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# Alliance Contracting a way to cut costs and improve quality

Australia's building contracts are characterised by a high level of disputation, declining quality and cost overruns. Our normal method of operation ensures that none of the participants are satisfied with the end result. In his paper to the forum, TOM GUTHRIE, Group General Manager of electrical contractor Ralph M Lee Pty Ltd said Alliance Contracting gives a ray of hope to a sorry industry.

In an Alliance Contract, the participants (client, designers, contractors etc) form themselves into one integrated team to deliver the project. A true Alliance will be characterised by:

- mutual trust and respect;
- primary emphasis on business outcomes for all parties;
- commitment to common goals;
- open communication and sharing of information;
- no party being able to profit at the expense of another, and
- costs reimbursed and reward earned by achieving common goals.

## Stick and carrot approaches

Alliance Contracts seek to achieve the desired behaviour by using the "carrot" approach, whereas most other contracts try to achieve desired behaviour by using the "stick" approach.

Liquidated damages, inequitable risk allocation, security deposits and onerous time bars are characteristic of the "stick" approach and are not found in Alliance Contracts.

Alliance Contract "carrots" typically are cost reimbursements, reward for performance, no blame joint problem solving and realistic expectations.

A properly constructed Alliance Contract should

- produce a better quality outcome;
- reduce delays and cost;
- eliminate conflict;

- facilitate decision making, and
- foster innovation.

The Alliance approach was developed for use on complex prospects in the oil and gas industry in the North Sea. The more complex the project, the more potential there is for interface problems; the more chance there is of cost and time overruns; the harder it is for the client to know where the project is up to, and the more chance there is of conflict.

## But will it work in Building?

It is working in the heavy engineering construction industry and there is no reason to believe it will not work in the Building Industry, provided the necessary behavioural changes can be achieved.

My company, Ralph M. Lee, is one of Australia's four national operating electrical construction contractors and has had considerable experience in both the heavy engineering and Building industries. Our experience tells us that of the two, heavy engineering projects are the more complex.

My perception of the Building Industry is that decreasing quality is of greater concern to end users rather than increasing cost. We have observed this particularly in hospitals.

## Different problem, same cause

While the main problem is different, the cause is the same. The current contractual arrangements are creating the unwanted outcome.

Typically, a builder will be chosen on a price only basis from a list of 10 or more tenderers. The design information on which he bases his tender will be incomplete because the designer has had insufficient time and money allocated to him to carry out the complete design.

The contract conditions will ensure that all the risk associated with the incomplete design is allocated to the Builder, whether he is capable of assessing it or not.

The client will then employ an army of contract managers to enforce the contract. The Builder will do the same, to defend his position and to try to generate variations to improve his margin. He will also take on the cheapest of subcontractors and perpetuate the problem down the line.

The whole system only allows any of the players to profit at the expense of one of the others and by pursuing their own self-interest.

## Declining quality, more disputes

That this system is producing declining quality and a high level of disputes should not be surprising.

To change the contractors' behaviour they first need to have their existence guaranteed. This is done by reimbursing their costs. They then need to have their goals for the project aligned with those of the client.

This is done by rewarding them from a common pool generated by meeting the client's goals for the project. Each

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can only be rewarded if the overall project goals are met.

To change the client's behaviour he has full access to the contractor's cost records throughout the project. The impact of any change on the project's final time and cost budgets is continually monitored.

If any have an adverse effect, the client is able to decide whether the change is essential or not or what other changes can be made to offset it.

Change is no longer a "negotiation" with the contractors as their actual costs are covered in any event. He knows all contractors are working towards the project goals because that is the only way they can earn a profit.

### Partner selection is the key

Selecting the right Alliance partners is the key to success in using the approach. The client must be more sophisticated than just picking the lowest-priced bid. As costs are being reimbursed, the client wants to employ contractors best able to manage those costs.

I suggest that the selection criteria should be:

- the track record of the designer or contractor on the type of work.
- the quality and experience of the project team he is proposing
- the quality of the project monitoring system he is proposing
- his trustworthiness

The most important of these factors is trust and this must be evident at the highest level in the organisations.

It is strongly suggested that the client's executive satisfies himself that a high level of trust is possible between him and each Alliance participant's chief executive. This is because it is the role of the respective chief executives to enforce alliance behaviour in their organisations.

Alliance Contracting is very new and there are no standard forms of contract

developed. However, the list of success stories is starting to grow and successful Alliance contractors and clients are usually willing to share their experiences.

A non-dispute clause is an essential part of an Alliance Contract and, in our experience, the non-dispute clause works. If the contract is properly constructed there is nothing to have a dispute about.

The contractors and designers have all their costs paid and all changes taken care of automatically. They are rewarded for meeting the project goals.

The client has access to all the information and can see that he is not being cheated. He is part of all decision making and he is only rewarding the designers and contractors if the project goals are met.

### Alliance contracts in Australia

My company has been involved in several Alliance contracts. These include the Boyne Island aluminium smelter in Gladstone, Queensland, BHP's HBI plant at Port Hedland, Western Australia, the Olympic Dam mine expansion at Roxby Downs, South Australia and the Alcoa alumina refinery at Kwinana, Western Australia.

I do not have the figures for the Boyne Island smelter project but I know that Comalco and Bechtel, who handled the contract for them, are claiming a substantial improvement in both time and cost compared with their recent experience with other contract methods.

BHP's HBI plant is ongoing as has been the subject of much press speculation. The Alliance there is a construction Alliance only and in my view has been very successful in giving the best possible construction result. BHP has supported this view by reaffirming the Alliance after their major review of the project in August last year.

Unfortunately the major design and budgeting problems experienced by BHP will not allow its full impact to be measured. However, even with the difficulties experienced by BHP on this project, there have been no disputes. All differences have been resolved easily within the contract structure. The way this project has progressed also emphasises the importance of including the designers in the Alliance. It is impossible for overall costs to be contained if designers are not part of the budget reviewing process.

The Roxby Downs project is ongoing and Bechtel/WMC are claiming good progress so far. Relationships are very good and expectations are high.

The Alcoa situation is a bit different. It is not a single project. Alcoa have formed an Alliance between themselves, Ralph M. Lee and Western Constructions (a mechanical contractor) to carry out regular maintenance and small project work. In its first year of operation Alcoa is claiming a 30 per cent reduction in overall costs for this activity.

None of the above operations is perfect but all are successful to a greater or lesser extent. I am not aware of any unsuccessful projects.

Recently the Federal Government approved the use of Alliancing principles for the construction of the National Museum in Canberra. And Sydney Water has adopted a similar approach for its Northside Sewerage Tunnel in Sydney.

We need governments to take a lead like this as all too often they are the worst offenders when it comes to unreasonable contract conditions and confrontational approaches.

The Federal and NSW Governments are to be congratulated for their courage in embracing this new approach. Others must follow or the Building Industry is destined to continue its slide into poorer and poorer performance.