CONTRACTING IN THE THIRD MILLENNIUM —RELATIONSHIP CONTRACTING

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1. RELATIONSHIP CONTRACTING —WHAT IS IT?

The traditional approach to contracting (within the construction and maintenance industry) can result in each party tunnel-visioning on the drafting and negotiation of documentation, which seeks to shift as much risk as possible to the other parties, without any real consideration of the relationship between those parties. There can be very good reasons for doing so, whether to provide the certainty of outcome which will attract equity investors or satisfy the usual debt financier requirements for little or no project risk, or to maximise the parties' insurance position or otherwise.

Despite this, blind focus on achieving a 'nirvana' in the allocation of risk, can ignore the real benefits which can flow from a co-operative contracting approach. It can also entrench from the outset the adversarial 'them and us' mentality all too frequently associated with the industry.

In response to this, industry has developed various contract models, which seek to place more significance on the commercial relationship than achieving a strict risk allocation, compendiously described as 'relationship contracting'.

As a simple working model, a relationship contract generally seems to have the following three characteristics:

- it provides a cooperative contract management structure by dealing with 'soft' issues such as:
  - shared objectives/principles;
  - an express commitment to cooperate;
  - consultation in decision making;
  - sharing of information; and
  - early resolution of disputes;
- it aligns the commercial interests of the parties by dealing with 'hard' issues such as time, cost and quality; and
- it adopts a risk allocation appropriate to the commercial objectives of the parties.

The precise legal and commercial implications of relationship contracting will depend on the specific structure chosen. The purpose of this paper is to canvas some of the most significant of these implications, and to illustrate how widely they can vary, in the context of four of the more prevalent structures which we have encountered. But first, some threshold issues.

2. WHAT'S IN A NAME?

Unlike Shakespeare's rose, it is critical—when considering the range of relationship contracting models available—to get the nomenclature right. One frequently sees (and cringes at) parties using terms such as 'alliancing' and 'partnering' interchangeably (as in 'We're taking a partnered approach to this alliance...').

As I once painfully discovered at a panel discussion on alliancing, the differences between the various models need to be kept in mind. In particular, don't try telling an alliancing convert that your project (which might seem to you to have alliancing aspects to it) is being delivered as an alliance, unless either you've met each and every one of the rigid criteria for membership of this exclusive club or are prepared to be defamed.

In any event, putting dented professional pride to one side, the four models of relationship contracting which I would like to discuss are (perhaps in increasing order of focus on the relationship):

- Partnering
- Collaborative Contracting
- Managing Contractor
- Alliancing.

The differences among those models can perhaps best be summed up as follows:

- Continuing the Shakespearean analogy, partnering could be likened to 'much ado about nothing'; the parties focus heavily on the relationship, by enthusiastically convening a partnering workshop at the outset of the project and preparing a warm and fuzzy partnering charter; however, in classic square peg/ round hole fashion, they then typically superimpose this structure on a traditional form of contract containing a risk allocation which is unlikely to sit consistently with the hype in the partnering workshop and charter; all in all, if things go well, then partnering gets the credit; however, as we shall see, if things go wrong, then a partnered approach can make things worse.

- Collaborative contracting is the model used by the Department of Defence on its Comprehensive Maintenance Contracts (CMC) for the maintenance of $13 billion of Defence infrastructure throughout Australia; it can be thought of as partnering 'with a twist'; like partnering, it focuses the parties' attention on the relationship through a collaborative contracting workshop at the outset of the contract; however, unlike partnering, it supports this by providing a risk allocation in the underlying contract which shares risk meaningfully (like managing contractor) and aligns the interest of the parties at least to some extent (like alliancing); collaborative contracting also avoids the potential legal baggage associated with partnering and alliancing.

- Managing contractor is a project delivery system which we originally developed for the Department of Defence in the early 1990's, but which has since been used extensively in both the public and private sectors; it is often used for the delivery of large projects for which the requirements have not been fully finalised and for which flexibility in delivery is therefore required; this model seeks to align the effort of the parties by aligning interest, rather than focusing explicitly on the relationship; managing contractor contracts are not let on a fixed time/fixed price basis, but rather on the basis of target dates and target costs (with the contractor only having a 'best endeavours' rather than strict obligation to achieve those targets).

- Alliancing is as laissez faire as one can get from a legal perspective; essentially, it says 'focus on getting the right parties involved in the project, fostering the right culture and providing the right commercial drivers, and everything else will follow ... and then you don't need to be as concerned about the terms of the underlying project contract (or even if there is one)'; alliances achieve this is by:

    - devoting significant time to recruiting the right participants;

    - negotiating an agreement which provides all participants with real incentive to achieve exceptional performance, by remunerating them for the 'cost' of their efforts and then creating a pool of potential profits to be shared in agreed proportions, the size of which is subject to the overall performance of the alliance;

    - establishing an alliance board which requires unanimous decisions; and

    - fostering a 'no blame' culture under which the parties release each other from all claims other than for 'wilful default'.

3. COMPARISON OF THE MODELS

3.1. Common Features of Relationship Contracts

I will compare the four models having regard to the following features:

- selection of project parties;
- early contractor involvement in the project and flexibility of workscope;
- upfront statement of mission, shared objectives and principles;
- contract management structure;
- sharing information on an 'open book' basis;
- alignment of interest/ incentivisation; and
- allocation of risk and 'no blame' culture.

As alliancing is the high watermark of relationship contracting, I will in each instance consider the relevant position under an alliance and then consider how the other models stack up against this from a commercial and legal perspective.

3.2. Selection of project parties

(a) Alliancing

Because of the strong reliance on the quality of the commercial relationship to achieve project outcomes under an alliance, it is critical for the principal to carefully select the other alliance participants. This will require greater emphasis on personal interaction and meeting during the 'tendering' process, to ensure that the organisations which are selected have a conducive corporate culture.

The advantage of this commitment from the outset is that, by hand picking the alliance participants, the alliance is given every chance of achieving, and indeed, exceeding its objectives. However, as against this, it is important for parties considering an alliance to keep in mind the significant resources which will be required in getting the alliance off the ground. Certainly, it would be folly to embark on an alliance—based on an alliance—without having first committed those resources to building the right team.

(b) Partnering, Collaborative Contracting and Managing Contractor

Typically, these models are closer to the traditional approach to contracting in this respect, with the contractor selected on the basis of a traditional one or two stage tender process. However, there is no reason why the principal could not tweak its tender process to obtain a better idea of each tenderer's attitude to the various relationship contracting aspects of its project.

For instance, under the collaborative contracting approach to the Defence CMC, tenderers are asked to submit a 'detailed contractor's activities proposal' in which they have to outline their proposed approach to all aspects of their activities under the contract. This includes, for example, their approach to the collaborative contracting process generally and to the use of key performance indicators (KPIs) for monitoring contractor performance. Tenderers are also asked to tender the KPIs which they consider would be most appropriate for measuring their performance.

3.3. Early Contractor Involvement in the Project and Flexibility of Workscope

(a) Alliancing

Alliancing is suitable for large, complex projects with an uncertain workscope. Further, to enable the alliance participants to achieve the exceptional results which an alliance can deliver, the participants must have early involvement in the planning and design stages of the project.

Alliancing will not be appropriate for every project. For instance, where a project has been fully designed, and the principal only requires construction of its design, there is little scope for an alliance.

(b) Managing Contractor

As with alliancing, managing contractor is particularly suitable for large, complex projects with an uncertain workscope and is less likely to be relevant where a project has been fully designed and therefore there is little scope or need for flexibility of outcomes.

(c) Collaborative Contracting

There is no reason why collaborative contracting cannot work with either a flexible or a reasonably fixed workscope. However, there is no doubt it is more likely to work well and deliver greater commercial benefits to the parties where the workscope is not overly-prescribed and the contractor has greater input.

(d) Partnering

As with collaborative contracting, partnering can be used with either a flexible or a fixed workscope. However, particularly if the contractor is given some incentive (such as a bonus for finishing early or a share of savings in the event of budget underruns), it will be necessary for the parties to preserve flexibility in the workscope and enable the contractor to manage this.

3.4. Upfront Statement of Mission, Shared Objectives and Principles

(a) Alliancing

Alliances are characterised by a clear statement of mission, objectives and principles. Although this will not necessarily have legal implications, it can be significant at a practical/site level. This can be particularly relevant where there is a high degree of collocation among the alliance participants within the one site office.

For instance, in the course of our role on the National Museum project in Canberra, we were frequently required to attend the site office at Acton Peninsula (within which all the alliance participants were collocated). The office walls were constantly bedecked with myriad charts and posters proclaiming the shared objectives and principles of the alliance participants and their various achievements and objectives on a periodic basis throughout the construction phase.

(b) Managing Contractor

Managing contractor does not quite have the same level of 'Hollywood' as alliancing in this respect. Rather than relying on extra-contractual proclamations of mission statements and shared objectives, managing contractor seeks to quietly achieve this through the contract. Primarily, managing contractor does this by removing the tensions ordinarily inherent in fixed time/fixed price contracting.

Managing contractor does not require the contractor to complete the project by a stipulated completion date (failing which, the contractor will be liable to liquidated damages) and to do so for a lump sum (within which the contractor typically has to absorb any increases in cost of delivery. Rather, managing contractor only requires the contractor to use its best endeavours to achieve completion by the target date and within the target cost.

(c) Collaborative Contracting

Collaborative contracting involves the joint development of shared objectives and principles at the collaborative contracting workshop held early in the life of the contract. This workshop and the objectives and principles developed do not have any contractual status; their role is simply to foster informal relationships and a common understanding between contract personnel from the outset.

Unlike partnering, collaborative contracting does not reduce the matters discussed in the workshops to a formal partnering charter. Rather, all relevant relationship contracting aspects which are to have contractual effect are already to be found in the terms of the underlying contract. In doing this, collaborative contracting seeks to avoid the risk—in the event of dispute—that the partnering charter could cut across the risk allocation in the underlying contract.

(d) Partnering

As with alliances, partnered contracts will usually be characterised by a clear statement of mission, objectives and principles. However, unlike alliancing, there is a real risk of inconsistency between those matters (usually reduced to a formal partnering charter) and the terms of the underlying contract. This means that, in the event of difficulties arising on a project, it may be open to the parties to use the partnering charter to distort the risk allocation invariably heavily negotiated under the underlying contract.

3.5. Contract Management Structure

(a) Alliancing

An alliance will maximise emphasis on communication, consultation and cooperation. Apart from emphasising this informally, an alliance will usually enshrine this in the contract management structure.

An alliance is usually administered at two levels, by a lower level management team and a high level alliance board responsible for strategic decisions and directions.

At the alliance board level, the alliance operates as a 'virtual corporation', formed by representatives of all alliance participants. Decisions of the alliance board are required to be unanimous and are not the subje of reference out to an independent expert or some other circuit breaker.

On the one hand, from a commercial perspective, alliance proponents say that the alignment of the parties' commercial interest ensures that they will break through deadlock. However, the absolute requirement of unanimity leads to the strong argument that the alliance 'agreement' is not in fact a 'contract' at all, as it lacks the requisite certainty of terms required for a binding contract. This may not be necessarily objectionable to the participants, provided that they are fully-informed of this and make their decision to 'do an alliance' on that basis.

(b) Managing Contractor

Managing contractor also seeks to enhance team building as between the principal and the contractor, to obtain the benefits of communication, consultation, and co-operation. However, the managing contractor (particularly as used by Defence) adopts a more traditional contract management structure using a 'project consultant' who is much like a traditional superintendent.

(c) Collaborative Contracting

The contract management structure under the collaborative contracting model can adopt any one of a number of approaches. For instance, it can adopt a more traditional approach, with the contract being administered by a 'contract administrator' on behalf of the principal. Conversely, it can involve the establishment of a contract administration board (much like an alliance board), comprising representatives of both the principal and the contractor. Or, it can fall anywhere in between, such as under the Defence CMC, where the parties are provided numerous opportunities to consult on a variety of matters, but with the Defence contract administrator providing contractual certainty by having the final say (subject to the possibility of independent expert determination of any dispute).

The point of distinction between collaborative contracting and alliancing is that the former does require the existence of a contract. Accordingly, if some form of co-operative contract management structure is adopted, then there cannot be a requirement for unanimity and there must be an ultimate circuit breaker in the event that the parties cannot agree.

(d) Partnering

As with collaborative contracting, partnering can adopt a variety of contract management structures. However, because it is frequently superimposed on traditional contract delivery methods, it is more likely to involve contract administration though a traditional superintendent.

3.6. Sharing Information on an 'Open Book' Basis

(a) Alliancing

If an alliance is to work properly, then it is critical that there be a free flow of information between all participants. The alliance agreement will therefore require the sharing of information on an open book basis. To support this, participants will usually require strong provisions preserving confidentiality and intellectual property.

(b) Managing Contractor

Managing contractor involves the appointment of a contractor who also wears a 'project manager's' hat vis à vis the principal in certain respects. Accordingly, free flow of information is also critical here, particularly from the contractor to the principal.

Given the scope of the contractor's role under the managing contractor (in design and letting and administering trade packages), the principal relies heavily on the contractor to act in its best interests. Accordingly, the contractor is placed under a duty of utmost good faith to the principal in performing its obligations under the contract.

(c) Collaborative Contracting
Where the underlying contract provides for the possibility of the contractor earning incentives based on performance against KPIs, or a component of the remuneration is based on reimbursement of costs incurred, then it is critical for the contract to provide for the sharing of information on an open book basis.

For instance, under the collaborative contracting model adopted for the Defence CMC, it is the contractor and not the principal who monitors its own performance against the KPIs. However, to ensure that the process is auditable from the principal's perspective, the contractor is obliged to provide access to all of its records on an open book basis to demonstrate (if required) that its performance has met the KPIs.

(d) Partnering
The extent to which such a provision is required under a partnered contract depends on the remuneration strategy. As with collaborative contracting, if it involves the possibility of incentives or reimbursement on a cost incurred basis, then access to the contractor's records should be provided.

3.7. Alignment of Interest —Incentivisation

(a) Alliancing
The remuneration strategy under an alliance is absolutely critical. It must align the interests of the parties and shape their conduct, so that they have a common objective in delivering the project in accordance with the required cost, time and quality parameters. This is particularly critical given the acknowledged absence of legal remedies (other than for wilful default).

Typically, alliance participants will be paid for the direct cost of their efforts on a reimbursable basis. Although this may come as a surprise to some, this will include the cost of rework to address defective design or work, even if the relevant participant was responsible for the defect.

The participants will then typically be paid their margin by sharing in a 'profit pool' in agreed proportions. The parties have a strong common objective in delivering the project in accordance with the required cost, time and quality parameters, as the size of the 'profit pool' and therefore their respective margins will fluctuate depending on the collective alliance performance against KPIs.

(b) Managing Contractor
The remuneration strategy under managing contractor is also critical to its success.

Under managing contractor, the primary interest of the principal is in achieving the best possible solution within the target cost. To do so, the nature of the project will usually require the contractor to explore alternative designs and contract delivery methods.