

MALLESONS STEPHEN JAQUES

Update

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Alliancing

Introduction

In the last update, we considered a number of alternative contracting structures and the advantages and disadvantages of each structure.

As indicated in that update, this update considers the nature and features of alliancing and when alliancing should be used. It is important to understand the decision whether to use alliancing as the framework for delivery of a project is dependant on the size, nature and complexity of the project as well as the participants involved. This is extremely important as there are significant dangers if alliancing is used as the framework for delivery of a project without appropriate consideration of these factors and the other issues identified in this update.

What is alliancing?

Alliancing is a co-operative form of contracting where the participants enter into a relationship (alliance) which is designed to align the commercial interests of the participants. Each participant in the alliance will share in the success or failure of the project and in decision making and risk management.

Under an alliance, the participants will structure their relationship to share commercial risk and reward. Therefore, it is in the interests of all participants to work co-operatively and openly.

What are the key features of alliancing?

An alliance generally has the following key features:

- (a) commonly aligned objectives;
- (b) joint and several liability between the participants;
- (c) fair and equitable sharing of risk between the participants designed to avoid any "win-lose" outcomes;
- (d) fiduciary duties;
- (e) a performance or incentive basis of remuneration which will include payment of costs and an agreed division of margin (profit) taking into account performance levels measured against clearly defined indicators;
- (f) an integrated project team;
- (g) an environment which encourages innovation and breakthroughs;
- (h) unanimous agreement by the alliance representatives, particularly for the division of responsibilities and the type and quality of works and services required to meet the objectives of the alliance;
- (i) commitment to a "best for project" approach which means that the alliance representatives will need to choose between any competing proposals put forward by a number of participants in the alliance;
- (j) open and honest communications, trust, integrity and respect;
- (k) depending on the type of alliance, a "no-blame" and "no dispute" culture; and
- (l) the use of a facilitator to guide the alliance participants and help create an alliance 'environment'.

How is alliancing different to traditional contracting?

Alliancing is often described as a "risk embrace" culture under which the parties seek to better manage risks by embracing them (rather than trying to transfer them) and then work together to manage them within a flexible project delivery environment. It is an agreement between two or more entities who undertake to work cooperatively, on the basis of a sharing of project risk and reward, for the purpose of achieving agreed outcomes based on principles of good faith and trust and an open-book approach towards costs.

In contrast, traditional contracting is often described as "risk transfer" where the parties seek to transfer as much risk as possible to others under a range of separate contracts. Under a traditional contracting arrangement, the owner and the main contractor would enter into a master/servant style contract for the performance of the works and the main contractor would then flowdown as many risks as possible by using a series of master/servant style subcontracts.

What is the role of a facilitator?

In order to promote the culture and objectives of alliancing, it is common for alliance participants to appoint an independent facilitator to assist them during the workshop and documentation phase and then the implementation phase of a project.

Workshop and documentation phase

During the workshop and documentation phase of a project, the main role of the facilitator is usually to assist the alliance participants by:

- (a) helping create an environment of trust, co-operation, open and honest communication and flexibility; and
- (b) implementing workshops for developing a group approach to identification of goals and objectives, stakeholder interests, functional performance requirements and risks and constraints.

Implementation phase

During the implementation phase of a project, the alliance management committee would normally ask the facilitator to focus on the following key issues:

- (a) developing an environment of trust, co-operation, open and honest communication and flexibility;
- (b) building best practice behaviours and focusing on common project goals;
- (c) monitoring results and making recommendations to keep the project on track; and
- (d) encouraging innovation and breakthroughs.

Why is it important to use a facilitator?

Alliancing requires a substantial and dramatic change in:

- (a) the way works and services are provided; and
- (b) the manner in which the parties relate to each other during the life of a project.

A facilitator is essential to the implementation and management of these changes and often provides the stimulus for the necessary cultural change which needs to be embraced by the alliance participants, the alliance management committee and the project management team.

When should alliancing be used?

The drivers for establishing an alliance as the framework for delivery of a project include the:

- (a) ability to efficiently pool together knowledge, skills and resources from across a number of parties with differing skill sets;
- (b) ability to select the "best team" for delivery of the works and services;
- (c) alignment of objectives;
- (d) increased possibility of exceeding required performance levels and obtaining a greater reward; and

(e) opportunities for economies of scale and increased profit margins.

Therefore, if a project is technically complex an alliance should be considered. Alternatively, an alliance should be considered when it is difficult to accurately define the finished 'product'. For example, when design is a key element and it is not feasible to complete the design prior to going to tender.

Alliances may also be appropriate when there is likely to be a long term relationship. An alliance environment may better equip the parties to deal with inevitable problems that arise over the course of the relationship than a more traditional contract. This is because the parties will have the freedom and ability, and indeed the obligation, to develop pro-active solutions to those problems. A more traditional structure may lead to disputes and the breakdown of the relationship.

The key determinative factor should be are the parties willing and capable of working in the co-operative way required for a successful alliance. If not, an alliance should not be considered.

When should alliancing not be used?

The obvious answer is whenever the pre-requisites discussed above are not present. If a project is straightforward an alliance is probably inappropriate. Similarly, if there is any concern that the parties involved will not be able to adopt an alliance 'mindset' an alliance should not be used because the integration and motivation of the parties will determine the success or failure of the alliance.

Alliancing is first and foremost about people and relationships.

The other key consideration is, does the project sponsor want to finance the project? If so, an alliance structure may not be suitable because lenders may be reluctant to finance an alliance on a non-recourse basis especially during the construction phase. This is because the lenders will not have the certainty of a guaranteed contract price and completion dates with the standard protections eg: step in rights, liquidated damages and performance bonds. As a result of these risks, we understand that a pure alliancing arrangement has not yet been used in a project financed on a project financing basis.

Alliancing challenges the way parties have structured their business relationships in the past. It will not work for all projects, particularly if the individuals involved do not quickly adapt to the culture of alliancing.

Conclusion

The commercial, bankability, financial, taxation and practical issues must be considered, in their entirety, before any decision is made as to the most appropriate and effective contracting structure for the delivery of a project.

For the reasons outlined in this update, alliancing is a project delivery arrangement which can be considered for complex projects or for long term relationships.

CONTACTS

If you need legal advice on the issues raised above, please contact:

Damian McNair
T +852 2848 4646
F +852 2868 0124
damian.mcnair@malleasons.com

Robert Milliner
T +852 2848 4650
F +852 2868 0124
robert.milliner@malleasons.com

Richard Mazzochi
T +852 2848 4617
F +852 2868 0124
richar.mazzochi@malleasons.com

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