



Australian Government

Department of Infrastructure and Regional Development



National Alliance Contracting Guidelines

Guide to Alliance Contracting

September 2015



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Document Updates

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Director - Publishing and Communications, Communications Branch
Department of Infrastructure and Regional Development
GPO Box 594, Canberra ACT 2601 Australia
Email: publishing@infrastructure.gov.au
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Note

Governments in each jurisdiction will have their own individual approval processes for capital investment projects, as well as policies (e.g. probity) and legislation that will impact on all capital works delivery. These over-arching jurisdictional requirements are precedent to the alliance practices covered in this document.

Acknowledgement

This Guidance Note is based on the guidance note of the same name prepared under the sponsorship of the Inter-Jurisdictional Alliancing Steering Committee with membership from:

- Department of Treasury and Finance, Victoria (Chair)
- Treasury, New South Wales
- Treasury, Queensland
- Department of Treasury and Finance, Western Australia
- Department of Infrastructure and Regional Development, Australian Government

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1

Introduction to the Guide

This Chapter outlines the purpose and structure of the Guide and describes the relationship of this document to other relevant government policy documents and guidelines.

1.1 Purpose of the Guide

This *Guide to Alliance Contracting* ('the Guide') has been prepared to provide consistent and leading practice guidance on alliance contracting to public sector agencies that develop and own infrastructure projects ('Owners').

This Guide reflects insights from government¹ and industry which have been gained from significant experience over recent years, including \$30 billion worth of public sector alliances that have either been completed or are currently being planned or implemented across Australia. The Guide draws upon learning from the many projects, which are now complete, and were procured using alliance contracting, and upon the findings and recommendations set out in the report *In Pursuit of Additional Value*.²

Benefits of alliancing

Alliancing has evolved to become a broadly accepted procurement and delivery method, which has been used to successfully deliver many risky and complex projects. Under an alliance contract, the Owner and the Non Owner Participants (NOPs) work together to collaboratively determine the best project solution and deliver the project.

¹ Unless otherwise stated, the expression 'government' is used to denote all the government entities of Australia, which include the Commonwealth of Australia and all Australian state governments and territories.

² Released by the Department of Treasury and Finance, Victoria, Australia in October 2009.

The Guide has been prepared to:

provide the minimum conditions for Owners in order to comply with the *National Alliance Contracting: Policy Principles* ('Policy')³ when delivering alliance projects;

provide guidance to public officials undertaking the planning and delivery of alliance projects to enhance Value-for-Money (VfM) outcomes for governments; and

improve the quality, consistency and commercial outcomes of government alliance projects.

This Guide has been developed recognising that alliance contracting:

should comply with all relevant overarching jurisdictional policies and principles that generally regulate public sector procurement;

is a complex commercial transaction and, accordingly, Owners should apply good commercial practices to the selection, development, procurement and implementation of alliance contracts; and

is now a mature procurement and delivery method for Owners, and has become a 'business-as-usual' option for delivering infrastructure projects, i.e., alliancing is no longer a pioneering, unique or novel approach to project delivery.

The Guide does not address issues related to the jurisdictional processes that apply to an approval of a project, or the process for the Owner's assessment of alternative procurement strategy options as part of the Business Case. There are other (overarching and general) government policies and guidelines that cover these matters.

1.2 Who should use this Guide

This Guide is intended to provide guidance to public officials who are involved in delivering projects through alliance contracting.

Other parties who may find it useful include:

firms that supply professional advisory services to Owners and public sector alliances; and

contractors or other suppliers that tender for alliance contracts in the infrastructure sector.

The Guide should be used as a road map to navigate the practical realities of alliance contracting; it outlines successful and proven practices in alliance contracting, and incorporates insights from recent research⁴ and experienced

³ The *National Alliance Contracting: Policy Principles*, published by the Commonwealth Department of Infrastructure and Regional Development, April 2011.

⁴ *In Pursuit of Additional Value – A benchmarking study into alliancing in the Australian Public Sector*, DTF Victoria, October 2009.

Participants. The Guide will assist Owners with the practical application of alliancing theory and policy, and to successfully select, develop, procure and deliver their alliance project in accordance with Government policies and principles.

1.3 Structure of the Guide

The remainder of the Guide is structured as follows:

Part One—Chapters 2 and 3—provides an overview of alliance contracting. It outlines the theories and key features of alliancing, and identifies the characteristics that will make a project suitable for delivery as an alliance.

Part Two—Chapters 4, 5, 6 and 7—provides detailed information and practical guidance on the development, procurement and implementation of alliance contracting from the point following the government’s investment decision to deliver the project as an alliance, through to the end of the alliance contract term. It identifies a range of specific issues, risks and opportunities that are likely to arise during the lifecycle of the project and provides guidance on how to address these.

Appendices: A–E: Developing a Governance Plan; Developing a Governance Plan external to alliance; NOP selection processes; Commercial Framework—Indicative Risk or Reward Regimes; Risk or Reward for cost and non-cost performance: worked examples. These Appendices provide further detail on each of these topics. Models and examples have been included; however, agencies should use these as examples only and tailor the content to suit their particular project.

Key points are highlighted by five types of text boxes:

	Overview of chapter
	Alliancing essentials
	A key alliancing feature
	Commercial realities
	Working with the commercial realities

1.4 How and when to use the Guide

This Guide has been written on the basis that Owners refer to other general (non-alliance specific) government policies and guidelines applying to procurement planning, infrastructure delivery and government decision making. In relation to alliance specific documentation, Owners should refer to the alliancing Policy, Guidance Notes and Templates⁵ in addition to the Guide. Figure 1.1 illustrates the wider context of documentation and indicates when to use the Guide in the hierarchy of planning and delivery steps in a project alliance.

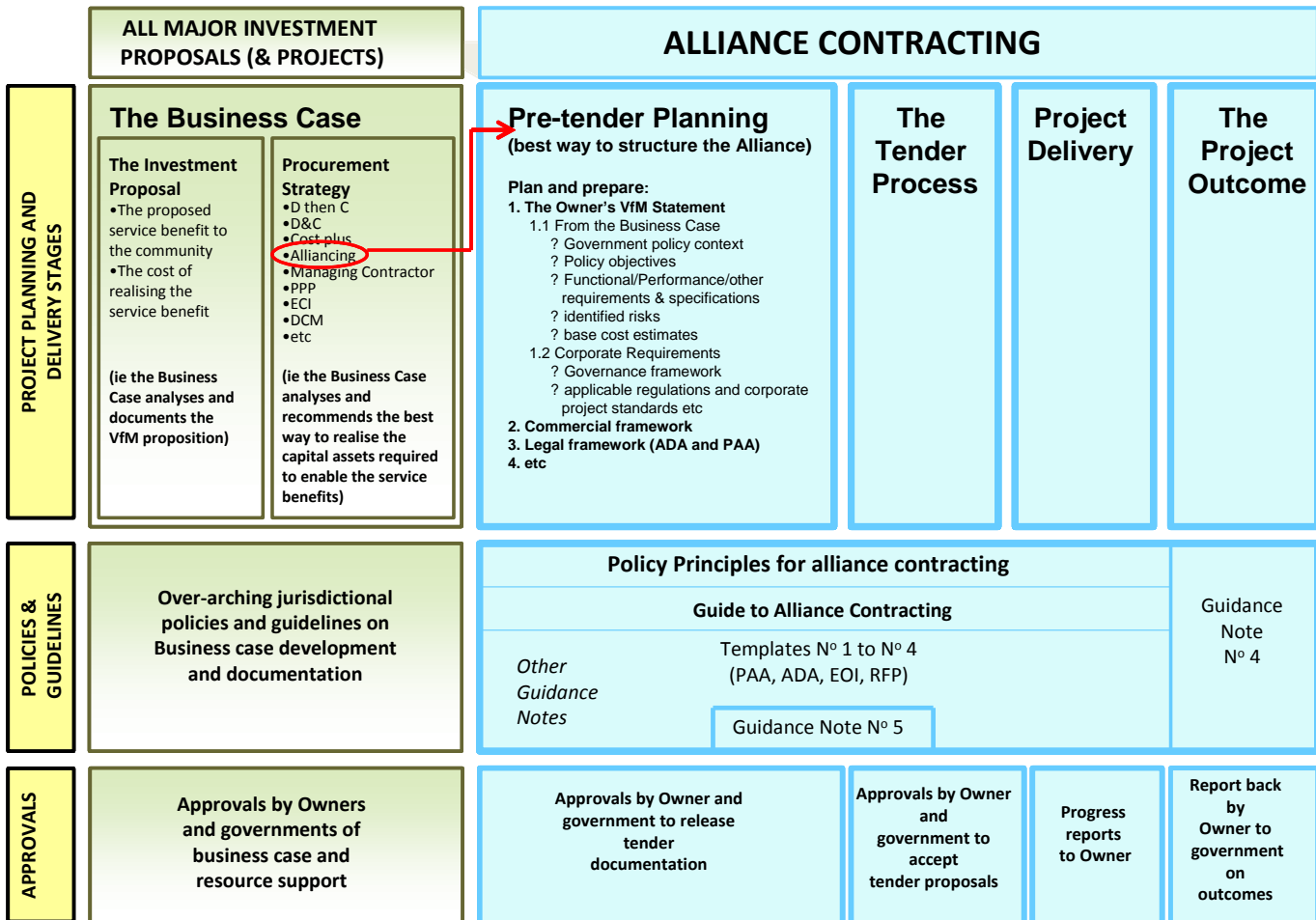


Figure 1.1: Hierarchy of planning and delivery steps in a project alliance

As shown above, the Guide (and the Guidance Notes and Templates) applies once an Owner has approval to deliver a project as an alliance (however, Chapter 3 of this Guide provides additional advice, which supplements general Business Case policies/guidelines, on the selection of alliancing as the preferred procurement strategy).

In some circumstances, it may be appropriate to depart from the processes set out in this Guide. Each Owner always has the flexibility to determine and

⁵ Published on the Department of Infrastructure and Regional Development website: www.infrastructure.gov.au

recommend processes which are efficient, 'fit-for-purpose' and best suited to achieving VfM outcomes for their specific project.⁶

The Guide has been prepared on the basis that when Owners undertake alliance contracting, they:

- are familiar with all relevant Acts and their jurisdictional policies and guidelines (whether alliance specific or otherwise);
- understand the practical challenges of prevailing market conditions that impact public sector infrastructure projects; and
- will call on specialist professional service providers (such as cost estimators, legal and commercial advisers), sourced either internally or externally, to assist them to deliver the project in accordance with the Policy, the Guide, Guidance Notes and Templates.

This Guide details 'what to do' not 'how to do it'

The Guide is not a standalone document on how to procure and deliver alliance projects. The Guide supports the approach of Owners calling on the skills, experience and expertise of a number of specialist advisers to assist with developing a tailored approach to procurement and delivering the specific project. The Guide has been prepared to provide advice to Owners about 'what to do' rather than attempt to fully detail the 'how to' aspects of an alliance.

1.5 Relationship with the Policy Principles for Alliance Contracting⁷ and Guidance Notes

This Guide is part of a suite of related documents that are specific to alliance contracting.⁸ The Policy sets out the minimum (mandated) requirements for alliance contracting. The Guide documents practices that will ensure that the principles set out in the Policy are satisfied. The Policy requires that planning and procurement activities are benchmarked⁹ against the alliance guidance material published from time-to-time. This published documentation currently includes this Guide and various Guidance Notes and Templates¹⁰ with others being planned. The list of *National Alliance Contracting* documentation current at the time of publishing this Guide is:

- Policy Principles for Alliance Contracting
- The Guide to Alliance Contracting

⁶ Refer to section 5.5.1 'Assess which selection process is most suitable'.

⁷ As released by respective jurisdictions from time-to-time (check the relevant websites of each jurisdiction for information).

⁸ Refer section 1.4.

⁹ Public sector agencies are required to benchmark their processes and performance standards so that they are at least as robust and comprehensive as set out in the Guide and Guidance Notes. However, as stated in section 1.4, Owners have the flexibility to determine and implement tailored processes in response to their specific project requirements so that they are 'fit for purpose' and better suited to achieving demonstrable VfM outcomes for that project.

¹⁰ Published on the Department of Infrastructure and Regional Development website: www.infrastructure.gov.au.

- Guidance Note 1: Language in Alliance Contracting
- Guidance Note 2: Insurance in Alliance Contracting
- Guidance Note 3: Key Risk Areas and Trade-Offs
- Guidance Note 4: Reporting VfM Outcomes
- Guidance Note 5: Developing the TOC in Alliance Contracting
- Guidance Note 6: ECI and Other Collaborative Procurement Methods
- Template No 1: The Model Project Alliance Agreement
- Template No 2: The Alliance Development Agreement
- Template No 3: Expression of Interest
- Template No 4: Request for Proposal.

In addition, jurisdictions may publish other documents which provide details of specific requirements for the use of alliance contracting. These should be read in conjunction with the Guide.

Owners will also need to be aware of all relevant general (non-alliance specific) jurisdictional policies and guidelines that may apply to them, such as those relating to probity, tendering processes and Business Case development.¹¹

1.6 Updates to the Guide

Updates to the Guide will be published from time to time on the Department of Infrastructure and Regional Development website: www.infrastructure.gov.au.

Business Cases

Business Cases are the vehicle by which governments make investment decisions. Although the requirements and expectations for Business Cases may vary in each jurisdiction,⁹ they have much in common and do not differ on the core principles. Like other procurement methods, Alliances will need to follow the normal investment lifecycle requirements of agencies and governments.

¹¹ Examples include The State of Queensland (Queensland Treasury) publication *'Project assessment framework – Alliance establishment and management'* and the National PPP Guidelines: *Volume 1 Procurement Options Analysis*.

PART ONE:

Overview of alliance contracting

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2 Introduction to alliancing

This chapter examines the key features of alliancing. It provides the theory and background to alliance contracting, and outlines the factors that make it a successful delivery method.

2.1 What is an alliance?

Alliance contracting is delivering major capital assets, where a public sector agency (the Owner) works collaboratively with private sector parties (Non-Owner Participants or NOPs). All Participants are required to work together in good faith, acting with integrity and making best-for-project decisions. Working as an integrated, collaborative team, they make unanimous decisions on all key project delivery issues. The alliance structure capitalises on the relationships between the Participants, removes organisational barriers and encourages effective integration with the Owner.

Risk sharing v risk allocation

The most significant difference between traditional contracting methods and alliance contracting is that in alliancing, all project risk management and outcomes are collectively shared by the Participants. In more traditional methods of risk allocation, specific risks are allocated to Participants who are individually responsible for best managing the risk and bearing the risk outcome. This concept of collective risk sharing provides the foundation for the characteristics that underpin alliance contracting including collaboration, making best-for-project decisions and innovation. If substantial and significant risk is allocated to individual Participants, then it may not be an alliance and those characteristics may not be necessarily required or appropriate.

Alliance agreements are premised on joint management of risk and opportunity for project delivery. All Participants jointly manage that risk within the terms of an ‘alliance agreement’, and share the outcomes of the project (however, the financial outcomes are not always shared equally between the Owner and the NOPs)¹².

Sharing management and consequences of risks

Historically, most alliances have been delivered on the basis of a 50:50 sharing of risks (and opportunities) and a capped downside for NOPs. This means that although risks may have been jointly managed by the Participants, potential financial consequences were not equally shared.

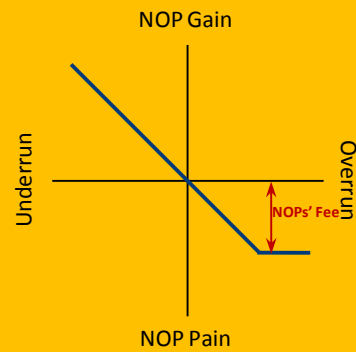


Figure 2.1: Historical Risk or Reward Models – Cap on NOPs’ Painshare

¹² The commentary in the Productivity Commission 2014, Public Infrastructure, Inquiry Report No. 71, Canberra, is noteworthy. It states “Under alliance contracting, risks are shared between government and the private party. Alliances may work well in some circumstances but recent practice has been increasingly wary of the model due to uncertainty about the overall cost of construction and potential to put off rather than deal with risk issues early (chapter 12). Alliances may nevertheless still have their place. In particular, they may offer value in specific circumstances where projects must proceed out of necessity, but where substantial risk cannot be clearly allocated to one party. For example, because risks are difficult to identify and quantify or there is disagreement over the price. These examples should be rare in an effectively-planned infrastructure environment (page 122)”.

An alliance contract works very differently to a traditional contract

Traditional contracts are founded on the traditional role of buyer and seller. The buyer wants an asset delivered at fair cost or better and the seller wants to deliver the asset for a fair return or better. The buyer describes its requirements and terms, often in the form of a Request for Tender and the seller proposes a solution, terms and price to deliver that requirement, in the form of a Tender response. This means that both parties build their own risk assessment into their price and stand to win or lose if the risk outcome is higher or lower than predicted for each of them. The resulting contract encompasses both the requirement and the offer and allows variations to these to be made as the work progresses, as per the agreed risk allocation model and Commercial Framework.

This approach works well where the project has few unknowns and the outcome is predictable. Whilst the buyer and seller are aligned on delivering the project, the buyer's motivation is to minimise the cost and the seller's motivation is to maximise the profit. The only moderator to this behaviour is the parties' desire to maintain a sustainable position (i.e. they will be concerned about reputation and staying in business) beyond the life of this project.

Where projects are more complex, with more unknowns, and the parties have less ability to confidently predict the outcome using traditional contracting, the parties will allow for higher levels of risk which will mean a higher tendered price, and/or they will have significant variations as the work progresses. This can lead to highly complex risk-allocation models and commercial frameworks with significant time and effort spent negotiating variations to the original agreement. Resolving these variations can be time consuming and costly.

Alliance contracting provides an alternative approach where the buyer and seller collaborate to develop the requirements and the proposal, combining their knowledge and experience to address the complexities and unknowns, with an objective of increasing their shared confidence in the outcome. They share exposure to the project outcome, which forms the basis of the Commercial Framework. The buyer and seller are aligned as minimising actual cost to the buyer and increasing profit to the seller. Time otherwise spent negotiating variations under a traditional contract becomes time spent finding the best solution to resolve issues and problems through the life of the project. The time and energy of the leadership team is spent on value-adding activities rather than contractual disputes; solving the overall project outcome is the objective and this aligns to each party's individual commercial objectives.

Alliancing is a complex delivery method, and success is based on four interdependent success factors of:

- an integrated collaborative team;
- the project solution;
- the agreed commercial arrangements; and
- the agreed Target Outturn Cost (TOC).

These are shown in Figure 2.2 and are enabled by seven key features:

- risk and opportunity sharing;
- commitment to ‘no disputes’;
- best-for-project unanimous decision-making processes;
- ‘no fault – no blame’ culture;
- good faith;
- transparency expressed as open book documentation and reporting; and
- a joint management structure.

It is the collective dynamic of these key features which characterise the function and contractual structure of the alliance. That is, the key features operate in an integrated manner to ensure that the Participants exercise common behaviours and pursue common goals to deliver the project. Essentially, this is what makes alliancing unique compared to other delivery methods, where each contracting party has its own independent goals and risk allocation.

A current trend in the procurement and delivery of infrastructure projects is for the Participants to apply one or more select features of alliancing as part of a non-alliancing project. For example, the traditional form of contract might be amended to include elements of collective decision-making, a joint management structure and a form of risk or reward regime, but will not have a ‘no disputes’ clause and will still transfer the key construction risks to the designer/contractor. However, under an alliance, each of the above key features is present, integrated and incorporated in the contractual framework for the project.

2.1.1 Alliancing success factors

An alliance is established by the Owner to deliver the Owner’s VfM Statement¹³ (i.e. the project’s approved capital and/or service objectives at a fair cost). It is useful to consider the successful establishment of the alliance as dependent upon four success factors shown in Figure 2.2:

Integrated, collaborative team

The combined team for an alliance project includes personnel from both the NOP and Owner organisations. These personnel will be allocated as members

¹³ Refer to *Guidance Note N^o 4, Reporting VfM Outcomes in Alliance Contracting* for details and a template on preparing the Owner’s VfM Statement

of both the leadership team and the management team. The affinity between members of the team and resulting project culture has a significant impact on the effectiveness of the key features of alliancing (described below) and the project outcomes. The Alliance Leadership Team (ALT) establishes and sustains the project culture.

Project solution

The project solution comprises the design solution, construction methodology and project delivery arrangements. The commercial arrangements and the TOC will be developed and agreed to reflect the unique project solution.

Commercial arrangements

The commercial arrangements, or the Commercial Framework, are agreed as part of the Project Alliance Agreement (PAA) and are intended to drive the alignment between the Participants. The commercial arrangements should reflect the unique project solution to ensure that the appropriate level of risk sharing and reward are achieved, and to drive the desired team behaviours and project outcomes.

Target Outturn Cost (TOC)

The Target Outturn Cost (TOC) is the estimated actual costs of designing and constructing the assets. It should reflect the project solution and the commercial arrangements.

However, for these four factors to work successfully to deliver the project, they must be supported by a number of key features that must be applied effectively. These features could be described as 'enabling' the delivery of the alliance, and are identified in Figure 2.2 below.

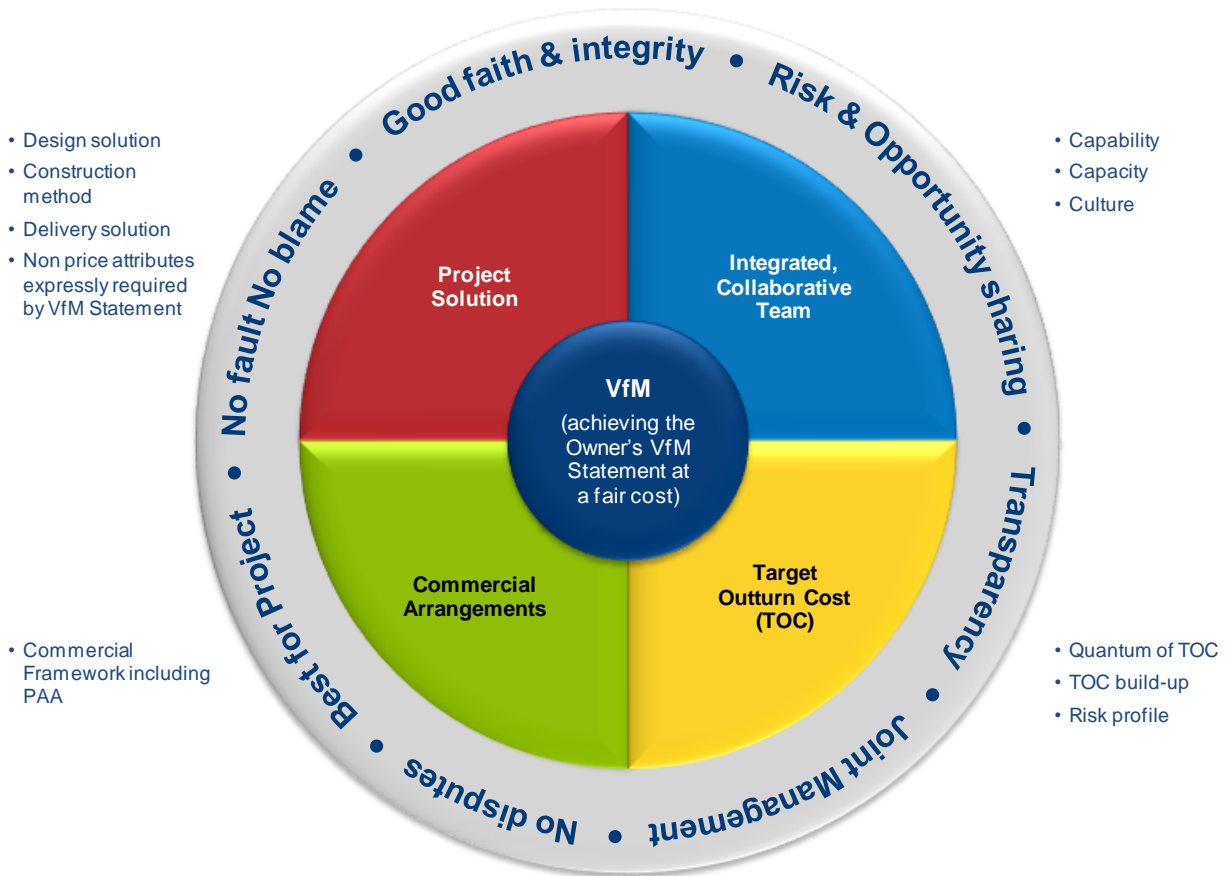


Figure 2.2: Alliance Success Dynamics

2.1.2 Key features of alliancing

Key alliancing features

An alliance is characterised by several key features that operate collectively as part of the alliance framework to ensure that the alliance is a success. It is the collective dynamic of these features that is unique to alliancing – generally, other delivery methods will only selectively apply one or more of the features to a more traditional contracting structure.

Although alliancing has a number of principles in common with other procurement options, including achieving VfM and protecting the public interest, it is underpinned by several key features which must operate collectively to create a framework for successful alliance project delivery.

The key features are:

- risk and opportunity sharing;
- commitment to ‘no disputes’;
- best-for-project unanimous decision-making processes;
- no fault – no blame culture;
- good faith;
- transparency expressed as open book documentation and reporting; and

- a joint management structure.

These features are described in more detail below.

Risk and opportunity sharing

The alliancing principle of 'collective assumption of risks' and the approach to remunerating the NOPs arising from risk and opportunity sharing is fundamental to understanding the alliancing culture.

Collective assumption of risks

Alliance contracting is generally characterised by the collective assumption of risk by the Participants. By assigning responsibility for delivering the Works jointly to the Participants, the alliance contract implements a risk and opportunity-sharing approach, as opposed to the more conventional approach of risk allocation. For example, the designer/contractor generally bears up to 100% of the construction risk under a traditional contract; however, under an alliance, the NOPs and the Owner share this exposure to construction risk.

Complex projects benefit from collective risk sharing

Projects that are suited to alliancing are complex. These projects benefit from the Owner and NOPs collaborating to solve problems and deliver the project successfully. Collective risk sharing encourages effective collaboration as all Participants will lose or benefit from the ultimate project success, and this differs from traditional contracts where one Participant can be successful in delivering on their obligations whilst the other contract parties may face a suboptimal outcome.

It should be noted, however, that where the NOPs' painshare is capped, the Owner will bear 100% of the designer/contractor risk (or 'pain') beyond the cap (although joint management of risks still applies). Irrespective of the Participants' shared exposure to risk, the core strength and attraction of alliancing is the benefit offered by joint management of risk, and for some projects, collectively assuming risks to minimise their impact.

Owners may retain some risks

The collective assumption of ALL project risks is often referred to as one of the key aspirations behind the 'traditional/conventional' alliance approach. However, the optimum solution may be for either the Owner or NOPs to retain a particular risk.

For example, consider the risk of potential delay (and related costs) associated with essential land acquisition/resumptions for a time critical project. The Owner may achieve a better VfM outcome by bearing the acquisition/resumption risk and providing for adjustment to the TOC in the event of resumption delay. This is because the Owner may be the only Participant in a position to influence and manage this risk.

When undertaking an alliance contract, the Owner is exposed to project risks that it would normally transfer to another party under a 'hard dollar contract' or a public-private partnership. Therefore, it is critical that the Owner has a thorough understanding of the risks it faces under the alliance contract (and the potential consequences if these risks arise) and have regard to project-specific issues. This understanding should inform the Owner's approach to procurement options analysis and to finalising the regime for risk and opportunity sharing under the PAA.

Risk assessment is subjective

The risk associated with a project will affect the price tendered to the Owner. The identification and assessment of project risk is a subjective exercise based on the experience and expertise of the individuals involved. There is no 'right or wrong' and no formula to check. In traditional contracting, proponents will propose a higher price for a higher-risk project so that they are confident they will make their required return on that project. They will balance the resulting price 'premium' with other factors including the strength of competition for the work, the economic environment and their desire to 'win' that piece of work. In alliance contracting, the Owner must be able to participate effectively in this process of identification and assessment of risk, because they will share the consequences of that risk assessment under the collective risk-sharing arrangements (and indeed bear all the consequences once the maximum painshare for the NOPs is exceeded).

Financial exposure to construction risk

Traditional risk-allocation projects usually provide for construction and design risk to be borne by the designer and contractor rather than the Owner.

By contrast, an alliance project has a collective approach to risk, which means that the Owner will share in construction and design risk (and opportunities).

In a traditional alliance, the Owner assumes a 'de facto' position as a designer and constructor Participant. If the alliance project encounters serious difficulties and moves into a cost overrun (beyond any NOPs' cap) then the Owner carries all of the design and construction risk.

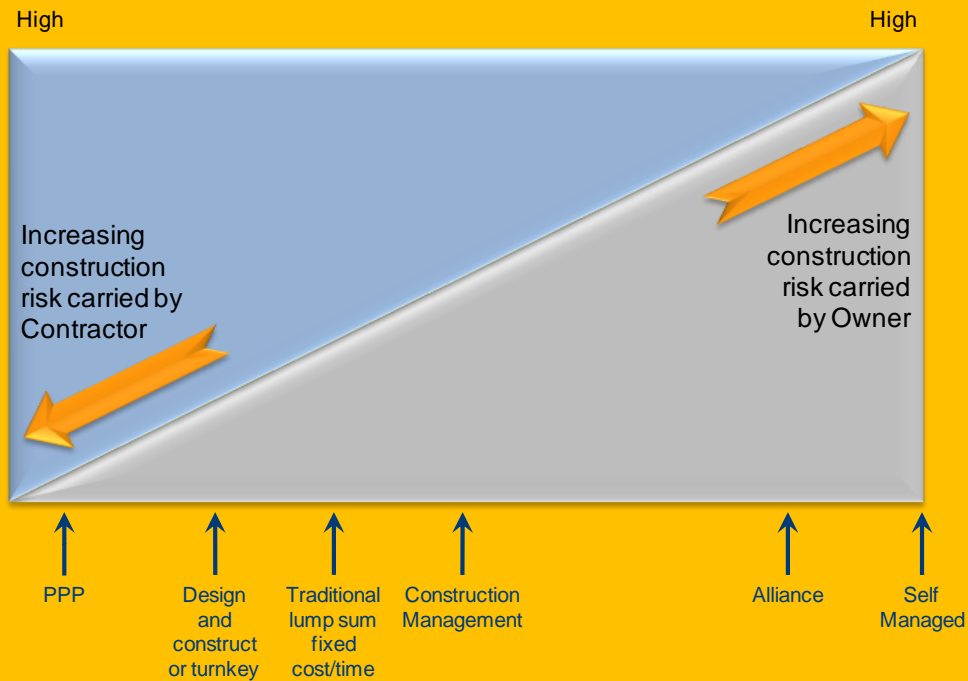


Figure 2.3: Design and construction risk continuum

Remuneration

The commercial and project objectives of the Participants are aligned through the development of a project-specific Commercial Framework. The standard Commercial Framework model for an alliance provides for the NOPs' remuneration to comprise the following three elements:

- their actual direct project costs (including, e.g., design and site overhead costs);
- their nominated fee (which comprises their profit margin plus an amount for corporate overhead); and
- a pre-agreed share of the 'pain or gain' outcome of the alliance project, which is determined by comparing actual and target performance in both cost and non-cost areas.

Making decisions on risk sharing

Owners should undertake a thorough risk analysis of the alliance project at the pre-tender stage to gain a better understanding of the risks they face and to assess how their risk profile should be reflected in the structure of the Commercial Framework. This is because the Owner may be accepting risks that it does not traditionally bear and may not fully understand (e.g. construction risk). Owners may need to seek expert advice in this situation.

Commitment to ‘no disputes’

Alliance contracts generally include a ‘no disputes’ mechanism where the Participants agree not to litigate, except in limited circumstances. The intention of this approach is to avoid the adversarial or ‘claims-based’ culture of the traditional contract, and in turn encourage the Participants to find solutions to problems, rather than to deny responsibility and seek to blame others. To give effect to this, alliance contracts have traditionally not included a formal dispute resolution procedure. The commitment to ‘no disputes’ is also typically supported by an obligation to act in good faith.¹⁴

Ideally, the ‘no dispute’ mechanism should also be supported by an Alliance Charter which sets up a model of agreed behavioural principles to drive decision-making processes and issue resolution. An Alliance Charter serves to align the Participants’ objectives in relation to the Project and reduce the risk of litigious disputes between the Participants. The Alliance Charter should form part of the executed PAA.¹⁵

‘No disputes’ does not mean ‘no disagreements’

It is important to remember that ‘no disputes’ does not mean ‘no disagreements’. Healthy challenge and debate is a sign of an effective team. The success of the alliance will be highlighted by the manner in which disagreements are addressed and resolved by the Participants. Friendliness does not guarantee effectiveness.

Best-for-project decision-making processes

A key feature of an alliance is the requirement for the Participants to make decisions which are ‘best-for-project’. The best-for-project principle is based on the understanding that the Participants will direct their decisions towards the collective vision and objectives of the alliance (which is fully aligned with the Owner’s VfM Statement), rather than their own self interests or the commercial interests of their employer. Ultimately, the Commercial Framework should operate to ensure that, by acting in the best interests of the project, the Participants will also be acting to support their own best interests.

Under an alliance, Owners are willing to trade-off their traditional contractual rights (under a ‘risk transfer’ contract) in exchange for NOPs bringing to the

¹⁴ Refer to *Guidance Note N° 1, Language in Alliance Contracting: A Short Analysis of Common Terminology*; Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

¹⁵ Refer to Template No 1: The Model Project Alliancing Agreement which can be found at www.infrastructure.gov.au.

project their good faith in acting with the highest level of integrity and making best-for-project decisions to achieve the project objectives (in accordance with the Owner's VfM Statement).

There is no concept of 'best-for-self' decision making under an alliance contract. The Participants operate in a peer relationship as part of a joint management structure where each Participant has an equal say in decisions for the project. It is expected that all joint decisions made by the Participants will be best-for-project. Generally, this means that those decisions will:

- be made in accordance with the alliance principles developed by the Participants and incorporated in the Project Alliance Agreement (PAA);

- drive the achievement of all project objectives (as per the Owner's VfM Statement) at a fair cost, where a fair cost is reference to best-in-market pricing;

- be made in a way that reflects the Participants' behavioural commitments under the PAA (including the Alliance Charter); and

- fully take into account public sector standards of behaviour and protects the public interest.

Best-for-project must be consistent with Owner's VfM Statement

The best-for-project principle is applied to align all Participants to a set of common objectives which reflect the Owner's VfM Statement. The best-for-project concept should only be used efficiently, effectively and economically to pursue project objectives that are part of the Owner's VfM Statement.

A 'no fault – no blame' culture

The establishment of a 'no fault – no blame' culture underpins the alliance-delivery method. It involves a commitment from each of the Participants that, where there is an error, mistake or poor performance under the alliance contract, the Participants will not attempt to assign blame but will rather accept joint responsibility and its consequences and agree a remedy or solution which is best-for-project. If the Participants disagree, they must work together to resolve issues in a best-for-project manner.

The 'no fault – no blame' culture is intended to optimise outcomes for the Owner by refocussing the Participants away from acting in a best-for-self manner and towards acting in a best-for-project manner. The PAA (including the Commercial Framework) should also be structured to encourage the Participants to address the relevant issue, rather than place blame.

Operate according to good faith and integrity

The requirement to act in good faith and with integrity underpins each of the key features of alliancing. The aspirational view of good faith is tied to the general behaviours and shared cultural values that the Participants aim to achieve in delivering the alliance project. These usually relate to cooperation and communication between the Participants, and a requirement to always be fair

and honest and act with integrity. Generally, the requirement to act in good faith includes:

an obligation on the Participants to cooperate in achieving the objectives set out in Owner's VfM Statement (including project contractual objectives and commercial criteria);

compliance with reasonable standards of conduct, having regard to the interests of the Participants; and

an obligation to act fairly, including not deriving any commercial benefit at the expense of other Participants.

Good faith and the Commercial Framework

Even if the Participants meet their obligation to act in good faith, this does not change the outcome or financial implications of their performance. That is, whether or not the Participants have exercised good faith in the decision-making process, the cost and time objectives of the project will still need to be achieved, and the actual outcomes of the project will be dealt with under the Commercial Framework. Ultimately, the Owner will bear the consequences of the project's outcomes regardless of the exercise of good faith by the Participants.

Also, the good faith bargain can be hard to enforce. Under most alliance contracts, failure to act in good faith is treated as a wilful default. However, identifying what is not good faith can be difficult. The development of an Alliance Charter would assist to develop more objective standards of conduct for the Participants.

The good faith obligation may not be terminated if legal proceedings begin between the Participants. This means that the Participants may be required to continue to act in good faith during a dispute. However, the requirement to act in good faith is generally limited to the performance of the collective obligations and responsibilities of the alliance, rather than attaching to the Participants' unilateral obligations and responsibilities. In particular, the Owner's good faith obligation should be specifically limited to the performance of collective obligations and responsibilities and do not restrict the Owner's discretions (i.e. 'reserved powers') that the Owner can operate unilaterally.

A consequence of the alliance relationship is that the Participants may be held to owe fiduciary obligations towards each other. A fiduciary relationship can arise and fiduciary duties can exist between parties that are engaged in some form of joint undertaking or activity. The mutual confidence and trust which underlies the alliance relationship, where one party is dependent for its ability to perform, and for the consequence of performance of its part of the alliance upon the conduct of the other, may give rise to a fiduciary obligation. However, the fact that an alliance relationship is of a commercial nature and that the Participants have negotiated the agreement, at arms length, would be a significant factor against any finding by a court that a fiduciary relationship and therefore fiduciary obligations exist.

Potential consequences of a fiduciary relationship include:

an obligation not to enter into any engagements which give or potentially give rise to a conflict between the fiduciary's personal interest and their duty to the other Participants; and

an obligation to account for profits or gains made by virtue of the relationship, or opportunity or knowledge resulting from that relationship (without the authority of the other Participants).

A statement may be included in alliance agreements that the agreement is not intended to create, nor will it be construed as creating, any fiduciary relationship (see Model PAA). However, while this will assist in reducing the likelihood of an agreement being interpreted that way, it will not necessarily prevent this interpretation by the courts. In deciding whether a fiduciary relationship exists, the court will look to a number of factors, including the particular contractual obligations contained in the alliance agreement and relative bargaining positions of the Participants.

It is important to note that the law of fiduciary obligations is complex, extensive and developing in ambit.

Transparency, expressed as 'open book' documentation and reporting

Under an alliance, Owners have the opportunity to work closely with the NOPs to make joint decisions for and manage their alliance project. The Participants commit to an 'open book' arrangement and have much broader mutual access and audit rights. These provisions ensure that the costs which are reimbursed to the NOPs under the remuneration framework have been actually and reasonably incurred. Moreover, it is important to be able to fully read and understand, in accordance with public standards of financial prudence, the 'open book' documentation and thereby reduce the risk of decisions that may adversely impact the Owner's objectives/interests.

The PAA requires the Participants to fully document their involvement in the project (including all defined Reimbursable Costs incurred by the Participants in performing the Works) and be transparent in all their dealings with each other in the context of the project. The Participants should establish and agree record-keeping and accounting practices and procedures to support this. Also, each Participant should grant the Owner, and other public sector bodies like the Auditor General's Office, full access and audit rights to any information, analysis and methodology related to the documentation prepared for the project.

In turn, the Owner needs to engage appropriate professional resources to properly understand and apply that documentation. Cost components which will affect payments made by the NOPs under the Commercial Framework should not be hidden from the Owner either by absence from, or aggregation in, the Target Outturn Cost (TOC). Ideally, the Owner should be able to identify where this may have occurred through access to the first principles elemental cost

estimates which support the NOPs' development of the TOC during the selection process.¹⁶

It is consistent with the NOPs' commitments to transparency, good faith and integrity, and making best-for-project decisions that the NOPs should proactively ensure that the Owner has a thorough understanding of the TOC (including how the TOC has been built-up). However, this does not diminish the Owner's responsibility to bring informed and insightful analysis to the commercial elements of the alliance.

This feature is also important for NOPs so that they are able to understand the reasons why certain decisions are made by the Owner.

A joint management structure

An alliance is a legal relationship between parties and has a well-defined governance structure. The structure has parallels to a company structure and generally comprises the following (as shown in Figure 2.4):

- Owner and NOP Corporations;
- Alliance Leadership Team (ALT);
- Alliance Manager (AM);
- Alliance Management Team (AMT); and
- Alliance Project Team (APT).

Each of these groups includes representatives from all Participant organisations. The formal governance framework enables the alliance to make all project decisions collectively and jointly manage all responsibilities. The PAA forms the contractual agreement which underpins the alliance governance structure.¹⁷

¹⁶ Refer to *Guidance Note N° 5, Developing the TOC in Alliance Contracting*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

¹⁷ Refer to Figure 2.4.

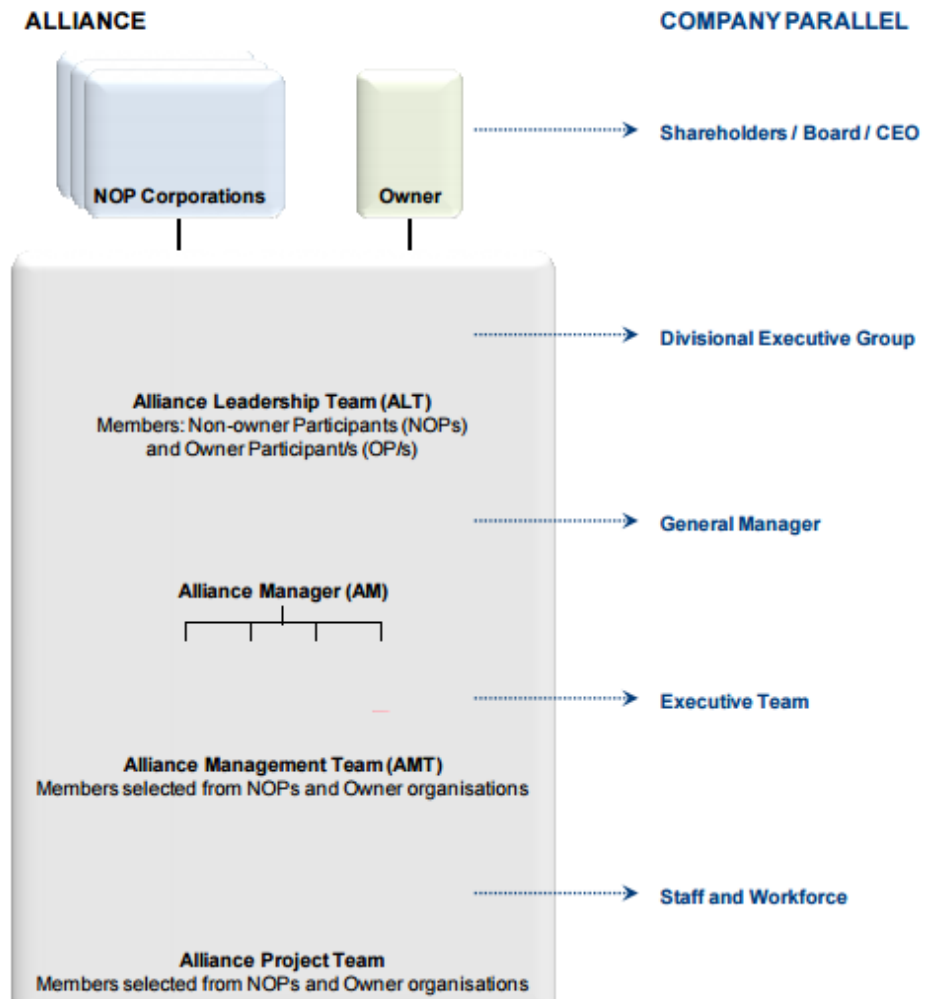


Figure 2.4: Typical alliance structure

A key feature of the joint management structure is that ALT decisions must be made unanimously. Every ALT member is entitled to cast a vote in the decision-making process and the final decision must be unanimous. However, certain important decisions will be reserved for unilateral determination by the Owner given that the Owner, as the client, will ultimately own and pay for the asset.¹⁸ These reserved decisions will be detailed in the PAA and typically include:

¹⁸ Where relevant, this also applies where the Owner is paying for a service to be performed by the alliance.

Changes to the Owner's VfM Statement, for example:

the scope of work;

the timing and sequence of project components;

emergency powers;

regulatory compliance;

termination;

project/Owner specific issues (e.g. personnel approval for military facilities, use of specific suppliers); and

external communications.

Alliance characteristics are evolving

As leading practices for alliancing continue to evolve, aspects of the key features of alliance contracts will change and different practices will be proposed by Practitioners. Public Officials must actively test and challenge these changing practices and ensure that the public interest continues to be protected and is not inadvertently eroded.

2.2 Differences between alliance contracting and traditional contracting

There are a number of differences between alliancing and traditional contracting.¹⁹ These include:

The key features discussed in section 2.1.2 operate in an integrated manner to ensure that the Participants exercise common behaviours and pursue common goals to deliver the project. In other delivery methods, each contracting party generally has its own independent goals and risk allocation.

The Participants are jointly responsible for delivering the works.

The Participants agree not to litigate in respect of the performance of the works, with limited exceptions (including a breach of the relevant behavioural 'commitments').

The Owner does not pay a fixed price for performance of the Works, but reimburses the NOPS for all costs which have been reasonably and actually incurred in performing the works, plus any fee (generally related to Corporate Overhead and Profit).

The Participants share the benefit of a cost underrun, and the 'pain' of a cost overrun, under the Risk or Reward Regime; and

The Participants commit to an 'open book' arrangement and have broad mutual access and audit rights to each other's documentation.

¹⁹ Refer to *Guidance Note N° 3, Key Risk Areas and Trade-Offs*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

In alliance contracting, a threshold issue for the Owner is their ability to provide appropriate capability to participate as a fully informed member of the alliance process.

Owner capability is a key to alliance success

Alliance contracting is a complex commercial transaction applied to complex projects. The Owner should have the capability to engage with the other alliance Participants on an equal footing ensuring that they fully understand the implications of sharing the risks and opportunities to deliver the project successfully. If the Owner cannot effectively engage in the decision making within the alliance they are exposed to risks and outcomes they are unable to manage or influence. For this reason, Owners must have appropriate capability to effectively participate in an alliance contract.

2.3 Evolution of alliancing

Early success of alliancing

The early pioneers of alliancing were experienced industry practitioners that established a new and different approach to the delivery of infrastructure projects. By focusing on project management culture and relationships, these pioneers established a new and innovative procurement strategy that provided additional value to the client.

Historically, government procurement of infrastructure has been based on the concept of open bidding in a competitive environment. As a result, the majority of infrastructure projects have been procured using traditional competitive bidding processes. However, as the Australian construction industry has evolved and matured, the approach to project delivery has diversified. In addition to the early 'traditional' methods such as 'design and construct', and 'construct-only' contracts, projects are now being delivered using public private partnerships and alliancing.

The more traditional contractual arrangements involve a competitive tender process, are documented with technical drawings and specifications, and incorporate commercial conditions of contract and structured payment systems based on fixed pricing or schedule of rates arrangements. Traditional construction contracts also generally involve risks associated with project delivery being transferred to the constructor (to varying degrees, in accordance with a negotiated position). This approach to risk allocation has sometimes been viewed as creating an unproductive positional relationship between the 'buyer' and the 'seller', which leads to an adversarial and more litigious environment.

What factors contribute to a 'more litigious' environment?

Traditional contracting has been associated with stories of an adversarial and litigious environment. However, the introduction of 'design and construct' contracts in the 1980s was hailed by the industry as a way of reducing such an atmosphere, compared to 'construct-only' contracts. It is worthwhile to reflect on the influence of poor planning and poor communication of project objectives and scope as a cause of adversarial behaviours by contracting parties. In particular, the *Guide for Leading Practice for Dispute Avoidance and Resolution* (published in 2009 by the CRC for Construction Innovation) cites poor contract documentation, scope changes due to client requests, design errors or site conditions, and poor communication or management as the key factors that contribute to disputes. Arguably, these factors (rather than the form of the contract) contribute more to the root creation of any negative project relationships.

To address this problem, the 'partnering' model was developed and promoted as a way of preventing disputes (rather than resolving disputes), improving communication, increasing quality and efficiency, achieving on-time performance, improving long-term relationships, and obtaining a fair profit and prompt payment for the designer/contractor. Partnering was not a contractual agreement, and therefore was not legally enforceable.

As the formal extension to the 'partnering' model, alliancing was first used in the oil and gas fields of the North Sea by British Petroleum (BP) in the early 1990s. When Australia embarked on its first alliance project in 1994, the Wandoo Alliance, the Owner decided to use project alliancing to:

- target reduced development costs;
- share time and cost risks; and
- minimise use of its management team.

Australia's first alliance project was delivered using a non-price competitive process for selecting the NOPs, and relied upon the behavioural principles of good faith and trust to create the desired alliance 'culture'. In particular, the PAA required the Participants to:

- achieve VfM in completing the project works;
- operate fairly and reasonably without detriment to the interest of any one Participant;
- use best endeavours to agree on actions that may be necessary to remove any unfairness or unreasonableness;
- allow individuals employed by one Participant to be transferred to another Participant (including responsibility for their workmanship and work);
- provide open book financials and other information;
- wherever possible, apply innovation to all activities particularly where it could reduce cost and time for completion and improve quality;

- use best endeavours to ensure that additional work remained within the general scope of works;

- apportion the share of savings and cost overruns (win:win or lose:lose); and

- avoid claims and litigation, arbitration and any other dispute resolution process.

From 1995 to 1998, the alliance delivery method became more sophisticated. The focus remained on ensuring a spirit of trust and cooperation, but the notion of a decision-making process based on 'what is best for the alliance is best for my organisation' also emerged. A number of new principles were also developed, including:

- applying tender and selection processes based on factors other than price;

- using the best people for each task/role;

- creating a no blame culture;

- establishing a clear understanding of individual and group responsibilities and accountabilities within the alliance governance structure; and

- emphasising business outcomes.

With the significant growth of the infrastructure market over the last decade, the use of alliancing has also enjoyed significant growth, and is now considered a mainstream approach to delivering projects. Collaboration and trust remain strong themes, and most principles and practices of the original alliances remain key features of alliancing today. These include:

- best-for-project focus;

- unanimous decision making;

- commitment of best-in-class resources;

- commitment to developing a culture that promotes and drives outstanding outcomes; and

- open, transparent and honest communication.

Figure 2.5 compares the public sector and private sector use of alliancing.

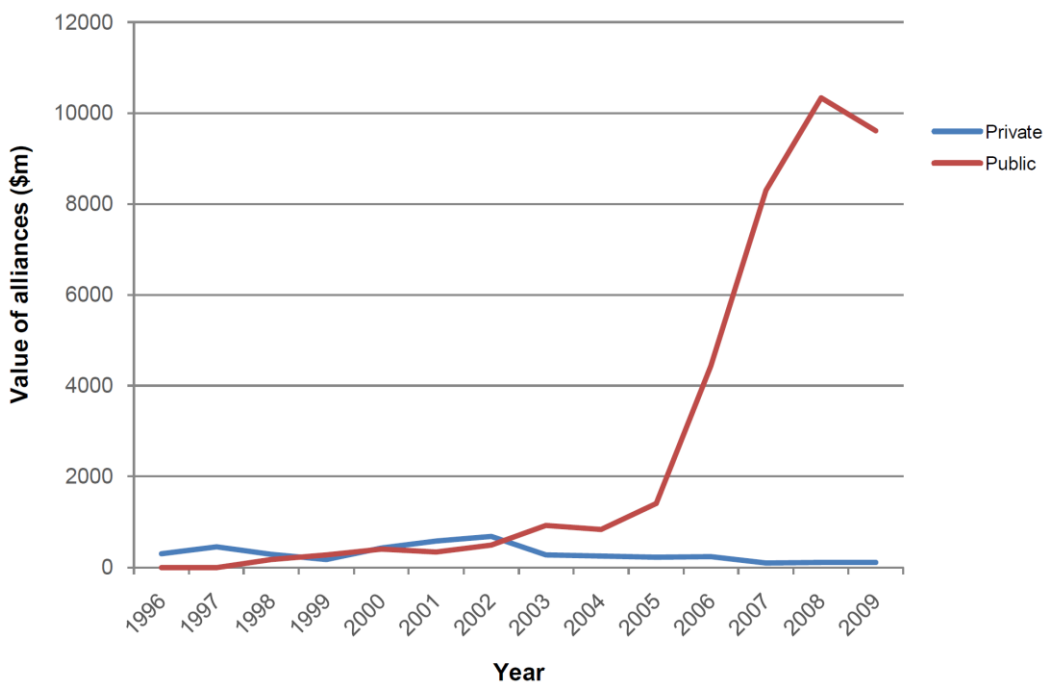


Figure 2.5: The value of alliancing projects undertaken by sector ²⁰

The above graph illustrates that the use of alliancing in the private sector has been relatively static while its use in the public sector has increased significantly. Although it is unclear why there is such a significant difference, it is clear that alliancing is used extensively by the public sector in Australia. This confirms that alliancing has matured into a mainstream method of delivering infrastructure projects across the public sector. Many people in the construction industry have been exposed to a number of alliancing projects, and for some practitioners, alliancing is their predominant experience.

'Business-as-usual'

When first introduced, alliancing was an innovative approach to project delivery but it is now commonly used to deliver projects across all Australian jurisdictions and is considered a mature (rather than emerging) delivery method. That is, alliancing has become a business-as-usual approach to delivering Government infrastructure projects.

The next evolution of alliancing will involve Owners taking a more tailored approach. In particular, the leading practice set out in this Guide signals a shift away from use of the 'traditional/conventional' alliance model. This shift reflects insights from government and industry gained from their experience in delivering alliance projects, and implements the procurement requirements that satisfy government's commercial and policy objectives. This shift away from the 'traditional' approach to alliance contracting should enhance the VfM outcomes achieved by Owners.

The possibility of achieving better VfM when delivering public infrastructure was revealed through recent research into current Australian alliancing

²⁰ *In Pursuit of Additional Value – A benchmarking study into alliancing in the Australian Public Sector*, DTF Victoria, October 2009

practices.²¹ The research demonstrated a need for existing guidance to be updated to reflect leading practice in the use of alliancing in the public sector. This Guide seeks to further develop and enhance the use of alliance contracting by addressing the issues raised in the research, and by building on the experience gained in recent years.

The language of alliancing has also evolved as the delivery method has matured. Guidance Note N^o 1²² has been developed to assist in achieving consistency in the meaning, understanding and application of specific terminology commonly used in alliance contracting.

2.4 Key roles in an alliance

There are a number of key roles that need to be performed for an alliance to be developed and delivered successfully. There are elements of these roles which are unique to alliance contracting as outlined below and addressed in more detail in Chapter 4. This chapter also discusses the roles of specialist advisers that may be employed to support the Owner or the alliance.

Table 2.1 below outlines the roles of the Participants in planning and delivery stages during an alliance project.

Table 2.1: Selected planning and delivery steps

Role in project lifecycle	1. Business Case	2. Owner's VfM Statement	3. Tender Processes & PAA	4. The Alliance (<i>Project Delivery</i>)	5. VfM Report (<i>Project implementation review</i>)
Government	Determines investment priorities and approves specific Business Cases. Provides funding (and/or underwrites risks).	Provides funding (and/or underwrites risks).	Provides funding (and/or underwrites risks). May have approval rights for specified tender milestones.	Provides funding (and/or underwrites risks). Receives progress reports from Owner (against original Business Case).	Receives formal VfM Report from Owner which assesses VfM outcomes against approved Business Case.

²¹ *In Pursuit of Additional Value – A benchmarking study into alliancing in the Australian Public Sector*, DTF Victoria, October 2009.

²² Refer to the *Guidance Note N^o 1, Language in Alliance Contracting: A short Analysis of Common Terminology*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

Owner	Identifies community need and possible solutions for funding by state. Prepares the Business Case.	Within the Business Case approvals, clearly articulates project parameters, objectives and budget; in the project's 'Owner's VfM Statement'.	Incorporates the Business Case/VfM Statement into the body of tender documents. Develops the tender criteria as part of NOP evaluation and selection. Develop draft PAA/KPIs/KRAs.	Maintains active informed commercial engagement in the alliance. Provides suitable representatives to be part of the alliance.	Prepares a post implementation review of the alliance project. Prepares the VfM Report.
Alliance	No role.	No role.	Aligns commercial and project objectives and agrees to PAA to deliver on Owner's VfM Statement and other tender requirements.	Provides regular project progress reporting to Owner.	Project documentation available to support post implementation review process.

Government: Public construction projects are ultimately funded and/or underwritten by the government (i.e. parliament/government) and the Owner acts under authority from the government²³.

Owner: the government agency responsible for delivery of the investment objectives set out in the Business Case for the project.

Owner's Representative (OR): The Owner will nominate a senior executive who sits outside of the alliance and is the key point of liaison between the Owner and the alliance. This person does not play a role inside the alliance.

Owner Participants (OPs): the Owner will nominate one or more representatives to be members of the Alliance Leadership Team (ALT). The Owner Participants (OPs), normally agency employees, have the same rights and responsibilities to the alliance as all other NOP members of the ALT.

Alliance Leadership Team (ALT): This is the leadership team which operates similarly to a Divisional Executive Group. The Owner and each NOP will have representation on this team with all members having equal rights and responsibilities. Typically members of the ALT are senior executives from each Participant.

²³ Refer to *Guidance Note No 4, Reporting VfM Outcomes*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011, for additional information.

Alliance Manager (AM): This person is selected by the ALT to lead the alliance. The AM reports to the ALT and is responsible for the delivery of the project. Typically this person is a highly experienced project manager from a NOP and chairs the AMT.

Alliance Management Team (AMT): This is the management team responsible for day-to-day delivery of the project. The Owner and NOPs will each have at least one representative on this team. This team is led by the AM.

Alliance Project Team (APT): This the integrated, collaborative team of NOPs and Owner's professional and support staff that plan, design and manage construction and delivery of all aspects of the Owner's VfM Statement.

2.5 The value proposition: key benefits, risks and trade-offs of alliance contracting

A key value proposition of alliancing is that government agencies trade-off their traditional contractual rights (under a 'risk transfer' contract) in exchange for NOPs bringing to the project their good faith and acting with the highest level of integrity to achieve collective goals. As discussed in section 2.1, the unique features of alliancing include the collective assumption of risks by the alliance Participants; best-for-project decision-making processes; a no fault – no blame culture; and a joint management structure. The aspiration behind these features of alliance contracting is that they will provide the following benefits:

performance enhancement: The Participants are encouraged to take calculated and agreed risks and opportunities to pursue cost savings and enhance project performance, without fear of legal liability if they fail;

focus on solutions: The alliance team will be able to focus on solutions, rather than blame, when problems arise during the project lifecycle;

reduced disputes: The risk of disputes is reduced, and the threat of litigation between the Participants is removed (except in limited circumstances);

cooperation: The Participants are able to cooperate in an honest and transparent manner to achieve the project objectives;

collective decisions: The alliance's decision-making processes are directed towards the shared, collective vision and objectives of the alliance, rather than serving the self interest of each alliance Participant;

risk management: The project's risks can be better managed through a collaborative effort, where each party's knowledge, skills and resources are shared;

flexibility: There is flexibility to adapt to scope changes, risks and opportunities as they arise during delivery of the project;

early commencement: The project may be able to commence earlier than may otherwise have been possible in a traditional contracting environment; and

innovation: Innovations are encouraged, which may result in cost savings and better Value-for-Money for the Owner.

These are seen as the key value drivers of alliancing, the means by which the objectives of the Owner's VfM Statement are achieved at a fair cost (i.e. referenced back to best-in-market costings).

A number of risks arise when an alliance, rather than a traditional 'risk transfer' contract, is used to deliver a project. It is crucial to understand those areas where the Owner may be 'trading-off' its usual rights under traditional project delivery models, in return for the benefits which should be obtained through entering an alliance agreement.²⁴

Tailoring the PAA to address risk

Alliance contracts have become increasingly standardised over the last few years, which provides industry Participants with certainty about their obligations and reduces some of the process costs of procurement.

However, there are a number of risks associated with using standardised contracts. It is important for Owners to ensure that any alliance contract is appropriately tailored to deal with the risk profile and commercial objectives for their specific project.

The risks which are often associated with alliance contracts, and which need to be understood when adopting the alliance approach, include:

capability: The Owner's team may not be sufficiently capable (e.g. skills, experience, behaviours) to deal with the complexity of the project and alliance delivery method.

'soft' TOC: An approach to the selection of NOPs, which does not evaluate price elements combined with any imbalance between the commercial capabilities of the NOPs and the Owner, may result in a 'soft' TOC which inflates the Owner's cost of delivering the project.

pricing: Because the NOPs are generally less exposed to the same risk under the alliance model (due to capping and sharing provisions), this should be reflected in a lower price paid by the Owner than for a traditional contract with a higher risk profile (for the same project risks).

Owner's exposure to risk: Under an alliance, the NOPs' pain share will sometimes be limited, whereas under a traditional contract the NOPs will usually bear 100% of the 'pain'—this means that, under an alliance, the NOPs face much lower exposure to consequences of poor project delivery. This may result in NOP corporations not providing their best team for the life of the alliance project. This is because, naturally, there is often competition as to where the most capable resources will be assigned. It makes sense to allocate top-performing individuals to projects with a more challenging risk profile where the NOP corporations have greater exposure.

²⁴ Refer to *Guidance Note N° 3, Key Risk Areas and Trade-Offs*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

use of subcontractors: The NOPs may use subcontractors, rather than their own staff, to deliver the project. The use of subcontractors will also attract an additional layer of fees.

risk allocation: The Risk or Reward Regime may not reflect, and deliver the intended benefits of, the risk and opportunity-sharing approach, e.g., where the NOPs' pain share is capped, the Owner will bear all design and construction risk once that cap has been reached.

additional costs: The remuneration framework may inadvertently incentivise the NOPs to exceed the original scope and Business Case requirements; this means that the Owner may incur additional, and unnecessary, project costs (any material scope changes must be approved by the Owner).

no legal recourse: A failure to perform a behavioural obligation (in accordance with the PAA) through wilful default may give rise to legal recourse for the Owner.

senior personnel required: Alliancing may require more involvement by senior representatives from the Owner in the early project stages to develop the alliance than traditional forms of contract.

cost overruns: Given that all agreed NOP Participant costs will be reimbursed to the NOP Participants, there is potential for significant cost overruns to arise under the Risk or Reward Regime.

It is important to understand each of these risks and their remedies. In particular:

terminology used in the PAA and its practical application;²⁵

the Commercial Framework and its appropriateness for the individual project and Participants;

resources required for the alliance, and the start-up and management costs during the procurement and delivery phases;

risks the Owner will bear under the Commercial Framework; and selection process approach.

Use experienced alliance practitioners to assist in tailoring the approach

The Owner faces the risk of suboptimal VfM results if advisers engaged for the project tend to follow established processes or 'recipes' for alliancing established by others. It is important for Owners to access experts who can assist the Owner to tailor the planning, development, procurement and delivery of their alliance project in a way that engages the industry effectively and applies good commercial analysis of the project.

Once there is a detailed understanding of the risks and 'trade-offs' mentioned above, these can be appropriately managed by implementing a tailored approach to each alliance project. The alliance should be structured to ensure that the

²⁵ Refer to the *Guidance Note N° 1, Language in Alliance Contracting: A short Analysis of Common Terminology*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

commercial objectives of the NOPs, and the VfM objectives of the Owner, are aligned.

In order to deliver the value proposition of alliancing, the alliance also needs to be structured to ensure that all Participants are held to account on the behavioural and cultural commitments of the alliance approach. For example, although most alliance agreements include a set of principles on which the culture of the alliance is based, broad 'motherhood' statements should be avoided, with the aim of an objective set of behavioural criteria.

As described in section 2.3.2, a formal charter of behaviours or rules of engagement for all Participants will help to define terms such as good faith and best-for-project for the Participants, and provide more certainty about how those definitions should be applied and enforced in the context of the PAA. A charter of behaviours (i.e. an Alliance Charter) should be tailored to meet any unique requirement(s) of a specific project and be finalised during commercial negotiations.

Develop an Alliance Charter

Owners should develop a 'charter of behaviours' to which Participants must commit and which is formalised in the PAA. A formal charter of behaviours would move away from broad 'motherhood' behavioural statements, towards more objective and understandable behavioural criteria. It would help define the required standards of conduct for the Participants, providing more certainty about many of the mechanisms in the PAA that rely upon those standards. Guidance Note N^o 3 provides a template form for an alliance charter.

Alliancing is dependent on establishing an effective team culture

Team effectiveness is underpinned by the prevalent culture, evidenced by the way team members behave and interact. Team culture is set by leadership and if proactively managed can be a very powerful enabler of team performance.

In an alliance, the ALT should lead as early as possible the development of a culture that enhances achievement of the alliance goals and Owner's VfM Statement. The desired culture should align to the behaviours required to enable the key alliancing features such as good faith and 'no disputes' to operate. Often the desired behaviours are described through establishing an Alliance Charter which documents the alliance values. However, the real culture of a team is demonstrated in how the team behaves and interacts.

Effective alliance teams have very strong cultures led from the top where the desired behaviour is demonstrated consistently by senior members of the alliance—they 'walk the talk'. The alliance team members see the senior leaders exhibiting the right behaviours and this leadership by example sets the expectations of the rest of the team. It clearly outlines what is and is not acceptable in that team.

In establishing a culture, it is important that 'hygiene' factors such as performance measures and delegations align to the desired behaviours. Examples of misalignment include when a team may require 'learn from our mistakes' to be part of the culture, but individuals may be 'punished' for reporting mistakes. Another example may involve individuals being required to take responsibility and make decisions, although the delegations do not support them doing this.

Culture can take time to establish. Leadership must determine how different the desired culture is from the current cultures of the Participants and determine how to achieve the desired culture. This should always be considered in the context of the alliance objectives that are founded on the Owner's VfM Statement. The desired culture is not an end in itself but one of a number of foundations for achieving the Owner's project objectives.

Investing in getting the culture right, will ensure that the benefits of alliancing are optimised.

2.6 Project alliancing and program alliancing

Broadly speaking, alliances may be categorised as a project, program or strategic alliance:

A 'project alliance' is generally formed for a single project, after which the team is disbanded.

A 'program alliance' incorporates multiple projects under an alliance framework, where the specific number, scope, duration and budgets of projects may be unknown and the same Participants are potentially delivering all projects. These are usually longer-term arrangements, in the order of 5–10 years. A program alliance can be effectively a pre-qualified panel of potential alliancing parties that an Owner establishes so it can expeditiously and conveniently select and form an alliance for a specific

project or for a package of related works. Where an Owner intends to establish a program alliance, there should still be a demonstration of the superior case for alliance contracting for the program, on a project-by-project basis, in the Business Case.²⁶

‘Strategic alliances’ relate to longer-term business relationships that involve incomplete commercial contracts between organisations (generally private) that generally do not include the principles referred to above. They are not the subject of this Guide.

Sometimes alliances are developed for the performance of operations and maintenance (O&M) services. This Guide has been prepared to assist Owners with project (asset) alliances but the same principles apply to O&M alliances.

2.7 The fundamentals of Government Procurement

Government seeks to observe high ethical standards and conduct in commercial engagements. Government and public officials must be able to demonstrate high levels of integrity and transparency in processes while pursuing VfM outcomes in the public interest.

A standard requirement for the public sector procuring building and construction works is contestability and competition.

These requirements are the foundation stone of public procurement and the building blocks of VfM outcomes. The inclusion of contestability and competition in procurement processes strengthens incentives to innovate and provides the most effective way of ensuring and demonstrating that taxpayers get the required outcomes at a fair cost (i.e. best-in-market pricing for the required supply at specified metrics of performance/quality). The capital cost of alliancing projects, which is generally greater than \$50 million, suggests that full contestability and competition is appropriate.

In relation to **contestability** requirements, departments and public bodies are required to make reasonable attempts to seek a wide field of tenders or quotations for public construction services. Unless the construction works are less than a specified threshold value²⁷ (which means a pre-qualified panel can be used), an open tender is normally undertaken.

²⁶ The subject of program alliances will be discussed in greater detail in a future Guidance Note.

²⁷ The threshold value, beyond which a pre-qualified panel is normally not appropriate, and an open tender should be used varies across jurisdictions.

The requirement of **competition**²⁸ is satisfied by applying a tender selection criteria that includes both price and non-price considerations. The selection of suppliers is encouraged on a VfM basis, meaning that decisions must be made on the basis of tender selection criteria which address a balance of both price and non-price factors.

Although the weighting and importance of price for a project can vary, depending on the project and the related circumstances, price needs to be included in the overall evaluation of a tender for both contractors and consultants. Price should be a key selection criterion for differentiating suppliers. Public sector multi-million dollar contracts are normally signed in circumstances where the risk exposure to the government is well dimensioned and government's contract costs clearly defined.

Any departure from using competition on the outturn price as a key tender selection criterion for a proposed alliance project or program represents a departure from government policy and therefore requires a formal exemption to be approved.²⁹

If the Owner considers that the public interest may be better served through restricted contestability and/or limited competition, then the rationale should be documented and approval sought for an exemption in accordance with the applicable government policies. This exemption would usually be sought as part of the Business Case for the project. Certain 'exemptions' are traditionally recognised where full contestability (e.g. a sole supplier situation) and/or full competition may not actually be possible or a more limited approach will better satisfy the public interest. For example, this will be relevant where works are of an urgent nature due to unforeseen events or occurrences such as:

- life threatening situations;
- occupational health and safety;
- security;
- loss of essential services;
- avoiding significant loss or damage to assets, or significant service delivery disruption; and
- weather protection.

²⁸ The term 'competition' should be understood as meaning competition on all elements of the project which are relevant to performance of contractual obligations for that project, and which are material to differentiating one tender party from another. These elements include outturn cost, relevant corporate track record, management systems, quality control systems, capability of the nominated people, etc.

²⁹ Writing in terms of good governance, the Productivity Commission 2014, Public Infrastructure, Inquiry Report No. 71, Canberra, reinforces this as good practice, stating that all governments should ensure use of transparent, innovative, and competitive processes for the selection of private sector partners for the design, financing, construction, maintenance and/or operation of public infrastructure (Recommendation 7.1).

*'The level of competition is of significant importance when selecting procurement options, as any procurement strategy or delivery model that departs from a price competitive route, such as alliancing or exclusive partnering, should only be agreed following a thorough analysis of the benefits afforded and when they can be clearly demonstrated.'*³⁰

The following figure illustrates the principles of competition and the requirement for seeking exemptions:

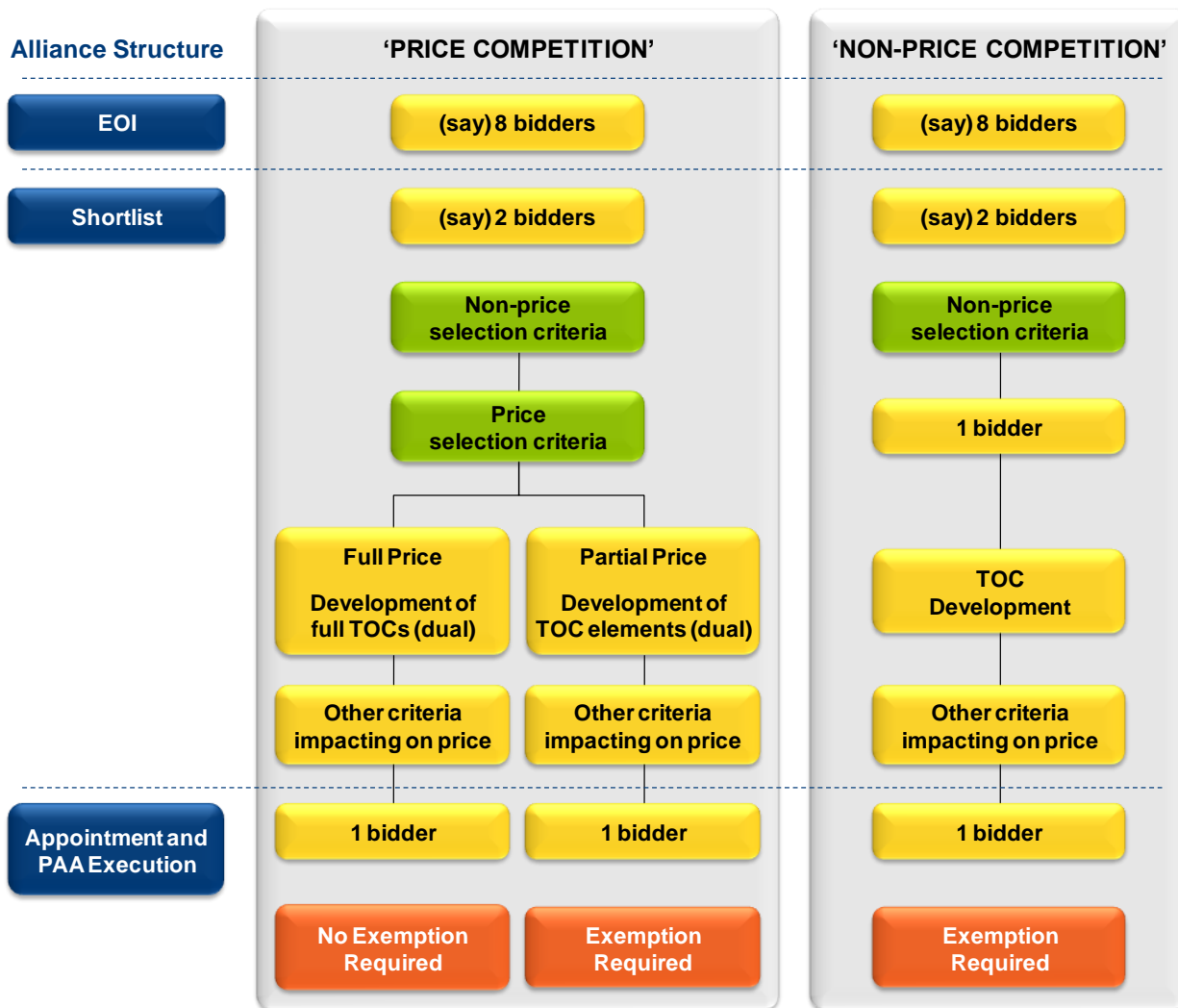


Figure 2.6: Application of competition in alliancing options

Australian governments have national and international obligations in relation to procurement such as the *Australia and New Zealand Government Procurement Agreement*; the *Australia New Zealand Closer Economic Relations Trade Agreement*; and the *Australia – United States Free Trade Agreement*. These are bilateral agreements which impose mutual obligations on government procurement. Owners need to ensure they conform to such international agreements where applicable.

³⁰ *Procurement Guidance Series – Relational Procurement Options - Alliance and Early Contractor Involvement Contracts*, Chief Procurement Office, Queensland Government, July 2008.

3

Choosing alliancing as a delivery method

This chapter discusses when alliancing is an appropriate delivery method to use for a project.

As discussed in Chapter 1, alliancing is now a mature and robust delivery method; it is no longer a unique or novel approach to contracting. Chapter 2 also highlighted that alliancing is a complex commercial transaction, and there is a need to understand the risks and benefits associated with alliance contracting.

The Owner's decision to use alliance contracting for a particular project will require strategic thinking, a good understanding of the approach likely to best deliver the Owner's VfM Statement, and ensuring the Owner has sufficient capability to deliver the project.

Alliancing should be used where it is the most appropriate delivery method

Owners should ensure that alliancing is not being used simply because the Business Case has been inadequately planned or where the project's scope is poorly defined. Instead alliancing should only be used where it is the best procurement strategy for achieving the approved Business Case objectives

3.1 Projects most suited to alliancing

Choosing the appropriate procurement strategy is critical for the successful delivery of a project. Generally, government policies and guidelines require that the appropriate procurement strategy be assessed and recommended as part of the Business Case. Furthermore, it is expected that once the Business Case and the procurement strategy are approved, work will commence to fully detail the strategy in the tender documentation and the project fully described before the tender process commences.

When determining whether an alliance contract, or any other project delivery model, is suitable to deliver a specific project, reference should be made to the comparative table contained in Guidance Note N^o 3³¹ and other relevant

³¹ Refer to *Guidance Note N^o 3, Key Risk Areas and Trade-Offs*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

procurement guidelines published by government.³² However, before any detailed comparison to other project delivery models is made, it is necessary to understand the 'threshold issues'³³ that should be satisfied before an alliance is considered as an appropriate option.

These threshold issues include:

project value: The policy provides that alliancing is generally not appropriate for simple procurement projects valued under \$50 million. This is due to the high initial start-up management costs (for both Owners and NOPs) associated with both procurement and delivery of alliance contracts.

resourcing: To successfully deliver an alliance project, the Owner will require sufficient internal resources, including senior executives, who can effectively represent and manage its interests in relation to external parties and the alliance contract. As a minimum, the number of internal resources available to procure and deliver an alliance contract can be expected to be equivalent to, if not of higher capability than, those normally made available to procure and deliver a traditional contract. The internal resourcing requirements for alliancing should be considered as part of the Business Case.

After taking into account these threshold issues, an alliance may be considered as a suitable project delivery method when the relevant project has one or more of the following characteristics:

- the project has risks that cannot be adequately defined or dimensioned in the Business Case nor during subsequent work prior to tendering;
- the cost of transferring risks is prohibitive in the prevailing market conditions;
- the project needs to start as early as possible before the risks can be fully identified and/or project scope can be finalised, and the Owner is prepared to take the commercial risk of a suboptimal price outcome;
- the Owner has superior knowledge, skills, preference and capacity to influence or participate in the development and delivery of the project (including for example, in the development of the design solution and construction method); and/or
- a collective approach to assessing and managing risk will produce a better outcome, e.g., where the preservation of safety to the public/project is best served through the collaborative process of an alliance.

Each of these characteristics is discussed further below.

³² For example, NSW Procurement Contracts Used for Construction Projects (July 2008), Refer also to Figure 1.1.

³³ These threshold issues are specific to each jurisdiction.

Exercise caution when using alliances in suboptimal conditions

Alliancing is sometimes selected because suboptimal conditions exist for project delivery. Generally, such suboptimal conditions as listed below will give rise to a cost premium and this should be factored into the decision to use alliancing.

Time pressure to deliver—achieving early project commencement through early NOP involvement: Compared to traditional project delivery methods, alliancing, with non-price competition, has been used to run planning, contract negotiations and construction activities concurrently rather than sequentially. Owners need to recognise that there may be a significant cost premium associated with this approach. Also, that early completion of the project is not guaranteed through earlier commencement.

Owner's in-house skills, systems and resources need improving: Managing the public interest in relationship contracting requires greater experience and capability from public officials in comparison to contracting approaches such as Construct Only or Design and Construct. A sound understanding of alliance contracting and appropriate in-house resources, skills and systems are necessary prior to undertaking an alliance.

Attracting scarce resources, especially in a buoyant construction market: Attracting scarce resources is often relied upon as a critical reason for choosing alliance contracting to deliver an infrastructure project. However, Guidance Note N^o 327 explains that this will not necessarily assist Owners to achieve the outcomes prescribed in the VfM Statement.

Insufficient Owner resources: If the Owner has insufficient resources to deliver a project through traditional delivery methods, then they are unlikely to have the required resources to deliver a project using an alliance as discussed in section 4.8 of this Guide. The demand on the Owner's resources is even greater under alliancing.

3.1.1 Project risks that cannot be dimensioned

Alliancing will generally be appropriate for projects that are characterised by major risks and complexities that cannot be dimensioned in the Business Case or soon thereafter. This is likely to have a material but indeterminate impact on achieving project objectives, which means that the flexibility and collaborative decision-making under an alliance contract may be desirable. Under the alliance approach, the parties can deal with any risks and complexities if and when they arise over the life of the project.

However, the existence of high-risk characteristics in a project will not, of itself, be sufficient to justify using an alliance. Significant risks, questions about the scope and complexity will nearly always characterise public infrastructure projects, and projects with these characteristics can often be satisfactorily delivered using contracting methods involving more traditional risk allocation.

Rather, Owners will need to demonstrate in the Business Case that traditional project delivery methods are incapable of delivering the objectives detailed in the Owner's VfM Statement by evaluating a range of delivery methods, including alliances.

3.1.2 The cost of transferring risk is prohibitive

Alliancing may be appropriate where the cost to the Owner of transferring the risk to the designer/contractor(s) is particularly high, a conclusion that needs to be based on an informed analysis of prevailing market conditions. The alliance approach should result in a reduced price to deliver the project, given that the risks are shared between the Participants and managed collectively, rather than transferred and managed solely by the contractor.

For some projects, the Owner's risk profile may be greater than a designer/contractor would normally accept under a traditional contract. For example, the project may be particularly unique or rare, which means that certain risks may be unknown and stakeholder management becomes more complex. Under these circumstances, the Owner would have to pay a premium to transfer certain risks to the designer/contractor under a traditional contract. Therefore, an Owner may find it attractive to undertake to deliver such projects through alternative delivery models such as managing contractor, early contractor involvement, and alliance contracts.

3.1.3 Urgent project start is required

Government priorities, in response to compelling community needs, often require a project to be delivered under extreme time constraints. This can manifest as a need to start construction as soon as possible, with the objective of an early project completion.

Regardless of the time imperative to complete the project, the Owner should:

- understand that there may be higher costs associated with using an alliance in these circumstances, due to the reduced time to prepare a robust and comprehensive Business Case and procurement analysis;

- ensure that the Business Case for the project addresses the cost premium that may be associated with using an alliance under extreme time constraints and where the Owner is unable to undertake a thorough procurement analysis;

- inform the decision makers about the cost premiums and potentially negative VfM impact arising from planning processes being truncated, in order to deliver the project within extreme time constraints; and

- ensure that an early start does indeed lead to the early completion required by government.

If there are time constraints imposed upon the project, it is still important to apply the appropriate level of competition to procure the project. If, however, there is a compelling reason for a departure from a fully competitive process, the rationale needs to be set out in the Business Case for approval in accordance with policy.

Does a shorter procurement process deliver the asset earlier?

It should be remembered that if the goal is to deliver a project in the shortest possible timeframe, a shorter procurement process will not necessarily achieve this goal. Indeed, agencies may encounter a longer construction period and a higher TOC due to inefficiencies during procurement, lack of project definition, and lack of innovation.

If an acceleration of the works is required so that early project delivery is achieved, the Owner will need to be comfortable that a price premium may be paid. For example, this premium may be paid in the form of an early completion bonus paid to the NOPs, extra work shifts, etc.

3.1.4 The Owner has valuable knowledge, skills and capacities

For some projects, it is critical that the Owner actively participates in the project solution as they have valuable knowledge, skills and capacities to contribute to the process. For example, the asset to be delivered may be part of a broader network and the Owner may have more knowledge about the type of asset than the private sector proponents. Specific examples of this could be signalling works in a rail network or a water treatment plant in a water distribution network.

3.1.5 Need for a collective approach to managing risk and opportunities

For some high-risk projects, the optimum VfM outcome may be achieved by the project solution being progressively refined and developed to reflect emerging risks. For example, these risks may arise in relation to stakeholders, network and legacy issues or developing a project in a live operating environment. The Owner is likely to obtain a better VfM outcome if the Participants work collaboratively to manage these risks and solve any related problems as they arise. As an emerging risk materialises, it will impact the design and scope of the works. A collective approach means the Owner is likely to achieve the desired project outcome without having to pay a substantial risk premium upfront, which would be the case if the risks were transferred to the designer/contractor under a traditional contract.

Additional reasons for using an alliance

Sometimes alliancing may be selected as a delivery method for other reasons. These reasons may contribute to the Owner's decision to use alliancing, but should not be relied upon as the primary reason to justify the selection of alliancing to deliver a specific project.

Innovation or outstanding outcomes are needed: Innovation or outstanding outcomes can occur and be achieved under any delivery method. This should therefore not be used as a sole rationale for using an alliance, but is an added consideration when innovation is encouraged and supported by Owner involvement.

To deliver new or emerging technology: Owners should give careful consideration to using an alliance to deliver new or emerging technologies. The risk-sharing model in alliancing means that Owners will share the risk of implementing any new technology on a project. Owners may be exposed to higher costs, or handover and operating difficulties. This higher risk exposure should be reflected in the commercial arrangements. Owners may select alliancing if they wish to share in the development of new technology.

No litigation over contractual disputes: Alliances are characterised by the key principle that, subject to certain exceptions, there is to be no litigation between the Participants. The removed threat of litigation over contractual disputes is attractive to both NOPs and Owners. Although the application of the principle means that alliances have not been the subject of many litigious disputes, it is impossible to completely remove the threat of litigation (see Guidance Note N^o 1). It is also important to remember that the 'no fault – no blame' culture (which supports the no litigation principle) should not mean there will be no disagreements between the Participants (refer to section 2.1.2).

PART TWO:

**Overview of the
development and
implementation
of alliance
contracts**

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4

Developing an alliance project

Once the Owner's decision to use an alliance has been approved, the Owner will need to prepare for selecting its alliance partner(s) and delivering the alliance project. These stages are discussed in Chapters 5 and 6.

This chapter addresses the preparation required by Owners and provides guidance on:

- understanding the commercial environment;
- developing the alliance's Commercial Framework and PAA;
- defining and planning the Owner's resources; and
- how best to engage and use specialist advisers.

Chapter 2 highlighted that an alliance is a commercial transaction between the Owner and the NOPs for the delivery of a capital asset.³⁵ The commercial and legal terms of that transaction, as agreed between the Owner and the NOPs, are set out in the PAA.

It can be expected that both Owners and the NOPs will seek to implement the commercial and legal terms that are favourable to themselves, the Owner because of its duty to guard the public interest and the NOPs due to their corporate obligation to optimise shareholder returns. These competing interests are not unusual and do not create an unhealthy situation, even in the context of developing an alliance.

The Owner's obligation to negotiate favourable commercial and legal terms for an alliance contract is no different to its obligation for other forms of contract. In all cases, the Owner needs to be proactive in developing project-specific commercial and legal terms that optimise the Owner's position and are consistent with the achievement of the Owner's objectives for the project. In doing this, the Owner needs to be also mindful of the reasonable and fair commercial objectives of the NOPs. This requires a thorough understanding of the prevailing commercial environment, the specific VfM objectives for the project (as expressed

³⁵ As noted in Chapter 2, the alliance delivery method and its associated characteristics is also applicable to operational and maintenance (O&M) services. For simplicity, in this Guide, reference to a capital asset will also include O&M services.

in the Business Case) and how the Commercial Framework should be applied in practice.

4.1 Understand the commercial environment

It is important to understand the wider commercial environment in order to tailor the selection and delivery of an alliance project accordingly. The commercial and project objectives of the Owner and the NOPs need to be aligned if the alliance is to operate effectively. The prevailing commercial environment will likely shift over time, reflecting a number of different considerations, which include:

- the general level of activity in the broader construction sector, with conventional wisdom being that as activity increases, then profits increase (which in turn, is likely to impact the NOPs' approach to bidding for work);

- companies becoming over-committed or extended during boom times, with the risk that performance levels may be adversely impacted and become inconsistent as a result;

- the Owner's appetite for risk sharing³⁶ (noting that this is a continuum) will vary over time in response to:

 - the prevailing government position and risk appetite;

 - the Owner's tolerance for risk and their current portfolio risk profile;

 - the government's capital works program intensity (which may relate to the size and/or speed of the capital program); and

 - the importance of a particular industry.

- the attractiveness of the project to potential NOPs, which may be influenced by factors including:

 - the proposed commercial and legal framework, including financial incentives provided to the NOPs;

 - the Owner's reputation;

 - the potential for the project to lead to further work for the NOPs; and

 - policies to compensate the NOPs for their costs of participating in the bid process.

- potential NOPs' risk assessment of the project and appetite for risk sharing generally (noting that this is likely to vary considerably amongst potential NOPs, depending on factors such as the size, culture, management approach and market share of the relevant NOP);

- the commercial objectives of the potential NOPs, their position in the market and their corporate objectives as publicly-listed organisations (which ultimately require them to maximise and sustain shareholder returns); and

³⁶ Refer to section 4.2 and Appendix F for further discussion of risk sharing in an alliance context

government policies or strategies which are relevant to infrastructure projects, such as local industry participation plans and free trade agreements.

There needs to be a thorough understanding of the commercial environment in which the NOPs operate in order to develop a Commercial Framework that will drive achievement of the Owner's VfM Statement.

4.2 Develop the Commercial Framework

The Commercial Framework is the key mechanism of the alliance contract which:

aligns the commercial objectives of the NOPs with the project objectives of the Owner and the investment objectives of the government;

should encourage and drive the NOPs to achieve the performance levels required by the Owner's VfM Statement; and

ensures the Owner is equipped to address any poor performance by the NOPs.

The NOPs' primary objective will be to achieve an attractive profit from the project for their shareholders. On the other hand, the Owner's objectives will be to deliver the requirements set out in the Owner's VfM Statement at a fair price.

Along with the framework for joint management and collaborative decision making, developing the optimum Commercial Framework is a foundation for alliance success; it should provide all Participants with an imperative to meet their behavioural commitments, and balance both the price and non-price objectives for the project. The Owner should ensure that the Commercial Framework is structured to target the achievement of the VfM outcomes required for the specific project, and to manage the associated risks.

The proposed Commercial Framework for the project should be developed by the Owner and be included in the tender documents (i.e. the Request for Proposal—RFP) issued to industry. However, it should be expected that the Commercial Framework will be further developed through discussion and negotiation with the NOPs as part of the selection process. The final agreed Commercial Framework will then be incorporated in the PAA.

The process for developing the Commercial Framework is set out below:

- understand the generic Commercial Framework³⁷ of alliance contracts; its purpose, mechanics and challenges;
- clearly identify the specific project objectives, risks and challenges outlined in the Business Case and the Owner's VfM Statement;
- tailor the generic Commercial Framework to reflect these project specific objectives and the prevailing commercial environment; and
- issue the proposed Commercial Framework with the tender documents (i.e. the RFP) and encourage the NOPs to provide innovative responses to

³⁷ Refer section 4.3

enhance the Commercial Framework (in the same manner as technical innovation is encouraged).

Owner's VfM obligations are no different under an alliance contract

The Owner's public interest obligations to negotiate good terms under an alliance contract are no different to its obligations under a traditional contract. It is important to establish a commercial and legal framework to achieve the Owner's specific objectives for the project, and then put that framework to the market, inviting commercial and technical responses and innovation from Proponents. The Owner should not postpone the creation of the Commercial Framework until the selection process or after the NOPs have been selected.

Commercial alignment at the organisational and individual level

The NOPs' obligations to their shareholders are to optimise profits while minimising risk. These profit expectations and risk appetite are set by the NOPs' corporation not by the alliance.

A distinction should be made between aligning NOPs with the Owner at a company level and aligning individuals within the alliance. Unless the individuals are personally aligned with alliance outcomes, it is a risk to the alliance overall. This may be exacerbated by issues in remuneration, bonuses, job security, etc.

4.3 The generic Commercial Framework

As discussed above, the Commercial Framework for an alliance (as incorporated in the PAA), is the principal mechanism that aligns the achievement of the Owner's project objectives with the commercial objectives of the NOPs. In particular, the Commercial Framework will set out the structure and principles that govern the NOPs' remuneration for the project.

The Commercial Framework typically provides for the NOPs' remuneration to comprise the following three elements:

Reimbursable Costs This covers the direct project costs and indirect project specific overhead costs actually and reasonably incurred by the NOPs (and the Owner if applicable) in the performance of the work.

the NOPs' fee: This comprises both Corporate Overhead and Profit, that is, the respective NOPs' agreed profit margin and a contribution towards recovery of non-project specific (or corporate) overhead costs; and

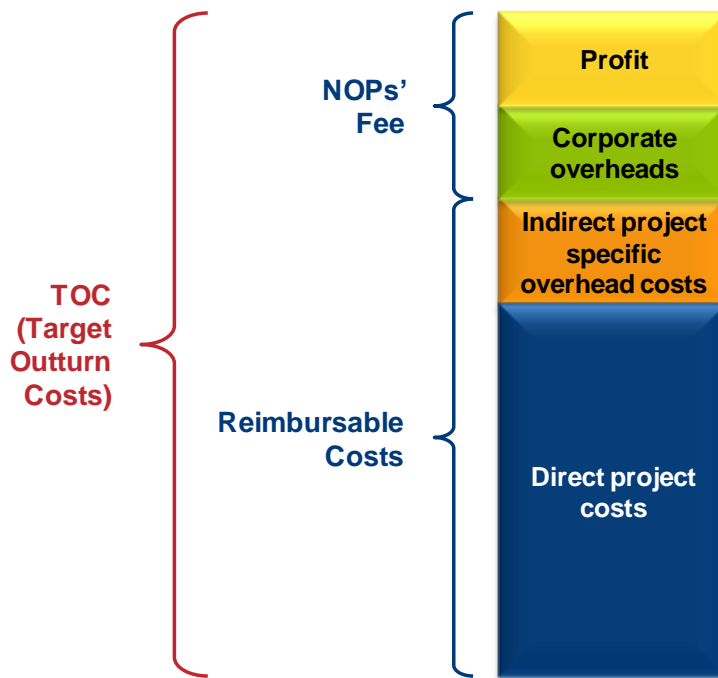


Figure 4.1: Alliance Compensation Framework

Risk or Reward Amount This is a performance-based payment to the NOPs that increases or decreases to reflect the project’s outcomes, and is designed to enable the NOPs to share in both the upside and downside associated with delivering the project. The Risk or Reward Amount measures the alliance’s actual performance against the target cost and other agreed project objectives. Generally, the Risk or Reward Amount will reflect an assessment of the Participant’s performance against both the financial and non-financial outcomes of the project.

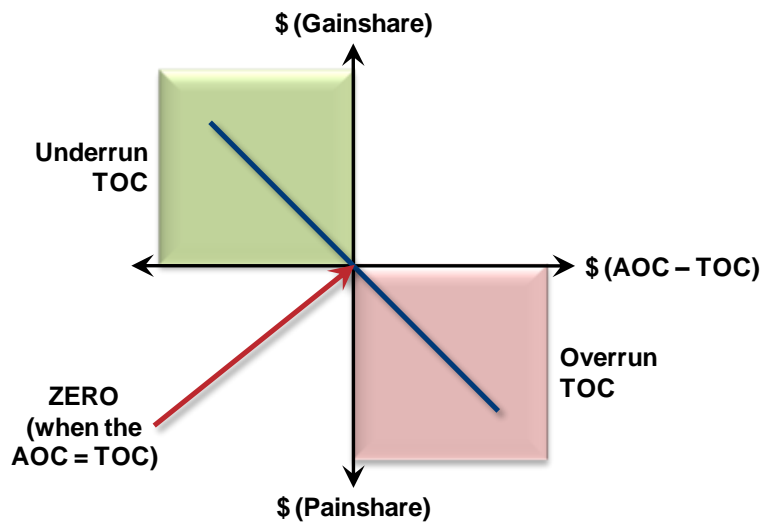


Figure 4.2: Risk or Reward Framework for Financial Outcomes

General principles that should guide the Owner when developing the proposed Commercial Framework for the alliance include the following:

The Commercial Framework should drive the right behaviours and incentivise the Participants to achieve the objectives set out in the Owner's VfM Statement.

The Commercial Framework should be clear, concise, and robust. It should be easily understood and able to be applied by all Participants.

There should be complete transparency in all project financial arrangements.

4.3.1 Reimbursable Costs

The principles that should guide payment to the NOPs of their Reimbursable Costs for an alliance project include the following:

Expenditure should be consistent with public sector standards for public monies.

The NOPs should only be reimbursed for costs which have been actually and reasonably incurred.

Reimbursable Costs should not include contributions to costs included in the Corporate Overhead and Profit component.

All claims for Reimbursable Costs and underlying project financial transactions should be open book and fully auditable.

Defining Reimbursable Costs

The proposed definition of Reimbursable Costs will be provided in the PAA issued with the tender documents.

There needs to be clear understanding and appreciation of those costs which should and should not be properly paid to the NOPs as Reimbursable Costs, and those costs which are more appropriately paid as part of the NOPs' Fee. For example, reimbursing the NOPs for professional development programs and the cost of entertaining alliance staff and workforce may not be appropriate when public monies are directly involved. Another example is that ALT members' costs of performing their duties (including attendance and travel) should usually be covered by the NOPs' Corporate Overhead, which requires a detailed audit of company records up front and declaration in the RFP. Other examples are addressed in '*Corporate Overhead*' below.

As a guide, the following examples (which are taken from actual alliances) would be considered inappropriate expenditure:

reimbursement of fees for postgraduate university study to members of the alliance;

Christmas parties for staff, workers and their partners that exceed government department standards; and

'excessive' prizes (such as boats and cars) to alliance personnel for contributing innovative ideas.

Reimbursing subcontractor costs

Subcontractors' costs under subcontracts procured for the alliance are only reimbursed to the NOPs when procured according to the Project Proposal's contracting strategy. This document should be incorporated in the PAA and require that the selection of subcontractors for the alliance is competitively tested, and that the procurement process is transparent. The competitive and transparent selection of suppliers and subcontractors is necessary for public infrastructure projects (including alliances) since sole-sourcing is generally not acceptable under government procurement policies. This is discussed in more detail in Chapter 6.

Auditing Reimbursable Costs

The process for defining and agreeing the Reimbursable Cost categories usually begins by the Owner undertaking an Establishment Audit of each NOP's relevant cost structure, as part of the selection process. Generally, the Owner will also engage an external Cost Auditor during project delivery to validate that the Reimbursable Costs claimed by the NOPs have been actually and reasonably incurred and that reimbursement is warranted. While this is a necessary and prudent requirement where public monies are involved, a Cost Auditor usually has an audit background and will only assess 'Were the costs actually incurred by the NOPs?' not 'Should the NOPs have incurred those costs?'. The Owner needs to be satisfied on both of these issues. It is also worthwhile for the Owner to have representatives with financial backgrounds embedded in the alliance to monitor these issues, in addition to the role performed by external auditors.

Project close out—estimated versus actual Reimbursable Costs

Certain Reimbursable Costs will not be known until project completion as it is sometimes administratively prohibitive to measure the costs progressively. Examples of this include staff costs (annual leave, training leave, bonuses, etc). In this case, it is common to include an estimate of the staff costs claimed progressively by the NOPs.

It is important that these costs are externally audited on project completion to ensure the Owner pays the actual costs and not estimates. A monetary adjustment (upwards or downwards) can then be made to the NOPs' payment as necessary to reflect the outcome of the audit.

4.3.2 The NOPs' fee

In addition to Reimbursable Costs, the Owner will pay the NOPs an agreed fee, comprising two components: Corporate Overhead and Profit.

The Corporate Overhead and Profit may be paid to the NOPs as either a:

- mark-up percentage on the NOPs' actual Reimbursable Costs incurred; or
- fixed amount, which is determined with reference to the NOPs' Reimbursable Costs component of the TOC.

In the context of an alliance it is essential that the rationale and composition of the NOPs' Corporate Overhead and Profit (often referred to as the NOPs' 'fee') is

understood. Firstly, the Owner may wish to compare fees between different NOPs as part of the selection process. Secondly, the Owner will want to be clear that the NOPs' fee doesn't inadvertently reimburse the NOPs for project costs that already comprise part of the Corporate Overhead component of the NOPs' fee.

The Profit component of the NOPs' fee is relatively straightforward and represents the NOPs' reward or 'margin' for the service they provide and the risks they take in performing the work.

The Corporate Overhead component of the NOPs' fee is less straightforward, particularly for professional service firms such as design consultants. In principle, it represents the recurring indirect costs of running the NOPs' business that are not linked directly to a project. These costs are usually recovered by the NOPs' corporate office by way of a cost-loading on each project expressed as a percentage of project value. However, the method of recovery varies considerably between designers and contractors and the Owner may need expert advice to understand this.

It is recommended that the Corporate Overhead and Profit of the individual NOPs be separately tendered and not aggregated into a single fee until the PAA is agreed. The primary reason is to allow transparency for the Owner and to assist in negotiating and developing the TOC.

Corporate Overhead

The NOPs' Corporate Overhead represents a multitude of costs. There is considerable variation between individual NOPs on what costs they will include within this component of the NOPs' fee and what they expect should be Reimbursable Costs. During the selection process, the NOPs and Owner will need to discuss and agree the classification of all likely project costs as either Corporate Overhead or Reimbursable Costs. Examples of the type of costs that may be included in Corporate Overhead are:

- corporate office costs, including administration and management staff;
- corporate IT management fees;
- corporate software licensing;
- financing costs (interest) on normal project cash flow;
- corporate management expenses (airfares, hotels) incurred in relation to the alliance;
- corporate managers' costs (generally including ALT attendance);
- staff bonuses;
- overtime payments;
- recruitment and redundancy;
- relocations;
- plant and equipment for the project office;

corporate OH&S auditing and system development costs;
staff development;
entertainment of staff and workforce; and
payroll and administration.

An Owner may need to seek specialist advice from an experienced alliance financial auditor to establish an appropriate definition of Reimbursable Costs. Ultimately, however, the Owner will remain accountable for the decisions about this and should therefore develop a thorough understanding of how the NOPs will develop and seek to negotiate both the Corporate Overhead amount and Reimbursable Costs definitions in the PAA.

The complexities of Corporate Overhead and Reimbursable Costs

The decision regarding what reasonably constitutes a Reimbursable Cost and what should comprise part of the NOPs' Corporate Overhead requires industry knowledge and expertise. Some items are clear; however, others are less so.

One example is the costs associated with preparing the Proponent's Project Proposal (such as estimating costs). Another example is the business-as-usual project audit(s) undertaken by the NOPs' corporate office in areas such as Safety, Environment and Quality.

Many (but not all) of the above costs are part of the Proponent's 'business-as-usual' costs and are covered by their Corporate Overhead. This means reimbursing those costs may result in the NOP/Proponent being paid twice.

Profit

The NOPs' Profit represents the amount agreed between the Owner and relevant NOP as reward for the service the NOP provides and the risk it undertakes.

Comparing Fees between competing NOPs

The recommended approach is for the Owner to request Proponents to submit their proposed Corporate Overhead and Profit with their EOI and again with their RFP, together with commentary on the Owner's proposed definition of the Corporate Overhead and the proposed structure of the Commercial Framework. When assessing each Proponent's Corporate Overhead and Profit and comparing those amounts proposed by competing Proponents, the Owner should ensure that:

The Proponents' profit lies within prevailing industry norms for the current commercial environment. If the amount is too low, this is unlikely to encourage the NOPs to supply their best teams and/or may inadvertently encourage inflation of the TOC in order to increase the likelihood of saving and hence increase Proponents' profit. By contrast, an excessive profit will reduce VfM by increasing costs and reducing commercial incentives for the NOPs to improve performance.

Tendered fees from competing Proponents need to be reconciled to account for any differences in the definitions of Reimbursable Costs and Corporate Overhead. For example, some Proponents will include the cost of items such

as IT support, payroll administration, defects liability period and safety plans in their Corporate Overhead. Others will levy the project an additional cost allocation.

The selection process recognises that the NOPs' fee has a marginal impact on the VfM outcomes for the project compared to other VfM elements such as the Project Solution, and this should be considered when designing the selection criteria and weightings.

Using business-as-usual fees to establish the NOPs' fee

An alternative approach to a Proponent nominating its fee is to establish the NOPs' fees post selection by auditing its business-as-usual fees (BAU) for comparable projects. However, this is not the preferred approach for a number of reasons. In particular:

It is an unduly complex process compared to the Proponents nominating their fee as part of their tender proposals, which the Owner can then assess independently.

An historical assessment of the NOPs' BAU fee may not reflect:

- the market's current conditions;
- the NOPs' current risk/reward appetite;
- the specific characteristics of the current project;
- a balance of profitable and unprofitable projects; and
- the lower risk profile (for NOPs) that is associated with entering into an alliance contract.

It is not a competitively determined outcome.

4.3.3 Risk or Reward Regime

The Risk or Reward Regime is the key mechanism in the Commercial Framework to encourage and reward exceptional performance (if required by the Owner), address poor performance, align the NOPs' commercial interests with the Owner's project objectives and drive the NOPs to meet their behavioural commitments. The Risk or Reward Regime should always be tailored by the Owner so that it is specific to the project.

The Risk or Reward Regime is developed from and with reference to the Owner's specific project objectives, minimum conditions of satisfaction (MCOS) and cost and non-cost key result areas (KRAs). Generally, the tender documents will specify the MCOS and KRAs which the NOPs are required to achieve in the performance of the work (or, where relevant, delivery of the services). The Risk or Reward Regime is then developed and finalised during the selection process, and forms part of the Project Proposal under the Alliance Development Agreement (ADA).³⁸ The agreed principles of the Risk or Reward Regime are then incorporated as part of the PAA.

³⁸ The Alliance Development Agreement for the project entered into between the project Owner and the NOPs under which the Project Proposal was developed for the approval (or otherwise) of the project Owner.

The Owner's project objectives are set out in the Business Case and are documented in the Owner's VfM Statement, and will include both price and non-price objectives. Therefore, the preferred approach is to structure the Risk or Reward Regime to reflect both price and non-price performance to incentivise the NOPs to achieve these objectives. Under the Risk or Reward Regime, the NOPs agree to put all (or a certain percentage) of their Corporate Overhead and Profit at risk, tied to their performance against the TOC and other non-price project objectives.

There are a number of ways to structure the Risk or Reward Regime. For example, in order to ensure that the NOPs are appropriately incentivised to achieve the objectives in the Owner's VfM Statement, the Owner could adopt either of the following two approaches:

1. **Option 1:** The Risk or Reward Regime is separated into two components, being a cost component (resulting in payment of gainshare or painshare for performance against the TOC), and a non-cost component (resulting in a separate payment to the NOPs of an amount for performance which is better than MCOS, or a liability payment from the NOPs for performance which is worse than MCOS).
2. **Option 2:** The Risk or Reward Regime does not contain separate components, but rather the calculation of gainshare or painshare for performance against the TOC will be modified to reflect the NOPs' performance in key non-cost areas. This means that the gainshare will be increased or the painshare decreased to reward exceptional performance by the NOPs, where this is required by the Owner's VfM Statement (or vice versa).

Appendix E sets out a number of graphical models which represent the numerous approaches that may be taken to structuring the Risk or Reward Regime, and notes the key advantages and disadvantages of each approach.

Developing the Risk or Reward Regime

The principles that should guide development of the Risk or Reward Regime include:

The NOPs' remuneration should be commensurate with their performance.

The Risk or Reward Regime should be based on and linked to real risks and benefits in the identified KRAs that affect the value of the project to the Owner, and the VfM outcomes set out in the Owner's VfM Statement. For example, the Owner may only require the NOPs' performance to exceed MCOS for certain KRAs.

If the Owner's VfM Statement requires exceptional performance for any KRA, each NOP should be genuinely incentivised to exceed MCOS through the Risk or Reward Regime.

The Owner should be committed to the NOPs being able to earn the full share of the available potential gainshare entitlements.

Price Performance: Cost KRAs

The Risk or Reward Amount which is payable by or to the NOPs is established as a share of the savings (or underrun) on actual outturn costs for the project against the TOC, or a share of the additional costs (or overrun). Typically, this share is 50:50 but considerable refinements can apply (as noted in Appendix D).

NOPs are not sharing in 'profits' or 'losses' of the project; instead, they are sharing in the outcomes of the project. From a cost perspective, a positive outcome will be achieved where there is a saving against the TOC, but it should be recognised that such savings do not represent a collective profit for the Participants.

Non-price Performance: Non-cost KRAs

As discussed above, the Risk or Reward Amount which will be payable to the NOPs to reflect performance against the Owner's non-price objectives is established by measuring the alliance's performance against pre-agreed KRAs. The PAA should incorporate an agreed regime for measuring the NOPs' performance against objective criteria, with pre-agreed financial returns or liabilities payable. It is important to note that the:

KRAs should only reflect the Owner's objectives and requirements (if any) for exceptional performance. The Owner needs to develop detailed definitions of MCOS for each KRA and for exceptional performance (if required).

KRAs may be measured by either lead or lag indicators but they should have a direct bearing on the Owner's objectives. For example, while 'alliance health' is clearly conducive to overall alliance performance, it is too remote from the Owner's specific objectives for the project, so should not be established as a KRA which specifically attracts financial reward.

Financial return ascribed to each KRA that requires exceptional performance should reflect the monetary value of that KRA to the Owner (not the alliance), and should only be paid where the Owner actually requires exceptional performance in relation to that KRA (and this performance has been achieved and demonstrated). Similarly, the NOPs should only incur a financial liability where they fail to achieve MCOS.

KRAs should be few in number (ideally 6 or less) and be capable of simple but meaningful measurement by all Participants, recognising the subjective judgment which is naturally associated with non-price objectives. Numerous and complex KRAs are counterproductive and will be difficult to apply and measure in practice.

KRAs should be clearly capable of driving behaviours throughout the alliance team, not just the ALT.

KRAs should not be designed to drive 'outstanding outcomes' (as defined by 'paradigm change', 'never been done before') unless exceptional performance is actually required by the Owner's VfM Statement.

Incremental increases in performance above MCOS (which are not defined as 'exceptional') may generate additional value for Owners; a scale can be

created through which a NOP can be rewarded for delivering additional value for performance that exceeds MCOS. This should only occur where the Owner determines that a performance that exceeds MCOS will assist to achieve the objectives in the VFM Statement. This scale of 'incremental increases' should be addressed in the PAA.

The payment for performance against KRAs that require exceptional performance can be either self-funded (a proportion of the Owner's share of any cost savings against the TOC) or paid from a separate performance pool established by the Owner. While self-funding can align price and non-price performance where savings are likely, it can render the KRAs ineffective if overruns are possible. The choice whether to incentivise non-price performance by self-funding through the Owner's gainshare, or by establishing a separate performance pool, is project specific and should reflect the actual value the Owner places on achieving exceptional performance for specific non-price objectives. Appendix D provides graphical representations of the different approaches.

Therefore, the Owner needs to provide the KRAs as part of the Commercial Framework. They cannot be developed during the selection process. Detailed risk assessment prior to awarding a contract means that Owners will be better placed to ensure that the Risk or Reward Regime actually drives the behaviours and outcomes that the Owner requires.

4.3.4 Target Outturn Cost (TOC)

The Target Outturn Cost (TOC) is central to the alliance Commercial Framework and will be the subject of some detail in Guidance Note N^o 5.³⁹ The TOC is used to confirm alignment with Business Case cost assumptions before executing the PAA and it is also the basis on which alliance cost performance will be assessed upon project completion.

For all practical purposes, the TOC is the Proponent's tendered price to the Owner.

However, there are some significant differences to a traditional tendered price. The TOC is, as the name suggests, a 'target' price offered by Proponents where the actual costs on completion of the alliance (i.e. actual outturn costs or AOC) will be compared against this target and any differences (usually termed underruns or overruns) will be shared between NOPs and the Owner in accordance with the agreed Commercial Framework.

It is at this price that the Proponent is prepared to share the project risks and financial performance with the Owner in accordance with the agreed Commercial Framework.

While the TOC as described above is a single dollar figure or number and is similar to a traditional tendered price, the development of the TOC in alliance

³⁹ Refer to *Guidance Note N^o 5, Developing the TOC in alliance contracting*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

contracting is fundamentally different to the development of a tendered price in a traditional delivery method. This is discussed further in Guidance Note 5.

The TOC can be developed in one of three ways, dependent upon the approach taken to selecting the NOPs as described in Chapter 5. The TOC may be:

competitively bid by Proponents through a full price competitive process based upon a detailed scope of work and Commercial Framework;

negotiated by the Owner with a Preferred Proponent using, as a base, the partial proposal which has been competitively bid between two shortlisted Proponents; and

negotiated by the Owner with a Preferred Proponent on the basis of the Proponent's final proposal that has not been competitively bid.

The differences between these three approaches to selecting the NOPs are discussed in Chapter 5; however, regardless of the approach, there are certain common components and principles underlying the TOC. These are:

The NOPs' fee

This comprises Profit and Corporate Overheads as discussed elsewhere in this chapter:

Profit: The NOPs' reward or 'margin' that their shareholders require for the service they provide and the risks they take in performing the work. This is tendered by the NOPs.

Corporate Overheads: Represents those recurring indirect costs that the NOPs incur in running their business that are not able to be directly linked to a project.

Reimbursable Costs

This comprises indirect overheads and direct cost.

Indirect project-specific overheads cost

This represents the NOPs' management overheads that can be directly linked to the project (e.g. supervision, site sheds, and insurances).

Direct project cost

This is an estimate of the most likely cost of delivering the agreed Scope of Work and is developed in detail from first-principles estimating.

There should be clear articulation of the inputs into the TOC (including design solution, construction methodology, productivities, etc.), which should reflect current industry best practice.

There should be considered allowance for likely project risks and opportunities.

The TOC is only meaningful when analysed alongside the Commercial Framework. The Framework will impact the TOC during both project delivery and post completion. For example:

the Risk or Reward Model (including any caps); and

other costs, such as requirements for project insurances (including deductibles and cover provided), Owner's costs in obtaining approvals, land purchases, etc.

Adjustments will only be made to the TOC as defined by the PAA.

A 'soft' TOC erodes VfM

A 'soft' TOC is not conducive to the public interest and, regardless of any gainshare or underruns, represents a serious erosion of VfM for the Owner. The Owner must make every effort to have a robust TOC. This is discussed in more detail in Guidance Note N^o 5.

4.4 Changes to the Commercial Framework

Occasionally, after execution of the PAA, it may be observed that the Commercial Framework is not effectively driving the alignment of the NOPs' commercial objectives and Owner's objectives. Reasons are varied and could include:

- changing Owner objectives; and
- unforeseen project challenges.

The Owner, through its Owner's Representative, needs to be alert to this possibility. If the Owner's Representative feels the Commercial Framework is not working effectively to achieve the project's goals, it should discuss this with the ALT and negotiate changes to the Commercial Framework.

This decision should not be taken lightly and only the Owner (in agreement with the NOPs) can change the Commercial Framework. The Owner Participant and the ALT do not have that authority.

Appropriate commercial and legal advice should be obtained in relation to any change to the Commercial Framework.

Innovative commercial arrangements

While Owners are encouraged to develop a project-specific Commercial Framework and include it in the tender documents, they should ensure that Proponents are encouraged in their responses to innovate commercially (as well as technically) in striving to best satisfy the Owner's VfM Statement. This may require guidance from Owners as to what areas of the Commercial Framework are or are not open to innovation.

4.5 Caps on Risk or Reward

Historically, most alliances have tended to automatically include a limit (or 'cap') on the amount of painshare that is payable by the NOPs. The cap is typically equal to the NOPs' Fee.

Is a cap on the NOPs' Fee appropriate?

A rationale which is usually provided to support a cap on the NOPs' Fee is that under an alliance, the NOPs are exposed to a share of the Owner's risk beyond their normal design and construction environment, and that a limit (or cap) on the NOPs' exposure is therefore appropriate.

However, under an alliance, the Owner is also exposed to a share of the NOPs' design and construction risk beyond their normal risk profile under a traditional contract (where these risks are transferred entirely to the D&C contractor). Logically, according to the rationale offered by designers/contractors, this means that the Owner's risk should also be capped.

In addition, if the NOPs' painshare is capped, this means that the Owner will bear all project risk once the cap has been exceeded. Traditionally, one of the key aspirations of alliance contracting has been the principle of 'win:win, lose:lose' for all Participants. However, in circumstances where the NOPs' risk is capped and the cap is exceeded, this principle will no longer apply.

As alliancing has matured as a method of project delivery, it is no longer considered essential to automatically apply a cap to the NOPs' painshare. Instead, the application of a cap should be assessed on a project by project basis. In particular, account should be taken of the following issues when considering whether a cap on painshare should apply, and the appropriate amount for that cap:

Risk and reward are intrinsically linked. The NOPs' fee will reflect, amongst other things, the potential amount of painshare that may be payable by the NOPs, and the desired reward for taking that risk. The level of any cap on the NOPs' painshare will vary according to the NOPs' risk appetite, the agreed fee and the project specific risks. Therefore, the level and appropriateness of any cap on painshare should reflect the project, the wider market and the specific NOP. Similarly, the Owner will have its own views about the appropriate fee.

The cap is most likely to be exceeded if the project is in distress. The Owner will bear all design and construction risk once the NOPs' cap on painshare has been exceeded. This is because the NOPs will be insulated from any further pain if the cost overrun continues beyond their cap. At the time of greatest need, a cap therefore has the potential to place stress on the key alliance features of 'risk and opportunity sharing' and best-for-project 'unanimous decision making'. Also, an alliance contract is underpinned by the principle that the NOPs' commercial objectives and the Owner's project objectives should be aligned. This approach is directed at avoiding the adversarial behaviours that may emerge under traditional contracts. However, in circumstances where the NOPs' painshare is capped and this cap is exceeded, the cap can create significant commercial misalignment given that, practically, the Owner is bearing all project risk.

If a cap on painshare is applied it may be appropriate to consider a reciprocal cap on gainshare (Risk or Reward Regimes 2 and 3 in Appendix D). This should be considered in the context of the particular project.

If a cap on painshare is in place, this may reduce risk contingencies built into the TOC.

If the painshare cap is set at the NOPs' fee (as has often been the case historically) it would require an overrun to the TOC of twice the NOPs' fee before the cap is reached.

Above all else, the NOPs will be motivated by the financial impact of any arrangement, whether it be negative or positive.

Tips for structuring the Commercial Framework

The principles of the Commercial Framework are relatively simple and straightforward. However, applying the Commercial Framework in practice will not achieve optimal outcomes for the Owner if sufficient attention isn't given to:

- definitional problems (e.g. are the NOPs' Corporate IT fees a Reimbursable Cost or part of the Corporate Overhead?);
- measuring costs (e.g. the NOPs' plant and equipment should be reimbursed 'at cost' but some NOPs do not have plant management systems that record cost);
- aspects of the Commercial Framework that may fail to align the Owner's and NOPs' objectives; and
- designing a Commercial Framework that fairly and satisfactorily deals with the possibility of a 'soft' TOC. A common approach is to include a 'flat spot' on the gainshare so that (for example) the first 10% of any cost underruns accrues 100% to the Owner before reverting to a 50:50 split between the Owner and the NOPs. However, in practice, this fails to align the NOPs and Owner to achieve that first 10% and is unlikely to drive desired behaviours.

4.6 Tailor a Commercial Framework to the Owner's project

Once the Owner has considered the general principles of the Commercial Framework outlined above, the Owner should be in a position to develop a Commercial Framework that applies specifically to its project. However, before the Owner can do this, it needs to clearly identify the price and non-price objectives; and major risks that apply to its specific project.

The Owner's VfM Statement should clearly set out this information in order to establish a Commercial Framework that effectively aligns the Participants' objectives.

Applying a generic Commercial Framework to a project is unlikely to assist Owners to achieve the Owner's VfM Statement. Appendix D includes examples

of Commercial Frameworks (together with advantages and disadvantages) that might assist Owners to develop their own project-specific Commercial Framework. These examples provide a starting point for tailoring the Commercial Framework to the Owner's specific project.

The approach to tailoring the Commercial Framework is determined by the Owner, and a suggested approach is to use a facilitated workshop (prior to calling EOIs/Proposals) attended by the Owner Representatives and targeted parties who can contribute to the identification and quantification of risks that the alliance could face.⁴⁰ This will allow for:

- a better understanding of the Owner's objectives in the Business Case and Owner's VfM Statement;
- an integrated approach to the Commercial Framework; and
- wider creative input.

An outline of agenda topics for that workshop could encompass:

- discussion on the prevailing commercial environment⁴¹ and likely impact for the Commercial Framework;
- presentation by the Owner of its project price and non-price objectives including the monetary value it ascribes to achievement (or otherwise) by the alliance against each objective;
- MCOS and discussion on likely non-price objectives (KRAs) including the monetary value to the Owner for each KRA where exceptional performance is required (if any);
- discussion on the Owner's risk appetite, any risks which could be prohibitive to share with the NOPs (and could therefore be excluded from the Commercial Framework) and the need (if any) for caps on the Risk or Reward Amount to limit NOP risk on certain items;
- discussion on current industry norms for NOP profit margins;
- selection of two or three base Commercial Framework templates from Appendix D for examination by Owner/Owner Representative subgroups;
- selection of a preferred Commercial Framework (which may have some detail to be developed after the workshop);
- stress test of the Commercial Framework in plenary with a range of scenarios; and
- agreeing the Commercial Framework to be included in the EOI/RFP including the rationale behind the Commercial Framework and providing guidance to potential NOPs on where innovation would be welcome.

⁴⁰ These parties could include Government Departments and Agencies as well as focussed interviews with relevant community interest groups.

⁴¹ Refer section 4.1

4.6.1 Seek Proponent's response on proposed Commercial Framework

The Owner's proposed Commercial Framework should be included in the EOI/RFP document together with its rationale and guidance on where innovation from Proponents would be welcome.

The Proponent's response should be part of the selection criteria which demonstrates their understanding of the:

- Commercial Framework and its mechanics;
- Owner's objectives; and
- project challenges.

The feedback should also demonstrate the Proponent's openness in challenging the Commercial Framework productively. This feedback will also provide a solid basis for a productive discussion topic with Proponents after submission of their written responses to the RFP.

As part of their response, Proponents should provide their proposed distribution of gainshare/painshare amongst individual corporations so that the Owner can assess the commercial alignment of the parties to the Project Proposal.

The Commercial Framework needs to be agreed (apart from non-material matters) with each Proponent as part of the selection and assessment process. The Commercial Framework should not be developed after executing the PAA since the final Commercial Framework should be a fundamental mechanism to evaluate the Proponents.

4.7 Develop the PAA

The legal framework for the alliance is set out in the PAA. Template No 1: The Model Project Alliance Agreement gives full effect to the principles in this Guide and should achieve optimal outcomes for the Owner from a legal perspective. The Model PAA is consistent with the current leading practice for alliance contracts which are procured for government infrastructure projects and agencies can tailor it to suit their specific project requirements.

Template No 1: The Model Project Alliance Agreement can be found at: www.infrastructure.gov.au

4.8 Define and plan the Owner's resources

The Owner must provide the right capability and capacity

Even if a project is well suited for alliancing, it should only be recommended as the preferred procurement strategy if the Owner can bring the right capacity and capability to the project. This is critical as the Owner shares in the project risks and must participate actively in the decision-making process and project management.

A key VfM driver and critical requirement for effective procurement is the Owner effectively negotiating and managing commercial issues with the private sector. To protect the public interest and realise optimal VfM outcomes, Owners should make sure that they have, and are able to apply, sufficient capacity and capability to alliance contracting.

The Owner requires a number of key resources to effectively engage with the market and NOPS throughout the planning, evaluation, implementation and post-delivery phases of the project. Appropriate mechanisms should be put in place upfront to ensure the Owner is able to fully benefit from a collaborative approach, and also does not suffer any disadvantage from a mismatch with the capacity and capability of NOPS.

The Owner should provide staff with sufficient seniority and expertise to provide active leadership in the alliance. By involving people with the requisite experience and authority in managing the project, the Owner is likely to achieve better alignment between the Participants, and therefore more robust decision-making processes within the alliance. The application of adequate resources to the project will place the Owner in a better position to achieve the benefits of alliancing.

Although it is preferable for the Owner to use internal resources as far as possible, these should be supplemented with specialist advisers as required.

The Owner should also provide physical resources that are required for the delivery of the project whenever it is more efficient and economical for the Owner to do so. These resources could include storage facilities, meeting venues and equipment.

4.8.1 Roles in lifecycle of an alliance

The responsibilities which should be undertaken by the various parts of the alliance structure are outlined in Table 4.1. The Guide does not address either the mechanics of the procurement or tender process or the roles of all key personnel in detail. The Guide assumes that Owners have this knowledge already, and instead the Guide focuses on matters specific to alliancing.

Table 4.1: Roles in lifecycle of alliance

Role	Lifecycle		
	Development (includes Business Case and procurement strategy)	Procurement (includes selecting the NOPs and agreeing the commercial arrangements)	Delivery (includes project closeout)
Owner (including Owner's Representative)	<p>Identify gaps in community service levels.</p> <p>Develop the Business Case.</p> <p>Progress and obtain approval of the Business Case.</p> <p>Prepare the VfM Statement.</p>	<p>Lead the procurement process including:</p> <ul style="list-style-type: none"> • establish and negotiate the PAA and Commercial Framework; • manage the EOI/RFP processes; • negotiate the TOC; • seek approvals from government to Business Case changes (if necessary); • manage the EOI / RFP processes. 	<p>Ensure delivery of the Owner's VfM Statement including:</p> <ul style="list-style-type: none"> • monitor progress, direct corrective action and approve deliverables; • revisit Business Case to ensure on track; • ensure compliance with governance arrangements; • consider and approve any changes to the project as per the governance arrangements; • undertake statutory obligations that cannot be undertaken by the alliance but have significant impact on the alliance works.

Role	Lifecycle		
	Development (includes Business Case and procurement strategy)	Procurement (includes selecting the NOPs and agreeing the commercial arrangements)	Delivery (includes project closeout)
Owner's Project Director ⁴²	n/a	<p>Optimise delivery of the Owner's objectives through:</p> <ul style="list-style-type: none"> • design and approval of NOP selection process • develop procurement road map • manage implementation of procurement process and selection of NOPs. <p>Business Case Alignment Report (BCAR)—the mechanism by which the government is informed of the outcome of the alliance selection and whether the tender outcome is aligned with the Business Case.⁴³</p>	May take a role in the ALT or the AMT, nominated on a best-for-project' basis.
Selection Panel Members	n/a	Evaluate Proponents against selection criteria and recommend preferred Proponent.	n/a
Owner's Support Team	Take a leadership role on behalf of Owner to manage the Business Case and provide the necessary services to finalise the Business Case.	<p>Maximise Proponent's project knowledge during Alliance Development Phase.</p> <p>Provide feedback to Selection Panel on team attributes.</p> <p>Provide guidance to ensure Proponents clearly understand scope</p>	May be the Owner's Participants.

⁴² Often agencies without a comprehensive project delivery structure will need to source this role externally.

⁴³ More detail about this report is provided in *Guidance Note N° 5, Developing the TOC in alliance contracting*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

Role	Lifecycle		
	Development (includes Business Case and procurement strategy)	Procurement (includes selecting the NOPs and agreeing the commercial arrangements)	Delivery (includes project closeout)
		of Owner's VfM Statement.	
Review Committee or Board	n/a	Monitor procurement process against Owner's objectives. Appropriate direction may be provided to Project Director at key decision points.	n/a
Alliance Leadership Team (ALT) Nominees (until selected) ⁴⁴	n/a	Negotiate technical, commercial, legal and team arrangements.	Leadership group with accountabilities for project delivery as agreed in the PAA.
Alliance Manager (AM) Nominee (until selected)	n/a	Lead Proponents' response to procurement process.	The senior manager accountabilities for project delivery as outlined in the PAA.
Alliance Management Team (AMT) Nominees (until selected)	n/a	Assist AM where required in responding to procurement process.	Report to AM, executive accountabilities for project delivery as outlined in the PAA.
Alliance Project Team (APT)	n/a	n/a	The alliance project delivery team that reports to the AM.

4.8.2 The Owner as Owner

The Owner acts in the following two distinct roles during the selection process and delivery phase of an alliance:

1. **The Owner:** the Owner ('outside the alliance') is ultimately responsible for delivering the service outcome to the government (as set out in the Business Case). The Owner may be the Minister, the departmental head, the agency's CEO or board; and
2. **The Alliance Participant:** the Owner acts as part of the alliance ('inside the alliance') through the Owner's Participants (OPs), who have been delegated responsibilities to deliver the capital asset as part of the alliance. The OPs

⁴⁴ Various roles are named as nominees as they do not take on that role until the Alliance has formed i.e. the PAA has been signed.

perform roles as members of the Alliance Leadership Team (ALT) and Alliance Management Team (AMT) Members during the delivery phase.

These two roles should ideally be undertaken by separate individuals/teams, however, limited Owner resources may mean this is not always possible. In some instances, it may be necessary to have some individuals acting in both capacities (e.g. a key senior executive or the CEO may fulfil the role of the ‘Owner’ outside of the alliance as well as being on the ALT as the Owner Participant). In this situation, the relevant individual needs to be very careful in undertaking the varying roles and responsibilities and this issue should be expressly addressed in external and internal governance plans.

Accountability to the government for delivering the investment outcomes identified in the Business Case (and hence in the Owner’s VfM Statement) rests with the Owner and cannot be delegated to third parties. The Owner should have ‘owner as owner’ representatives independent of the alliance to certify payments; negotiate and recommend scope/TOC changes; and test scope changes against the required outcomes in the Owner’s VfM Statement.

4.9 Specialist advisers

The following specialist advisers may be used by the Owner to assist with various stages of the procurement process. The Owner can source its specialist advisers internally, or engage external consultants.⁴⁵ It is recognised that some advisory firms may be able provide specialist advice across two or more skill sets. However, although it may be convenient (and may appear to be the most efficient option) for the Owner to engage one firm, it is important to ensure that the quality of the fit-for-purpose advice is consistent across all of the roles required to be performed⁴⁶ and that advisers should not be asked to provide advice which is outside of their competency (or PI insurance). Agencies need to ensure any potential conflicts of interest are appropriately managed.

Table 4.2: Specialist Advisers

Adviser skill set	Role
Commercial Adviser	The Commercial Adviser has a specialist in-depth understanding of the markets and commercial workings of Proponents for an alliance project. They advise on how to tailor the selection process to achieve the project objectives and requirements set out in the Owner’s VfM Statement. They support the Owner from the Business Case stage (once alliancing is confirmed) through to selection and often in the delivery and close out stages, providing commercial advice and evaluation. The Commercial Adviser assists the Owner in coordinating the involvement of other specialist advisers. Key

⁴⁵ The government’s preferred approach is to use its own public service resources with external providers employed to fill capability gaps but not to fulfil leadership roles.

⁴⁶ For example, an Alliance Facilitator is a common term for various parts of the Commercial Adviser, Transaction Adviser and Behavioural Coach roles. Other consultancy firms will offer commercial advisory services that cover Commercial Adviser and Transaction Adviser. The Owner needs to make an informed judgment as to whether one person/firm can satisfy the combined requirements of these roles.

Adviser skill set	Role
	<p>activities may include:</p> <ul style="list-style-type: none"> • assisting the Owner to develop the alliance strategy, Commercial Framework and selection process; • assisting the Owner to develop procurement process documentation including the Expression of Interest, Industry Briefing, Request for Proposals, proposed PAA (including the Commercial Framework), and the Evaluation Plan; • assisting the Owner to determine and facilitate the most appropriate workshops for project development; • providing insights into the Proponents' offer and subsequent delivery; • assisting the Owner in evaluating the Proponents' Project Proposals; • reviewing Owner budget estimates (including Owner's Comparative TOC if appropriate); and • assisting the Owner during Finalisation and Award stage to optimise technical and contract requirements.
Transaction Adviser	<p>The Transaction Adviser programs and leads the implementation of the procurement strategy. Key activities may include:</p> <ul style="list-style-type: none"> • assisting the Owner's team to develop and quality assure procurement process documentation including the Expression of Interest, Industry Briefing, Request for Proposals, Proposed PAA, Commercial Framework, and Evaluation Plan; • assisting the Owner to coordinate and manage the selection process; and • facilitating Selection Panel discussions and evaluation workshops.
Insurance Adviser	<p>Assisting the Owner to determine the most appropriate approach to insurance requirements.⁴⁷</p>
Legal Adviser	<p>The alliance legal adviser provides legal input and advice to the Owner. Key activities may include:</p> <ul style="list-style-type: none"> • providing advice in EOI & RFP terms and conditions; • developing the draft PAA; • providing advice to the Owner on the Proponents' comments on the draft PAA; • finalising and coordinating execution of the PAA; and • providing advice on legal issues as they arise (e.g. adjustment events).

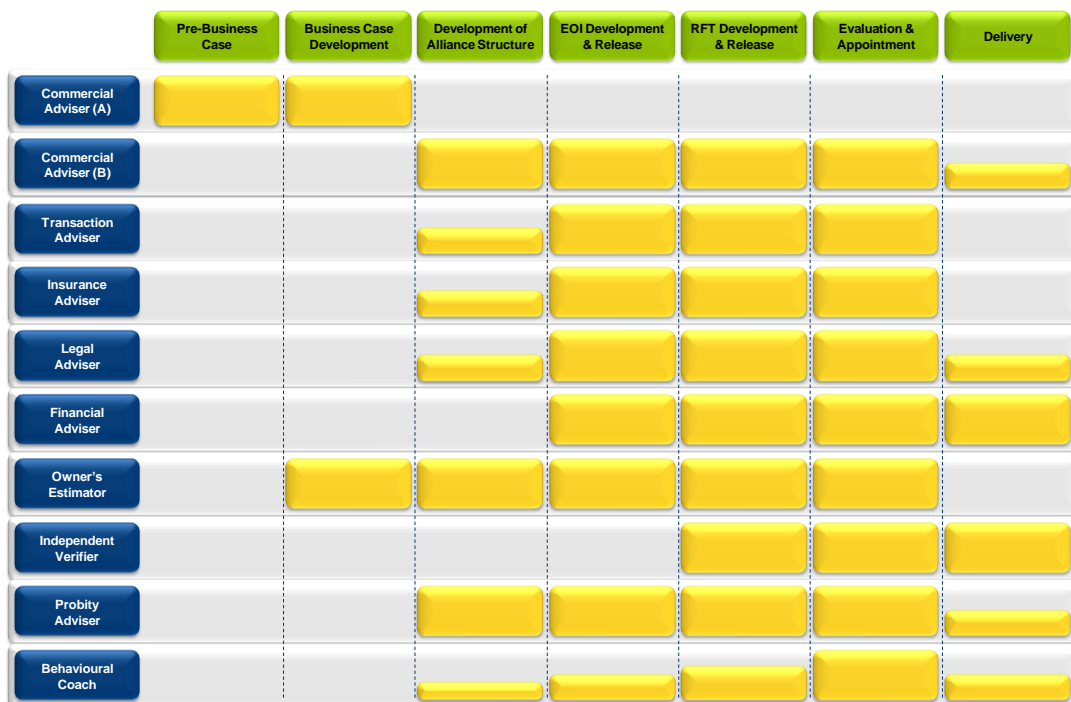
⁴⁷ Refer to *Guidance Note No 2, Insurance in Alliance Contracting – Selling Insurable Risks*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

Adviser skill set	Role
Financial Auditor	<p>The Financial Auditor provides an assessment of financial aspects of each Proponent's offer for use in the selection process. Key activities may include:</p> <ul style="list-style-type: none"> • investigating the financial capacity of individual Proponents; • investigating the Proponents' costing structures so that a clear understanding is gained of the proposed allocation of costs between Corporate Overhead and Reimbursable Costs; • assisting to establish appropriate definitions of Reimbursable Costs and Corporate Overhead; • confirming that the Reimbursable Cost rates (including direct cost multipliers) submitted by the Proponents reflect actual costs; and • considering the use of specialist support to assess not only whether costs were actually incurred, but also whether they should have been incurred.
Owner's Estimator	<p>The Owner's Estimator has in-depth understanding of how designers/contractors cost infrastructure (or building) works and provides cost-estimating services to the Owner. The role of the Owner's Estimator is described in detail in Guidance Note N^o 5⁴⁸. Key activities may include:</p> <ul style="list-style-type: none"> • developing an Owner's Comparative TOC if required and refining it as the project develops and further information emerges; • reviewing and commenting on the Proponent's proposed Project Solution and risk assessment; • validating that the Proponent's TOC (or each TOC component) is robust; sufficiently covers the key elements of the works (i.e. the TOC is sufficient to meet the Owner's requirements set out in the Business Case), and includes an appropriate risk contingency; • calculating a risk-adjusted price for each Proponent's TOC (or partial TOC) that will provide the Selection Panel with a better understanding of the commercial offering from each Proponent; and • verifying that the estimated cost of any Adjustment Events after the finalisation of the TOC represents an appropriate estimate of the associated cost. <p>(Owners may find that some Transaction Advisers or Commercial Advisers can provide this service.)</p>

⁴⁸ Refer to *Guidance Note N^o 5, Developing the TOC in alliance contracting*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

Adviser skill set	Role
Independent Verifier	<p>The Independent Verifier (IV) provides assurance to the Owner that the alliance has effectively and efficiently designed and constructed the work to meet the requirements of the PAA.</p> <p>The need for an IV may arise if an Owner considers that they have a governance responsibility to be assured by independent parties that the alliance has designed and constructed the work in accordance with the PAA. To do this, the Owner engages an Independent Verifier (IV) who sits outside of the alliance and reports to the Owner. The IV may be one of the Owner's employees.</p> <p>The decision to use an IV will reflect several factors including the:</p> <ul style="list-style-type: none"> • Owner's internal governance requirements; • risk and complexity of the project and the Owner's familiarity with these; • likelihood and consequences of non-complying quality (either in design or construction); • capability and capacity of the Owner's Representative(s); and • additional cost of the IV balanced against likely benefits. <p>Owners will need to assess the above factors when deciding whether to use an IV and determining the scope of service.</p>
Probity Adviser	<p>The Probity Adviser ensures that the relevant Government probity standards and requirements are met through the selection and delivery process.</p> <p>The Probity Adviser will ensure that Owner interaction and/or integration with Proponents / NOPs can be achieved while satisfying probity requirements.</p>
Behavioural Coach	<p>Behavioural coaches can assist the Selection Panel to develop a better understanding of the Proponent's potential to form an alliance with the Owner's personnel. Key activities may include:</p> <ul style="list-style-type: none"> • undertaking behavioural assessments; and • providing training and tools to allow the Selection Panel to undertake behavioural observation and assessment. <p>After the PAA is signed, the alliance may decide to use a Behavioural Coach to consolidate alliancing behaviours.</p>

These advisers are typically engaged as outlined in Figure 4.3, however each adviser may also be involved on an ad hoc basis as required.



Commercial Adviser (A): specialist in preparation of Business Cases, including advising on various procurement options generally.

Commercial Adviser (B): specialist in alliancing with in-depth understanding of the markets and commercial workings of Proponents for an alliance project. This expert advice would be called upon full-time once the alliance procurement option is confirmed as part of the Business Case approvals.

Figure 4.3: Typical engagement of advisers

4.10 Delivery phase resources

The Owner should nominate the physical and human resources (although not necessarily the names of individuals) it proposes to provide during the delivery phase of the alliance project in the tender documents issued to the market (i.e. the RFP). These should be considered by the Proponents in their Project Proposals.

The Owner's human resources should generally be appointed to the alliance on the basis that they are the best people for the job. This approach should apply to the potential candidates from all Participants, and should result in a high-calibre team capable of delivering a successful project that achieves the VfM outcomes required by the Owner.

During the delivery phase, it is preferable for the Owner's team to work completely within the alliance as much as possible, and report to the Owner through the alliance governance structure. This approach should foster the creation of a single, cohesive team with a common focus on the delivery of the project objectives. Due to resource constraints, statutory or corporate requirements, this may not always be possible. However, Owners should seek to minimise the number of non-alliance resources working on alliance activities.

The following resources are likely to be required during the procurement process to fulfil the Owner's roles and responsibilities discussed in section 4.8.2.

4.10.1 Alliance Leadership Team (ALT) Members

The ALT is the key decision-making body for the alliance. It is responsible for providing leadership and governance to the alliance, and ensuring that the obligations of the Participants are fulfilled and the Owner's VfM objectives are achieved.

The ALT members should be senior managers from within the Participant organisations that have a deep understanding of the objectives expressed in the Owner's VfM Statement. All ALT members should have sufficient line authority within their home organisation to mobilise resources as required, and the appropriate capability and capacity to make the key decisions for the project.

Research has shown that active senior level participation by the Owner's ALT members is likely to result in enhanced clarity of project objectives and better VfM outcomes.⁴⁹

4.10.2 Alliance Manager (AM)

The AM is selected by, and reports to, the ALT. The AM has the most senior manager accountabilities for the alliance and manages the Alliance Management Team (AMT). The AM is responsible for managing the day-to-day operations of the alliance.

While all alliance positions are populated on a best-for-project basis, it is common that the AM is sourced from the NOPs given the experience, skills and leadership they provide.

4.10.3 Alliance Management Team (AMT) Members

The AMT is responsible for the delivery of the project and the achievement of the Owner's project objectives in accordance with the ALT's strategy and policy. The AMT is headed by the AM and provides day-to-day leadership and management to the Alliance Project Team (APT).

The Owner's AMT members should be experienced leaders in their disciplines appointed on a best person for the job basis.

4.10.4 Alliance Project Team (APT)

The APT comprises all alliance members reporting to the AM. The Owner's APT members should be appointed on a 'best person for the job' basis. The Owner should also consider providing the senior finance manager for the project as they will be familiar with the governance and probity requirements for spending public funds.

4.10.5 Non-alliance Owner resources providing technical assistance

Some Owners have statutory obligations related to the delivery of the alliance works that cannot be transferred to the alliance. For example, an Owner may be required to approve design work that will be incorporated in an existing,

⁴⁹ *In Pursuit of Additional Value – A benchmarking study into alliancing in the Australian Public Sector*, DTF Victoria, October 2009.

operational transport network, and its statutory obligations will not allow it to transfer this function to the alliance.

In these instances, the Owner should allocate appropriate internal resources to undertake the required activities in line with the alliance program. These Owner resources need to be made accessible and available to the alliance in key technical, commercial, operational and stakeholder areas to properly manage the work interfaces between the alliance project and the Owner's wider operations and organisation.

4.10.6 Owner resources within the alliance

The importance of Owner Participants being involved in key alliance positions and having the necessary skills and experience is often underestimated. The number of Owner resources, and the skills and experience level of those resources, will significantly influence whether VfM is achieved in the project delivery phase. They will bring to the alliance a critical understanding of the Owner's business values and wider corporate environment and network systems.

The complex commercial relationships which operate within an alliance demand that key Owner Participants (e.g. Owner's members on ALT, AMT and other senior project roles) collectively have the same level of capability as the NOPs, in each of the key project delivery disciplines. A distinction should be made between Owner Participants having actual project delivery experience with alliances, and having experience with performing manager/supervisor roles under traditional project delivery models. Owner participation is necessary to provide reasonable coverage of the key disciplines which will impact on whether VfM is achieved, including design and construction, procurement, commercial and project management and project controls.

The Owner Participants also need to take a pro-active approach to determining alliance resource needs and selecting the right candidates for key alliance positions. This requires sufficient experience to determine the suitability and ongoing performance of alliance resources, and to initiate corrective action when insufficient or inadequate resources are identified.

4.10.7 Physical resources

Physical resources should be supplied to the alliance by the Participants on a best-for-project basis. It is likely that in some instances, the highest level of value against the Owner's VfM Statement will be achieved by the Owner providing these resources. Examples include:

- The Owner may be able to obtain the best terms and conditions for the provision of specialist materials due to pre-existing government supply agreements (e.g. existing agreements for the provision of turn-outs for a rail alliance).
- The Owner may have a specialist piece of equipment that is available and can be supplied to the alliance at a better than market rate (e.g. ballast tamping machines).

- The Owner may have vacant offices that the alliance can use at minimal cost.

4.11 Prepare resources for their roles

The Owner's resources should have an appropriate level of knowledge to undertake their roles, which means that training may be required. Training sessions may include:

- overview of alliance contracting;
- commercial skills training;
- roles and responsibilities during the selection process (for the Owner's Support Team and selection panel); and
- roles and responsibilities during the delivery of an alliance project (ALT, AMT and APT).

Owners who may be engaged in delivering multiple alliance projects should consider common alliance training sessions across all projects to reduce costs and use resources effectively.

4.12 Best use of specialist advisers' professional services⁵⁰

Advisers can have a significant impact on the VfM outcomes of the alliance project, and should therefore be engaged and used appropriately. The quality of the advisory services obtained by the Owner will depend upon the quality of the Owner's informed management.

The Owner should consider the following issues to ensure that advisers are managed in a manner that enhances VfM outcomes for alliance projects.

4.12.1 Owner's leadership

The Owner should take the strategic leadership role in the implementation of the Business Case, and manage its accountability to the government. This is consistent with the Owner retaining accountability for the successes of the Business Case outcomes. Advisers may be engaged to support the Owner in this role. However, the key business decisions, which fall outside the alliance's responsibility, are made by the Owner. Typically, such decisions are made in practice by the Owner's senior responsible officer, or sometimes by Steering Committees, etc.

4.12.2 Advisers' duty of care responsibilities

Advisers have a duty of care to their client (the Owner and therefore the government). This duty of care is expressed in differently in various jurisdictions, however, the intent is the same. For example, the Law Institute of Victoria,

⁵⁰ This section is based on an unpublished document: *Advice to departments/agencies regarding proforma for seeking a request for proposal for consultants on Partnerships Victoria projects*, June 2004, Department of Treasury and Finance, Victoria.

Professional Conduct and Practice Rules 2005 provides 'rules' for lawyers that could also be applied to other professional advisers:

Has a duty to supply 'to clients ... services of the highest standard unaffected by self interest.' (Ref A (iii)).

'Always deal with clients fairly, free of the influence of any interest which may conflict with a client's best interests.' (Ref p.10)

'Act honestly and fairly in client's best interests and maintain clients' confidences.' (Ref 1.1)

'A practitioner must not, in any dealings with a client ... allow an interest of the practitioner or an associate of the practitioner to conflict with the client's interests.' (Ref 9.1)

'A practitioner must seek to advance and protect the client's interests to the best of the practitioner's skill and diligence, uninfluenced by the practitioner's personal view of the client or the client's activities, and notwithstanding any threatened unpopularity or criticism of the practitioner or any other person, and always in accordance with the law including these rules.' (Ref 12.1)

4.12.3 Knowledge transfer

The Owner should consider establishing a structured knowledge transfer program to extract the maximum value from external advisers. As a condition of engagement, external advisers should be required to formally recognise this program and structure their provision of advice to achieve an appropriate transfer of knowledge to the Owner. The Owner would be able to consider that advisers had been successfully engaged where the Owner's dependency on those advisers is reduced over time (often public sector engagements are very effective in transferring knowledge and providing valuable experience to advisers).

4.12.4 Competition and contestability

A strong and diverse advisory market, with robust and healthy competition, will lead to innovation and creativity in ideas and promote continuous improvement in the practice of alliance contracting. Advisory services should be sourced through a contestable and competitive selection process to avoid any appearance of simply re-engaging 'favourite' advisers.

Key selection criteria should make clear that advisers claiming to bring proprietary processes, documents and knowledge to an engagement will be assessed carefully. This should not impact the effective transfer of knowledge to subsequent alliance projects and reduce long-term contestability. Also, the Owner will need to be satisfied that the adviser still has the flexibility to think innovatively and provide tailored advice, beyond any propriety position to address the unique circumstances of a specific project.

4.12.5 Capability of individual advisers in firms

The quality of advisory services will ultimately depend upon the skills and ability of the individual adviser actually doing the work. Therefore, the Owner

should be careful to engage consulting firms on the basis of the capability of the specific individuals who will be providing the advice, rather than on the firm's overall reputation alone.

It is important to ensure that if key individuals from a firm are nominated in a tender response, that those individuals are available to execute the assignment for the required duration. The same result will not necessarily be delivered where the firm substitutes different individuals to perform the work, and the Owner should not accept this approach without review. Similarly, the Owner should be cautious about accepting other forms of substitution, such as reducing the time of one key adviser and correspondingly increasing the time of another.

Before engaging any specific adviser, the workload of nominated advisers on other projects should be checked.

4.12.6 Ongoing management

Achieving VfM from any specific adviser will depend upon both parties understanding the scope of the works and the required advisory outputs. If these are not clearly understood, agreed and documented by the Owner and adviser, then VfM (and any agreed cap on fees) may be jeopardised. As part of its ongoing planning processes, the Owner should also forecast advisory workloads and anticipated fees.

Interfaces between the various advisers on an alliance project need to be managed and clear instructions should be given regarding their respective responsibilities in relation to the work of others. There is also a need to determine at what stages of the alliance project the input of an adviser is required. It is generally unnecessary for all advisers to be involved over the full life cycle of the project.

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5

Selecting the Non-Owner Participants

This chapter outlines the principles that the Owner should apply in selecting the Non-Owner Participants. As discussed in earlier Chapters, alliancing is a well established project delivery method that is now a standard form of contracting in the infrastructure sector. The features of alliancing are commonly understood and procurement processes well established. This is reflected in the leading practices for selecting the Non-Owner Participants described in this Chapter.

5.1 Alliance success dynamics

Once the Owner has made the decision to use an alliance as the method to deliver its project, the Non-Owner Participants (NOPs) should be selected with reference to the requirements set out in the Owner's VfM Statement. In particular, the selection process should be targeted at assessing the Proponents on the basis of their potential to optimise VfM for the Owner. This will be determined by their ability to satisfy the requirements of the Owner's VfM Statement at a fair actual outturn cost (AOC).

The Owner's starting point should be to determine which bids are likely to achieve this outcome through a detailed selection criteria and process which requires the Proponents to develop and tender a Project Proposal addressing price and non-price selection criteria.⁵¹ Effectively, the proposal tendered by the Proponents will address the following four interdependent components of the alliance project as shown in Figure 5.1:

- **The project solution**—comprising the design solution and construction and delivery methods that will be used to deliver the capital asset requirements set out in the Owner's VfM Statement;
- **The integrated collaborative team**—which covers the capability and capacity of the NOPs, and culture of the integrated NOP/Owner team members;

⁵¹ In addition to the Guide, further detail is provided in *Guidance Note N° 5, Developing the TOC in alliance contracting*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

- **The commercial arrangements**—the remuneration framework (including definitions of Reimbursable Costs and Corporate Overhead), the Risk or Reward Regime, and other terms and conditions which comprise the PAA; and
- **The Target Outturn Cost (TOC)**—quantum of the total outturn cost, which should fairly estimate the expected outturn cost at the end of the project, as well as the breakdown and risk profile of that TOC.

These components need to be considered in the context of tender selection criteria that also assesses the NOPs likely performance on the following key features of alliancing:

- risk and opportunity sharing;
- commitment to ‘no disputes’;
- best-for-project unanimous decision-making processes;
- ‘no fault – no blame’ culture;
- good faith;
- transparency; and
- a joint management structure.

Tender selection criteria should be designed (and documented) that addresses all these components in order to select the NOP that is best placed to deliver the requirements set out in the Owner’s VfM Statement.

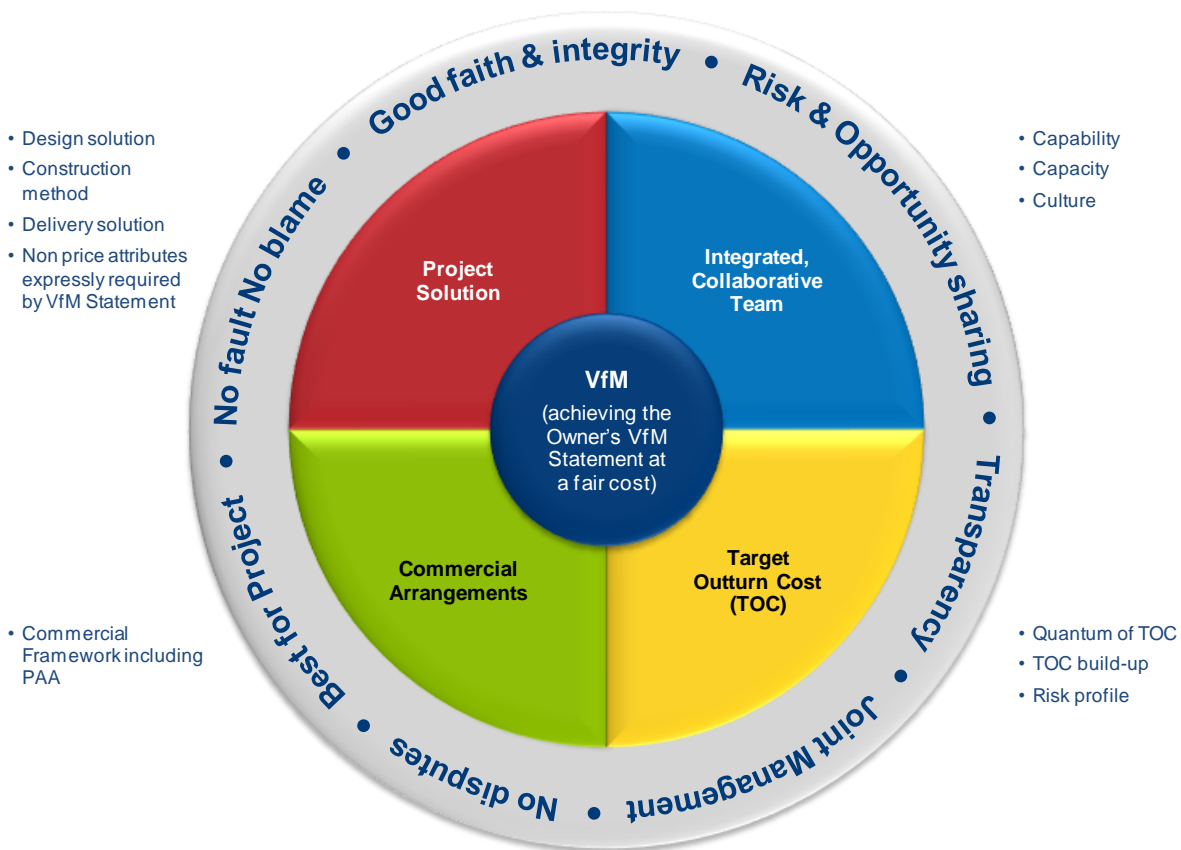


Figure 5.1: Alliance Success Dynamics

5.2 Tailoring the selection process

Alliancing is a complex commercial transaction and the Owner needs to give due consideration to these complexities, in the context of the prevailing market conditions, to ensure that the selection process is appropriate for the particular project.

As noted in Chapter 3, the projects most suited to alliance contracting will often have risks which cannot be defined or dimensioned and this means that for some alliance contracts some of the elements of the Project Proposal are unable to be fully developed prior to selecting the NOPs. This is consistent with projects best suited to alliancing that will often have unique or extraordinary challenges that should be approached on a case-by-case basis rather than on the assumption that 'one size fits all', particularly in relation to the selection process.

5.2.1 Differences between alliance and other selection processes

The selection process for alliance contracts is sometimes different to traditional selection approaches for 'risk transfer' contracts. For example:

Project Solution: In alliancing, there is significant value in the Owner working closely and collaboratively with the Proponents to develop elements of the design solution and construction method prior to a final tender offer submitted by the Proponent(s).

Team: The alliance culture should be characterised by a high level of teamwork and cooperation between the Owner and NOPs. Therefore, it is appropriate for cultural factors to be applied as a key selection consideration.

TOC: The TOC, effectively the 'contract price', is developed by the Proponents in collaboration with the Owner.

Commercial Framework: The Commercial Framework should be designed to incentivise the NOPs to achieve the Owner's project objectives in collaboration and on an equal footing with the Owner's Participants.

5.2.2 Similarities between alliance and other selection processes

However, these differences from traditional contracting do not exempt Owners from the requirement to comply with existing government procurement policies. As discussed in section 2.7 of the Guide, these policies drive the exemplary standards in procurement expected of public officials handling public funds, as well as VfM outcomes for government. In particular, compliance with government procurement policies is necessary to ensure transparency, contestability, and competitiveness. The Owner will need to take each of these overarching government policy objectives into account when designing the selection process for an alliance.

It is understood and accepted that for any publicly-listed company, the key corporate objective is to grow its business responsibly, ethically and sustainably through winning as much profitable work as possible. In order to do this, the Proponents will need to differentiate themselves from competitors so that the Owner selects them over and above others, to perform the work. This drive to

differentiate should result in the Proponents being motivated to propose innovative project solutions that are 'better' than their competitors' proposals (but which still ensures they achieve an attractive profit level for the project).

This link between competition and innovation is fundamental to ensuring that the Owner is able to optimise the project's VfM outcomes. Building effective competition⁵² into the selection process across the four components of the alliance project means there is more incentive and opportunity for Proponents to differentiate themselves and showcase their capabilities and capacities to deliver the project. In addition, the Proponents will be incentivised to provide innovative solutions that put them ahead of their competitors.

A selection process which optimises the opportunity for innovation and differentiation between the Proponents should result in better VfM outcomes for the Owner. It allows the Proponents to prepare and submit the best Project Proposal that they can. As part of a properly structured selection process, competition is an important mechanism by which both the Owner and the Proponents can align and achieve their respective project and corporate objectives.⁵³

5.3 The tender selection criteria

The Owner's selection of the NOPs is based on a number of tender selection criteria which cover both non-price and price elements of the project. The tender selection criteria should be developed to suit the objectives for each specific project.

The Guide deals only with certain specifics of alliancing in tender selection criteria. The design and implementation of tender selection criteria is complex with many mandatory requirements prescribed by legislation, jurisdictional policies, guidelines, good probity practices, etc. Moreover, an Owner will normally introduce its own mandatory and non-mandatory criterion.

The principles which should inform this process include:

- the criteria should address the Proponents' capability and capacity in the context of the Owner's VfM Statement;

- separate criteria should be set to address each of the four interdependent components of an alliance project (i.e. project solution, Team, TOC and Commercial Framework) and the key features of alliancing;

- the criteria should enable Proponents to demonstrate points of differentiation from other Proponents; and

- explicit guidance should be given to the Selection Panel on how to assess and compare cost and non-cost criteria.

⁵² Effective competition is not about getting the lowest price through squeezing reasonable NOP profit or margins but through better design solutions, construction methods, high-capability team members, etc. Simple squeezing of profit and/or margins is seen to be counterproductive to optimising actual outturn cost outcomes.

⁵³ *Competitive Edge – The Evidence*, The Serco Institute, 2007.

The tender selection criterion consists of broadly two main criterion groupings:

- non-price elements; and
- price elements.

Both are important to the Owner in order to successfully select the NOPs and deliver a successful alliance.

5.3.1 Non-price elements

There are a number of non-price elements of the project which are crucial to establishing a successful alliance. In particular, the dynamic of alliance contracting requires the NOPs and the Owner to form an integrated, collaborative and cohesive team. The alliance 'culture' created by the Participants underpins the joint decision-making process and the Participants' commitment to 'no fault – no blame', open book reporting and transparency.

The following is a list of non-price selection criteria which may be applied to select the NOPs. The list is not intended to be exhaustive, but rather illustrates the non-price elements that are usually incorporated in tender selection criteria for an alliance project:⁵⁴

PAA and Commercial Framework: Proponents should demonstrate that the Participants who constitute their team are willing to comply with a PAA consistent with the proposed alliance principles, behaviours and Commercial Framework arrangements documented in the RFP.

Team capability: Proponents should demonstrate that their proposed project team nominees have sufficient managerial, technical and leadership competencies to deliver projects of the nature, size, scale and complexity of the respective projects. Proponents should also demonstrate that these team competencies will be maintained for the duration of the project, from the Alliance Development Phase through to Practical Completion and handover.

Financial capacity: Proponents should demonstrate that the parties who constitute their team have the financial capacity to deliver the project.

Accreditation: As a minimum, Proponents should:

- provide copies of the certificates of all relevant ISO and other accreditations for all parties who constitute their team; and
- indicate whose management system will be used.

Project systems: Proponents should explain the proposed approach to introducing project systems into the alliance.

Corporate experience: Proponents should provide details of the relevant experience of the Participants who constitute the Proponent's team in the delivery of projects of similar size, complexity and risk profile as the Owner's project, including:

⁵⁴ This list has been adapted from the *Request for Proposal for Dam Infrastructure Projects Wyaralong* prepared by Queensland Water Infrastructure Pty Ltd, October 2008. Their permission to summarise and edit their document is gratefully acknowledged.

- design and optimisation;
- construction and commissioning; and
- maintenance during the Defects Liability Period.

Proponents should identify the link between this corporate experience and the project teams nominated

Governance: Proponents should consider and comment on the model proposed in the RFP.

5.3.2 Price elements

There are a number of price elements of the project which are crucial to delivering an alliance which satisfies the Owner's VfM objectives. As explained in section 2.7 of the Guide, the Owner evaluates price elements of the project as part of the tender process in order to comply with Government procurement policies (unless an exemption is obtained).

There are broadly three approaches for selecting the NOPs on the price elements of the tender selection criterion as described below:

- full price selection process;
- partial price selection process; and
- non-price selection process.

Aside from government policy considerations, the key difference between the three options is the level of completeness and detail provided by the Proponents in their Project Proposal, and the opportunity they have to differentiate themselves, before they are selected as the preferred Proponent.

1. Full price selection process

The NOPs are selected using both non-price and price criteria. In relation to price criteria, this process requires the Proponents to tender a full target outturn cost (TOC).

This approach is generally used when it is possible and effective to obtain a full TOC estimate from more than one Proponent. It also allows the Owner to assess the Proponents' performance against the non-price selection criteria in the context of the Proponents actually undertaking project activities (rather than participating in staged interviews, scenarios or roleplaying).

Generally, a full price competition selection process will be conducted over the same duration and with similar resource requirements as a partial or non-price competition selection process (refer to "In Pursuit of Additional Value", Victorian Department of Treasury and Finance, 2009). However, generally the cost of conducting a competitive process is immaterial when compared with the additional overall VfM that the government derives through this competition. It is also important to note that a competitive process fulfils public sector policy and required procurement.

Additional information is provided in Appendix C1 and Guidance Note 5.

2. Partial price selection process

There are various options for selection processes that include both non-price criteria, and some price and commercial criteria. However, these alternatives to the full price selection process do not result in the Proponents tendering a full TOC, and can therefore be referred to as 'partial price' selection processes. These options may include competitive selection criteria which require the Proponents to tender 'partial' pricing based on:

- design solution;
- construction method;
- delivery solution;
- prices for identified packages of works/services;
- the Commercial Framework, including Reimbursable Costs and Corporate Overhead, Profit margins, and any payments to the NOPs outside the TOC (e.g. gainshare entitlements, the Performance Pool (if any), and any other incentive payments); and
- non-price selection criteria (e.g. culture and teamwork).

One of the main objectives of the partial price selection process is to use competitive tension to drive innovation across the project components in an expedited timeframe. This will probably mean that it is neither possible nor effective to develop a full committed TOC. Rather, a budget TOC (hence the name 'partial price') is expected.

Caution needs to be exercised by the Owner before requiring Proponents to contractually commit to elements of the budget TOC. The reason is that the TOC consists of a large number of complex interdependent items and bidding a limited number of items may encourage 'underpricing' of those items by Proponents in the knowledge that it can be readily offset by 'overpricing' the balance of the TOC after the Proponent assumes preferred status and the full TOC is negotiated.

Evaluating the Proponents on the basis of some or all of these competitive selection criteria has the benefit of leading to a partial pricing of the alliance project. It also allows the Owner to assess the Proponents' performance against the non-price selection criteria in the context of the Proponents actually undertaking project activities (rather than participating in staged interviews, scenarios or role-playing).

It should be noted that applying competition to the Proponents' proposed Profit (i.e. NOPs' Fee) during the selection process does not constitute effective price or partial price competition. Rather, effective competition is applied to the maximum extent possible across all four interdependent components referred to

earlier: Project Solution, Team, TOC and Commercial Framework.⁵⁵ Additional information is provided in Appendix C2.

Real time' evaluation of Proponents

Importantly, selection on the basis of a Project Proposal which incorporates a full contract price or partial contract price will allow the Owner's selection team to observe in 'real time' the Proponents' project management skills and the affinity between the Participants' teams, which are key success factors in any alliance delivery strategy.

Competition focus on fees can be counterproductive

A selection process that is biased towards a competition on proposed NOPs' Fees and/or Indirect Overheads is not recommended.

The aim of the selection process is to select the Proponent with the highest potential to satisfy the Owner's VfM Statement at the lowest outturn cost. This will best be achieved by competition across all four interdependent components (Project Solution, Team, TOC and Commercial Framework).

The Proponent's Fee is only a small part of these components. In fact, a lower fee may arguably reduce the attractiveness of the project and discourage Proponents from applying their best resources.

A lower fee and corporate overhead may also have unforeseen adverse consequences, since NOPs may be incentivised to develop and implement a suboptimal Project Solution that reflects their lower indirect overhead rather than a lower TOC.

Simple squeezing of profit and/or margins is seen to be counterproductive to optimising actual outturn cost outcomes.

3. Non-price selection

Under this approach to selection, the NOPs are selected solely or predominantly on the basis of non-price criteria. This approach to selection of Proponents is normally carried out through written submissions or interviews, scenarios or role playing. Owners should exercise caution when considering whether to adopt this approach. Generally, it is rare that at least some elements of the project solution and pricing are unable to be developed in a competitive environment.

The non-price selection process has often been used historically when the Owner requires an immediate start to the project. As explained in Guidance Note 5, under best practice conditions this time saving may be negligible or non-existent. Essentially, the Non-price approach allows a sole preferred bidder to be appointed on the basis of a capability statement. Once a sole bidder has been identified, the Owner may be able to engage, by a side agreement for the performance of early works, that bidder to commence those works (rather than having to hold-off on the works until a competitive selection process has been completed). However, before undertaking such early works (in parallel with the

⁵⁵ Refer Diagram 5.1 'Alliance Success Dynamics'.

primary selection process), the Owner should ensure it is not effectively 'captured' by that bidder.⁵⁶ In these cases, the non-price selection process should be approached with caution. If an immediate start is crucial for the project, another alternative is for the Owner to engage a third party to undertake early works that are not dependent on the final project design. Additional information is provided in Appendix C3.

Early works is not best practice and should be avoided

Under any selection process, engaging Proponents to perform early works is not best practice and should be avoided;

- Early works can lead to the capture of the Owner, as it would be difficult to engage a different Proponent to complete the project.
- The performance of any early works (e.g. side agreements for early works) should be consistent with public sector standards for procurement and arms length negotiations.
- If early works must be performed, the relevant work package should be 'quarantined'. For example, to the extent possible, Owners should avoid allowing Proponents to fully mobilise on site (e.g. site sheds that cannot be transferred to another contractor.)

Probity caution

Owners need to be acutely aware of any conflicts of interest that may arise throughout the selection process. The use of suitably qualified and experienced probity advisers can assist in addressing these and other issues. One potential probity issue is that firms providing advisory services to Proponents on alliancing issues may also be employed by an Owner on a project involving the same Proponents.




Such potential conflicts of interest need to be identified and managed appropriately.

5.4 Comparison of selection options

There are significant differences between the three common selection processes as shown in Table 5.1.

⁵⁶ *Guidelines for Managing Risks in Direct Negotiation*, NSW Independent Commission Against Corruption (ICAC), 2006.

Table 5.1: Comparison of selection approaches

	Full Price	Partial Price	Non-price
Objective	Select NOP offering best Project Proposal		
Competitive Elements	 <p>Full Proposal. Developed project solution. Developed construction method. Fully-developed Commercial Framework. Observe and evaluate the combined Project Team 'in action' (Owner and Proponent/s). Price (full TOC).</p>	 <p>Partial Proposal. Concept project solution. Preliminary construction method. Commercial Framework principles Observe and evaluate Proponent Team 'in action'. Budget/indicative TOC including some pricing of components.</p>	 <p>Limited Proposal. – – – Team workshop. –</p>
Material/significant issues post selection	Negligible.	Negotiate TOC (on basis of Partial Proposal).	Negotiate TOC. Develop design solution. Develop construction method. Develop Commercial Framework. Experience Project Team 'in action'.
TOC	Tendered.	Competitively negotiated (on basis of partial Project Proposal).	Negotiated without the basis of a competitive Project Proposal.

5.4.1 Comparison of sequencing in the various selection options

Figure 5.2 compares the three selection processes with a more traditional D&C selection process. The diagram shows the progression to select the Preferred Proponent in each selection process, which is broadly similar except for the Non-price process where the Preferred Proponent is selected without a competitive Alliance Development Phase.

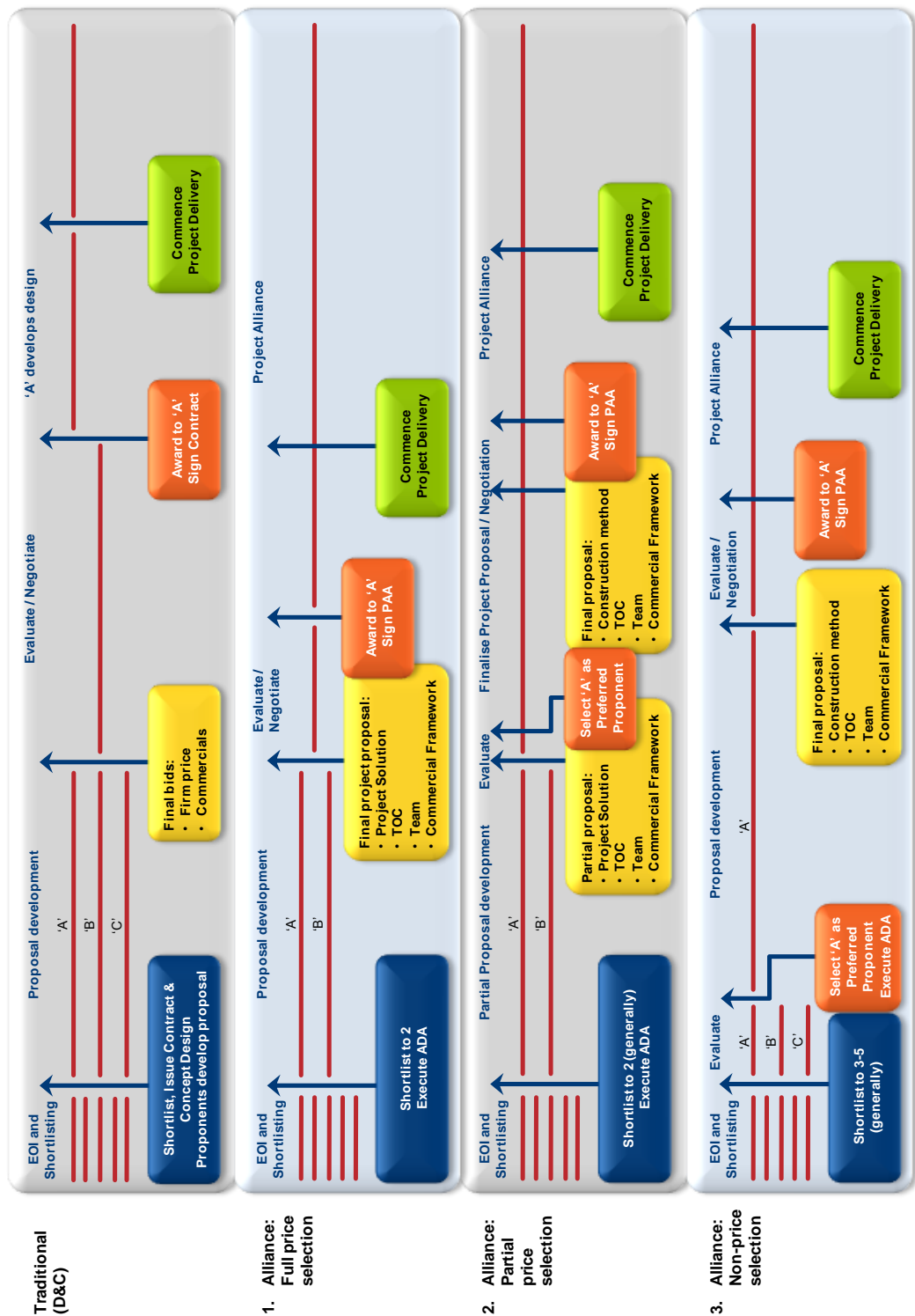


Figure 5.2: Comparison of procurement activities and milestones in selection processes⁵⁷

⁵⁷ This diagram illustrates the relative timing from EOI and short listing through to project delivery. The exclusive nature of the non-price selection process means that a compromised or expedited approach can be taken to the preparation of tender documents prior to calling EOIs. Note that durations and times are indicative only and will vary depending on project circumstances, approvals and complexity.

5.4.2 Comparison of timing of key milestones in the various selection options

Figure 5.3 compares the key milestones of:

- alliance Development Phase commences;
- final TOC agreed;
- preferred Proponent selected;
- PAA signed; and
- project delivery commences.

Recognising that the times are indicative and will vary between projects, it is noteworthy that all processes lead to similar commencement dates for project delivery since this is contingent upon agreeing the Final TOC and executing the PAA.

More details on each of these three selection processes, as well as relevant extracts from example RFPs, are set out in Appendix C.

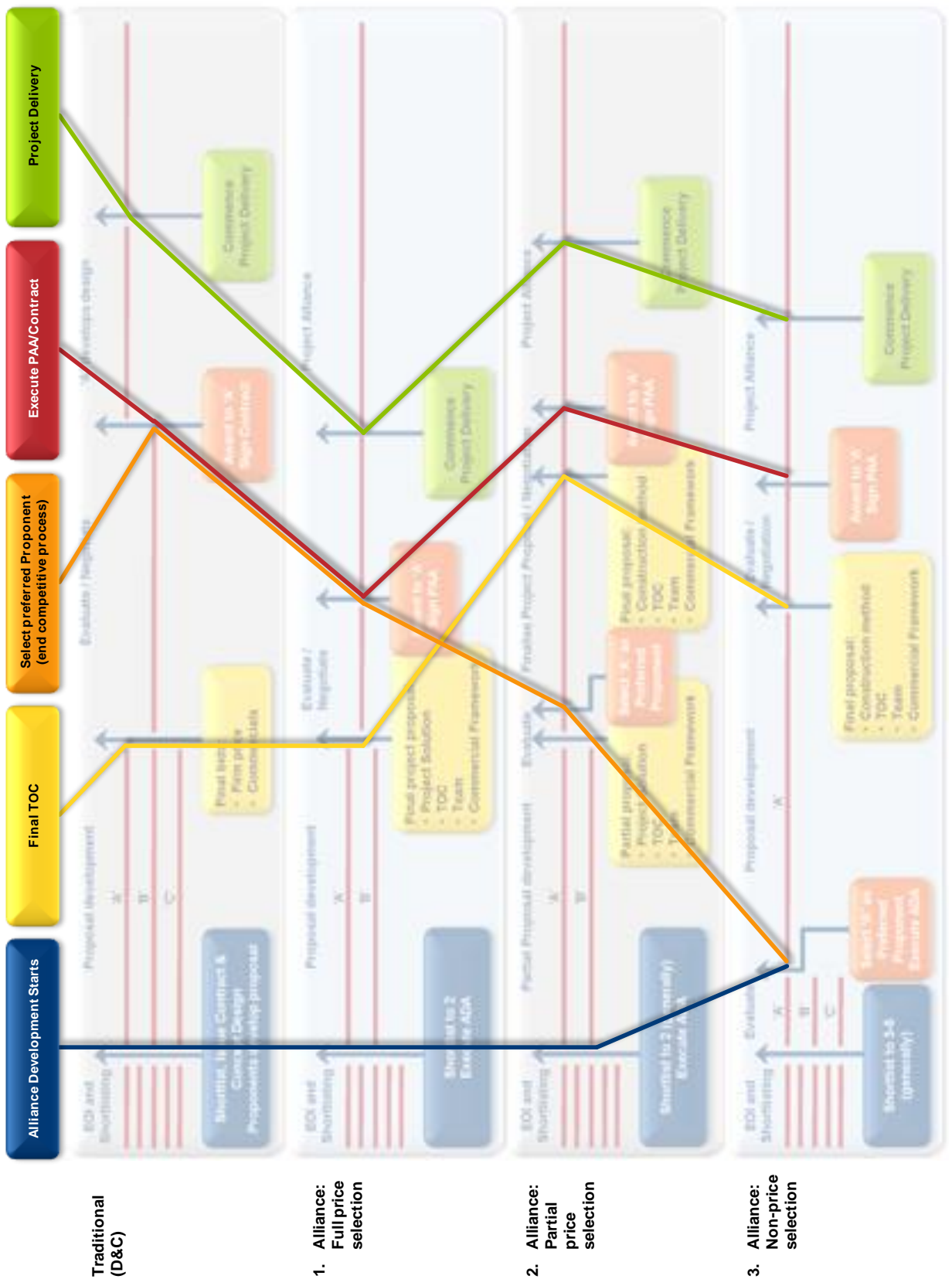


Figure 5.3: Comparison of milestones in NOP selection processes

Alliancing provides an opportunity for Proponents to play to their unique strengths and optimise value to the state

Selecting the NOPs through a competitive process provides the Proponents opportunity to differentiate themselves from competitors by proposing innovative and unique approaches to the project.

Allowing the NOPs to compete on all four elements (commercial arrangements; project solution; team; TOC) rather than just a single element (e.g. team) allows the NOPs the maximum opportunity to 'play to their strengths' and provide a more holistic response because they are not constrained to one component.

This is good for both the Proponents, allowing them to compete on a full display of their merits; and for the Owner who can take greater confidence in having selected a team that is demonstrably best placed to deliver its project objectives.

5.5 Other considerations

The following considerations for the Owner are common to each of the different options for selecting the NOPs. These should be considered and applied by the Owner as warranted by the context of the specific characteristics of each alliance project.

5.5.1 When to use the various NOP selection processes

The Guide explains that an alliance should only be considered as a suitable project delivery method when the Owner has the right capabilities and when one or more of the following characteristics exist:

- The project has risks that cannot be adequately defined or dimensioned in the Business Case nor during subsequent work prior to tendering.
- The cost of transferring risks is prohibitive.
- The project needs to start as early as possible before the risks can be fully identified and/or project scope can be finalised, and the Owner is prepared to take the commercial risk of a sub-optimal solution.
- The Owner has superior knowledge, skills, preference and capacity to influence or participate in the development and delivery of the project (including for example, in the development of the design solution and construction method); and/or
- A collective approach to assessing and managing risk will produce a better outcome, e.g., where the preservation of safety to the public/project is best served through the collaborative process of an alliance.

Once the decision is made to use an alliance, the next step is to decide how to select the NOPs: full price, partial price or non-price. The default position, (as detailed in the Guide) is full price competition. Partial price or non-price processes represent a departure from Policy and the Owner must seek an exemption⁵⁸ as part of the Business Case.

⁵⁸ The process for applying for an exemption is specific to each jurisdiction.

Characteristics 1 and 2 from the above list could justify the use of partial or non-price competition if undefined or undimensionable risks would have a significant impact on cost estimates. Depending on the extent, or potential severity, of this undimensionable risk, the optimum selection process may be full, partial or non-price. Included in such a characteristic is that the scope of the design and works, for whatever reason, cannot be adequately dimensioned upfront and is best done post TOC development (during the construction phase).

The other characteristics (3, 4 and 5) would generally not be considered in themselves as justification for departure from full price competition. It is possible in uncommon circumstances, that the potential price premium for departing from the policy and full price competition can be justified in the request for exemption contained in the Business Case.

To seek exemption on the basis of possible time savings would normally be an insufficient justification, since under best practice conditions there is considered to be no material difference in the timeframes for the three available selection processes (full, partial, non-price). However, it is acknowledged that there are occasions, albeit rare, where community needs require a start to construction (not just 'early works') as soon as possible (this situation should be distinguished from completing the project as soon as possible). Truncated planning and procurement processes may be required to meet the need to 'start as early as possible'. To effect a time saving, it may also require that the PAA is executed much earlier than set out in this Guide. The Owner needs to fully dimension the risks and cost premiums associated with such special strategies.

Normally, it is the expertise of private sector Proponents that an Owner seeks to utilise in partnership when selecting NOPs. However, there may be cases where the Owner has exclusive abilities or superior skills (e.g., managing design risk) and is looking for a special alliance partner to develop unique project deliverables. Here the Owner should request exemption from the policy for the use of non-price competition on the basis that it is not possible to have effective competition because of a limited range of competitors.

The following diagram provides further guidance in the use of full, partial and non-price processes where the project risks are undimensionable.

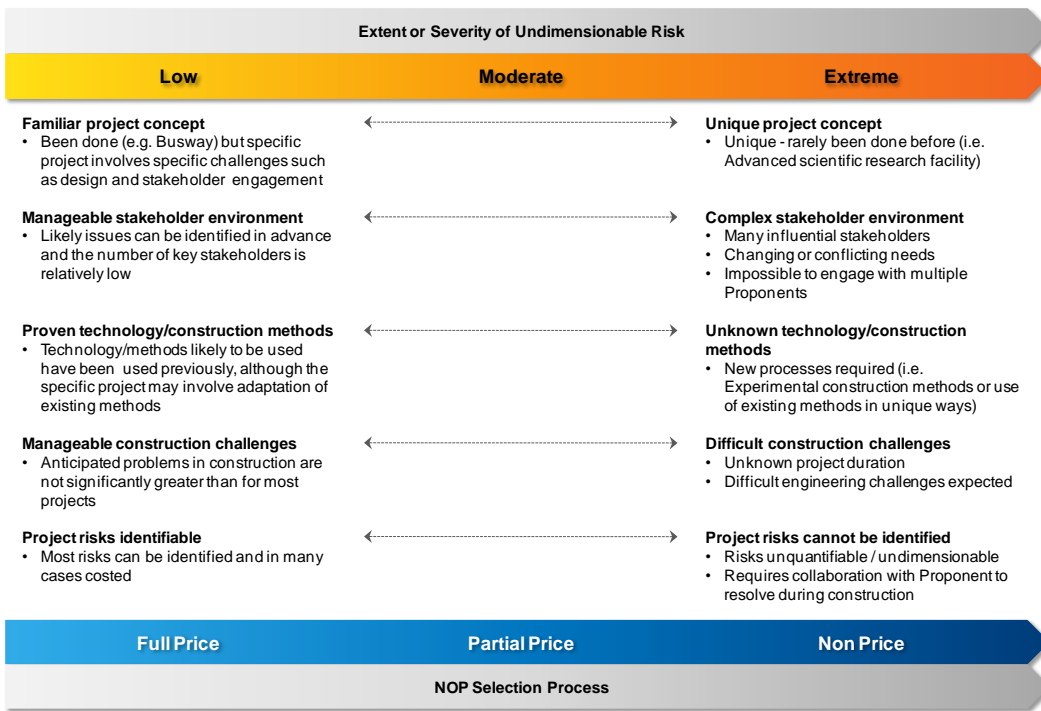


Figure 5.4: NOP selection process and the ability to dimension the project solution

This diagram illustrates that as the extent of or severity of undimensionable risk increases, so will the suitability of other than full price competition NOP selection processes. When exemption from using full price competition is sought, Owners should demonstrate that the presence of undimensionable risks preclude the effective use of the full price selection process and the Owner should work through the partial process before, as a last resort, approval to use the non-price process is sought.

5.5.2 Determine how the Proponents will be reimbursed for the Alliance Development Phase

The scope of service and breadth of risk to be considered by the Proponents in developing their project solution and TOC can be significantly greater than traditional contracts. This means that the Proponents are likely to incur higher internal and external costs. Also, alliance contracts require a much greater input from Proponents’ senior management due to the need for more active participation in the selection process.

Where jurisdictional policies allow, it is recommended that a substantial proportion of each Proponent’s project development costs (for both Full Price Selection and Non-price Selection) be reimbursed to the Proponents because:

the tendering costs incurred and senior management effort required by Proponents are significantly beyond the costs and effort required for traditional contracts;

the unsuccessful Proponents will likely have developed innovative solutions that can reasonably be claimed by the Owner as intellectual property (IP); and

contestability policy objectives of government will be enhanced by reducing barriers to entry to the alliance market.

On balance, a 'starting point' suggestion is that a fair 'proportion' of tendering costs to be reimbursed is 50% of the Proponents' likely costs during alliance development. These costs could be estimated by the Owner (with assistance from its Commercial Adviser) and noted in the EOI/RFP documents as a lump sum payment. However, any reimbursement should be conditional on the Proponents satisfactorily submitting a Project Proposal, and on the transfer of all IP rights to the Owner relating to the project design and delivery solution that was created during the alliance development phase.

It should be noted that in the non-price selection process, the preferred Proponents have been historically fully reimbursed for their costs.

Ownership of intellectual property

It is likely that an unsuccessful Proponent may develop innovative ideas during the Alliance Development Phase that may be valuable to the Owner.

The Owner should secure Intellectual Property rights in ideas developed during the alliance development phase, and provide access to these to the preferred Proponent prior to executing the PAA. This will allow more considered assessment by the preferred Proponent (and Owner) of any commercial advantages the ideas may offer and will also ensure the Owner receives 100% of any benefit (i.e. not 50% under the gainshare regime post execution of the PAA).

5.5.3 Owner's Comparative TOC

The Owner's Comparative TOC ('OCT') is the Owner's best estimate of the Actual Outturn Cost (AOC) of the project. The Owner may consider whether it is worthwhile for its project to prepare and progressively update its own TOC to compare to the TOC developed by the NOPs. The OCT would progressively develop from approved Business Case to final agreement of the TOC and execution of the PAA. The OCT has the potential to deliver VfM for government and introduce more robust costing of an alliance project. The mechanism may deliver some of the benefits of Public Sector Comparator under PPPs, such as requiring the Owner to robustly challenge and quantify risks and other requirements.

The purpose of the OCT is several fold:

- it prepares the Owner to evaluate the Proponents' competitive TOCs effectively and expeditiously, and negotiate the TOC as an informed Owner;
- it is a mechanism that ensures the Owner develops a detailed understanding of the commercial aspects of the alliance project; and
- it becomes part of the prudent project controls that the Owner uses to monitor outturn costs throughout the project (including during the alliance development phase).

The OCT will be informed by the Owner's emerging knowledge of the project as the procurement process progresses and details are provided by the Proponents.

In particular, the OCT will be adjusted to reflect the Proponents' design solution and construction methodology together with their risk assessment and TOC estimate.

Owners can find guidance regarding the preparation of the OCT (including level of accuracy, pricing methodology and risk assessment) in Guidance Note N^o 5.⁵⁹ In simple terms, the Owner would prepare the OCT to a level commensurate with the TOC being prepared by the Proponents.

Given that the OCT is likely to be informed by the competitive Project Proposals submitted by the Proponents, it is not appropriate that it be disclosed to the Proponents at any stage.

5.5.4 Progressive selection processes

Generally, the Guide has been written to reflect the Owner selecting its alliance partners (NOPs) in a single stage.

However, there may be times when the Owner determines that this is not the optimum selection strategy and that a better VfM outcome may be achieved from selecting its alliance partners progressively.

For example, the Owner may determine that it is beneficial to firstly select a designer to progress design options, before selecting a contractor to join the alliance. The Owner may believe that a progressive process for selecting designers and contractors will enable it to select the 'best-in-class' designer and contractor. This may not be possible in a single stage selection when the Proponents' teams are already formed as a consortium.

Similarly, the Owner may wish to select a key supplier as an alliance partner before selecting the designer and/or contractor.

It is expected that, to the maximum extent possible, the Owner will also apply the principles and intent of the selection process outlined in Chapter 5 to progressive selection processes.

⁵⁹ Refer to *Guidance Note N^o 5, Developing the TOC in alliance contracting*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

6 The Project Delivery Phase

This chapter deals with how alliances operate in the project delivery phase, which occurs after the PAA is executed, the TOC has been agreed and the Participants commence delivering the project.

The Owner is interested in achieving VfM throughout the project life cycle and therefore, the need to exercise commercial rigour and diligence continues after the PAA is executed and the TOC has been agreed.

As discussed in earlier chapters of this Guide, alliancing is a complex commercial relationship between the Owner and the NOPS. The PAA defines the legal obligations of the Participants to deliver the Owner's VfM Statement. Moreover, the NOP selection process and the interplay of the key alliance features should set the establishment of an integrated, collaborative and highly capable team which will be positioned to achieve the Owner's VfM Statement successfully. Nevertheless, the other interplay between the Owner's project objectives, the NOPS' commercial objectives, and the Participants' obligation to make collective decisions that are best-for-project, should be acknowledged. Issues for the Owner's attention in the project delivery phase of the alliance project include:

- ensuring ongoing alignment between the commercial objectives of the NOPS and the Owner's project objectives (to deliver the Owner's VfM Statement at a fair cost);

- under an alliance the Owner has the greater financial exposure to risk, however, risk management is shared equally between the Participants; and

- given that the approach to remuneration under the Commercial Framework is reimbursement of NOPS' costs, there needs to be assurance that monies are being expended in a way that serves the public interest and meets public sector prudential standards.

The delivery phase of an alliance will be different for each project. The guidance in this chapter addresses the following key areas during delivery of the alliance project:

- effective governance—internal and external to the alliance;

effective Owner representation and resources inside and outside the alliance, including key management and leadership roles on the ALT and AMT and the Owner's access to independent advice on the alliance's activities;

ensuring the fundamentals of good project management and project controls are established and maintained;

ensuring expenditure of public funds is prudent and appropriate, and that all cost ledgers, cost claims and cost reports are reviewed on a monthly basis and audited regularly;

creating greater certainty in the AOC by minimising the need for TOC adjustments;

ensuring rigorous review of and justification for any proposed or potential scope changes;

managing the alliance culture to ensure it is healthy and productive (i.e. it is a means to an end, not an end in itself);

ensuring 'no blame – no disputes' operates to optimise project delivery (and does not lead to 'no accountability and no disagreements' between the Owner and the NOPs); and

providing monthly progress reports to the Owner.

6.1 Effective governance—external and internal to the alliance

Governance can be described as a process for directing and managing projects, a system for holding projects accountable and controlling them, and a framework for the effective assignment of specific and overall accountability for delivering the project. It is a set of policies, principles, rules, and supporting practices put in place to run a project.

The importance of good project governance as a critical success factor in delivering major infrastructure projects is widely acknowledged. Similarly, a lack of sound project governance is well recognised as a major contributor to project failure.

It is therefore essential that formal governance arrangements be established for all major projects, including alliances.

However, the legal structure of an alliance, involving multiple parties with collective responsibilities, presents additional complexities which require governance to be implemented at two levels:

'Outside' the alliance

This refers to the governance requirements that Owners consider for any major project regardless of the delivery method and includes the governance interface between the Owner and the government.

‘Inside’ the alliance

This refers to the concept of an alliance as a ‘virtual organisation’ and its internal governance requirements.

Good governance also requires that all individuals involved will have in-depth knowledge in relation to the fundamentals of alliancing and the details of project objectives, deliverables and commercial/legal arrangements.

6.1.1 Governance external to the alliance

Each jurisdiction provides guidance on governance for major infrastructure projects. The following general principles of project governance have been adapted from the *Victorian Investment Lifecycle Guidelines* to suit alliancing.

Project reporting requirements should be established for progress reports on previously agreed key success factors, including relevant deadlines. Key Government stakeholders should be kept informed of progress, starting with the development of a Business Case.

Government investments need strong, direct, unambiguous lines of accountability and management. Where multiple agencies are involved, the responsibilities of the Participants should be clearly identified and understood. Issues should be identified (including emerging risks and opportunities) and management of them assigned according to each agency’s contribution and level of responsibility. Cross-agency development or operational arrangements should be structured to avoid gaps in accountability, and have clear, unambiguous responsibilities for outcomes, without unnecessary duplication.

Some general principles guide the establishment of the alliance governance structure:

Engagement of an external party to manage a project does not divest the agency of accountability for the project outcomes.

‘Contractual’ agreements for project management and decision making within the joint management structure of the alliance need to be respected by governance outside the alliance, and clear separation of responsibilities and accountabilities, including identifying those decisions which are reserved for unilateral determination by the Owner.

The Owner needs to focus on the risks it bears throughout the project and the core services it needs to deliver in the long term.

Elements of a governance plan outside of the alliance are provided in Appendix B.

6.1.2 Governance internal to the alliance

The legal structure of an alliance, which involves multiple parties with collective responsibilities and a collaborative decision-making process, presents a number of complexities for governance within the alliance.

The starting point in an alliance is joint, self-management of those matters pertaining to delivery of the Owner's VfM Statement within the bounds of responsibility set out by the PAA.

Governance within the alliance should ideally be addressed by incorporating a formal and detailed governance plan in the PAA. However, it is recognised that some non-material matters may need to be decided following execution of the PAA (e.g. meeting location and format of ALT minutes).

The internal governance structure (and associated plan) should be developed and tailored to fit the complex requirements of the specific alliance project—one size does not fit all. It is also recognised that a convoluted and overly complex governance plan may fail to achieve the Owner's governance objectives.

An example of an Alliance Governance Plan is included in Appendix A. This has been adapted from the Water Corporation of Western Australia.

6.2 Good project management and project controls

A successful project will always involve good project management including planning, programming and controls over time, cost and quality.

The core experience of project management and project controls are also the important foundations of a successful alliance. Alliance coaching, facilitation or team development will never compensate for inadequate or insufficient project delivery experience or project management skills in the alliance team. Ensuring that the alliance team has adequate project delivery skills and experience is fundamental to achieving the Owner's VfM outcomes. These skills are required in both the Owner's Representative and in key alliance personnel.

6.3 Expenditure of public funds

In a typical alliance, the Participants are effectively jointly responsible for managing the expenditure of public funds. This is fundamentally different to the way contractors are paid under traditional contracts. An alliance needs to ensure that public funds are expended prudently, properly and wisely, including addressing public accountability issues that may arise for Owners in connection with related party transactions, where related NOP companies may act as suppliers to the alliance.

The role of the Owner's financial auditor is typically limited to verifying that the Participants' costs have been actually and reasonably incurred. The alliance financial auditor checks that expenditure has been actually incurred in accordance with pre-determined processes and authority levels. The Owner should consider supplementing the financial auditor role to verify that expenditure by the alliance has been incurred in accordance with the Owner's VfM statement and government procurement standards; and in the most efficient, effective and economical way.

6.4 Adjustment Events

Adjustments to the TOC will apply in the limited situations agreed by the Participants under the PAA (which should incorporate the Adjustment Event Guidelines finalised during the selection process).⁶⁰ These identified acts, events and circumstances which may result in the TOC being altered are known as Adjustment Events.

The Owner will need to adjust the TOC where the Owner has directed a change to the project works which amounts to a significant change, amendment or alteration to either the scope of works, or the fundamental requirements of the works. This type of Adjustment Event is referred to as a 'Scope Variation'. Scope Variation Benchmarking Guidelines, which provide indicative examples of when a direction by the Owner will constitute a Scope Variation, should be developed and agreed by the Participants during the selection phase and incorporated in the PAA.

It is expected that if any Scope Variations occur during the delivery phase, this will generally involve a change to the Owner's VfM Statement and will therefore require Owner approval.

Cases of genuine innovation by the alliance, which could not have been foreseen during TOC development, should not constitute an Adjustment Event—that is, the NOPs should be entitled to the benefit of any cost savings to the alliance that arise in connection with genuine innovations. Reviews should take place of any innovations which have arisen during the project delivery phase to determine whether they have made a 'genuine' contribution to cost savings. The NOPs' entitlement to any gainshare payment should follow demonstration to the Owner of how the relevant cost savings against the TOC have been achieved. If the Owner determines that innovation is not demonstrated, the NOPs' gainshare entitlement should be reduced to the extent that the relevant cost saving innovation/approach should have been identified during the TOC development. General changes to the scope of work or the technical brief for the project (e.g. reduction in the quality of materials) should not constitute an Adjustment Event.

Cost underruns and overruns may occur for any of the following reasons:

- human error in the TOC;
- innovation post TOC;
- risks that didn't materialise (e.g. escalation was less than expected);
- systemic market change, i.e. changes in the market that are not project specific (e.g. movement in prices for key items); or
- if none of the above apply, a TOC that lacked rigor.

The requirement for the NOPs to demonstrate how cost underruns have occurred satisfies fundamental requirements for public sector scrutiny of

⁶⁰ Refer to clause 12 of the Model Project Alliance Agreement in Template No 1: The Model Project Alliance Agreement.

expenditure/public accountability requirements. Further guidance on this topic is provided in Schedule 4 of the Model PAA.

The selection process should be structured to incentivise the NOPs to bring forward potential innovations or opportunities prior to finalising the TOC.

Consideration needs to be given to ensure that the omission of scope (from the PAA documentation which establishes the scope of works for the alliance) or pricing omissions from the TOC does not lead to a Scope Variation during the delivery phase. The Owner needs to ensure that the PAA clearly reflects the agreed scope of work, scope of services, any risks retained by the Owner, and the Owner's reserved powers.

If an Adjustment Event occurs, the ALT will recommend to the Owner a reasonable adjustment to the TOC (and, where relevant, the KRAs or the Date for Practical Completion). The Owner should undertake a valuation of the increase or decrease in costs independently from the alliance, taking into account the relevant TOC estimate and risk provisions within the TOC and the Owner's VfM Statement before deciding on the ALT's recommendation.

6.5 Rewarding outstanding outcomes

Owners will often select alliancing to deliver a major infrastructure project on the basis of the potential to achieve outstanding outcomes and gamebreaking performance (which is usually described in various alliancing literature as 'not been done before', 'quantum not incremental improvement', etc).

However, outstanding outcomes and gamebreaking performance (as described in alliance literature) are not always required to achieve the requirements set out in the Owner's VfM Statement. In fact, pursuing performance standards and outcomes that are inconsistent or not aligned with the VfM proposition in the Business Case may even erode VfM.

Including cost of achieving outstanding outcomes in the TOC

Alliance development activities should only be undertaken to the extent that they directly support achieving the Owner's VfM Statement. Alliance culture and relationships should not be considered as the objectives or outcomes to be achieved by the alliance in their own right. In other words, they are a means to the end, not the end in itself.

The Alliance may decide to engage service providers to assist the Alliance to achieve Owner's requirements for outstanding outcomes (e.g. team building) to realise the resulting gainshare. The costs of these services should not be included in the TOC.

6.6 No blame, no dispute

The no blame and no dispute clauses in many PAAs can be misunderstood and are often not applied in the intended manner. For example:

No blame does not mean no accountability. In alliancing, all Participants should be held accountable for what the team expects and requires of them, and poor performance should be dealt with accordingly by the ALT.

No blame does not mean ‘no differences in opinion’. The pursuit of a ‘no blame’ alliance culture should not materialise as an emphasis on friendly relationships where challenge and debate are suppressed. Friendliness is not a substitute for effectiveness. Indeed, absence of any major disagreements can sometimes signal that the alliance is not on track to achieve VfM. Effective alliance teams are often characterised by a high level of constructive debate, and a preparedness to challenge and be challenged. Debate should not be considered a sign of weakness or failure of the alliance. Generating and resolving these differences positively and expeditiously are a sign of a healthy alliance.

6.7 Progressive Status Reports

Alliancing is not a ‘set and forget’ project delivery approach for Owners and NOPS. To provide confidence that the project is being delivered efficiently and effectively by the alliance, periodic and independent audits of the progress and performance of the works should be undertaken.⁶¹ Monthly reports by the Alliance Manager should favour ‘information not data’ as voluminous reports can inadvertently mask rather than illuminate issues.

The Alliance Manager should reforecast in detail the ‘costs to completion’ of the project on at least a quarterly basis and present the revised estimate of actual outturn costs together with planned remedial measures if appropriate.

6.8 Project close-out

Prior to accepting the works (i.e., prior to the Owner certifying that Practical Completion has occurred), the Owner can seek information that reconciles scope, service level and actual outturn cost between the TOC and the Owner’s VfM Statement. Any variations should be explained with reference to innovation, risk profile, performance levels or changes. In this way the alliance can concentrate on demonstrating that the objectives of the VfM Statement have been delivered and remedying any remaining gaps or issues.

This information has the additional advantage of ensuring clarity and alignment for all Participants on their respective objectives at the time of Practical Completion when the project will likely move into an operation phase. This work by the alliance at this time will also feed into the Owner’s VfM Report to be produced post-completion for the government and validated independently by parties separate from the alliance. Such a validation of the VfM Report will

⁶¹ Refer to *Guidance Note N^o 4, Reporting VfM Outcomes*, Department of Infrastructure and Regional Development, Commonwealth of Australia, March 2011.

usually be undertaken by specialist commercial adviser that has been engaged by the Owner.

The PAA will continue through the defects liability period up until Final Completion. Prior to the Final Completion Certificate being issued, the Financial Auditor should undertake a final audit of all Reimbursable Costs. This should include a reconciliation of actual and estimated allowances (for such matters as staff bonuses and annual leave), non-cost performance and salvage value of capital assets to produce a statement of the final Risk or Reward Amount against the Final (adjusted) TOC.

At project close-out the AOC can be finalised. The AOC for the project is the actual total cost for the delivery of the alliance works by the alliance inclusive of NOPs fees and reimbursable costs to the NOPS and the Owner. Refer to Guidance Note N° 4 for further discussion.

Alliancing can provide a powerful problem solving environment

If an alliance is established well with appropriate commercial arrangements and supporting culture, it is a powerful environment for problem solving. As issues and risks emerge through the project life, the alliance members focus on collectively resolving issues rather than attributing blame.

⁶² Note that this independent validation refers to informed scrutiny that is independent of the alliance; and should not be read as a reference that the Owner needs to necessarily engage external advisors to carry out this validation.

7 Learnings

Alliances are complex transactions and much has been learnt by Owners, NOPs and advisers about how to optimise VfM. This Chapter provides typical comments from these alliance Participants which may be useful for consideration in developing and implementing future alliance contracts. Some of these learnings are incorporated in this Guide. Readers of this Guide are encouraged to submit their own insights, learnings and issues for potential inclusion in updates that will be made from time-to-time.

These learnings are grouped according to a generic project life cycle below recognising that many of the insights will span several stages.



Many of the learnings and insights below are provided as a summary of comments or quotations which reflect the actual words used. These are not attributed to individuals to maintain confidentiality. These learnings and insights were collected over a period of 18 months as part of a consultation process about alliancing across Australia.

A great deal of literature continues to be produced that is focussed on the positive, comfortable messaging of alliancing. This chapter attempts to open the discussion on learning, encouraging both comfortable and uncomfortable learnings.

7.1 Business Case—Insights

The Business Case provides the Owner with the basis for establishing the Owner’s VfM Statement for use by the alliance. The level of rigour in the Business Case has a direct impact on the potential for VfM to be optimised by the alliance.

A good Business Case is a threshold to achieving good public value. The better the Business Case, the greater the value dividend, and without it, value

will be lost. It sets parameters for measuring success and will help avoid drift and capture.

[a state audit office]

7.2 Procurement Strategy—Insights

It is generally expected that the suitability of the alliance delivery method is assessed (along with alternative methods) during the preparation of the Business Case and also that its proposed use is expressly recommended in the Business Case.

After approval of the Business Case, it is expected that the procurement strategy will be detailed and tailored to the particular project. This will encompass a range of matters, some of which have been discussed in Chapters 3, 4 and 5. Various insights include:

‘If a project is going to be an alliance, be clear that alliancing behaviours do have a starting point, there are negotiations before we get to the collaborative behaviours. The alliance does not start as soon as you announce it.’

[a construction contractor]

‘Know why you are doing an alliance—this is critical in understanding what you are seeking from the alliance that you can’t get elsewhere and hence how to structure the alliance; and it also means you know why you are not doing a D&C, PPP, Managing Contractor, etc.’

[an Owner’s Representative/Participant]

Alliancing should be seen as the exception not the norm to the project delivery profile of an organisation. Do not select Alliancing as the default mechanism.

[from various sources]

‘The management effort by all the ALT parties in an alliance is much greater than in a D&C—by a factor of 2.’

[an Owner’s Representative/Participant]

‘If the client can’t muster the right people then they should discount using an alliance.’

[an Owner’s Representative/Participant]

7.3 Selecting the NOPs—Insights

Once the decision has been made to use an alliance as the delivery method, the Owner will choose a strategy to select the NOPs. This strategy is discussed in Chapter 5.

While the overriding objective is to select the Proponent who demonstrates the best potential to deliver the Owner’s VfM Statement (i.e. capital asset at a fair cost) there are a myriad of issues to be considered:

'Hard core project management skills and technical excellence in an individual is not always found in social stars. Those skills are core critical and must not be overlooked.'

[an Owner's Representative/Participant]

'Choosing the right partner requires the Owner to have an in-depth knowledge of what its organisation wants and have a capable team during the selection process to assess the Proponent's capabilities, to see through spin and coaching.'

[an Owner's Representative/Participant]

Competition and contestability will add value as it produces innovation, ideas, better quality. The selection criteria requirements will ensure that the market grows against those criteria.

[a state Treasury official]

Be prepared to call the alliance tender a failure and re-evaluate procurement method if value for money outcomes can't be met by bidders or the project cost is too high. i.e. there needs to be an explicit confirmation—a 'no/go' step.

[an Owner's Representative/Participant]

The quality of relationships—need to keep in mind the distinction:

Family (friends) relationships—good relationships are in themselves the reward.

Business relationships—good relationships are a means to good business outcomes (shareholders and taxpayers do not pay us just to have good relationships with people).

[a state Treasury official]

'The commercial bargaining power of the Owner in a one-step PAA (i.e. TOC negotiated after executing the PAA) is very weak—he must walk away from a formal contract if he doesn't agree to the TOC. This takes a lot of strength, political courage and conviction and in my experience is a rare event.'

[an Owner's legal adviser]

7.4 Agreeing the commercial arrangements—Insights

In simple terms, the commercial arrangements define the price the Owner is to pay for the project's benefits to be delivered by the alliance. The Owner should develop and agree commercial arrangements (including the PAA, TOC and Commercial Framework) before selection of the preferred tenderer. Relevant insights include:

Owners must negotiate the TOC as an entire number and Owners should not yield to the temptation to leave parts of the TOC 'to be agreed later' or to carve out items that cannot be agreed with the NOPs.

[an Owner's Representative/Participant]

The development of the TOC is a robust commercial negotiation, not a collaborative workshop.

[a construction contractor]

'We need capability to read the open book and to recognise when commercial negotiations are taking place; "visibility" (e.g. open book) is of little worth if the Owner does not "see" what is in front of them. Similarly we need the capability to understand and challenge assumptions and contingency.'

[a state Treasury official]

People and resources participating in a development of the TOC need to be highly skilled in order to challenge assumptions and validate the TOC—critical players need to be in the room to challenge the composition of the TOC and all innovations/savings need to be accounted upfront before the TOC is finalised.

[an alliance facilitator]

7.5 Project delivery—Insights

The expectation of the project delivery stage is to achieve the VfM objectives defined in the Business Case. This requires achieving the project's objectives in terms of cost, time, quality and non-price objectives for a fair cost.

Relevant insights include:

Is it really Outstanding or just BAU by another name? The BAU expectation is actually changing year-on-year through continuous improvement in practices and performance metrics. 'Outstanding' means a quantum change that informed opinion would judge to be clearly a significant departure from current industry best practice and best practice trends.

[an Owner's adviser]

A focus on 'just price' is equally unacceptable as is a focus on 'just non-price'. A feel good DVD of happy alliance Participants, workforce and general public is only part of the story—the whole story needs a comprehensive robust financial analysis.

[a state Treasury Official]

'The NOPs should be asked to demonstrate where savings have occurred. The Owner will need to "unpick" the risks and opportunities to identify whether the savings were made due to good luck, good management or a "soft TOC".'

[an Owner's Representative/Participant]

8

Glossary and Acronyms

8.1 Glossary

This glossary contains definitions of key defined terms used in the Guide. A more detailed set of definitions is contained in Section 1.1 of Template No. 1: Project Alliance Agreement which can be found at www.infrastructure.gov.au.

Term	Meaning
Business-as-usual	The practices and activities that are normally undertaken by a business.
Business Case	The vehicle that is used by the Owner to obtain approval and funding to undertake the project as required by that Owner's jurisdiction.
Commercial Framework	This sets out the structure and principles that govern the NOPs' remuneration for the project.
Non-Owner Participants (NOPs)	All Participants to the alliance excluding the Owner.
NOPs' Fee	Corporate Overhead and Profit as defined in the PAA.
Owner	Entity which will own the asset to be delivered by the alliance and generally has responsibility for the procurement of the alliance.
Owner's VfM Statement	The Owner's VfM Statement sets out the project deliverables to be achieved by the Alliance and the success criteria by which the Alliance will be ultimately judged. It is designed to be specifically relevant to, and applied by, the Alliance. The development of the Owner's VfM Statement should use the approved Business Case as the starting point; and in addition incorporate project level details that expand on the normal specifications and corporate standards found in Business Cases.
Participants	All Participants to the alliance (Owner and NOPs).
Project Alliance	The contractual agreement of the alliance.

Term	Meaning
Agreement	
Proponents	Organisations that respond to EOI or RFP.
Public Officials	Individuals employed by the Government.
Reimbursable Costs	The direct project costs and indirect project specific overhead costs actually and reasonably incurred by the NOPs in the performance of the work as provided in the PAA.
Risk or Reward Regime	The mechanism for determining how the pain or gain of the project will be shared between the NOPs and the Owner.
Target Outturn Cost or TOC	The specific sum developed by the Participants and approved by the project Owner under the Alliance Development Agreement as being the pre-estimate of the Reimbursable Costs, Corporate Overhead and Profit and Risk & Contingency Provisions for bringing the works to a stage where the Final Certificate can be issued under this Agreement, as set out in the Project Proposal.
Value-for-Money (VfM)	<p>Value-for-Money is a measure of benefits (which covers quality levels, performance standards, and other policy measures such as social and environmental impacts), balanced against the price and risk exposure of achieving those benefits.</p> <p>Generally, Value-for-Money is assessed on a 'whole-of-life' or 'total cost-of-ownership' basis. This includes the various phases of contract period, including transitioning-in and transitioning-out.</p> <p>The concept of 'long-term sustainability of Value-for-Money' often applies, and this emphasises the government's focus on investment choices that ensure Value-for-Money outcomes are promoted and protected outside the contract period and over successive anticipated contracts.</p>
Works	<p>The whole of the works and services to be performed by the Participants from time to time under the PAA and includes:</p> <ul style="list-style-type: none"> any direction by the project Owner or scope variations; the construction plant; and rectification work necessary to make good any defects arising before and during the Defects Correction Period, <p>but excluding any works or services performed by the Participants which are not directly referable to the Owner's VfM Statement, the scope of works and the assumptions adopted by the Participants in developing the TOC.</p>

8.2 Acronyms

ADA	Alliance Development Agreement
ALT	Alliance Leadership Team
AM	Alliance Manager
AMT	Alliance Management Team
AOC	Actual Outturn Cost
APT	Alliance Project Team
CFW	Commercial Framework
D&C	Design and Construct
DTF	Department of Treasury and Finance
ECI	Early Constructor Involvement
EOI	Expression of Interest
IAA	Interim Alliance Agreement
IE	Independent Estimator
ISO	International Organisation of Standardization
KPI	Key Performance Indicator
KRA	Key Result Area
MCOS	Minimum Conditions of Satisfaction
NOP	Non-Owner Participant
OCT	Owner's Comparative TOC
OP	Owner's Participant
OR	Owner's Representative
PAA	Project Alliance Agreement
PPP	Private Public Partnership
RFP	Request for Proposal/s
TOC	Target Outturn Cost
VfM	Value-for-Money

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9

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A Developing a Governance Plan

Appendix A is provided separately at www.infrastructure.gov.au.

Appendix A is provided by the kind agreement of the Water Corporation of Western Australia (Water Corp). Copyright resides with Water Corp and their permission to present this document in the Guide is gratefully acknowledged.

The Water Corp's *Capital Alliance Governance Manual* can assist agencies in developing their own governance plan for their specific project.

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B Developing a Governance Plan external to alliance

Introduction

Effective governance external to the alliance ensures that there is proper (and timely) direction on policy issues, accountability for project decisions and mechanisms in place to control and deal with unpredictable events and outcomes that may arise over the life cycle of the project. An external governance plan will assist the Owner to achieve the high standards of integrity and transparency required of public sector procurement processes, and to manage any serious issues that may lead to major time and cost overruns and failure to achieve the objectives in the Owner's VfM Statement.

Ultimately, Owners will need to develop governance plans and frameworks that suit the particular requirements and challenges of their specific alliance project. This appendix provides some background information and basis for discussing the appropriate model for a particular project.

Models of a governance framework

Three models of an external governance structure for an alliance project are discussed on the following pages.

Alternative 1

This model can be used where the Owner is well experienced in alliancing contracting or the project is relatively straight forward and can be governed within the Owner's existing corporate structures.

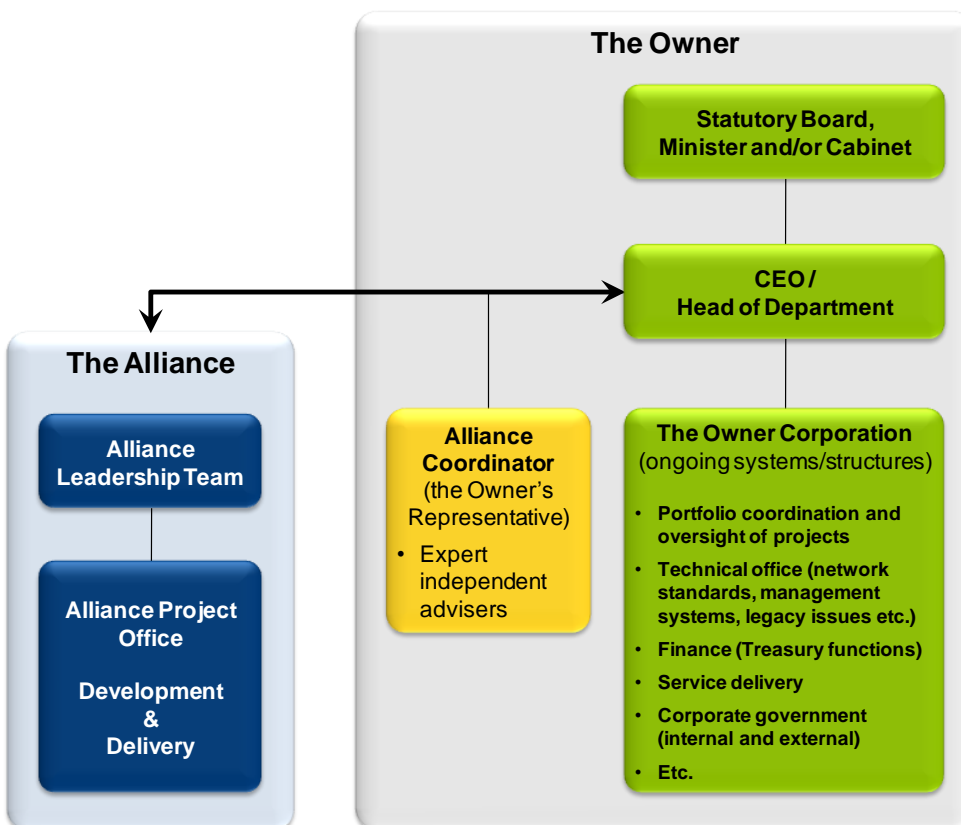
The key project governance roles and responsibilities external to the alliance include:

The existing Owner 'statutory board', which remains the ultimate decision-making authority for the Owner and hence for the alliance project. This is usually the Board of a statutory authority, a Minister, Head of Department and/or Cabinet.

The Owner's CEO, who exercises executive ownership of the alliance project.

The Owner's Alliance Coordinator, or the Owner's Representative, who takes the lead in providing independent advice and the 'corporate view' to the Owner's CEO on any issues, submissions and reports forwarded by the alliance to the Owner. The Alliance Coordinator can be expected to be supported by the Owner's independent expert advisers.

This alternative can be illustrated as follows:

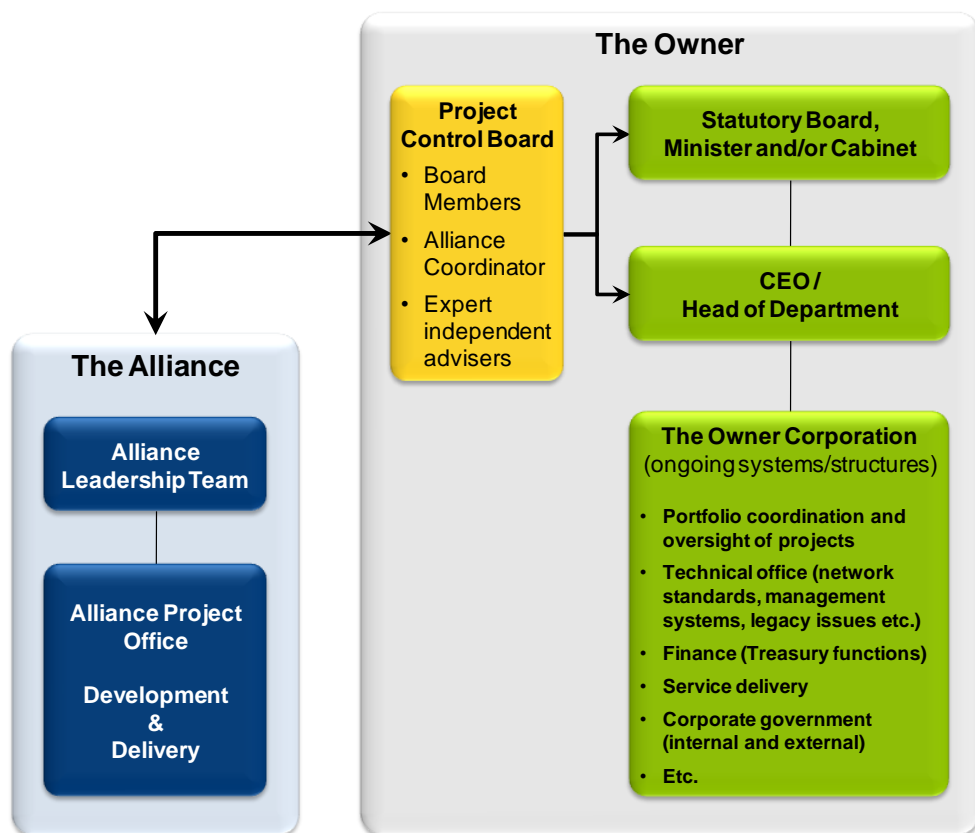


Alternative 2

In some particularly complex projects, the Owner may wish to be advised by a Project Control Group (PCG). For example, the PCG may be chaired by the CEO and include members of the Owner's Statutory Board. The PCG may also include public officials external to the Owner corporation, e.g., members of the PCG may be drawn from other agencies/government departments.

The role of the PCG builds on that of the Owner's Alliance Coordinator. However, the PCG does not determine the alliance's delivery strategies for the project, but ensures that appropriate strategies are developed and implemented. Therefore the PCG needs to satisfy itself, and then provide assurance to the Owner, that the Alliance will perform as required.

This alternative can be illustrated as follows:



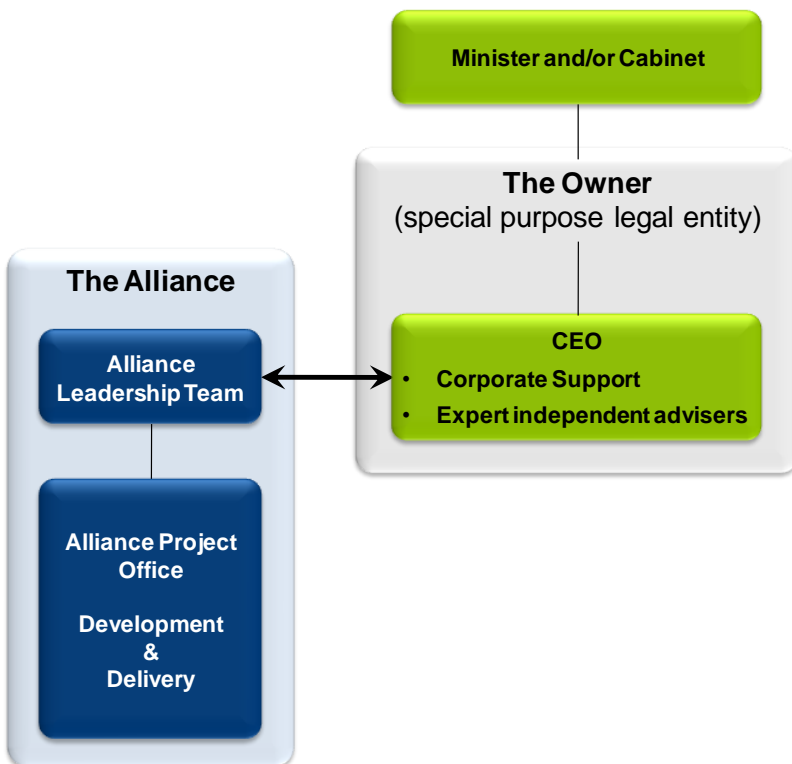
Alternative 3

In some particularly complex and very large projects, the government may establish a separate legal entity to provide the required external project governance. The key advantages of this approach include:

- the Owner is able to focus on its existing core business without becoming overwhelmed by the project;
- providing the necessary strategic focus of a senior group who are removed from the pressures of day-to-day management; and
- providing the project with the appropriate balance of independence and controls in relation to the speedy decision making required to facilitate an effective alliance.

The role of the special purpose legal entity (e.g., a department may establish a statutory authority to govern its major alliance) is to assume the role of the Owner.

This alternative can be illustrated as follows:



Governance roles

The following table provides an overview of the roles and responsibilities of the key parties in the project governance:

	ROLE	RESPONSIBILITIES
The Owner	<p>Ultimately accountable to the government for delivery of the Project.</p> <p>Provides effective corporate governance in relation to the Project to ensure successful project outcomes.</p> <p>Corporate direction.</p> <p>Treasury functions.</p> <p>Determines and delegates appropriate authority for project delivery.</p> <p>Provides to the alliance the VfM Statement.</p>	<p>Establishes corporate policy in relation to the Project.</p> <p>Provides adequate and timely project funding.</p> <p>Exercises the Owner's Reserved Powers in accordance with the PAA, e.g., approve necessary expenditure outside the established project budgets; approve all supply and revenue agreements; and/or approve all major contract procurement for the performance of the works in accordance with delegated authority levels.</p> <p>Provides appropriately high level project liaison and representation.</p>
Project Control Group (if required; otherwise these roles and responsibilities will be addressed by the Alliance Coordinator)	<p>Accountable to the CEO/Board for monitoring and reviewing performance of the Alliance to achieve the objectives in the Owner's VfM Statement.</p> <p>Makes recommendations to the Owner on reports and submissions from the Alliance.</p> <p>Investigates deficiencies and initiate responses.</p> <p>Provides effective project-based governance for the delivery of the Project (rather than day-to-day management).</p>	<p>Ensures the Owner's VfM Statement is clearly understood by the alliance.</p> <p>Puts recommendations to the Owner on submissions from the Alliance.*</p> <p>Effective and accurate reporting to the Owner.</p>
Alliance Coordinator (the Owner's Representative)	<p>Provides independent advice and corporate view to the PCG (if established, otherwise the Owner's CEO) on any issues or reports in connection with the Alliance.</p>	<p>Provides independent advice to the PCG (if established, otherwise the Owner's CEO) on any reports, submissions and/or recommendations from the ALT.</p> <p>Supports the Owner's independent expert advisers.</p>

* An alternative is that the PCG provides (all or some) approvals to the alliance under delegation from the Owner.

Delegated authorities

The speed of decision making is a critical factor for successful project delivery in the fast-paced environment of delivering a major infrastructure project. Therefore, the governance structure should include clearly delegated authority levels to ensure that decisions under the PAA (in particular, decisions which rely upon the Owner's Reserved Powers) be made in the most timely and efficient manner for the project.

Any delegated authority levels should be subject to governance controls over expenditure for project decisions outside the scope of the alliance.

Project monitoring and reporting

Effective project governance relies on timely and accurate monitoring and reporting of project progress and performance.

Performance standards and benchmarks (e.g. time, costs, and compliance with technical standards) need to be agreed and incorporated in the PAA to ensure the NOPs clearly understand their performance requirements, and to ensure the Owner can objectively measure the NOPs' performance.

Project governance protocols

To streamline and support effective and efficient project governance for the Project, specific protocols need to be established to guide communication, interaction and approval processes between the alliance, the Owner corporate office and project stakeholders.

The preliminary list of protocols to be developed includes:

- Project Communication and Approvals Processes (e.g., the need for internal communication and coordination protocols between the Alliance and Owner's corporate office); and

- External Stakeholder Communications (e.g., media relations protocols).

C NOP selection processes

C1—Full Price Selection Process

- Process overview
- Process flowchart
- Example RFP

C2—Partial Price Selection Process

- Process overview
- Process flowchart
- RFP Extract
- Example of innovation through competition

C3—Non-price Selection Process

- Process overview
- Process flowchart

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C1—Full Price Selection Process

C1 – FULL PRICE SELECTION PROCESS OVERVIEW

The commentary below is in support of the attached flow chart which provides details of the selection process when NOPs are selected using full price. Further detail is provided in Guidance Note 5.

EOI and shortlisting phase

In a full price selection process (generally) two Proponents are shortlisted on the basis of the following hurdle criteria:

- company capacity and track record;
- experience of team members;
- team's alliance affinity; and
- fees and response to Owner's draft commercial arrangements.

Alliance development phase

An Alliance Development Agreement is executed between each of the shortlisted Proponents and the Owner. Where it is allowed by jurisdictional policies and practices, the Owner can offer a capped fee-for-service agreement through which the Owner reimburses the Proponents' costs incurred to develop their Full Project Proposals. The Owner will retain the IP rights to any material developed during this phase, regardless of which Proponent is successful in selection. The Owner can then use this IP to enhance the successful Proponent's Final Project Proposal.

The shortlisted Proponents each develop a Final Project Proposal that contains:

- Project Solution;
- Proposed Team;
- Proposed Commercial Arrangements; and
- TOC.

These Final Project Proposals are developed with interaction by the Owner. The Owner also uses this interactive development activity to assess the Proponents' performance against the non-price selection criteria in the context of the Proponents actually undertaking project activities (rather than participating in artificial interviews, scenarios or role-playing).

A competitive selection process allows Proponents to differentiate themselves by demonstrating their capabilities, capacity and commercial attractiveness.

It is expected that the Owner will establish processes to ensure that as each Proponent's Final Project Proposal is developing, there is adequate separation of Owner Participants to assure a robust competitive process between the Proponents that satisfies probity requirements, while maximising Owner interaction.

This topic is considered in more detail in Guidance Note 5.

Evaluation and final negotiation phases

A preferred Proponent is selected from the competitively bid Final Project Proposals and the Owner will negotiate, if necessary, until the Proposal meets the requirements of their VfM Statement.

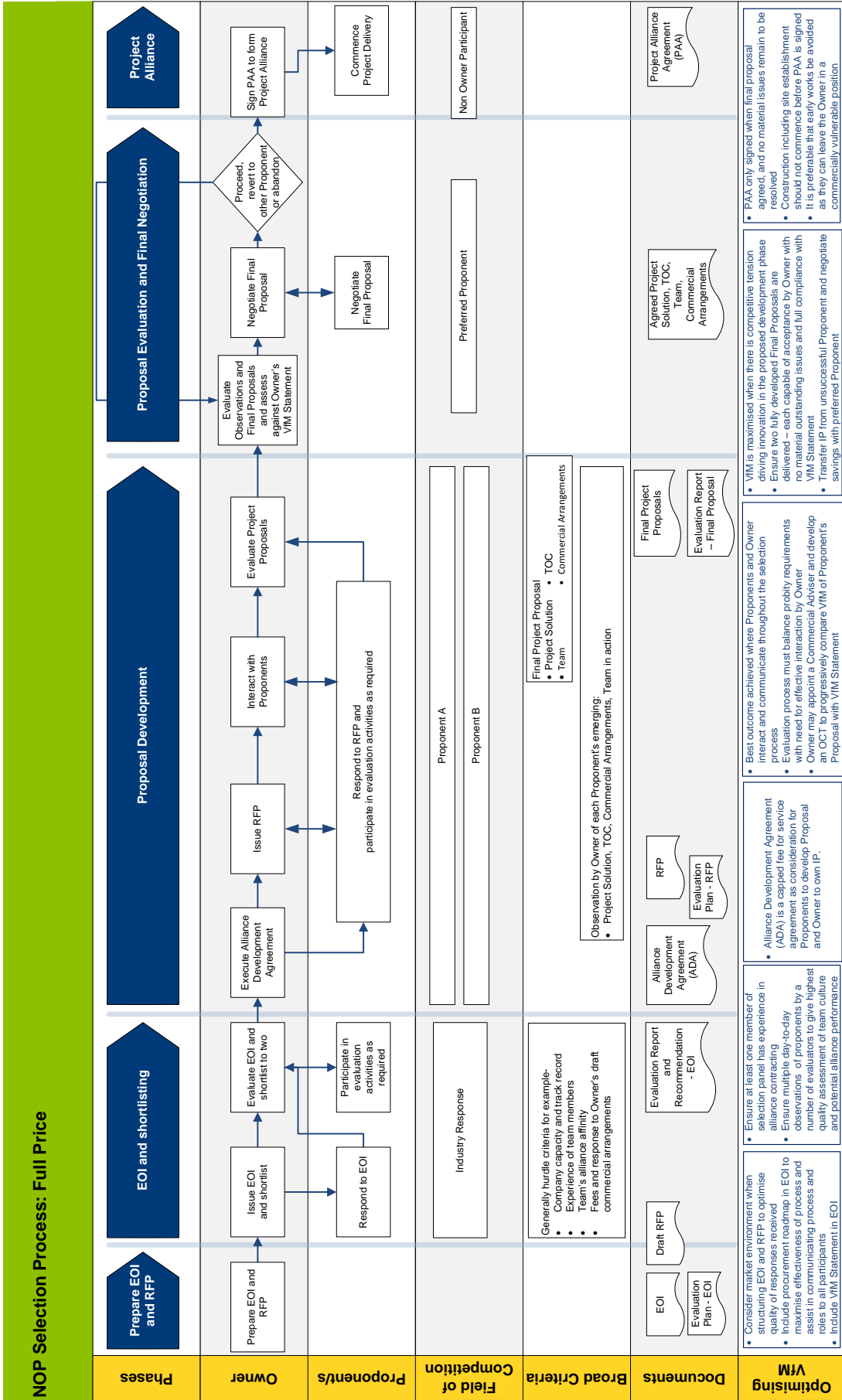
The Owner retains the second Proponent until the preferred Proponent's Final Project Proposal is accepted. This allows the Owner to revert to the second Proponent if they cannot reach agreement with the preferred Proponent.

The Final Project Proposal is evaluated against separate project-specific and pre-determined selection criteria based on the four components (project solution, team, commercial arrangements and TOC) including the observations of the Owner Participants over the selection phases.

Project alliance

After all material issues are agreed (including TOC, PAA and Commercial Framework) and Business Case assumptions confirmed, the PAA is executed, the alliance is then formed and project delivery commences.

C1 – PROCESS FLOWCHART



C1 – EXAMPLE RFP

Water Corporation of Western Australia

The Request for Proposal for the Southern Seawater Desalination Project

Copyright resides with Water Corporation and their permission to present this document in the Guide is gratefully acknowledged.

The attached document is a Request for Proposal (RFP) that illustrates many of the principles of the Full Price process for selecting the NOPs. The document was specifically prepared by the Water Corporation of Western Australia (Water Corp) to form alliances to design and construct, and to operate and maintain the Southern Seawater Desalination Project.

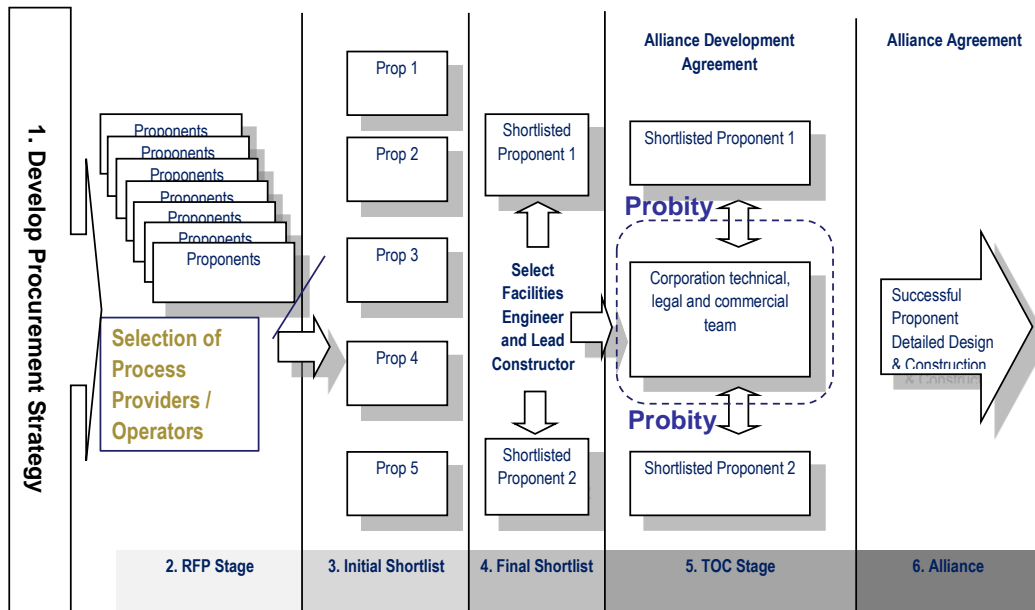
The RFP was prepared by Water Corp tailored to its specific project requirements and corporate practices. This document is provided to illustrate the full price process in a RFP that lead to a successful project. The document is not provided as a template RFP that can be readily utilised on another project. Rather, this RFP is presented to assist Owners in understanding the broad issues in developing their own project specific RFP should they choose to follow a full price selection process for the NOPs.

Broadly, the Southern Seawater Desalination Project RFP aligns to the intent of this Guide and the process shown in Appendix C. However, there are some areas where terminology differs and/or there are different emphases that are material enough to warrant explanation. Hence, for the purpose of clarity, the following commentary is provided on various elements of the RFP.

Overview

As with most infrastructure projects, the Southern Seawater Desalination Project had unique features that needed to be incorporated into the RFP, for example, Water Corp used a two part alliance; a D&C Alliance and an Operations Alliance. Moreover, Water Corp used a progressive NOP selection process, selecting first the Operator and then collectively (the Operator and Water Corp) selecting the D&C Participants. This serves to highlight the complexity of many infrastructure projects and the need to tailor the RFP to the specific project.

An Overview of the Southern Seawater Desalination procurement process



Intent of the RFP

The overall intent of the RFP is similar to that of the Guide. That is, a process leading to shortlisting two Proponents who each submit a binding TOC and design during the ADA stage. This is then evaluated on the basis of cost and non cost criteria.

Governance within the alliance

There are no significant differences.

Project objectives

The Guide's approach is to document the Owner's objectives by way of a detailed VfM Statement, which is derived from the approved Business Case. This VfM Statement would be provided to the shortlisted Proponents.

Language and terminology

The language is substantially similar. Some differences include:

Margin = NOP Fee

Direct Costs = Reimbursable Costs

Evaluation Panel = Selection Panel

Commercial Framework

The RFP presents the Owner's preferred Commercial Framework by way of key principles and invites Proponents to review and constructively critique them. The Guide supports this process but recommends that the Owner develops the draft Commercial Framework beyond principles to a detailed stage for inclusion in the EOI/RFP documents.

Selection process

The selection process aligns with the intent of the Guide in regard to assessing both price and non-price criteria but doesn't use the four 'alliancing success factors' as explicit categories as recommended by the Guide. The RFP adopts a similar position to the Guide in that all material issues are to be resolved during the competitive ADA stage (CFW/PAA/TOC/Design etc) prior to selecting preferred Proponents.

Reimbursement of bid costs

The RFP proposes a (capped) reimbursement of bid costs which the Guide supports where jurisdiction policies allow it.

Best-for-Project

The Guide recommends that 'Best for Project' is clearly understood in the context of achieving the Owner's VfM Statement

Outstanding outcomes and through performing teams

The RFP requires that the Risk/Reward Regime focus Participants on achieving 'outstanding outcomes'. The Guide, however, recommends that such outstanding outcomes should be required only when necessary to satisfy the Owners VfM Statement.

Due to the size of the file, Water Corp's RFP for the Southern Seawater Desalination Project is not provided here. It can be found through this link on the Water Corp's website:

http://www.watercorporation.com.au/_files/PublicationsRegister/15/RfP.pdf

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C2—Partial Price Selection Process

C2—PARTIAL PRICE PROCESS OVERVIEW

The commentary below is in support of the attached flow chart which provides details of the selection process when NOPs are selected using partial price.

EOI and shortlisting phase

In a partial price selection process (generally) two Proponents are shortlisted on the basis of the following hurdle criteria:

- company capacity and track record;
- experience of team members;
- team's alliance affinity; and
- fees and response to Owner's draft commercial arrangements.

Alliance development phase

An Alliance Development Agreement (ADA) is executed between each of the shortlisted Proponents and the Owner. Where it is allowed by jurisdictional policies and practices, the Owner can offer a capped fee for service agreement through which the Owner reimburses Proponents' costs to develop their Partial Project Proposals (and also the Final Project Proposal for the preferred Proponent). The Owner will retain the IP rights to any material developed during this phase, regardless of which Proponent is successful in selection. The Owner can then use this IP to enhance the successful Proponent's Final Project Proposal.

The shortlisted Proponents each develop a Partial Project Proposal that contains:

- Project Solution;
- Proposed Team;
- Proposed Commercial Arrangements; and
- TOC Budget (partial price).

The main difference between the partial and the full price process is that the TOC submitted by shortlisted Proponents is only at budget (partial price) stage because project characteristics mean that it is neither possible nor effective to develop a full committed TOC.

These Partial Project Proposals are developed with interaction by the Owner. The Owner also uses this interactive development activity to assess the Proponents' performance against the non-price selection criteria in the context of the Proponents actually undertaking project activities (rather than participating in artificial interviews, scenarios or role playing).

A competitive process to selection allows Proponents to differentiate themselves by demonstrating their capabilities, capacity and commercial attractiveness.

It is expected that the Owner will establish processes to ensure that as each Proponent's Partial Project Proposal is developing, there is adequate separation

of Owner Participants to assure a robust competitive process between the Proponents that satisfies probity requirements, while maximising Owner interaction.

A preferred Proponent is selected from these competitively bid Partial Project Proposals and then works with the Owner to develop a Final Project Proposal. This Final Project Proposal contains:

- Project Solution;
- Proposed Team;
- Proposed Commercial Arrangements; and
- Final TOC.

The Owner retains the second Proponent until the preferred Proponent's Final Project Proposal is accepted. This allows the Owner to revert to the second Proponent if they cannot reach agreement with the preferred Proponent.

Evaluation and final negotiation phases

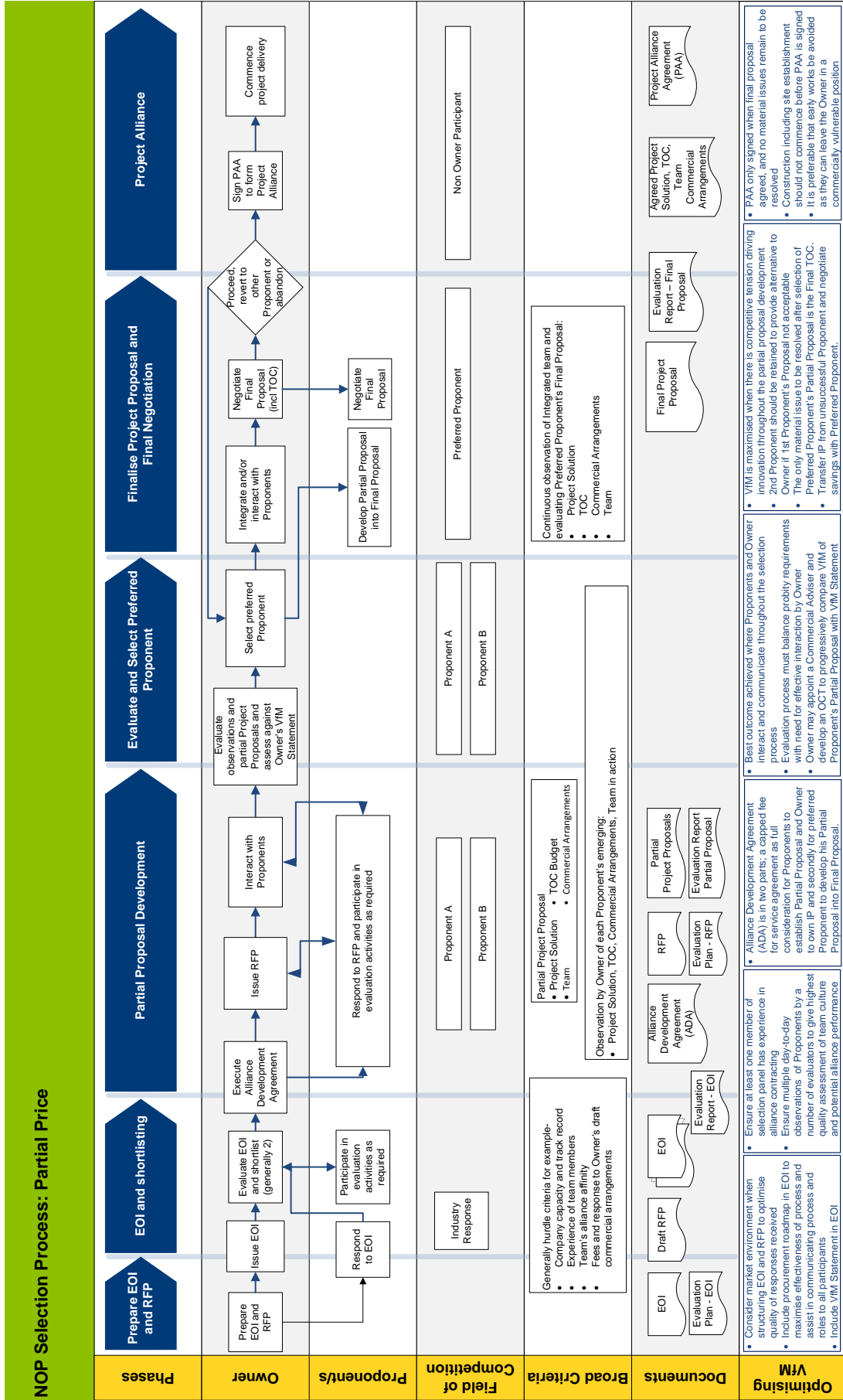
The Partial and Final Project Proposals are evaluated against separate project specific and pre-determined selection criteria based on the four components (project solution, team, commercial arrangements and TOC) including the observations of the Owner Participants over the selection phases.

If the Owner is not satisfied with the preferred Proponent's Final Project Proposal, they can revert to the second Proponent to negotiate a Final Project Proposal that satisfies the Owner's VfM Statement.

Project alliance

After all material issues are agreed (including TOC, PAA and Commercial Framework) and Business Case assumptions confirmed, the PAA is executed, the alliance is then formed and project delivery commences.

C2 – PROCESS FLOWCHART



C2 – CASE STUDY

A case study will be provided in due course.

In the meantime, the following pages provide two examples of the partial price selection process.

C2—RFP EXTRACT

To provide guidance, it is expected that the RFP will contain the elements described in the Table of Contents below:

This Table of Contents has been adapted from Queensland Water Infrastructure’s Wyaralong Dam Request for Proposal and their permission to present this document in the Guide is gratefully acknowledged.

TABLE OF CONTENTS – RFP: Partial Proposal Development (PPD) Phase

1.0 OVERVIEW

[describe background to the project, the NOP selection process, it’s status; shortlisted Proponents, and the purpose of the document RFP; selection of preferred Proponent]

2.0 PARTIAL PROPOSAL DEVELOPMENT (PPD) PHASE

2.1 Overview PPD Phase

[describe the PPD process, it’s timeline, Owner interaction, RFP deliverables, milestones, selection process & criteria]

2.2 Payment for PPD Phase

[outline the purpose of the Alliance Development Agreement]

2.3 PPD timeline

[provide a graphical ‘roadmap’ of the PPD Phase, its timeline and relationship in the overall NOP selection process]

3.0 THE PROJECT

[provide detail about the project/s]

3.1 The Project Overview

[from the EOI reiterate / expand the project description, details, status and service benefits]

3.2 The Project VfM Statement & Objectives

[from the EOI reiterate Project VfM Statement, ultimate ownership of the asset and the Owner’s objectives for the Project Proposal]

3.3 The Project Alliance Development Phase: Risks & Challenges

[outline the Owner’s view of the issues facing shortlisted Proponents in developing a Project Proposal; related and parallel projects, project interfaces, stakeholders, etc]

4.0 ALLIANCE PHILOSOPHY

[describe the preferred alliance model, ALT structure, the Owner's personal & nominated management positions and the alliance commercial and legal frameworks]

- 4.1 Alliance Philosophy and Principles
- 4.2 Leadership Structure and Relationships
- 4.3 Capabilities within the Project Alliance
- 4.4 Alliance Legal & Commercial Framework

5.0 INVOLVEMENT WITH THE OWNER

[provide instruction, rules of engagement and suggested practices for interaction with the Owner's team including specific protocols to maintain appropriate process probity, avoid conflicts of interest and ensure security of Proponent's intellectual property]

- 5.1 Owner Interaction Process & Protocols
- 5.2 Information Required by the Owner

[provide instruction for access by the Owner's team to information necessary for the Owner to conduct the evaluation including to price and estimating data necessary to develop the Owner's Comparative TOC ('OCT')]

- 5.3 Specific Workshops

[provide guidance for specific workshops of particular interest to the Owner or the selection panel. Decide in advance how the observations of the teams in action will be used in the evaluation]

6.0 RFP SUBMISSION

- 6.1 Overview

[define the RFP submission purpose, how it will be used in Proponent selection and disclose information sources to be relied upon in proposal assessment. Outline the relationship between each selection criterion and the Owner's VfM Statement]

- 6.2 Non-Price Selection Criteria

[detail the specific requirements and deliverables for each non-price criterion, refer 5.3.1]

- 6.2.1 Non-price criteria A
- 6.2.2 Non-price criteria B
- 6.2.3 Non-price criteria C

6.3 Price Selection Criteria

[detail the specific requirements and deliverables for each price criterion, refer 5.3.2. Multiple criteria are used to evaluate price selection in a partial price competition and specific attention should be made to the format of all elements to enable effective assessment]

6.3.1 Price criteria A

6.3.2 Price criteria B

6.3.3 Price criteria C

6.3.4 Price criteria D

6.4 Submissions Expectations & Requirements

[highlight any specific submission requirements relating to detail the specific RFP requirements and deliverables for each criterion. Particular attention should be made to guide the format, layout and form of the price elements to enable direct comparison between Proponents]

7.0 PDP EVALUATION

[outline the pre-determined evaluation and selection process necessary to deliver the requirements set out in the Owner's VfM Statement.]

8.0 SELECTION PANEL

8.1 Selection Panel

8.2 Probity Advisor

9.0 PROPOSAL REQUIREMENTS & LODGEMENT DETAILS

9.1 Format

9.2 Lodgement

10.0 PROCEDURAL MATTERS

10.1 Legal Obligations

10.2 Terms & Conditions

C2 – EXAMPLE OF INNOVATION THROUGH COMPETITION

The following example⁶³ is presented to assist practitioners in understanding the use, benefits and pitfalls of using the Partial Price selection process to drive innovation in the project solution.

In 2007, the Department of Lands was faced with the need to urgently provide permanent water supply to remote towns in northern Australia. A critical ingredient involved the design and construction of a small dam across a low creek. The project had been investigated several times over the last 25 years; the site characteristics were known; geotechnical investigations conducted; and environmental and other regulatory appraisals in hand.

A concept design had been prepared by the Owner following numerous option studies. It involved a 150 m wide and up to 20 m high wall that was to be constructed from a compacted earthfill core with armour rock on the outside. The riverbed on which it sat consisted of highly variable geotechnical conditions, typically several metres of sand overlaying weathered basalt to a depth of about 10 m. Geotechnical advice was that the weathered basalt on site was unsuitable for use in the construction of the bund; all armour rock would have to be imported (at significant cost) from a quarry some 20 km away.

The Owner investigated the possible procurement strategies in some detail and elected to use the alliance delivery method due to the undimensionable geotechnical risk and the extreme urgency of the project. It was strongly believed that the project did not lend itself to innovation since the design was ‘tried and proven’ and had been reviewed many times over 25 years. The Owner’s expectation in using alliancing was primarily one of reducing time rather than achieving significant cost savings.

Notwithstanding this, the Owner opted for a Partial Price process to select the NOPs and shortlisted two Proponents using conventional EOI techniques. These Proponents then competed over a seven week period to develop and present their:

- concept design solution;
- construction methodology; and
- budget TOC (partial price).

The Owner also interfaced with and observed both teams in action through a structured process that was conducted under probity guidelines.

⁶³ For reasons of commercial confidentiality, some non-essential details have been changed from the actual case study.

While one Proponent provided a concept design, construction method and budget TOC that was very similar to the Owner's, the other Proponent had a radically different approach which produced a budget TOC some 30% less.

The reason for the difference in TOCs was not the Proponents' proposed fee (both were similar) but that they approached the foundation risk from opposing attitudes:

1. started conservatively and needed to be challenged; and
2. started with extreme innovation and higher risk then moderated approach to arrive at the design solution.

The team that presented the more innovative approach had exhaustively pursued and investigated international best practice and unearthed a construction technology that enabled them to use the weathered basalt rather than importing (expensive) rock. The peripheral logistical issues were significant but had been largely solved by the innovative team.

Because the Owner had interacted with Proponents during the competitive process the evaluation period was very short. The Owner considered that there was little discernible difference between the Proponent teams and subsequently appointed the more innovative Proponent as preferred and two months later negotiated a full TOC close to the Proponent's budget TOC or partial price.

This case study highlights three benefits:

1. Competition motivates innovation by Proponents.
2. Competition allows the Proponents to differentiate on the basis of their innovative capabilities.
3. A dollar saved through innovation pre-PAA is worth more than twice as much as an innovation delivered post-PAA because:
 - a. the saving does not get recognised as part of the gainshare because it was realised before the PAA and the TOC already includes it; and
 - b. innovation in the early stages of Project Development will result in much more significant savings than those possible at the latter stages, where the design and construct methodology has already been locked in.

C3—Non-price Selection Process

C3—NON-PRICE PROCESS OVERVIEW

The commentary below is in support of the attached flow chart which provides details of the selection process when NOPs are selected using non-price.

EOI and shortlisting phase

In a non-price competition selection process a preferred Proponent is selected on the basis of the following criteria:

- company capacity and track record;
- experience of team members;
- team's alliance affinity;
- project understanding;
- approach to developing project solution and TOC; and
- fees and response to Owner's draft commercial arrangements.

Alliance development phase

An Alliance Development Agreement is executed between the preferred Proponent and the Owner. Where it is allowed by jurisdictional policies and practices, the Owner can offer a capped fee-for-service agreement through which the Owner pays the Proponent to develop their Final Project Proposal. The Owner will retain the IP rights to any material developed during this phase, regardless of whether the Proponent is successful in selection.

The preferred Proponent will then develop a Final Project Proposal that contains:

- Project Solution;
- Proposed Team;
- Proposed Commercial Arrangements; and
- TOC.

This Final Project Proposal is developed with interaction and integration by the Owner.

Evaluation and final negotiation

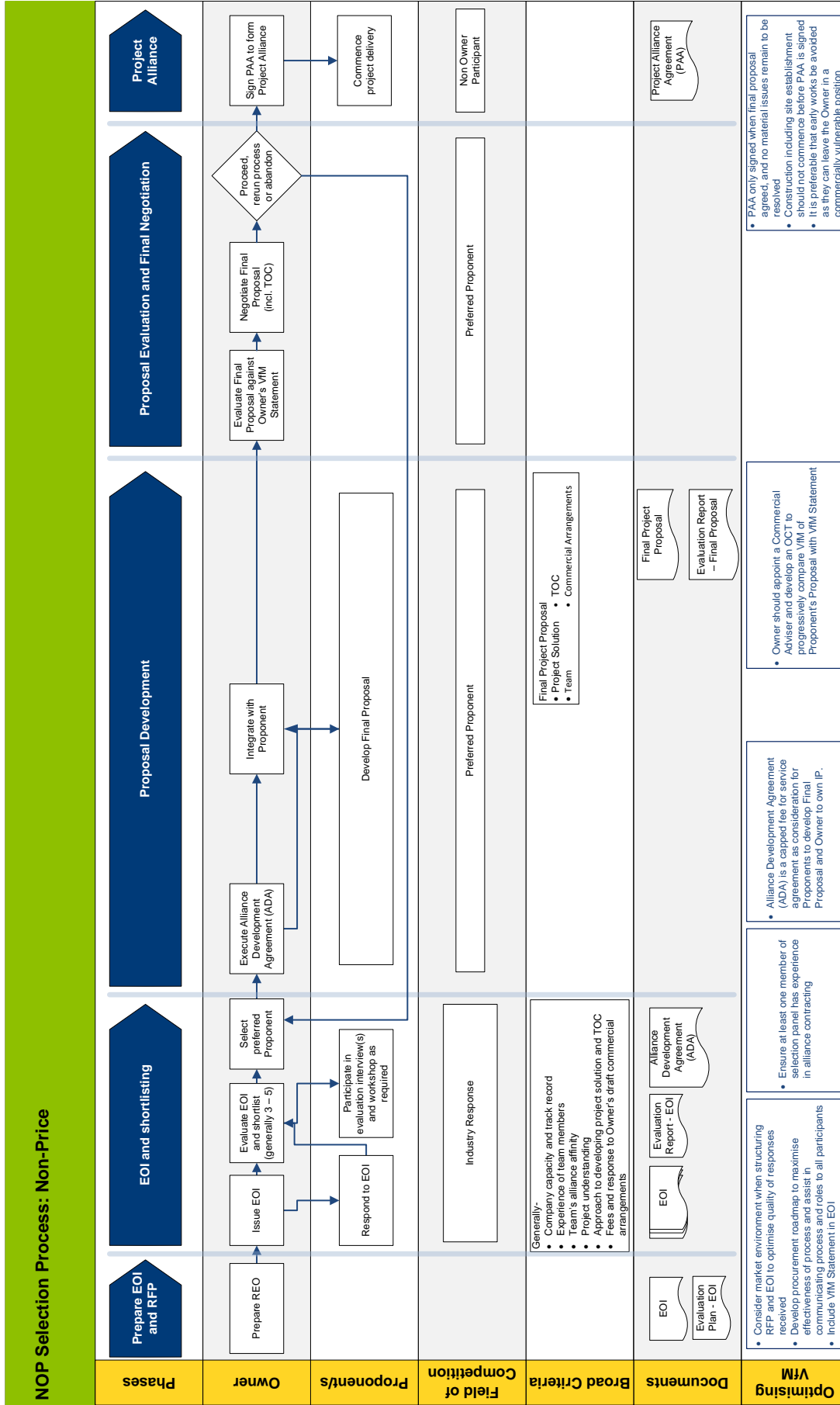
The Final Project Proposal is evaluated against the Owner's VfM Statement. The next step is to then negotiate the Final Project Proposal (including TOC) with the preferred Proponent.

If the Owner is not satisfied with the preferred Proponent's Final Project Proposal, they can revert to the shortlisted Proponents to select another Proponent to develop and negotiate a Final Project Proposal that satisfies the Owner's VfM Statement.

Project alliance

After all material issues are agreed (including TOC, PAA and Commercial Framework) and Business Case assumptions confirmed, the PAA is executed, the alliance is then formed and project delivery commences.

C3 – PROCESS FLOWCHART



D Commercial Framework—Indicative Risk or Reward Regimes

Chapter 4 provides an overview of the issues to consider in relation to structuring the Commercial Framework for an alliance. As discussed, the key purpose of the Commercial Framework is to align the Owner's project objectives and NOPs' commercial objectives, therefore the Commercial Framework needs to be tailored to the specific alliance project.

A Risk or Reward Model, which may be suitable for one project, is unlikely to be appropriate for another project due to differences in factors such as the Owner's specific project objectives and preferences, the NOPs' risk appetite and market conditions.

There are endless ways that the Risk or Reward Regime could be structured. It is important to ensure the structure is appropriate to drive the achievement of the project objectives as set out in the Owner's VfM Statement, and to encourage the Participants to meet their behavioural commitments. For example, the Risk or Reward Regime should only reward exceptional performance in non-cost areas where this is required by the Owner's VfM Statement. The following graphs show some of the different ways to structure Risk or Reward Models. These graphs should assist Owners to understand some of the options available to them and the key issues they need to consider.

This is not intended to be an exhaustive list of the possible structures, and instead has been designed to illustrate some of the principles which underpin Risk or Reward Models, including the advantages and disadvantages which are associated with some of the various approaches. It is not suggested that any particular model set out below should be used by Owners; each of the various approaches may support, or fail to support, achievement of the Owners objectives under various circumstances.

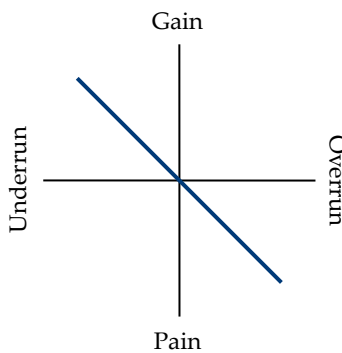
The Owner should provide a proposed Risk or Reward Regime as part of the tender documents released to the market. This means the Risk or Reward Regime can be developed and finalised during a competitive selection process where the Proponents have the opportunity to propose innovative commercial solutions that are specifically tailored to the project.

Finally, the Owner should exercise caution in relation to applying any of these models. Rather, the Owner should use the following models to assist in building a preferred position. For example, the Owner may selectively apply certain

elements of different models to reflect the risk profile and objectives for its specific alliance project.

1 Traditional Risk or Reward Model

Under this model, both underruns and overruns are split equally between Owner and NOPS as 50:50 gainshare/painshare.



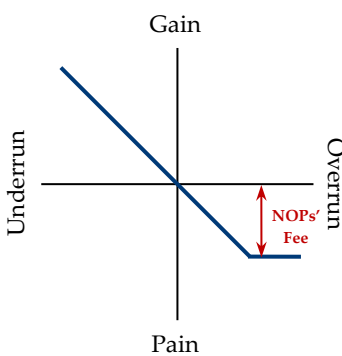
There is no link to performance on non-cost KRAs. This means that the NOPS only have a financial incentive to achieve cost targets, and there is no additional payment for achieving exceptional non-cost performance (if required by the Owner). That is, there is no incentive for the NOPS to achieve non-cost KRAs.

The model is designed to achieve optimum commercial alignment between the Participants in regard to cost outcomes, i.e., the Participants share the risks and rewards of the project's cost outcomes equally.

2 Historical Risk or Reward Models—Cap on NOPS' Painshare

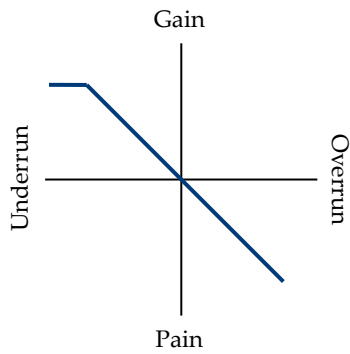
NOPS' painshare is capped at their Corporate Overhead and Profit.

Historically, this is the model which has been used for most alliance contracts.



The cap on painshare may be attractive to the NOPS if the project risk is particularly high. However, the cap means that the Owner will carry the entire project overrun where the project becomes distressed. This may undermine the key features of the alliance, including the concepts of risk and opportunity sharing and 'best-for-project' decision making. Also, this model does not include any incentive for the NOPS to achieve non-cost KRAs.

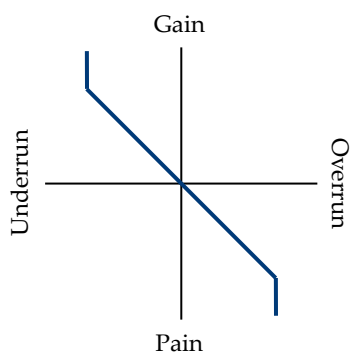
3 Caps on NOPs' Gainshare



Similar to model 2 above, but with a cap on the NOPs' gainshare.

The cap on gainshare may alleviate concerns of the potential for NOPs to earn 'super profit', but may reduce NOPs' incentive to pursue further innovations and cost savings. There is also no incentive for the NOPs to achieve non-cost KRAs.

4 Caps on Owner's Gainshare/Painshare

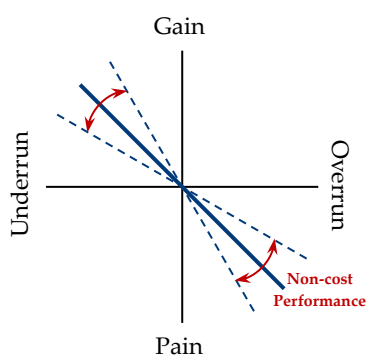


The Owner has a cap on their possible gainshare and/or painshare.

The concepts and principles discussed above in relation to caps on the NOPs' gainshare/painshare also apply here. That is, the caps under this model may not drive the right behaviours from the Participants.

Under this model, the NOPs will carry the entire project overrun beyond the cap.

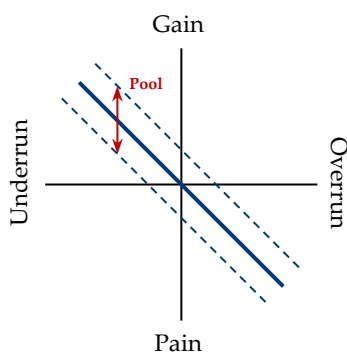
5a Link with Non-Cost Performance—Self Funded



The gainshare and/or painshare is adjusted to reflect performance on non-cost KRAs.

In this model, non-cost positive performance is essentially self-funded and only rewarded if cost underruns occur. This means that if there is a cost overrun, the NOPs' will have a reduced incentive (if any) to achieve the required performance level for non-cost KRAs.

5b Link with Non-Cost Performance – Pool



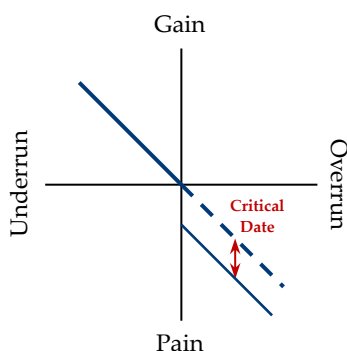
This model is supported by a separate pool established by the Owner to incentivise the NOPs' performance against non-cost KRAs. This should only be used where the Owner requires the NOPs to achieve exceptional performance (i.e. performance that exceeds minimum conditions of satisfaction – MCOS) in those KRAs to deliver extra value to the government.

The Owner could be faced with funding exceptional performance against non-cost KRAs even though the project is over budget.

Generally, there is no impact on the NOPs' painshare unless the NOPs fail to achieve MCOS in the relevant non-cost KRAs.

Refer to 'Alternative 1' in the Risk or Reward Regime set out in the Model PAA.

5c Link with Non-Cost Performance – Modifiers



In this model, the NOPs will be required to pay a one-off 'penalty' where they fail to achieve MCOS for a particular non-cost KRA (e.g. a date critical to the Owner, or safety and health requirements).

Similarly, this model can be structured to reward the NOPs with a 'bonus' in lieu of a 'penalty', where they achieve exceptional performance (if required).

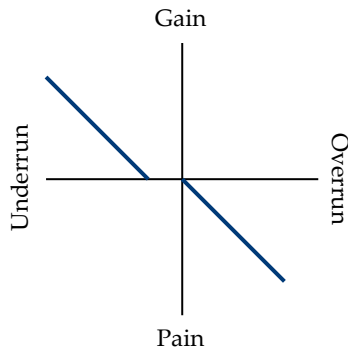
Such bonus or reward payments still require the Owner to exercise some caution. For example, in seeking to achieve the Owner's target date and avoid paying the penalty, the NOPs may be incentivised to incur significant acceleration costs. There is also the risk that this approach may drive unforeseen adverse behaviours if the critical date is missed by only a small amount of time.

However, bonus payments may be appropriate for other non-cost KRAs, where the Owner requires exceptional performance to be achieved.

Refer to 'Alternative 2' in the Risk or Reward Regime set out in the Model PAA.

6 Flat Spot on Underrun

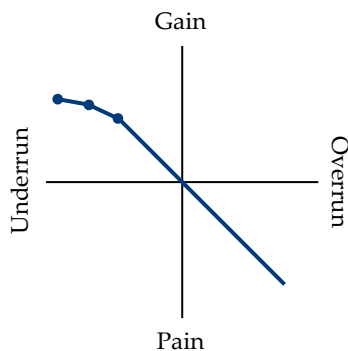
Under this model, the NOPs are not entitled to any gainshare payment until a minimum level of savings is achieved.



This approach is sometimes used to 'bridge the gap' when the Owner accepts the TOC being set at an amount which it considers may be too high (i.e. where the Owner and NOPs are unable to 'agree' the TOC).

The 'flat spot' will result in the Owner's objectives and the NOPs' objectives not being aligned. This can produce unintended consequences, e.g., Participants will not be driven to reduce costs, and the NOPs may be driven to incur additional and unnecessary costs (e.g. acceleration costs). Therefore, the Owner should exercise some caution in relation to this model.

7 Reducing Gainshare



Under this model, gainshare steadily reduces as overrun increases.

This may reduce the potential for NOPs to earn 'super profits', but can also reduce the NOPs' incentive to pursue further innovations or cost savings.

The same concept can also apply to painshare

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E Risk or Reward for cost and non-cost performance: worked examples

This appendix presents worked examples of calculating the Risk or Reward on project completion.

In order to illustrate the underlying principles these examples are presented in simplified conceptual form rather than the complexity that could be expected in an actual alliance. Thus:

The NOPs' fee is presented as an aggregate single figure that is fixed as a lump sum once the TOC is agreed.

The non-cost risk or reward is treated as a performance score from a single KRA (recognising that in practice there may be several KRAs).

There are no adjustments to the initial TOC due to Owner changes.

The calculation and distribution of the Risk or Reward amongst individual NOPs is not presented.

Model 1a) Cost and Non-Cost Performance Not Linked

Base Data: a) TOC Components

Reimbursable Costs	\$ 88 m
NOP (Aggregate) Fee	\$ 12 m
TOC	\$100 m

b) Cost Gainshare/Painshare Split

50:50, no caps

c) Non-Cost Reward/Penalty

A separate pool of funds has been established by the Owner as reward/penalty for non-cost performance that is not linked to cost performance.

Alliance Performance on Non-Cost KRA	Score	Reward/Penalty to NOP
Achieve Stretch Target	100	\$2 m
Business as Usual	0	nil
Poor	-50	<\$2 m>

Risk or Reward Calculations:			
Model 1a)	Scenarios		
	1 Very good cost and non-cost performance	2 Mixed – Very good cost and poor non-cost performance	3 Very poor cost and non-cost performance
TOC	\$100 m	\$100 m	\$100 m
AOC	\$90 m	\$90 m	\$125 m
Under (Overrun) to TOC	\$10 m	\$10 m	<\$25 m>
Non-Cost Performance Score	100	-50	-50
Cost Gainshare/<Painshare>			
Owner 50%	\$5 m gain	\$5 m gain	<\$12.5 m> pain
NOPs 50%	\$5 m gain	\$5 m gain	<\$12.5 m> pain
Non-Cost Reward/Penalty to NOP	\$2 m reward	<\$2 m> penalty	<\$2 m> penalty
Total Gainshare/<Painshare>			
Owner	\$5 m	\$5 m	<\$12.5 m>
NOP	\$7 m	\$3 m	<\$14.5 m>

Model 1b) Cost and Non-Cost Performance Not Linked – Cap on NOPs’ Painshare

The Base data for Model 1b) is similar to Model 1a) except that the Commercial Framework now includes a Cap of \$12 m on the NOPs’ painshare.

Model 1b)	Scenarios		
	1 Very good cost and non-cost performance	2 Mixed – Very good cost and poor non-cost performance	3 Poor cost and non-cost performance
TOC	\$100 m	\$100 m	\$100 m
AOC	\$90 m	\$90 m	\$125 m
Under (Overrun) to TOC	\$10 m	\$10 m	<\$25 m>
Non-Cost Performance Score	100	-50	-50
Cost Gainshare/<Painshare> (pre-cap)			
Owner 50%	\$5 m gain	\$5 m gain	<\$12.5 m> pain
NOPs 50%	\$5 m gain	\$5 m gain	<\$12.5 m> pain
Non-Cost Reward/Penalty to NOP	\$2 m reward	<\$2 m> penalty	<\$2 m> penalty
Total Gainshare/<Painshare> (pre-cap)			
Owner	\$5 m	\$5 m	<\$12.5 m>
NOP	\$7 m	\$3 m	<\$14.5 m>
Cap on NOP Painshare	\$12 m	\$12 m	\$12 m
Total Gainshare/<Painshare> (after applying cap)			
Owner	\$5 m	\$5 m	<\$13 m>
NOP	\$7 m	\$3 m	<\$12 m>

Model 2a) Cost and Non-Cost Performance Linked

Base Data: a) TOC Components

Reimbursable Costs		\$ 88 m
NOP (Aggregate) Fee		\$ 12 m
	TOC	\$100 m

b) Cost Gainshare/Painshare Split

50:50, no caps

c) Non-Cost Reward/Penalty

NOP performance on non-cost KRAs is reflected in an increase (or decrease) in their share of cost under/overruns. There is no separate pool of funds and any reward can only be funded by cost underruns.

Alliance Performance on Non-Cost KRA	Score	Reward/Penalty to NOP (Cost Gain/Pain split)
Achieve Stretch Target	100	75:25
Business-as-Usual	0	50:50
Poor	-50	25:75

Model 2a)	Scenarios		
	1 Very good cost and non-cost performance	2 Mixed – Very good cost and poor non-cost performance	3 Poor cost and non-cost performance
TOC	\$100 m	\$100 m	\$100 m
AOC	\$90 m	\$90 m	\$125 m
Under (Overrun) to TOC	\$10 m	\$10 m	<\$25 m>
Non-Cost Performance Score	100	-50	-50
Cost Gainshare/<Painshare>			
Owner	\$5 m gain	\$5 m gain	<\$12.5 m> pain
NOPs	\$5 m gain	\$5 m gain	<\$12.5 m> pain
Non-Cost Reward/Penalty to NOP	Reflected in gain/pain split		
Total Gainshare/<Painshare>			
Owner	\$2.5 m	\$7.5 m	<\$6.25 m>
NOP	\$7.5 m	\$2.5 m	<\$18.75 m>

Model 2b) Cost and Non-Cost Performance Linked – Cap on NOPs' Painshare

The base data for Model 2b) is similar to Model 2a) except that the Commercial Framework now includes a Cap of \$12 m on the NOPs' painshare.

Model 2b)	Scenarios		
	1 Very good cost and non-cost performance	2 Mixed – Very good cost and poor non-cost performance	3 Very Poor cost and non-cost performance
TOC	\$100 m	\$100 m	\$100 m
AOC	\$90 m	\$90 m	\$125 m
Under (Overrun) to TOC	\$10 m	\$10 m	<\$25 m>
Non-Cost Performance Score	100	-50	-50
Cost Gainshare/<Painshare> (pre-cap)			
Owner	25% gain	75% gain	25% pain
NOPs	75% gain	25% gain	75% pain
Non-Cost Reward/Penalty to NOP	Reflected in gain/pain split		
Total Gainshare/<Painshare> (pre-cap)			
Owner	\$2.5 m	\$7.5 m	<\$6.25 m>
NOP	\$7.5 m	\$2.5 m	<\$18.75 m>
Cap on NOP Painshare	\$12 m	\$12 m	\$12 m
Total Gainshare/<Painshare> (after applying cap)			
Owner	\$2.5 m	\$7.5 m	<\$13 m>
NOP	\$7.5 m	\$2.5 m	<\$12 m>

