined.

## Timing

Traditionally projects are primarily delivered sequentially. This model requires a significant design effort prior to the start of the project and, as a result, can delay its commencement. Alliancing has been found to allow greater parallel activity, thereby significantly reducing the time for project delivery.

Many people are of the view that it is possible to commence and complete an alliance project in less time than the same project could be delivered using an alternative delivery methodology. The reason for this is said to be the ability to engage with the principal contractors prior to the project being fully defined or documented and the associated ability for parallel activity processes to be followed rather than sequential programming. Indeed many projects have come to be delivered as alliance projects because proponents believe that the relevant time deadlines could not be met through any other delivery methodology.

## Operating Environment

Delivering a project in a non-greenfields context was regarded, by those interviewed, as being particularly difficult. Examples include the upgrade of an existing highway, the maintenance or upgrade of an existing processing plant or new works within a busy transport corridor. These brownfield projects bring an element of complexity and, at times, unpredictability, in relation to the risks that might afflict the project, making them suitable candidates for alliancing.

## Relationships

There are two distinct types of relationships that can exist within a project, 'command' and 'third party'.

Some projects involve many third parties, such as the presence of adjoining landowners and community interest groups.

Other projects may have a complex management or command structure associated with them. This could arise if the participants in the project are involved in complex ownership arrangements or complex governmental structures.

In both these cases, the nature of relationships may produce a risk profile which can potentially make the project a suitable candidate for alliancing.

## Project Cost

Many of those I interviewed considered a project value of around $50m as being the minimum to justify the formation of an alliance. This was founded on the basis of the level of commitment and involvement required by senior personnel from the initial meeting/ workshop stage through to ongoing work on the alliance board and as part of the integrated development/ management team.

However, other participants were comfortable with the prospect of alliancing on projects with a value as low as $20m or $30m.

There was considerably less support for the prospect of alliancing for projects below this threshold. Nonetheless some were of the view that alliancing is inherently scalable, and that its principles and behaviours could be appropriately adapted and applied to projects as small as $5m.

Whilst the size of a project may be a factor in determining its suitability for an alliance, it is not the case that a large project is necessarily suitable for an alliance.

An example project, that was referred to often in discussions, was the Southern Cross Station project (the rebuilding of Spencer Street Station in Melbourne). This $700m project was delivered through a *Partnerships Victoria* arrangement. It encountered significant challenges. Many people expressed the view that this was an ideal alliance project, characterised by its technical complexity, delivery in a complex operating environment and subject to tight time constraints. However, others felt that whilst the project had engineering and other complexities, the use of a Partnerships Victoria model, or other non-alliance model, was more suitable.

08

## Technical Solution

With some projects the best technical solution, or perhaps the only feasible technical solution, will not be apparent prior to the involvement of the construction team. A Design and Construct contract is, in some instances, a response to this circumstance. An 'Early Contractor Involvement' approach is another response. Many people believe this is an ideal circumstance for the use of an alliance contract. It is thought that the perceived encouragement of innovation, together with the shared commitment to achieving an appropriate and cost effective technical solution, and the ability to do so without the constraints of a fixed price environment, all combine to facilitate a technical solution that might not have been identified through another delivery methodology.

A number of tabular tools have been developed to assist with the task of analysing projects for suitability for the alliance model. One such table is set out in Figure 7 below.

Figure 7 – Tabular analysis for suitability of Alliance contracting

| | | Weight | Low Rating | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | High Rating |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Is early delivery of the project of value to the owner? | 20% | No value at all | | | | 0.8 | | | | | | | Of great value |
| 2 | Nature of work – green field versus brown field | 15% | Total of green field | | | | 0.6 | | | | | | | Many critical interfaces with existing operating facilities |
| 3 | Technology – proven or radical? | 10% | Well proven stable technology (will not evolve during project) | | | | | | | 0.7 | | | | New and/or evolving |
| 4 | Risk culture of owners? | 10% | Totally risk averse – risk transfer culture | | | | 0.4 | | | | | | | Strategic management of risk – sophisticated view of risk |
| 5 | Tight guaranteed maximum price (GMP) | 10% | Tight GMP essential | | 0.2 | | | | | | | | | Owner flexible within range |
| 6 | Industrial relations environment | 10% | Very low risk | | | | 0.4 | | | | | | | Very high risk |
| 7 | Proven relationship contracting record with potential engineering contractors | 8% | No track record or bad track record | | | 0.24 | | | | | | | | Good track record |
| 8 | Sensitivity to disruption from aboriginal/heritage/ environmental issues | 7% | Very low risk | | 0.14 | | | | | | | | | Very high risk |
| 9 | Owner's understanding/ experience of project delivery process? | 5% | Little experience | | | | | | | 0.35 | | | | Very experienced |
| 10 | Will construction require single (multi-discipline) or many contractors? | 5% | Will require many different contractors | | | | | | | | 0.4 | | | Could be constructed by one contractor |
| | | 100% | Drop down totals | - | 0.34 | 0.24 | 2.2 | - | - | 1.05 | 0.4 | - | - | = 4.23 |

Source: Australian Contractors Association, 'Relationship Contracting: Defined', *Relationship Contracting – Optimising Project Outcomes*, 1999, p. 11.

# 08

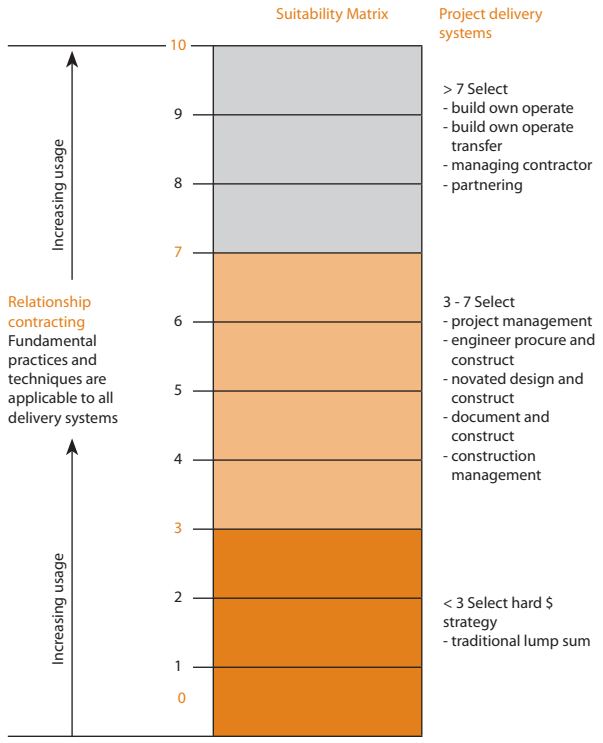
The tabular analysis gives rise to a 'suitability score' which indicates alliance suitability. The 'score' is applied to the model in Figure 8 to suggest a preferred project delivery methodology.

In addition to these central criteria, others interviewed admitted to additional motivators, being:

(a) a desire to 'be involved';
(b) an ambition to 'reach for the stars'; or
(c) a desire to enjoy the thrill and reward of applying their technical expertise and experience in a team environment which is outcome focussed.

Some participants were adamant that an alliance was only suitable if it allowed for 'stretch capacity' in at least two components of the 'Time-Cost-Quality Triangle'. That is, in order to drive the correct behaviours, there must be the capacity to strive for excellence in at least two of the three components.

Figure 8 – Selection of project delivery methodology




Source: Australian Contractors Association, 'Relationship contracting: Defined', *Relationship Contracting – Optimising Project Outcomes*, 1999, p. 12.

# 09

# Constraints on involvement

The success of an alliance depends not only on the identification of an appropriate project, but also the involvement of the right people.

Respondents confirmed that the decision about the personnel to be involved from the outset is critical. The attitudes and behaviours of these people have a key role throughout; from the selection stages through to project completion. Therefore it is vital to involve senior people. The participants must have authority, insight, flexibility and confidence. They must display respect for the points of view of others and be able to put to one side pre-conceived ideas they might otherwise have about the motivations and behaviours of other participants. However, this does not mean they should be naive.

These behaviours and authority levels might only be found in a few people in any organisation. Some alliance participants consider that the potential scarcity of suitable personnel places a constraint on the number of alliances that an organisation can participate in at any one time. Indeed some very large engineering organisations have suggested that they would presently have difficulty participating in more than one or two alliances in any state at the one time.

However, as more alliances occur, more people will gain experience from participating in an alliance and more organisations will become comfortable with alliances as a delivery methodology. This will facilitate the opportunity for organisations to participate in a greater number of alliances.

09

The 'people shortage' issue is regarded as significant. A number of industry participants see this as the most pressing constraint on the successful implementation of alliances as a more widespread delivery model. Indeed, some fear that the adoption of an alliance model too quickly will be counter productive as inexperienced or unsuitable people find themselves involved in an alliance and such people will be unable or unwilling to display the necessary behaviours. Such alliances are at a greater risk of failing. A succession of failed alliances has the potential to put a brake on the adoption of alliances.

There is debate as to whether this 'people and authority' issue is more of a constraint in the government sector than it is in the private sector. Interviews revealed that private sector participants see it as being a more challenging issue for government whereas the government sector does not necessarily share this view.

The perceived 'people constraint' on the use of alliances could be exacerbated by the growing interest in competitive alliances. If each alliance project has two teams involved in the process, up to final team selection, then there will be fewer experienced and appropriate people available to service other projects.

# 10 Involvement by government

One of the key behaviours necessary for the success of an alliance has been described as 'have a good idea in the morning and implement it in the afternoon'. This requires ability, in those participating in an alliance, to either be able to make decision or secure decisions in a timely manner.

One of the probable consequences of an alliance is the need to make a commitment which will have a financial impact on the organisation. The impact, from a principal's perspective, may be an increase in cost. The impact, from the perspective of all parties, may be an impact on the *gain share/pain share* outcome or the acceptance of an outcome which sees a participant not being held directly accountable for its poor performance. Whilst these potential outcomes are woven into the very fabric of the alliance arrangements they may still create difficulty for some organisations. Some observers considered that the difficulties are particularly relevant for government and constitute an impediment, perhaps a fatal impediment, to government participation in alliances.

The impediment is, in part, seen to derive from the presumed limited authority levels of government representatives participating in an alliance.

At the end of the day this seems to be more an issue about planning rather than a fatal impediment. Arrangements can be made, within government, for representatives to be given the necessary authority to make decisions, and commitments, 'on the spot'. Alternatively, arrangements can be put in place to secure prompt decision making by those in government not immediately involved in the alliance.

All that is required to put these arrangements in place is proper planning so that the delegated authority levels can be established and so that government can make the appropriate budgetary allowances.

Some government participants considered that this issue of authority levels was overstated in the context of government and under emphasised in the context of the private sector. In other words, it was often enough the case that the private sector participants encountered greater 'organisational difficulty' than the government did.

One solution to the perceived 'organisational difficulty', seen by some to peculiarly impact on government, is to include, as a *Key Results Area* in the *gain share/pain share* mechanism, a focus on ease and timeliness of reporting to government and ease of securing decisions from government. This has the potential to influence the behaviour of the alliance team and lead to behaviours which are directed towards ease of decision making in government.

There is an also an assumption by some that the government will not, as a matter of principle, shoulder or

share risks. Such an attitude could be fatal to alliance contracting in the government sector.

This assumption is not supported by the *Partnerships Victoria* risk allocation policy. Under a Partnerships Victoria project the private sector partner will be obliged to accept the bulk of the risk involved in any project. This reflects the nature of the *Public Private Partnership* structure (of which *Partnerships Victoria* is an example), in which the Government, by purchasing service outputs, avoids the risks associated with the process that produces those outputs. However, *Partnerships Victoria* policy also advocates an optimal allocation of risk, seeking to minimise both project costs and project risks by allocating particular risks to the party best able to control them. Accordingly, there is scope for the Government to 'take back' certain risks – namely those risks which it is in a better position to control. It is also important to note that Partnerships Victoria policy accepts the need to be flexible about risk allocation, such that the final risk allocation in any project will ultimately depend on the particular characteristics of the project.

'Value for money' is discussed generally elsewhere in this paper. 'Value for money' is seen by many to be of critical and peculiar interest to government. Indeed, some proffered the view that the requirement to transparently demonstrate 'value for money' would be an insurmountable hurdle for government.

One government organisation that has confronted the 'value for money' issue in the context of less traditional procurement models is the Commonwealth Department of Defence. The Defence Materiel Organisation (DMO), within the Department of Defence is the largest procurement organisation in the country. Often the market place in which it seeks to make its procurement is very small. At times there is no choice as to supply – there is only a sole source. The DMO has also found itself involved in alliance projects from time to time.

With the weight of all the Commonwealth procurement controls bearing down on it, including the *Commonwealth Procurement Guidelines* and the Australia-US Free Trade Agreement, the DMO has been able to satisfy itself that its procurements are '... in accordance with the policies of the Commonwealth ...[including the Commonwealth Procurement Guidelines 2005] ... and ...make efficient and effective use of ... public money...' (as required by the *Financial Management and Accountability Act* 1997 (Cth)) notwithstanding that they are sometimes 'sole source' or via an alliance model.

# 11

# How do people find themselves involved?

There is a growing enthusiasm amongst contract managers in some organisations to 'try out' alliancing. While alert to the potential alliance project opportunities, enthusiasm is generally tempered by an inclination not to 'rush into it'. Thus, it is the tension between this enthusiasm and patience which has resulted in a number of organisations finding themselves involved in their first one or two alliances.

These first involvements in alliancing can precipitate inclination for ongoing involvement. If the project was right and the right people were involved then the mood for alliancing gains momentum. However if the project did not really command an alliancing solution or if the organisation and its personnel were not ready or suited to it, then the mood will swing away from further alliances.

# 12
# Ongoing behaviours

It is important that all personnel involved in the alliance project understand both the reason for the adoption of an alliance delivery methodology as well as the need to maintain alliance behaviours throughout the project. If, for example, the Owner's project manager adopts an alliance solely with the intention of identifying a solution to a complex project, then, once that solution is identified, there is a risk that alliance principles will be discarded, and there will be a reversion to traditional behaviours. This can result in discordance amongst the alliance team, causing the alliance to be unable to effectively respond to subsequent issues which may arise.

# 13
# Depth of the alliance

The depth and breadth of participants in an alliance will vary. In a construction project, for example, there will be many participants. The team of design professionals may number half a dozen or so and there may be one or two key major equipment suppliers with dozens of more minor suppliers. There may be two or three key construction disciplines with a handful of other subcontractors. The question arises as how many of these participants should be brought under the alliance umbrella.

The size of the alliance will influence its ability to function effectively. The greater number of different interests that must be accommodated within a 'best for project' philosophy, the more difficult it will be to ensure success.

One response to this challenge is to create sub alliances. The prime alliance might involve the principal, the lead design consultant (or perhaps two) and the lead contractor (or perhaps two). Where two or more contractors are to participate in the alliance then it may be that the arrangements between those contractors are outside the prime alliance. Those contractors would then participate in the prime alliance as a virtual single contractor.

A natural collection point for a sub alliance may be the prime suppliers. Alternatively, or additionally, the prime alliance may constitute a single purchasing vehicle through which all acquisitions for the project are made. This may be a separate legal entity or a virtual entity.

A sub alliance may also be established for the key subcontractors. An area which has received little attention to date is the involvement of the workforce. Should the unions be brought to the alliance table? What role can a union play in the success or failure of an alliance? These issues are yet to be explored.

Even if unions are not directly involved in the alliance, benefits can flow to the workforce. The different atmosphere can itself be a benefit – a more enjoyable workplace in which a 'best for project' attitude is recognised. The benefits for the workforce can be more direct and tangible. The gain share/pain share mechanism could include KPIs which relate to industrial harmony and satisfaction. These could be boarder than 'no lost time injuries' statistics.

# 14
# Competitive alliances

Opinions regarding the desirability or otherwise of competitive alliances are mixed. There are those who steadfastedly support the single TOC alliance, while others favour the dual TOC (or competitive) alliance. There are also those who are comfortable with either approach depending on the circumstances.

Firstly, what is a competitive alliance? In a traditional (or single TOC ) alliance, the team selection decision is taken very early in the process. This is most often done prior to the agreement as to the TOC. Indeed, one of the early key tasks of the alliance team is to develop and agree the TOC.

In a competitive (or twin TOC ) alliance the principal continues to work with more than one team (usually no more than two teams) in the development of the TOC. The alliance team selection decision is made later in the process.

Those who support competitive alliances give the following reasons:

- **lower TOC** - the competitive tension prior to the selection of the team results in a lower TOC;
- value for money – the competition between the two teams, results in increased price transparency thereby improving 'value for money';
- **innovation** – the competitive tension encourages the two teams to maximise the development of innovative responses during the selection process and mitigates against 'innovation hoarding'. That is, where a single TOC team does not immediately make visible all of the innovative opportunities that it identifies but rather keeps those ideas as a means of driving down its own costs of participating in the project, thereby enhancing its profitability. A robust and fulsome costs audit process during the alliance project may also mitigate against this possibility;
- selection decision – the ability of the Principal to view the behaviours of the two teams over a longer selection process allows for natural behaviours of the teams to become apparent. This facilitates the Principal making a better team selection decision.

Those who oppose competitive alliances give the following reasons:

- **philosophy** – there is a strong body of thought that sees the adoption of an alliance as a commitment by the organisation to doing business in a different way. The adoption of a competitive alliance is seen to be inherently inconsistent with this commitment;
- **behaviour** – there is also a strong body of thought that sees critical aspects of an alliance as being the behavioural aspects. Any threat to these behaviours threatens the potential for success of the alliance (one participant had observed very different behaviours in the same individual depending on whether the model was a single TOC or a dual TOC);
- **longevity of the model** – a concern was expressed that competitive alliances could effectively become indistinguishable from a traditional Design and Construct methodology and, as a result, pose a real threat to the ability of the alliance model to gain a strong foothold in the project delivery landscape. Indeed it was considered that 'tinkering' with partnering had lead to the demise of that approach and the same could occur with alliancing;
- **cost** – the cost of the selection process will rise significantly in the case of a competitive alliance.

It should be noted that there are fewer examples of competitive alliances, and that only a small number of owners have undertaken projects using each of the two models. Therefore observations about competitive alliances (whether positive or negative) come largely from alliance consultants or facilitators.

At least one owner had utilised each of the two models on different projects. That owner did not experience any particular difficulty with the competitive alliance model. The view of the owner was that those who are intolerant of competitive alliances are not in tune with the contractor marketplace or the requirements of owners.

It has been suggested that the risk profile of the project will influence its amenability to a competitive alliance approach. A project which requires significant technical innovation and the technical delivery solution is not clear at inception may not be as amenable to a competitive alliance approach as a project which involves considerable risks during the delivery phase.

Some observers consider that a competitive alliance is the appropriate mechanism to satisfy the 'value for money' test. The TOC, and the margin for profit and overheads is the subject of a competitive process leading up to the entering into of the final alliance agreement. This process is said to satisfy those who have a taste for transparency and objectivity and is also thought in fact to deliver better 'value for money'.

# 14

Others considered that this approach will gradually, (or perhaps not so gradually), result in alliancing becoming afflicted with the ills that are common to more traditional delivery methodologies – that is unrealistically squeezed margins and the same disconnect between initial expected cost (based on an unrealistic TOC) and the actual end cost.

Some observers consider that those who prefer a competitive alliance have not had sufficient time to become comfortable with alliance philosophy. Therefore, as they acquire more knowledge of the process and are more familiar with the potential benefits and the stresses that a competitive process can exert on a developing alliance team they will come to prefer a single TOC alliance.

At this stage it does not appear that there has been sufficient time or volume of projects to provide an empirical, rather than philosophical based decision as to the appropriate role of each of the two methodologies.

# 15

# Value for money

One of the key challenges for the alliance delivery model is to respond to the need to demonstrate 'value for money'. The 'value for money' issue is raised by the absence of a 'lump sum fixed price' and the often perceived equivalence with a 'cost plus' contract. This issue can be of particular interest for government owners.

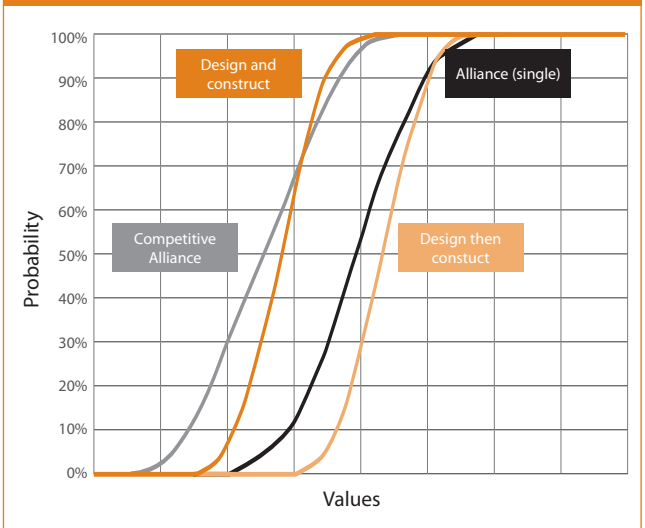
The concern regarding 'value for money' can, in part, be addressed by the transparency that arises from the usual audit processes put in place for an alliance project. An experienced project auditor (who may be a quantity surveyor or project accountant) may be retained as part of the settlement of the TOC, and the agreement of the margins for profit and overhead. In some instances three such auditors have been retained, one by the owner, one by the contractor and one jointly. The task of the auditor at this stage is to assist the parties in agreeing a TOC and the relevant margins and in doing so for the parties to be satisfied as to the 'value for money' issue.

There is a concern held be some that the industry participants manoeuvre the TOC and the *gain share/pain share* mechanism, such that those participants enjoy a satisfactory return even if the maximum pain delivered by the *gain share/pain share* mechanism is borne.

A number of consultants have developed tools to assist with this 'value for money' analysis. The risks of various delivery methodologies are analysed and the potential for there to be an increase in costs considered. Computer based tools are applied to this analysis to produce a comparative 'value for money' report. An example of such a report is set out in Figure 9.

This approach has not only been applied prior to the

Figure 9 – An example of a 'value for money' analysis




Sources: Presentation by Mr Mike Montefiore, Burnett Water Pty Ltd, 2005.
The Department of Treasury and Finance, State of Victoria, 'Project budget', *Project Alliancing, Practitioners' Guide*, April 2006, p. 45.

project. On one or two occasions, respondents reported application of this approach after the conclusion of the project. In one instance the alliance methodology resulted in estimated savings of approximately $100m compared to a *Design and Construct* method (the project value was approximately $500m).

It is not only the private sector that has developed and utilises tools to analyse the 'value for money' question. In Victoria, the *Private Sector Comparator* has been used in the context of *Partnerships Victoria* projects. A modified version of this tool could be used across project delivery methodologies as a means of exploring and demonstrating 'value for money'.

Early discussions with the Auditor-General (or other relevant body) can also assist in minimising the potential for expressions of concern by those bodies. Whilst it would be inappropriate to ignore any observations which an Auditor-General might make about an alliance model it is also relevant to bear in mind that many projects, irrespective of the delivery methodology are the subject of comment by Auditors-General.

The focus on the 'value for money' issue in the context of an alliance may be out of balance when the potential difficulty in demonstrating 'value for money' in the context of any project is considered. In the case of a traditional Design and Construct contract it is often the initial contract sum which is focussed on in considering 'value for money'. However, it is very rarely the case that the final amount payable equals the initial contract sum. In almost all cases the final amount payable will be greater than the initial contract sum. It is also often the case that in considering the final amount payable no account is taken of the cost (direct and indirect) of any dispute that might have arisen.

If a comparison of delivery methodologies is to be undertaken, and 'value for money' is to be part of that comparison, then focus should be directed to both the ability to accurately predict the final amount payable and the differential between the initial contract sum and the final amount payable. If this approach were applied to each delivery methodology then it may be that the 'value for money' issue is no longer primarily associated with alliance contracting but becomes an issue to be considered in all cases.

The focus on 'value for money' is already broader than merely a focus on alliance contracting. The Gateway Review program operating in Victoria already has the capacity, particularly through Gateway 6, to explore and test 'value for money' outcomes.

It is important to distinguish 'value from money' from 'lowest cost'. Invariably participants, including those from government, did not support selection of participants on a 'lowest cost' basis. Indeed some principals recognised that an excessive preoccupation with 'lowest cost' selection, and the consequent reaction of contractors to 'cut their margins to the bone', had undermined the Australian construction industry and was against the interests of principals.

The issue of 'value from money' in the context of 'lowest cost' becomes particularly interesting when put beside a consideration of market depth. The risk of accepting the 'lowest cost', in a reflex way, increases when there is a thin marketplace as there is in Australia at present.

An example of how 'lowest cost' might not deliver 'value from money' can be seen in considering the trade off between capital cost and operating and maintenance cost in the context of a long term asset. The delivery of 'lowest cost' in the capital context may result in very poor operating and maintenance outcomes with a consequent growth in 'whole of life' cost.

One area of alliancing that can be particularly problematic

# 16 Insurance

is the role of professional indemnity insurance. Many principals have fallen into the habit of taking significant comfort from the availability of professional indemnity insurance. However there is some question about the appropriateness and value of this comfort, particularly in light of the recently introduced proportionate liability legislation.

The traditional drafting of a professional indemnity insurance policy relies upon the professional being liable to a third party. It is this liability in respect of which the professional is indemnified. Such a policy has two particular characteristics which make it problematic in an alliance context – the beneficiary of the policy is the professional and the policy only responds if there is a liability.

A cornerstone of an alliance contract is the absence of several liability and the existence of 'no suit/no liability' provisions. These characteristics would result in a traditional professional indemnity policy responding to a claim by a third party, but not responding to a loss incurred by the owner or another alliance participant. If the professional is not vulnerable to a claim and has no potential liability, then the policy will not respond.

Until very recently, unless the alliance participants preserved rights against each other which could trigger liability for professional negligence, the risk of loss to the owner because of design negligence has been uninsurable.

Thankfully, although the insurance market has been slow to respond to this challenge, there are now several underwriters who have developed project alliance specific 'first party' professional indemnity insurance policies which provide cover to all participants for loss they suffer as the result of a breach of professional duty by another participant.

However, the availability of project specific insurance will fluctuate with the hardness or softness of the insurance market. It is also influenced by the global 'whole of business' insurance arrangements of many of the potential participants. These arrangements often leave little room for an additional project specific policy.

It could be anticipated that recent difficulties of obtaining appropriate professional indemnity insurance, and the developed reliance by many principals on the availability of such insurance, might dampen the enthusiasm for the adoption of alliances. However, this did not seem to be the case from our research. Indeed, some participants had not addressed this issue in any detail, apparently assuming that professional indemnity insurance would be available in the usual way. Others considered that the benefits from the alliance process (in particular the reduced expectation of the need to draw on the coverage of such a policy), outweighed the fact that an appropriate policy was most likely, unavailable.

# 17 Financing alliances

Project financing has become a much favoured means of financing the construction of new projects. The inclination of a financier to confine its ability to secure return of the funds advanced to the project and its revenues, involves a fine and sophisticated assessment of risk. The financier looks to reduce the capacity for unpredictability in as many variables as possible.

An inescapable characteristic of an alliance is the absence of a fixed price for the asset under construction. Hence, from the financier's perspective, one of the potentially most significant variables is open ended. This creates a real difficulty in establishing an alliance project under a project finance model.

This difficulty does not impact on governments who have the capacity to fund the project. However it may constrain the evolution of a hybrid PPP/alliance model.

To overcome this difficulty it is likely that key participants in the alliance team will be required to expose their balance sheet (perhaps within some constraints) to the risks of the project. This can limit the types of organisations who can participate in an alliance as the organisation must have sufficient financial strength to endure 'worst case' outcomes of the project.

The finance market has, for many years, demonstrated that it is adept in developing hybrid products to respond to, or indeed develop, a market appetite. One response of the financing market to alliances, particularly long term alliances requiring a regular cash flow (typical characteristics of a PPP project), might be to provide a segmented product which makes available a project finance model during long term delivery whilst securing balance sheet exposure during asset development.

# 18 Disputes

As suggested earlier, the absence of liability and a 'no blame' culture coupled with 'no suit' documentation are essential distinguishing characteristics of an alliance. It has also been observed that outcomes that flow from a successful alliance are greater satisfaction with the project. This in turn leads to reduced disappointment and the decreased likelihood of a participant pondering 'what might have been' if it had been able to bring legal proceedings.

This positive outcome may be reason enough for adopting an alliance model, even if the project does not otherwise have the qualifying characteristics. The gains to be made in impacting the usual dispute culture are considerable. Some participants suggested that 80% of construction projects end up in dispute (not necessarily formal legal dispute) and the amount involved is often in the order of 30% to 40% of the project cost. Although surprising, this sentiment was echoed by a number of participants. Even a small improvement in these figures has the potential to bring considerable benefit to participants in the industry.

# 19 Defects

In a pure alliance, where all risks are shared, responsibility for defects, is shared by the alliance participants. This means that the cost of rework (during the project) and the cost of defect rectification (during or after the work) is shared and not the sole responsibility of the party carrying out the defective work.

During the project this issue potentially impacts all parties through the *gain share/pain share* mechanism. Ultimately, if the *gain share/pain share* pool has been exhausted, the Principal will bear the burden of this cost.

The question arises as to how this issue is dealt with following the conclusion of the project. The financial arrangements for the alliance will be finalised at some point – usually at the conclusion of the defects liability period. At this point the final reconciliation of the reimbursable elements and the *gain share/pain share* elements will be carried out. Following this final reconciliation there is no capacity to carry out further financial adjustment. The consequence of this is, if a defect appears in year 4 after the conclusion of the project, the Principal will bear the full consequences of the defect.

There was little enthusiasm reported for the adoption of a mechanism to allow for the recalculation of financial outcomes should such a situation arise. Indeed, parties have been content to rely upon a combination of appropriate selection of alliance participants (both at an organisational level and an individual level) and appropriate monitoring of quality throughout the project. Such a reliance on the monitoring of quality could suggest that particular attention should be paid to the quality assurance provisions in the alliance contract and the processes established to implement those provisions.

# 20 Experience

The majority of those interviewed considered that prior experience with alliancing was a significant issue. The involvement of organisations and personnel who had been involved in previous alliances was seen to assist in the ease of establishing the alliance and operating the alliance. These seasoned alliance participants were seen to be able to assist the novices in accepting the validity of alliancing and in making the transformation from a suspicious and defensive approach to one of openness and collaboration.

However there were a number of people who felt that the second alliance was at higher risk than the first. This was particularly so in the case of the same parties participating in the second alliance. Complacency and excessive confidence, resulting in loss of focus and dedication, were seen to be the risk factors peculiar to the second alliance.

# 21
# Process cost

The subject of process cost raised much discussion. The seniority of personnel, intensity and duration of involvement of those personnel all add to the process cost. There has been little rigorous study and analysis of this issue. Estimates range from 2% to 6% of project cost being consumed in establishing and maintaining the alliance framework.

Although there has been little rigorous study of the process cost of an alliance, the study in relation to other delivery methodologies has also been scant. This is particularly with regard to the inclusion of the process and management cost associated in heading off and resolving disputes - costs which are often ignored.

Whilst most people intuitively accepted that there is a higher process cost associated with an alliance, many considered that it was worthwhile bearing this cost in order to enjoy to the benefits that flowed from alliancing. The benefits were seen to outweigh the costs. Indeed the issue was seen as the timing of incurring of cost rather than a material increase in the cost. In an alliance context there are higher process costs earlier in the project (associated with setting up and maintaining the alliance) with lower process costs later in the project (when disputes might otherwise arise).

Even if the potential costs associated with a dispute are ignored, many believe that the ongoing costs of participating in an alliance are less than for a traditional delivery methodology. This reduced ongoing cost is seen to result from:

- the participation in the management of the alliance, through the Alliance Management Team, being less intense than is considered necessary and appropriate by others; and
- the combined management resources required for the project being less than would otherwise be the case. In a traditional project all teams have their own management resources whose role includes 'keeping an eye on' the other participant. However in the collaborative, transparent and non suit environment of an alliance this 'watchdog' role is less necessary.

One participant reported that an alliance project he had been involved in, had management costs of only 1.5%, compared with more traditionally delivered projects incurring management costs up to 10%.

A number of design professionals considered that the initial cost burden borne by them was less in the context of an alliance. This reduction in cost resulted from much of the design and documentation work (often done at highly discounted fees in order to secure involvement in a project) now being done as part of the development of the TOC. Therefore it became a project cost that was borne by the project.

However this was not a uniform view amongst those interviewed. Some participants noted that in a traditional Design and Construct project the design consultants would be paid (albeit perhaps at a heavily reduced rate) for design development work. In an alliance much of that work went without reimbursement.

The costs, for a design professional, can vary significantly between a single TOC alliance and a competitive alliance. It was reported that design development costs are less for a pure alliance and are far more for a competitive alliance, in comparison to a usual Design and Construct Project.

# 22 Market depth

The issue of the depth of the appropriate people resources has been discussed previously in this paper. In addition, there is an issue as to the depth of the available contractor marketplace, which has its own relevance.

Just as a principal needs a strong balance sheet to participate in an alliance so does a contractor. The contractor also needs to have sufficient resources available to it in order to respond to the demands for innovation, involvement and problem solving. Many of those interviewed expressed reservations about the number of organisations in Australia who possessed the right combination of resources (people, financial and intellectual) to sustain a vibrant alliance sector.

Views differed as to the consequence of such a thin marketplace. On the one hand some observers considered that this results in little price competition and therefore increases the prospects of alliancing bringing optimal 'value for money'. On the other hand, a thin marketplace may result in less than optimal mix of participants with a consequent increase in the prospect of failure.

# 23 Other project delivery methodologies

It is clear that all but a few consider that for an alliance to succeed a significant investment of effort and commitment of senior personnel is required. The latter is required throughout the project as well as during the selection process.

Against this background the question arises as to whether success of the methodology grows from this investment rather than from the alliance delivery method itself. That is, should the same commitment and attitude be applied in a traditional Design and Construct contract would it enjoy the same enthusiasm and the same success?

Many people believed that it is in fact the investment that drives success and that such success can be enjoyed with any delivery methodology. Others, whilst agreeing that this change in the intensity and nature of participation is a key driver of success, believe that habits are too entrenched to allow that investment to occur in the context of more traditional delivery methodologies and that it is necessary for there to be a paradigm shift to secure this investment. They believe that alliancing is the vehicle through which this paradigm shift can be achieved. Finally there are others who consider that the risk sharing and the *gain share/pain share* mechanism are the keys to a successful alliance and the absence of these in other delivery methodologies will inevitably result in inferior outcomes.

There is a uniformly held view that alliancing is only one of a large number of project delivery methodologies and that it should only be used in appropriate circumstances. If alliancing is used inappropriately it is not likely to bear fruit and indeed may lead to a less than optimal outcome.

Another, perhaps competing, delivery methodology that has enjoyed significant favour over recent years is the *Public Private Patrnerships* (PPP) or *Privately Funded Infrastructure* (PFI) model. It is expected that up to 15% of projects in Australia might be procured using a PPP/PFI methodology, indeed up to 30% of projects in the UK are said to currently use such methodologies.

As with all delivery models there are varying views as to the success of the PPP/PFI model and what its distinguishing characteristics are. Some expressed the view that the implementation of the PPP model had seen unsustainable attempts at complete risk transfer to the private sector. Some even expressed the view that this was an essential distinguishing characteristic of the PPP model.

23

Such a view is at odds with the material published by the Victorian Government, which seeks to optimise risk allocation by ensuring that the Government takes back certain risks if it is appropriate to do so. In doing so, it will, in certain circumstances, be able to secure better value for money whilst protecting the public interest.

An issue which attracted much discussion was whether it was possible for there to be a hybrid PPP/alliance delivery model.

Those who considered the allocation of all risks as a distinguishing characteristic of the PPP model naturally could not see a hybrid model evolving. They regarded the risk sharing philosophy of an alliance as absolutely inconsistent with a PPP.

There was also seen to be an irresolvable clash of qualifying criteria. If the outputs and specifications are known, then PPPs were seen to be the preferred model. In situations where outputs and specifications could not be settled at project commencement, then alliances were deemed more appropriate.

Others considered that such a hybrid could develop, particularly in respect of the service delivery period of a PPP project. Those who considered a hybrid could develop focussed more on the 'payment for service' and the 'service delivery' elements of a PPP project rather than merely the allocation of risk.

With a plethora of delivery models available there might be concern about room for yet another model. Some observers thought that PPPs have seized more than their share of the project delivery market space and saw alliances taking back some of that space. There was a view expressed that the alliance model might eventually account for perhaps 15% to 20% of public sector infrastructure procurement activity.

24

# Alliances under pressure

Much of the publicly available material on alliances describe the success stories. Indeed it is very difficult to identify a failed alliance. This might be because alliances are inevitably successful or it might be that people are reluctant to discuss poorer outcomes.

In exploration of this issue I sought to identify instances of stress in an alliance project and to ascertain whether the alliance process had been resilient in the face of that stress. I found that few projects appear to have been afflicted by stress that would rigorously test the alliance. Of the very small number that had, the alliance was reported to have successfully worked through that tension and developed a multiparty solution acceptable to all. There were no reported instances, (other than through third party speculation) of an alliance 'breaking' under stress.

Those who speculated on what might cause an alliance to fail under stress consistently nominated having the wrong people in the team as the primary likely cause. The absence of sufficient authority being held by the team members was nominated as a secondary cause. An inherently bad commercial model was also seen as a risk to success.

This very positive picture is a little at odds with some of the less formal anecdotal information that sometimes bubbles to the surface. It seems that the jury may still be out on the resilience of an alliance in the face of stress.

# 25 Alliances potential legacy

The benefits or otherwise of using alliancing for a particular project will be apparent within the 'bubble of time' surrounding that project. However, there is the potential for alliancing to bring benefits beyond the particular project and for its legacy to more pervasive.

Those who have worked in an alliance team often report that the rewards and satisfaction together with the absence of conflict make it difficult to revert to work on a project delivered under a more traditional methodology. Some organisations see a key risk of alliancing as being the prospect that the organisation will not be able to make available, to its skilled and valued employees, enough projects with this collaborative flavour in order to retain those employees.

Not only does alliancing have the potential to impact on individuals in the way described, it can also impact more broadly on the organisation. After all an organisation is merely a collection of individuals gathered around a common structure and business objectives. Changes to the perspectives of the individuals in the organisation will, over time, result in a cultural shift to the organisation. The rate of this change may be accelerated by the involvement of senior personnel in alliance projects.

One participant, who had observed the growth of PPPs in the UK saw how that project delivery methodology fundamentally altered the behaviour of contractors and believed that alliancing had the potential to do the same.

# Our alliancing experts


**Phillip Greenham**

**Partner**

Tel +61 3 8608 2540
Fax +61 3 8608 1023
Mobile 0417 012 144
Email *phillip.greenham@minterellison.com*



**Ian Briggs**

**Partner**

Tel +61 7 3119 6165
Fax +61 7 3119 1165
Mobile 0411 239 427
Email *ian.briggs@minterellison.com*



**David Fabian**

**Partner**

Tel +61 2 9921 4783
Fax +61 2 9921 8088
Mobile 0412 104 783
*Email* *david.fabian@minterellison.com*


## Disclaimer:

Alliancing: A Glimpse of the Real World View was prepared by Phillip Greenham, of Minter Ellison. It is not intended to be fully comprehensive nor as a substitute for legal advice. Professional advice should be sought before applying the information to particular circumstances.

Contact your local Minter Ellison partner, or one of our alliancing experts to receive advice in this area.

While all care has been taken in the preparation of this publication, no liability is accepted for any errors that it may contain.

# Minter Ellison Group Offices

## AUSTRALIA

### Melbourne
Rialto Towers
525 Collins Street
Melbourne VIC 3000
Tel +61 3 8608 2000
Fax +61 3 8608 1000
*Phillip Greenham,*
*Stewart Nankervis, Peter Wood*

### Sydney
Aurora Place
88 Phillip Street
Sydney NSW 2000
Tel +61 2 9921 8888
Fax +61 2 9921 8123
*Pamela Jack, David Fabian,*
*David Goldstein, Nicole Green,*
*Julian Hill, Elizabeth McKechnie,*
*Glen O'Connor*

### Canberra
Minter Ellison Building
25 National Circuit
Forrest Canberra ACT 2603
Tel +61 2 6225 3000
Fax +61 2 6225 1000
*Elizabeth Whitelaw*

### Brisbane
Waterfront Place
1 Eagle Street
Brisbane QLD 4000
Tel +61 7 3119 6000
Fax +61 7 3119 1000
*Ian Briggs, Scott Budd, Ross Landsberg*

### Adelaide*
Grenfell Centre
25 Grenfell Street
Adelaide SA 5000
Tel +61 8 8233 5555
Fax +61 8 8212 7518
*Clay Wohling*

### Perth*
Level 51 Central Park
152-158 St George's Terrace
Perth WA 6000
Tel +61 8 9429 7444
Fax +61 8 9429 7666
*Greg Steinepreis, Graham Anstee-Brook*

### Gold Coast*
159 Varsity Parade
Varsity Lakes QLD 4227
Tel +61 7 5553 9400
Fax +61 7 5575 9911

### Darwin
Level 4, 66 Smith Street
Darwin NT 0800
Tel +61 8 8981 3399
Fax +61 8 8981 8757
*Cris Cureton*

## USA

### San Francisco
50 California Street 36th Floor
San Francisco CA 94111 USA
Tel +1 415 869 6400
Fax +1 415 869 6430

## UNITED KINGDOM

### London
10 Dominion Street
London EC2M 2EE
Tel +44 20 7448 4800
Fax +44 20 7448 4848

## NEW ZEALAND

### Auckland
Minter Ellison Rudd Watts*
Level 20 Lumley Centre
88 Shortland Street
Auckland New Zealand
Tel +64 9 353 9700
Fax +64 9 353 9701
*Stephen Price, Stephen Moylan*

### Wellington
Minter Ellison Rudd Watts*
Level 17 Trust Bank Centre
125 The Terrace
Wellington New Zealand
Tel +64 4 498 5000
Fax +64 4 498 5001

## ASIA

### Hong Kong
15th Floor, Hutchison House
10 Harcourt Road
Central
Hong Kong
Tel +85 2 2841 6888
Fax +85 2 2810 02351
*David Goldstein, Ian Cocking*

### Shanghai
Suite 42, Floor 39, Plaza 66
1266 Nan Jing West Road
Shanghai 200040
The People's Republic of China
Tel + 86 21 6288 2171
Fax + 86 21 6288 2172

### Jakarta
Makarim & Taira S**
Level 17
Summitmas Tower 1
JL Jenderal
Sudiman no 61
Jakarta 12069
Indonesia
Tel +62 21 252 1272
Fax +62 21 252 2750

* Minter Ellison Legal Group member

** Associated offces

To email an individual lawyer, use firstname.lastname@minterellison.com, except for those in New Zealand, where firstname.lastname@minterellison.co.nz should be used.

For more information about Minter Ellison visit:

www.minterellison.com



MinterEllison LAWYERS