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A message to the private sector - alliance contract delivery provides value for money with certainty of outcome

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Alliance contracting has now been around in Australia for some 15 years and over the last six to eight years it has grown in stature as a legitimate and viable delivery method. For those who have been engaged in it as owners, designers or contractors, it is accepted as a form of delivery that will generate certainty of outcome while underwriting value for money in that outcome. Indeed, the delivery form does not engender a separate owners', designers' or contractors' view alone, as being in the one team all will tend to see it from the same perspective.

Despite the respectability and legitimacy alliancing has earned to date, the bulk of the application and, thus, its successful outcomes, have been in the public sector. The conservative, traditional and bureaucratic side of industry has embraced this new and earlier unproven method, put its trust in it and, almost without exception, enjoyed successful outcomes. The private sector, supposedly unencumbered by the rigors of accountability that can stifle innovation, have not embraced alliancing with the same enthusiasm because of the suspicion it's just cost plus. This does not recognise the genuine sharing of risk and reward it entails.

The purpose of this article is to provide a message to those owners in the private sector, as well as their bankers and financiers, that there is a better way than the traditions they have known to ensure that the certainty of outcome and value for money they require can be achieved. I'll point out here that any reference to alliancing and alliance contracting means the 'pure alliance' delivery form.

Other forms of alliance delivery have been developed, such as competitive alliancing, and while presumably legitimate in their own right they are not the subject of this discussion.

Alliance methodology

To assist in the promotion of the alliance methodology to the private sector, a brief overview is provided. This is not meant to be an exhaustive explanation of alliance philosophy, nor indeed a detailed briefing on how to set up an alliance or choose an alliance partner, as there are existing well documented papers on this already.

What is an alliance?

- An alliance is two or more parties (one of whom should be the owner) bound both legally and philosophically by a single agreement.
- The alliance agreement is thus the contract, but is simple and brief.
- The alliance participants should have access to total delivery capacity from within the team, and any party who can have an effect on the outcome should be included in the alliance team.
- Apart from the alliance agreement, the parties should be bound by a commitment to a common set of objectives. These objectives should be well thought through by the owner and must represent what they are looking for in total - the parties then share jointly in the risks and opportunities to achieve these objectives.
- The entire delivery is then to be carried out by an integrated team which has the ability to perform the job. An individual's fit with the team should be the only criteria for selection, not company of origin.
- The obligations in the agreement become collective and not individual - it's all about what alliance participants should do and not about what individual parties or companies should do.

Alliance principles

The principles are simple in that they are founded on trust. All participants must win or all must lose with an appropriate sharing of commercial and other risks and opportunities. All decisions must be made within the alliance, all transactions are open book and all parties' costs are reimbursed at cost. By putting the alliance's interest ahead of the individual company's (from whom the participant might come), everybody's interests will be met by linkage into the ultimate risk/reward.

Alliance benefits

Specific examples of benefits are highlighted later, but these can be generally summarised as:

- earliest possible start (and finish);
- lowest direct cost solution;
- optimal management of undefined risk;
- reduced layers of management;
- flexibility in actions; and
- singular focus on single outcomes - getting the job done with no wasted effort.

Case studies

The following provides a summary of my extensive experience in Queensland in the alliance delivery process.

Cannington Project Port Development, North Queensland

In 1996 BHP, the developers of Cannington silver mine in north Queensland, were left with a dilemma when they lost access to a port outloading facility. They needed to develop a complete new facility to a fixed budget within about 20 months. Thiess was chosen to enter into an alliance with BHP to deliver the facility. Designs and methodology were developed to contend with the unknown and poor ground conditions.

A budget was set and by all working together in the alliance, and with the owner heavily involved, the first ore was loaded out in early 1998. The whole facility was completed on time and within the tight budget. The project won many construction excellence awards.

Pacific Motorway, Gold Coast

The Pacific Motorway between Brisbane and the Gold Coast was delivered by the Queensland Main Roads as a series of construct only packages. Issues with design, ground conditions and traffic affected all sections of the job, causing delays and contractual conflict. The last section, to be commenced by Thiess, was on the critical path and beset by delays. In January 2000 the forecast was for the project to take between 13 and 15 months to complete. As this was well beyond the required completion date of September 2000, Queensland Main Roads took a leap of faith and decided to complete the project as an alliance with Thiess. A budget was developed, the barriers were removed and the owner, designer and contractor were assembled into a single team. In adversarial teams, it had taken 20 months to complete the first 60 per cent of the job - yet the same group of people working in one team completed the last 40 per cent in six months.

All work was completed by September 2000 to meet the required overall motorway opening date and the tight budget was slightly exceeded. The process and the senior level of commitment had allowed the combined team to achieve what was otherwise not possible.

Awoonga Dam Raising, Central Queensland

In May 2000 the Gladstone Area Water Board (GAWB) forward sold in excess of their existing yield capacity. Raising the dam was required but there were issues such as community sensitivity, environmental concerns and the impact of capital cost on the water price. GAWB decided to adopt the alliance delivery method and Thiess were chosen to enter into the alliance to complete the project to a tight timeframe and budget. By working closely with the designers and with the involvement of the owner, smarter ways were developed to provide better functionality and in a shorter time and at reduced cost. The project was completed by mid-2002, some six months ahead of schedule and well under budget. The project was embraced by the community and all environmental issues were managed. Some 60 per cent of the time and cost savings came from design collaboration, and 80 per cent would not have been achievable in a traditional delivery.

Inner Northern Busway, Brisbane

The project involved constructing a dedicated busway through unknown and poor ground conditions and under a series of major rail connections. Thiess was chosen by the owner, Queensland Transport, and the designer SKM, as the alliance partner and through close liaison of all parties, including the Queensland Rail stakeholders, innovative ways of construction with reduced impact were developed. The project was finished on time by the end of 2003 and slightly under budget only through the close collaboration of all parties in the seamless methodology chosen.

North Queensland Gas Pipeline, North Queensland

Enertrade was required to develop a link to transport coal seam methane gas from Moranbah to an existing gas fired power station in Townsville. With a fixed budget and timetable, land access not yet finalised, design still at a preliminary stage and the recent history of disputation in the pipeline industry, Enertrade decided upon the alliance delivery method and chose Thiess Nacap as their partners. The integrated project team overcame a number of unforeseen issues including poor ground, which required reconstructing a number of the river crossings, and finished on time in September 2004, slightly under budget.

Table 1 below summarises the outcome of the above mentioned alliances which is believed to be typical of others delivered under the same methodology.

Table 1: Summary of a small sample of alliance outcomes

	Value	Program	Budget	Certainty of outcome	Value for money
Cannington Port	$80m	✓	+1 per cent	✓	✓
Pacific Motorway	$55m	✓	+5 per cent	✓	✓
Awoonga Dam	$110m	✓	-15 per cent	✓	✓
Inner Northern Busway 3	$32m	✓	-1 per cent	✓	✓
Nth Qld Gas Pipeline	$150m	✓	-1 per cent	✓	✓

Table 2: Comparison of owner costs for various delivery methods using $100 million of construction works as comparison

Delivery method	Owners starting price	$M	Owners outturn cost	$M
Construct Only Schedule of Rates	Low tender, say	100	Contract Costs will go up by between 6 per cent and 25 per cent as a result of site issues, design issues, final cost, say	106-125
	Owner should allow 10 per cent contingency	10		
	Design costs by owner, say 5 per cent	5		
	Supervision / contract admin costs, say 1 per cent	1	Supervision and design will run over say total	7-8
	TOTAL	**116**	**TOTAL**	**113-133**
Design and Construct	Successful tenderer will find smarter solution (say 3 per cent saving), including design costs (say 5 per cent) but including additional margin for risk / cost of tendering (2 per cent), low tender, say	104	Contract costs will still go up for a whole bunch of reasons but less than for construct only, say 4 to 20 per cent	105-125
	Allow to pay losing tenderers a tendering fee say 2 x $0.50	1		
	Supervision / contract and admin is potential more complex, say 2 per cent	2	Supervision and admin will overrun	3-4
	Owner contingency should be reduced due to revised interfaces / perceived reduced risk profile (6 per cent)	6	Unsuccessful tenderer fee	1-1
	TOTAL	**113**	**TOTAL**	**113-130**
D C & M	Will be similar to D & C for construction component but will put risk money into the maintenance.			
	TOTAL	**113**	**TOTAL**	**113-130**
Alliance	Target cost estimate is developed over optimum time and contains design savings / opportunities, contingency and client costs. Construction costs will be dearer than low tender construct only to be realistic	105	A fairly good sample of alliances has demonstrated – 5 per cent to +5 per cent covers nearly all outcomes therefore final outturn 116 $\pm$ 5 per cent	110-122
	Design will be greater than 5 per cent, after making allowance for development of innovation	6		
	Owner costs can be deemed to be included but allow	1		
	Contingence will still be needed but less then for D & C	5		
	TOTAL	**116**	**TOTAL**	**110-122**

Overview of industry outcomes

Further results of around 40 pure or traditional alliances completed over the last six or so years have been gathered. These results are available partly through the collaborative and communicative environment that pervades the alliance process, as well as by virtue of the fact that 90 per cent of them were public sector alliances where information is more freely available.

Of these alliances there are only two known to have exceeded the original target cost estimate (TCE), but in both cases it was by less than 6 per cent. Another two were some 15 per cent under the TCE. The remainder were within this range and generally very close to the TCE, that is, within a few per cent.

By comparison, performance of the traditional delivery method against budget is only anecdotal, but a pertinent question is: What per cent of contracts delivered in a traditional form end up under the owner's original budget (that is, contract value plus owner's contingency)?

While no published list or researched databank may exist, anecdotal evidence could easily be gathered, and in the last 10 years it would be suggested that the number that have exceeded the budget would be a lot more than acceptable. A calculated estimate based on industry knowledge and even the briefest research would suggest more would have exceeded the budget than come in under it.

Included in Table 2 on the previous page is a hypothetical build up comparing a range of outturn costs for traditional versus alliance delivery methods based on experience, known industry outcomes and beliefs, which attempt to explain and quantify the points that have been made above.

The conclusion is that alliance delivery is at worst a similar outturn cost to traditional contracting and at best 7 to 9 per cent cheaper notwithstanding that time, quality and functionality will be far better; that is, value for money is improved. Performance against time is an equally unacceptable result; and how many of these traditional projects have delivered a product that the owner can say met all of its expectations? Of the alliance projects, time has not been an issue with completion, either ahead of original schedule or within a timeframe that has not implicated the owners commitments. Also there is no knowledge of any project being delivered by an alliance where the owner has not had his expectations met or greatly exceeded in terms of his requirements.

As mentioned above, most of these alliances were public sector funded. So it can be seen that the public sector has come to accept that alliance delivery does provide certainty of outcome and value for money, and has been enjoying the benefits of the outcomes. The private sector has not yet, however, seen the benefits of alliance contracting or indeed embraced the methodology. Mature private sector owners may see the benefit where the budget is balance sheet funded, but where project finance is involved it is still not considered a viable option because of lack of perceived certainty with the ultimate price.
This can be dealt with by careful analysis of the TCE and appropriate contingencies being agreed and jointly managed.

Applicability of alliance delivery to private project financed development

It is an accepted business maxim that a project financed development must have certainty of outcome to 'bank the deal'. Further, to make it 'bankable' it must provide value for money otherwise the money ill be invested elsewhere, with a competing project or competitors who can potentially provide a better deal for the money. So what does this mean from a debt and equity point of view. Put simply:

- debt needs assurance that it will get its money back in a certain period of time; that is, certainty of outcome is paramount; and
- equity needs assurance that the capital cost is not compromised such that its share does not need to be increased and that its return will be assured at a minimum rate; that is, certainty of outcome and value for money are paramount.

Owners and their advisers (financiers, lawyers and so on) have up till now equated certainty with fixed priced contracts. The only certainty here is that, that is, the minimum price which will be paid. Another certainty is that there will be conflict, additional moneys will be paid and someone will lose, or maybe both parties to the contract will lose. What is not certain is whether the owner's contingency will be enough, whether the timeframe will be compromised and whether the ultimate product will be of optimum value.

As a proposal, the owners, financiers and advisers should consider the track record of alliances with regards to certainty of outcome. As equity stakeholders consider sharing or reducing project contingencies to share the project upside (alliance track record suggests the target cost is +5 to -15 per cent achievable, including contingency) when 'banking' your job. Providing incentive to parties to meet or underrun the budget means the equity percentage is not compromised by cost overruns. Also consider whether the alliance track record (as compared to the fixed price contract track record) might ensure a better equity return (through reduced cost, time or better product) and, indeed, attract cheaper debt as the project becomes a more desirable investment.

The construction industry has progressed a long way in the past eight years. It's now time for the finance sector to understand and accept why it has to change and to take a leap of faith based on not just good common sense but some fairly strong evidence and facts enjoyed by and supported by the rest of industry.✹

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