

Introduction to Alliancing and Relationship Contracting

QLS/BAQ Symposium 2002 – Session K
Construction Law – 02 March 2002

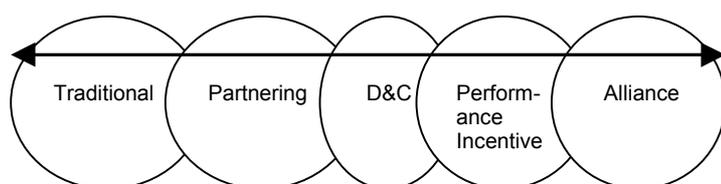
Roger Quick
Partner
GADENS LAWYERS
BRISBANE*



Introduction

The words *Relationship Contracting* are used to describe delivery methods that concentrate on relationships between the parties to a construction contract as well as the project's requirements. i.e. those methods which postulate that the task domain (the job) is as important as the relationship domain (how the job is to be done). Relationship contracting can cover various forms of construction contract. *Alliancing* is one of them. The following diagram indicates the various project delivery systems in current use. The complexity of management of the relationships increases from the traditional contract to the Alliance;

Figure 1: Degree of Complexity¹ →→→



All contracts;

- require a relationship between the parties, so as to achieve the objectives of the contract;
- are a formal expression of the relationship between parties.

Unfortunately, the law of contract, and the drafting, negotiation and interpretation of contracts have

meant contractual relationships are inherently adversarial.

Relationship contracting encourages parties to move away from the confrontation and encourages them to work together to achieve outstanding outcomes.

Is a Contract Necessarily Adversarial?

A contract is a binding mutual promise or agreement by two or more parties, recognised by the law and enforceable before the courts.² The word *Contract* etymologically means a drawing together of persons. This suggests a relationship of good faith, fair dealing and reasonableness. However, the law of contract developed because of the explosion of commerce during the industrial revolution. Its basis is "freedom of contract". Contracts developed as a reflection of the *laissez-faire* economy, in a climate of high regard for liberty, morals and legal principle.³ Commercial parties were the "*architects of their own destiny*"⁴ and freely agreed to their rights, obligations and liabilities. Such a bargain was sacred, courts would not lightly interfere.⁵ On the basis of principles such as freedom of contract and *caveat emptor*, the courts enforced a contract according to its terms, even if those terms were unfair or oppressive or caused severe hardship to a party.⁶

This historical development of the law of contract necessarily resulted in parties to contracts being able to treat another party as an adversary. Because of the strict enforcement of the contract's terms, a party could assume he or she was able to further his or her own interests at the expense of the other.⁷ A party entered a contract at their own risk and contracted to protect his or her interests because the law offered limited protection of those

* I would like to thank Reece Allen for his assistance in the preparation of this paper.

¹ Adapted from McLennan A (2001) *Relationship Management in Contracting*, Paper Presented to the Institution of Engineers (Australia) 22 March 2001 at 8.

² Guest A.G (1989) *Chitty on Contracts: General Principles: 26th Edition*, Sweet & Maxwell, London at p 1.

³ Carter J.W and Harland D.J (1991) *Contract Law in Australia: 2nd Edition* at [113].

⁴ Sir Anthony Mason *Contract, Good Faith and Equitable Standards in Fair Dealing* (2000) 116 *Law Quarterly Review* 66 at 70.

⁵ *Printing and Numerical Registering Co v Sampson* (1875) L.R 19 Eq. 462 per George Jessel M.R at 465. See Mason *supra* at 70.

⁶ Mason *supra* at 70.

⁷ Mason *supra* at 70.

interests outside the terms of the contract.⁸ This climate of potential conflict still pervades:

- the negotiation of the terms of the contract, ie who agrees to bear what risks?;
- the interpretation of it, ie do those terms mean I bear that risk?, and
- litigation over how those terms deal with an event or consequence which has arisen from performance of the promise; who is responsible for a breach of those terms? – Are you saying I agreed to that?

Weakening of Freedom of Contract

Because of the harsh consequences of the doctrine of freedom of contract, and the recognition that parties to a contract did not necessarily have equal bargaining power, both the courts and the legislature have created an overlay over oppressive contractual terms. The courts generally, and in particular the High Court of Australia, have been active in this. The High Court has created, recognised or reinterpreted principles such as unconscionability⁹, promissory estoppel¹⁰, frustration¹¹, co-operation and business efficacy¹², fiduciary obligations¹³, unjust enrichment¹⁴, mistake¹⁵ and privity of contract so as to ensure a fair¹⁶ bargain between the parties to a contract.

Contracts also now have an important statutory overlay. This overlay may be general, such as misleading and deceptive conduct under s 52 of the *Trade Practices Act 1974* (Cth) or specific to particular contracts, such as the requirement for

⁸ Mason *supra* at 71.

⁹ *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447. See generally Mason *supra* at 83-94 and Carter et al *supra* at [118].

¹⁰ *Waltons Stores (Interstate) Ltd v Maher* (1987) 162 CLR 221

¹¹ *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337

¹² *Secured Income Real Estate (Australia) Ltd v. St Martins Investments Pty Ltd* (1979) 144 CLR 596; *Meehan v Jones* (1982) 149 CLR 571

¹³ *United Dominions Corp Ltd v Brian Pty Ltd* (1985) 157 CLR 1; *Hospital Products Ltd v United State Surgical Corp* (1984) 156 CLR 41.

¹⁴ *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221

¹⁵ *Taylor v Johnson* (1983) 151 CLR 422.

¹⁶ *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107.

written variations under s 67H of the *Queensland Building Services Authority Act 1991* (Qld).

Good Faith

A further development of the law of contract is the emergent doctrines of good faith and reasonableness.¹⁷ There has been judicial recognition of a duty of good faith in contractual negotiations¹⁸ and contractual performance¹⁹ by state Supreme Courts in Australia. Requirements of good faith are essential to *Alliance* contracts and relationship contracting generally.

History of Contract in the Context of Construction Law

The adversarial legacy of contract is evident in construction contracts today. Like contracts generally, construction contracts developed out of enormous construction activity during the nineteenth century. Traditional commercial construction contracts usually involve two resourced and contractually astute commercial parties. Because of this the courts have been reluctant to interfere with the result of their negotiations.

CONSTRUCTION CONTRACTS

Importance of Construction Contracts

Relationship Contracting concepts, such as partnering and alliancing, do not remove the need to get the contract right. The disputes experienced by the construction industry are caused or contributed to by:

- inappropriate allocation of risk resulting in unfair contracts;
- poor project definition producing defective documentation;
- imprecise definition of the respective roles of the parties confusing responsibilities of the

¹⁷ For a learned discussion see Mason *supra*.

¹⁸ *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991) 24 NSWLR 1. For a discussion of agreements to negotiate in good faith see Singleton C (2001) *Agreements to Negotiate in Good Faith* (2001) 21 (4) Proctor 14. Singleton includes a useful table (at 15) setting out examples of good faith and bad faith.

¹⁹ *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234; *WMC Resources Ltd v Leighton Contractors Pty Ltd* [1999] WASCA 10; *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 197: see Allen R.J. *Would you like 'good faith' with that?* (2001) 21 (11) Proctor 26.

parties and leading to deficient management.²⁰

Getting the Contract Right

Getting the contract right at a technical level requires, amongst other things:

- choosing the correct project delivery strategy;
- retaining some level of familiarity with the standards (eg AS4300-1995) and structuring the contract correctly so the contract is a useful tool on site and not just in the court room;
- a careful identification and fair allocation of risk (see further below);
- drafting appropriate terms and administering the contract properly so as to avoid claims and disputes. This includes improved communication, early resolution of difficulties through negotiation, maintaining and allowing timely access to appropriate records etc;
- drafting terms to manage change in the project. This is essential because construction is a dynamic process, however the common law is static and inflexible. The common law requires absolute performance of the contract, and doctrines such as frustration or implied terms have limited scope (which is why parties often pre-agree to events which excuse performance in a *force majeure* clause).²¹

Risk

From a principal's point of view, risk in a traditional construction contract equates to a potential liability for money claims and possible consequential losses resulting from poor performance by the contractor. From a contractor's point of view, risk equates to a potential increase in the cost of performance of the work under the contract and possible liability for consequential losses.

Under the common law construction projects are about allocation of risk in an environment of uncertainty. The project parameters, such as time, cost and quality are usually pre-agreed

before any construction starts. The traditional approach by principals in dealing with this risk and uncertainty is a risk transfer strategy, that is, shifting as many risks as possible on to the contractor, who in turn shifts or steps down risks onto subcontractors and designers. This strategy has resulted in a construction industry plagued by dispute and cost overruns.²²

The traditional construction contracts (including lump sum, schedule of rates, design and construct and turnkey contracts exemplified by AS2124-1992 and AS4300-1995) all reflect this risk transfer approach in some measure. They are also negotiated and amended in an adversarial environment, resulting in an even more inappropriate allocation of risk, detrimental to the time cost and quality objectives of the job to be done.²³

The consequence of placing the majority of risks on the contractor (who then steps down construction risk on subcontractors and design risk to designers), is little incentive for an excellence or innovation on a project: the sword of litigation hangs over all as they work! The greatest opportunity for profit for the contractor is to minimise the cost of the construction, which has a detrimental effect on quality and non-financial objectives such as safety and environment. Furthermore the canny contractor faced with a contract signalling a risk transfer policy by the principal has defensive strategies available such as:

- concealment of substantial costs to the principal eg the pricing of the cost of defective work into lump sum work;
- the stifling of innovation; and
- ignoring rather than acknowledging a problem.

The result all too often is that when a problem arises, the cost efficient choice for the contractor is to choose to ignore the problem rather than embrace and overcome it.²⁴ Furthermore, if the contractor suffers losses due to an inappropriate allocation of risk, it can seek to recover those cost overruns by claims, aggravating an inherently

²⁰ Gyles Royal Commission as quoted in Quick R (1995) *The Partnering Contract: Some First Thoughts* (1995) 14(4) ACLR 125 at 127.

²¹ For a discussion of the adaptation of contracts to deal with changed circumstances see Wright M.E. (1984) *Effect of Changed Circumstances on Mineral and Petroleum Sales Contracts* (1984) AMPLA Yearbook 331.

²² For example see NPWC / NBCC (1990) *No Dispute: Strategies for Improvement in the Australian Building and Construction Industry*, Canberra and Gyles Royal Commission (1992) *Final Report of the Royal Commission into Productivity in the Building Industry*, Sydney.

²³ Jones D. (2001) *Keeping the Options Open: Alliancing and Other Forms of Relationship Contracting with Government* (2001) 17 BCL 153 at 154.

²⁴ Australian Constructors Association (ACA) (1999) *Relationship Contracting: Optimising Project Outcomes*, ACA, Sydney at 8.

adversarial relationship and making litigation a probability rather than a possibility.

This risk profile often results in detailed negotiation over the terms and conditions of the contract and in particular exclusions of liability.

Risk Allocation - A fair result of negotiation?

The principle commonly quoted for the appropriate allocation of risk is the *Abrahamson* principle. Essentially this is that a party should bear a risk when they are the best party to control it.

Under this principle a party should bear a construction risk where:

- the risk is within the party's control;
- the party can transfer the risk through insurance or as a premium on its services, and this is the most economic and practical way to deal with the risk;
- the economic benefit of handling a risk rests with the party bearing the risk;
- the placing of risk on that party is in the interests of efficiency;
- if the risk eventuates, the loss falls on that party at first instance.²⁵

The principle has been widely accepted as meaning a principal²⁶;

- should not ask a contractor to price an unquantifiable risk within control of the principal; and
- may ask a contractor to price and control a neutral risk.

There is recent international research supporting this approach.

²⁵ Abrahamson M. (1982) *Risk Management*, Paper Presented to International Construction Law Conference, Sydney, 19-21 October 1982. For a discussion of risk management see Construction Queensland Equitable Delivery Taskforce (2001) *Wealth Creation through Equitable Asset Delivery*, Construction Queensland, Brisbane at 18-19.

²⁶ The findings of *No Dispute supra* were based on the Abrahamson principle.

The Grove Report²⁷

Jesse B. Grove III, a New York based construction lawyer, was commissioned by the Hong Kong Government to review the General Conditions of Contract used for construction by the Hong Kong Works Bureau. The Grove Report approves the *Abrahamson* principle, but states that the same common considerations underlie all questions on risk allocation:

- which party can best control the events that may lead to the risk occurring?
- which party can best manage the risk of it occurs?
- Whether or not it is preferable for the employer to retain an involvement in the management of the risk.
- Which party should carry the risk if it cannot be controlled?
- Whether the premium charged by the transferee is likely to be reasonable and acceptable.
- Whether the transferee is likely to be able to sustain the consequences if the risk occurs.
- Whether, if the risk is transferred, it leads to the possibility of risks of a different nature being transferred back to the employer.

The importance of appropriate risk allocation is emphasised by a study quoted by Grove showing that 5 percent of the project cost may be saved by the single decision of choosing the most appropriate terms of contract.²⁸

Other instructive comments about risk allocation in the Grove Report include;

- Insurers should take a risk when they are willing to do so at a reasonable cost. However, as the principal pays for the insurance (either directly or through an

²⁷ The Grove Report – Grove, J.B. III (2000) *Consultant's Report on Review of General Conditions of Contract for Construction Works for the Government of Hong Kong Special Administrative Region*, November 6 2000 see http://www.constructionweblinks.com/Resources/Industry_Reports__Newsletters/Nov_6_2000/grove_report.htm. The Grove Report was the subject of discussion at the Hong Kong Risk Management Conference, the papers from which are published in [2001] ICLR 207 at 302-485.

²⁸ The Grove Report *supra* at para [4.5]

increased contract sum), such a risk is still allocated to the principal;²⁹

- It is possible to share risks, for example, through sharing of overruns, awarding extensions of time but not prolongation costs, limitation and exclusion clauses and setting liquidated damages below actual damage. However, there is no logical basis for sharing risks, except:
 - to give both parties an incentive to avoid and mitigate the risk;
 - since parties are adequately motivated already to handle risks which they are responsible, sharing risks is simply a spirit of compromise;³⁰
- allocating unforeseeable risk to contractors results in contractors who are gamblers and claims artists, predominating amongst the winners of contract awards.³¹ A rational contractor who prices such risk is unlikely to be the lowest bidder;
- it is largely the principal who can reduce risks through pre-construction planning, exploration and design effort (it is submitted this includes appropriate contract selection and quality documentation);³²
- during the construction phase, it is largely the contractor who can mitigate the effect of a risk occurrence.

The significance of this analysis is that most of the risks in a project, including determining the appropriate allocation or any risk that will occur during the construction phase, can be dealt with by the principal prior to the selection of the contractor. This provides an incentive for the principal to invest money early in investigating the risks, produce quality documentation to deal with those risks and consider embracing rather than transferring risk.

It is difficult to escape the conclusion that if they devoted more thought and more resources at this early stage, principals would save significant money over the life of the project.

One further difficulty with risk allocation as it is usually understood is that it is "static" i.e. the

²⁹ The Grove Report *supra* at para [4.2]

³⁰ The Grove Report *supra* at para [4.4]

³¹ The Grove Report *supra* at [6.1]

³² The Grove Report *supra* at [7.3]

parties agree to the allocation at a point in time, usually even before the project starts.

Because of the problem of identifying and allocating risk and making it stick, a principal may choose to embrace the risks of a project rather than allocate them. However, traditional forms of contract are inappropriate for embracing risk, so the industry has developed alternative forms which align the objectives of the parties to the project. These relationship contracts, which may be classified as performance incentive contracts, include partnering and alliance contracts.

RELATIONSHIP CONTRACTING

The Australian Constructors Association (ACA), a lobby group representing major construction contractors, defines *Relationship Contracting* as;

*"a process to establish and manage the relationships between the parties that aims to: remove barriers; encourage maximum contribution; and allow all parties to achieve success."*³³

This definition can be divided into four elements;

- *"process to establish and manage the relationships between the parties"* – ie. including any partnering or alliance charter;
- *"remove barriers"* – barriers in a conventional construction contract may include items such as an unfair risk allocation, eg terms excluding latent conditions, barring claims unless they are notified in an impossibly short time, which may create an element of mistrust between the parties. A relationship contract may seek to overcome these issues by using a gainshare / painshare compensation regime and positively incentivising the parties' relationship;
- *"encourage maximum contribution"* as the success of relationship contracting is dependent upon commitment and trust by people, most relationship contracts contain procedures encouraging contribution, such as by the "partnering" charter or Project Alliance Board in an alliance;
- *"allow all parties to achieve success"* – relationship contracting looks for the elusive "win/win" by the alignment of common goals and gainshare/painshare mechanisms for remuneration. This criteria recognises that one party's gain should not be at the other party's loss.

³³ ACA *supra* at 4.

A RELATIONSHIP CONTRACT?

Relationship contracting covers a broad range of possibilities. What therefore would a "relationship contract" look like? A "relationship contract" could for example contain the modification of a standard construction contract such as AS2124-1992 or AS4300-1995 to include features of project specific partnering such as:

- a formal meetings procedure;
- project control group / board;
- key performance indicators;
- a relationship charter;
- a staged dispute resolution procedure such as with CEO negotiation.

In sum, a relationship contract can be any contract which seeks to emphasise the relationship between the parties to achieve optimal outcomes for the job to be done. Relationship contracting is a contract employing some form of management regime (whether within or outside the terms of the contract) to manage the relationship. There are, however, at least two contracts crafted with the concerns of relationship contracting in mind.

Project Partnering Contract - PPC2000

The Association of Consultant Architects (ACA) (UK) commissioned UK law firm Trowers & Hamlins to draft a multi party partnering contract. This commissioning resulted in the publication of PPC 2000 – The ACA Standard form of Contract for Project Partnering.³⁴ PPC 2000 came about as a result of recommendations from the UK Government's Construction Task Force Report "Rethinking Construction".

PPC 2000 is described by the ACA as "a non-adversarial construction contract that provides the foundation for the partnering process". PPC 2000 is not a "pure" alliance contract (as an alliance is understood in Australia) because not all risks are shared.

Significant relationship contracting features of PPC 2000 include that:

- a multi-party Partnering Project Team (including the principal, contractor, subcontractors and designers) enters into a single partnering contract;

- the parties have a specific duty of co-operation and incentives for teamwork;
- the design, procurement and construction process is integrated;
- a "core group" of Partnering Team members is formed, akin to a Project Alliance Board;
- performance incentives are linked to key performance indicators, including provision for agreement of Profit, Central Office Overheads and Site Overheads;
- the Partnering Team is responsible for risk management and the parties agree as to the balance and sharing of risk;
- dispute resolution is staged through Partnering Team negotiation, to the Core Group and then to adjudication if necessary.

PPP 2000 is a genuine attempt at a relationship contract incorporating a partnering concept into the terms and conditions of the construction contract itself. A similar attempt has been made in Australia by the Department of Public Works and Services (NSW) with C21.

PARTNERING

Partnering is an American concept which emigrated to Australia in the early 1990's as a result of the Gyles Royal Commission.³⁵ Partnering essentially involves the parties agreeing to a partnering "charter" which is usually an informal, and therefore non-binding, document governing the relationship between the parties. The partnering charter and commitments to it evidence a moral platform to encourage all parties to work together so as to meet or better the project objectives without dispute.

Partnering Charter

Partnering charters usually include moral commitments such as trust, equity, co-operation, commitment, good faith and the development of, and commitment to, mutual goals and objectives. These commitments may assist the parties to overcome the inherent adversarial nature of the contract.

The partnering charter is usually outside the construction contract, though the contract may be modified to support the partnering arrangement. A partnering charter is thus not a substitute for a

³⁴ PPC 2000 is available from the ACA see <http://www.acarchitects.co.uk/>. A summary of the key features of PPC 2000 is available at that site.

³⁵ For a good description of the concept see Uher T.E (1994) *What is Partnering?* (1994) 39 ACLN 49; Quick R *supra* at 125.

well drafted contract reconciled with the partnering charter.

Interrelationship between Partnering Charter and Construction Contract

The interrelationship between the partnering charter and the construction contract should be considered so that:

- the contract is drafted to accommodate the objectives of the partnering arrangement; and
- the partnering arrangement promotes the relationship aspects of the contract so as to assist the time, cost and quality objectives of the project.³⁶

Contract amendments to support a partnering arrangement may include:

- an obligation to observe good faith and fair dealing;
- identification of key personnel responsible for communicating with other parties;
- payment incentives such as bonus payments for achieving project objectives, key performance indicators, quality assurance compliance etc;
- requirements for structured project meetings;
- provisions allowing for early notification of problems arising on the project;
- staged dispute resolution clauses to include Chief Executive Officer negotiation and mediation.

In addition there should be elements of the partnering process:

- teambuilding and partnering workshops;
- goal setting such as agreed benchmarking and measures for continuous improvement.

Criticisms

Partnering has been the subject of significant criticism, primarily because it is non-binding, and when the project unravels, parties usually resort to

³⁶ Critchlow J. (2000) *We don't need a contract, we're partnering* (2000) 12(3) ACLB 21 at 22-23.

litigation under the construction contract.³⁷ Further criticisms include;

- partnering seeks to achieve a win / win, while the construction contract governing the parties risks and obligations is still win / lose;
- partnering requires the commitment of additional resources by all parties. These costs may outweigh any benefits to the project;
- partnering will not overcome inherent defects or risks in the project, such as poor design documentation or latent conditions.³⁸

Partnering does emphasise the culture required for relationship contracting and the need to manage relationships, but because of its informal nature, it may be unable to formally govern how the relationship is to work and how the parties are rewarded for their commitment to the relationship. In other words, the moral commitment made by the parties cannot overcome the misalignment of the parties commercial objectives. At the same time, the *Trade Practices Act 1974* (Cth) may mean that the arrangement achieves a legal status the parties did not contemplate.

Distinguished from Alliancing

The fundamental flaw in partnering is that the obligations in the partnering charter are considered by the parties to be non-binding, while the construction contract may be still adversarial. Therefore, partnering has been a success on projects which have run smoothly, but has failed in difficult projects where parties have been free to resort to adversarial means to resolve their problems.

Alliancing is the incorporation of partnering ideals into a construction contract itself, therefore overcoming the fundamental flaw of partnering - lack of binding obligations.

Alliancing also focuses on incentivising the contract, such as sharing of risk and gainshare / painshare to provide financial incentives for co-operation. Ross³⁹ considers that under an alliance, risks are allocated in a precise manner

³⁷ See eg. Dorte J. (1996) *Implications of Partnering for Mining and Construction* (1996) 12 BCL 174; Tyrill J. (1997) *The Dark Side of Partnering* (1997) 56 ACLN 30; Critchlow J. *supra* at 21.

³⁸ See Tyrill J. *supra*

³⁹ See Ross J. (2001) *Introduction to Project Alliancing (on engineering & construction projects)* – Paper presented to Defence Partnering & Alliances Conference – Canberra, November 2001 at 1.

through the operation of those risk / reward arrangements.

The benefit of partnering in the 1990's was that construction industry professionals learnt relationship contracting concepts that they then applied to alliance contracting. Partnering and alliancing have a similar rationale, that is co-operation and alignment of objectives, but alliancing goes further by including that rationale in express terms in a construction contract.

ALLIANCING

Definition of Alliancing

Alliancing is a project delivery method whereby the parties to the project, including the owner and the contractor, form an alliance team to deliver the project, a virtual project delivery vehicle. The basic rationale is that of a risk sharing collaborative approach to project delivery rather than the traditional adversarial approach.

By embracing the risks on the project and then putting together a strategy to deal with those risks as they arise, the parties seek to achieve a "win / win" for all parties involved and better results for the project. The Principal takes back risk so as to effectively manage it.

Because of the popularity of the term, "*Alliancing*" has been used to describe numerous forms of construction contract, some of which incorporate alliancing aspects but cannot be categorised as a "pure" alliance.⁴⁰ A "pure" project alliance requires at least these three elements

- the parties assume collective responsibility for delivering the project;
- the parties assume collective ownership of all risks associated with the project;
- the parties enter into a gainshare / painshare arrangement assessed against pre-agreed targets they have jointly committed to achieve.⁴¹

History of Alliancing

Alliancing was first developed in the Oil & Gas industry in the early 1990's. The Oil & Gas industry in developing new oil wells in the North Sea required a project delivery strategy which could deliver a project at a lower cost to make previously uneconomic fields worthwhile. As a

⁴⁰ see Ross J. *supra* at 1 for a description of the requirements for a "pure" project alliance.

⁴¹ Ross J. *supra* at 1.

result, the concept of project alliancing, involving a team of stakeholders for each oil and gas project was developed. These initial alliances were very successful.⁴²

Because of the success of Alliancing in the UK, the concept was first used in Australia on Oil & Gas projects.⁴³ Since that time Alliances have been used on a significant number of large infrastructure projects in Australia, both for public sector and private sector principals. One of the recent successful Alliances in Australia, and a world first for a building project as distinct from a complex engineering project, is the Acton Peninsula Alliance for the National Museum of Australia.

When is an Alliance Suitable?

Alliancing has been most successful on projects where the principal has been unable to identify, and the contractor has been unable to price, the risks involved. If risks can be easily identified and fairly allocated, a standard lump sum contract is most likely to be appropriate.

Ross⁴⁴ states that an alliance is suitable where there are;

- numerous complex and/or unpredictable risks;
- complex interfaces;
- difficult stakeholder issues;
- complex external threats;
- very tight timeframes;
- a high likelihood of scope changes (eg due to technological change, political influence, etc);
- a need for owner interference or significant value adding by the owner during the delivery;
- threats and/or opportunities that can only be managed collectively.

⁴² The Institute of Petroleum (1994) *Cost Reduction Initiatives for the New Era*, Institute of Petroleum, London. For a history on the development of alliancing in Australia see Thompson G (1999) *Alliance Partnering as a Tool for Project Delivery* – Paper presented to the Building Growth for Innovation Forum, Sydney, May 1999 at and Ross *supra* at 20. CRINE is now incorporated into LOGIC (Leading Oil & Gas Industry Competitiveness) see www.logic-oil.com.

⁴³ The first project may have been the Wandoo B Oil Platform by Ampolex, which commenced in 1994. See Ross *supra* at 19.

⁴⁴ Ross *supra* at 2.

It is submitted that an alliance should be considered where;

- the project has unusual objectives or objectives which cannot be priced, eg unusual environmental requirements, community issues etc;
- the project has numerous stakeholders each with conflicting roles or objectives.

Is an Alliance a Performance Incentive Contract?

What are Incentives?

Incentives are a basic part of any construction contract promoting motivation in the contractual relationship between the owner and the contractor.⁴⁵ Incentives can take two forms, the form of inducements and encouragements (positive incentives), or threats (negative incentives).

Incentives can be cost incentives, schedule (time) incentives or technical incentives.

Technical incentives are those tied to performance measures other than cost and schedule. Usually focused on quality and safety, incentives may cover any area of performance that the owner wants to enhance.

One can argue that a performance incentive contract is a contract which ties these incentives to the final remuneration of the contractor.

Performance Incentive Aspects of an Alliance

An *Alliance* contract is a performance incentive contract because the remuneration of the contractor is tied to performance of the project according to a target cost. This is in the form of a positive inducement because the contractor is guaranteed at least their costs. The relationship aspects of an alliance assist parties in working together to achieve that superior performance.

Essential Features of an Alliance Contract

An Alliance Contract usually has the following essential features;

- Real commitment to the alliance at the highest level; ie., the respective corporate cultures must be receptive to it.
- An emphasis on agreed business outcomes reflected in performance driven payment, incentives and "pain" sharing.
- Performance obligations are collective in that the parties agree to share all risks and rewards.
- Identification of shared objectives, measurable rewards and risks may include historical data of the "contractor's" profit and overheads prior to agreeing to the terms of compensation so that they can be benchmarked against industry practice.
- An equitable "risk and reward" profile. This usually means payment to the contractor based on reimbursement of costs plus a fee.
 - "Open book" accounting and external audit of the contractors' claims.
 - The contract will usually be partly or wholly "cash neutral". The contractor may put fee and sometimes overhead at risk.
 - Incentives reward exceptional performance in accordance with agreed objectives.
 - Incentives should not be guaranteed.
 - The Contractor may lose everything except reimbursement of its own costs.
- An overarching obligation of good faith imposed on all parties.
- Structured payment to the participants is structured so that:
 - Each party is paid 100% of their project specific overheads; +
 - A fixed lump sum fee to cover overheads and profit; +
 - An equitable sharing of any profit or loss on the project in accordance with pre-agreed targets for both financial and non-financial criteria.
- The parties form a "Project Alliance Board" (PAB) with representatives from all

⁴⁵ Ashley and Workman (1986) *Incentives in Construction Contracts*, Construction Industry Institute (CII) of America.

parties to make decisions on the project. The Board, a unanimous, final decision making group,

- decides the strategic direction of the alliance;
- resolves disagreements and disputes by unanimous decision.
- The parties have a "Project Alliance Team" with day to day management functions delegated to the best person for a particular task on a "best for project" basis;
- Actual performance is by an integrated construction/maintenance team consisting of the best person for the job from each participating party's organisation;
- The parties develop and commit to an "Alliance Charter" which sets out fundamental principles and obligations to be followed in the relationships on the project;
- The parties agree to avoid litigation by resolving issues within the alliance, (apart from fundamental breaches such as wilful default, insolvency or bankruptcy of a participant). In other words recourse to the courts is curtailed if not prohibited;
- The parties agree to an intensive relationship management process to encourage innovation, support parties who are suffering difficulties in performing their obligations and encourage outstanding project outcomes;
- An owner may terminate for the owner's convenience but not for the contractor's default (except for wilful default and insolvency). A contractor has no right to terminate;
- Everyone involved:
 - is appropriate in terms of personal values, attitudes and skills;
 - puts the interest of the project first, not the interest of their employer.
- A clear understanding of individual and overall responsibilities and accountabilities. Generally, responsibilities are those of the team and not of individual parties.
- Absolute transparency in all financial transactions. Financial transactions audited by the External Alliance Auditor.
- Insurances may have to be tailored to the relationship. Generally, insurance is a

problem in alliancing because liability for poor performance is shared jointly and not allocated to particular parties.

- Innovation and continuous improvement techniques are encouraged.
- A subcontracting strategy is agreed by the PAB.
- Variations affect the target cost and may be confined to substantial or fundamental changes in the scope of the work.
- No liquidated damages for delay in completion.

Alliance Document Structure

An alliance agreement may be one of three models;

- A single contract model (such as the Acton Point Alliance);
- A two contract model with a Interim Project Alliance Agreement (IPAA) and Project Alliance Agreement (PAA); and
- A three contract model where the documents comprise;
 - Master Alliance Agreement
 - Interim Project Alliance Agreement;
 - Project Alliance Agreement.

Under the two contract model there is a IPAA and PAA for a single project, while under the single contract model there will only be a PAA. The further a project is designed and costed the more a single contract model is possible. Whatever the contract model, the alliance should reflect the essential features discussed above to be a "pure" alliance.

Master Alliance Agreement (MAA)

The purpose of the MAA is to provide the framework and basis for a future relationship including documenting the commitment between the parties to:

- apply alliance principles to future specific work; and
- to enter into an Interim Project Alliance Agreement (negotiation of scope and terms and conditions for performance of work).

The MAA may include terms such as a Master Alliance Charter, a general commitment by the

participants to the alliance across a range of possible jobs and general terms such as good faith and confidentiality.

The MAA may be thought of as a strategic alliance or even a standing offer.

Interim Project Alliance Agreement (IPAA)

The IPAA provides the framework and rules for negotiating the application of alliance principles to a specific job as expressed in the MAA including:

- the scope of work;
- roles and responsibilities;
- allocation of individual team members;
- terms of compensation;
- insurance requirements; and
- other commercial terms.

Project Alliance Agreement (PAA)

The PAA provides the terms of the alliance relationship as developed during the term of the IPAA. It is the most detailed of all the alliance documents and establishes the rights and obligations of the alliance participants. The PAA sets out the structure and procedures of the PAB and the Project Alliance Team, the behavioural principles of the alliance, such as good faith, termination provisions, payment structure and time, cost and quality issues.

National Museum Alliance

The recently completed National Museum of Australia (NMA) and the Australian Institute of Aboriginal and Torres Strait Islander Studies, in Canberra ACT, was delivered by the Acton Peninsula Alliance (APA). The APA Partners included the Commonwealth Department of Communications, Information Technology and the Arts, the ACT Government, Architects Ashton Raggatt McDougall and Robert Peck von Hartel Trethowan, Bovis Lend Lease, Tyco, Honeywell and Anway and Company.

With the NMA the Architects were selected first. An alliance allowed for innovation in the project, allowed the contractors to include "buildability" into the design, and principal stakeholders to have input into the design and construction.

Project quality was also of utmost importance, with one of the agreed objectives being to ensure that project quality was minimised without sacrificing design integrity or quality. Failure to

meet this design integrity was linked to cost penalties for the alliance members.⁴⁶

Why an Alliance?

Because of the uncertainties of design and construction risk and the need for innovation in the design, construction and engineering processes, the NMA lent itself to perfecting an alliance form of project delivery. Casey identified reasons for using an Alliance at the NMA:

- the importance of the project required the client to be actively involved;
- there was an absolute cap on available funds for the NMA;
- the timeframes were considered short, with the project starting 3 months late and the opening date being inflexible due to Centenary of Federation celebrations;
- quality was paramount with a technically demanding design;
- because of the technically demanding design, the scope of work was not easily defined up front;
- an integrated approach was required between the architects and exhibition designers;
- the expertise of the contractors and the input of government was wanted early in the process. Therefore the "eyes on, hand off" style of design and construct contract was unsuitable.⁴⁷

APA Document Structure

As far as the author is aware, the Alliance Contract chosen for the APA was a single form model.

The APA included the usual criteria required for a "pure" project alliance including:

- remuneration of the participants on a direct costs, plus overhead and margin basis only;
- a no dispute clause restricting access to litigation except in the instance of "wilful default";

⁴⁶ Casey D (1999) *Case Study: National Museum of Australia*, Paper presented to Relationship Contracting in Construction Conference, Sydney, 29-30 June 1999.

⁴⁷ Casey *supra*.

- a commitment to alliance principles and an alliance charter;
- "open book" accounting procedures;
- a quality pool for achieving key performance indicators including workmanship, cultural excellence, safety, environment, public relations and employment of indigenous people;⁴⁸
- termination for convenience.

The project was managed by an Alliance Leadership Team consisting of nominated representatives of all the Alliance members and a Project Management Team, the equivalent of a Project Alliance Team.

Why a Success?

The unusual nature of the NMA lent itself to using an alliance contract. A project supports the use of an alliance when the project meets the "suitability" criteria listed above.⁴⁹ That being said, it also appears that the NMA was a success because of the relationship management on the project and the desire of the Alliance Participants to work together on a "best for project" basis.

CONCLUSION

Relationship contracting has developed in response to the adversarial nature of construction contracts. Furthermore, the inappropriate allocation of risk by principals, together with a selection of incorrect project delivery strategies, has compounded the inherent misalignment of parties' objectives and multiplied conflicts and litigation. All participants in the industry - principals, contractors, designers and lawyers recognise that a better way of contracting is needed. Relationship contracts, and in particular alliances, have been very successful in delivering projects which are inherently risky and uncertain due to their ability to satisfy the trinity of objectives time, cost and quality.

Further Reading

1. Australian Constructors Association (ACA) (1999) *Relationship Contracting: Optimising Project Outcomes*, ACA, Sydney
2. Construction Industry Institute of Australia (CIIA) (2001) *Re-engineering the*

Construction Delivery Process: Think Tank Report, CIIA, Brisbane, 26th April 2001.

3. Construction Queensland Equitable Delivery Taskforce (2001) *Wealth Creation through Equitable Asset Delivery*, Construction Queensland, Brisbane.
4. The Grove Report – Grove, J.B. III (2000) *Consultant's Report on Review of General Conditions of Contract for Construction Works for the Government of Hong Kong Special Administrative Region*, November 6 2000 see http://www.constructionweblinks.com/Resources/Industry_Reports_Newsletters/Nov_6_2000/grove_report.htm
5. Jones D. (2001) *Keeping the Options Open: Alliancing and Other Forms of Relationship Contracting with Government* (2001) 17 BCL 153
6. McLennan A (2001) *Relationship Management in Contracting*, Paper Presented to the Institution of Engineers (Australia) 22 March 2001.
7. Quick R (1995) *The Partnering Contract: Some First Thoughts* (1995) 14(4) ACLR 125.
8. Ross J. (2001) *Introduction to Project Alliancing (on engineering & construction projects)* – Paper presented to Defence Partnering & Alliances Conference – Canberra, November 2001.

⁴⁸ Casey *supra*.

⁴⁹ See Ross *supra* n 44.