Relationship Contracting in Australia: Partnering, Alliancing and Other Arrangements

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I. Introduction

The Australian construction industry has experienced a growing desire to implement general change to the way projects are delivered. The relationships among parties to a conventional construction project are inherently adversarial, often leading to costly and drawn-out disputes. This arises, in part, from the traditional lump sum remuneration method for construction, which sets the economic interests of owner and contractor in fundamental opposition. Many owners, consultants, and commentators have concluded that to address this state of affairs innovators must not merely reallocate risk within the existing adversarial structure, but also radically reassess the nature of the relationship between owner and contractor. To this end, the concept of cooperative or relationship contracting has developed as a challenge to the futility of the conventional adversarial positions of parties to a construction contract. However, as with all innovations, there are aspects of alliancing which need to be understood in order for measured judgements to be made as to its implementation.

Though the concept of relationship contracting is broad and inclusive, discussion has tended to focus initially on partnering, and more recently on project alliancing, to the exclusion of other types of relationship contracting. This paper will discuss the attributes, and some of the advantages and disadvantages, of five alternative project delivery options that come under the banner of relationship contracting.

II. Introduction to Relationship Contracting

It is increasingly recognised that the "zero-sum"—"your gain is

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my loss"—mentality which traditionally characterises the construction industry is counter-productive. The belief that any incremental gain must come at another party's expense is structurally enshrined in the conventional construction contract and generates a variety of inefficiencies. Significant amounts of time and money must be put by each party into the common routine of defending its contractual position. Even where the parties are on relatively good terms, project management costs will include, for instance, full and detailed documentation for use in later disputes. Where problems do arise, they are often dealt with by blame-allocation rather than by a collaborative search for solutions. Differences of opinion often escalate into disputes and claims, as the informal adversarial attitudes of the parties harden into formal conflict. This animosity reappears as defensiveness in contract negotiations, which becomes a contest between parties each attempting to transfer more risk onto the other.

Moreover, the conventional construction contract is not an instrument which facilitates excellence of outcome. The quality of the project delivered is likely to be the lesser for being executed in an adversarial environment. The contractor has an interest in minimising construction costs, even at the risk of producing substandard results. Design work may not be as much a matter of exploring the best solution for the client's purposes as a reaction to inflexibility prompted by cost constraints. Importantly, typical contractual mechanisms such as liquidated damages and performance security provide only negative incentive to perform. At most they will ensure compliance with the minimum contract requirements; there is little in a traditional construction contract to reward outstanding work or to encourage the contractor to strive for an excellent result.

The term "relationship contracting" embraces a wide and flexible range of approaches to managing construction based on recognition that there is mutual benefit in a cooperative relationship between owner and contractor. This is often expressed as the establishment of a "win-win" scenario. Essentially, relationship contracting seeks to emphasise points of convergence between the respective interests of owner and contractor, and in so doing, to facilitate solutions to issues traditionally characterised by divergence of the parties' interests.

While in a sense the realities of project delivery have always necessitated relationship contracting, it is important to recognise the concerted push which has been made in recent years to achieve the widespread restructuring of the basic relationship between client and contractor. The Australian Constructors As-

sociation (ACA), for instance, has warmly endorsed relationship contracting as being based on "commonsense, open mindedness, adaptability, inventiveness, prudent risk-taking, fairness, commitment, and the reflection of these values in behaviour by the contracting parties; and proven delivery strategies and techniques . . . which optimise project outcomes and deliver optimum commercial benefits to all parties involved."[1]

Within ACA's endorsement of relationship contracting as a general panacea, some key specific ideas in this endorsement are that:

- the owner should appreciate that sometimes it can better manage its risks through embracing rather than transferring them;
- aligning the goals of the owner and contractor in a gainsharing/painsharing framework facilitates an optimum project outcome; and
- relationship contracting allows for collaborative endeavours to improve project outcomes rather than focusing on penalising nonconformance.

The various manifestations of relationship contracting combine these ideas to differing extents, and with lesser or greater degrees of formality. They range from the cooperative development of projects through partnering to formal project alliances and the development of longer term relationships with groups of contractors.

III. Partnering—The Informal Understanding

The term "partnering" has been used in a variety of ways, but it best describes a situation whereby the parties performing a project—at least the owner and contractor but also potentially others including major subcontractors—set out in a special document, or charter, relationship guidelines emphasising trust, mutual objectives, fair dealing, good faith, cooperation, and commitment to the project. An important aspect of partnering is that the parties express an intention, wherever possible, to share the risks of unforeseen difficulties and to divide any windfalls.

Partnering is not a project delivery system in the traditional sense; the partnering charter is best seen not as a contract but as a covenant describing the attitudes and consultative processes mutually approved of by the parties. Partnering may be imple-

[1]Australian Constructor's Association, Relationship Contracting: Optimising Project Outcomes (1999), *available at* http://www.constructors.com.au/publications/rc__general/Relationship%20Contracting%20Optimising%20Project%20Outcomes.pdf (last visited October 7, 2009).

mented in the context of any delivery system. The charter will "sit behind" the contract proper, without generally being itself legally binding. Accordingly, partnering is at the informal end of the relationship contracting spectrum. It does not require the overhauling of conventional contractual mechanisms as to, for instance, remuneration or dispute resolution. This characteristic of partnering provides the benefit of allowing the parties to make a genuine attempt to implement a norm of good faith, while retaining the security and certainty of allocation of risk and liability dictated by the actual construction contract.

However, having a foot in each camp has certain disadvantages. In one sense, partnering can be seen as going too far. Although the charter is not legally binding, the kinds of undertakings given by the parties may imply duties of good faith enforceable by a court of equity. That is, the *behaviour* of the parties in entering a partnering agreement (irrespective of its enforceability) may indicate to a court that the parties have assumed higher duties of fair dealing than ordinarily arise in commercial contracts. Therefore, not only is it possible that parties are mistaken in viewing the charter as a mere "gentlemen's agreement," but any disputes which do occur may be complicated by the operation of principles of equity (as opposed to pure contract law).

On the other hand, partnering can be seen as not going far enough: the charter is ultimately an idealistic gloss over what remains an inherently adversarial relationship. Partnering will not necessarily provide any commercial incentive for the parties to cooperate. Moreover, if partnering merely overlies a typical construction contract, certain contractual provisions, such as liquidated damages clauses, will directly contradict the spirit of the partnering charter.

Much of the success in the partnering approach is attributable to national culture. For example, in the case of Japanese companies, partnering is evinced through the arrangements of the Big Six in the Japanese construction industry. The Japanese culture is considered to be a fundamental platform on which trust and commitment operate.[2]

IV. Project Alliancing—The Alignment of Commercial Interests

Project alliancing is the high-water mark of relationship contracting in respect of the design and construction of a facility. This strategy directly rejects the inherent conflict between par-

[2]Liu and Fellows, An Eastern Perspective on Partnering, 8 Engineering, Construction and Architectural Management 9, 10 (2001).

ties to traditional construction contracts by erecting a new type of structure, the "alliance," through which each participant shares in the success or failure of the project and in decision making and risk management. The actual roster of "participants" varies among projects, but may include design professionals and lower-tier parties such as key subcontractors in addition to owner and contractor. All relationship contracting involves some kind of alignment of objectives; a project alliance agreement distinctively seeks to formally align the commercial interests of the respective participants. Under such an agreement, unlike a partnering charter positioned behind a conventional project delivery structure, the parties actually agree to share commercial risk and reward so that it is in all participants' interests to work cooperatively and openly.

This goal is primarily achieved by the formulation of a performance or incentive basis of remuneration. The owner agrees to meet all the direct costs, and some or all of the overheads, incurred by nonowner participants and to provide additional reward in the form of profit at risk.

At its simplest, an alliance contract establishes a target cost and a risk/reward curve, allowing the benefits of any project savings or the burden of any overruns to be shared according to a prearranged formula. Thus the incentive to perform has a commercial impetus and is contained in the contract itself. In addition to the basic objectives of meeting the target cost and time of completion, the contract may introduce other benchmarks, usually known as key performance indicators (KPIs), against which performance may be measured and bonuses awarded. KPIs might include, for instance, adherence to environmental or safety standards and satisfaction of community expectations. They, and the target cost, must be established collaboratively by all participants at the outset of the project. The risk/reward curve can be made quite complex, to give weight to critical objectives, and to multiply rewards for outstanding achievement or impose penalties for poor performance. Appendix 1 to this article illustrates a basic risk/reward curve.

A project alliance contract may contain a distinctive "no disputes" clause. All differences of opinion are to be resolved unanimously by an alliance board (the decision-making and managerial body, comprising representatives of each participant created under the alliance agreement). Participants expressly agree not to use arbitration or litigation as a dispute resolution technique. Additionally, the contract states that participants will have no legal or equitable cause of action against any other par-

ticipant except in the case of wilful default or possibly insolvency. The idea of "no blame" is crucial to the project alliance approach.

A project alliance is project-based; though it may take a variety of forms, it always incorporates or applies to a specific scope of works. This feature distinguishes it from a strategic alliance, which is usually a long term relationship spanning many projects or a lengthy period of time. For each new project alliance, the owner will undertake a rigorous selection process, calling for proposals from either individual organisations or preformed consortia, and identifying the preferred bidders through a procedure involving interviews and workshops on alliancing. Given that the target cost is established collaboratively after, or near the end of, the selection process, the selection criteria are a range of "soft dollar" measures, rather than tender price, including evidence of the bidders' abilities to complete the full scope of the works, achieve outstanding results, innovate, and provide the necessary resources.

Alliancing is a practice equally available to, and often used by, private sector owners, but there are various benefits particularly appealing to public sector agencies, in respect both of meeting the demands of budgetary austerity, and of ensuring that the special requirements of public works projects are achieved.

In comparison to the conventional construction contract, the project alliance as a mode of project delivery facilitates various practices which may result in ultimate cost savings. These may be summarised as follows:

- The contractor gains a better understanding of the owner's needs from the outset of the project.
- The owner is better able to utilise the other participants' skill in defining its requirements and avoiding wasteful practice.
- There is a reduction in the costs associated with each parties' defence of its contractual position.
- Problems which arise are met by a creative and collaborative search for solutions.
- Parties are incentivized to strive for best practice and outstanding results, rather than to do merely the minimum required to avoid penalty or termination.

These factors add up, in the avoidance of disputes and all kinds of waste, to an enormous potential for the project alliance to bring the project in at (or under) budget and on schedule, a fact

recognised by its increasing implementation by various Australian government agencies.[3]

Additionally, project alliances allow public agencies more rigorously to assure performance in respect of the noncost objectives which may be crucial to the owner. Intense scrutiny of the delivery of public works projects by stakeholders and the public at large makes it desirable for the owner to have the ability to strictly monitor such noncost objectives as environment, safety, and community relations. Furthermore, the flexibility of the KPI benchmark mechanism is such that the kinds of objectives which the owner can entrench as performance measures are limited only by what can be objectively measured. In the Northside Storage Tunnel alliance for Sydney Water, for instance, the owner introduced the novel KPI of "community," and the National Museum of Australia alliance for the Commonwealth Government incorporated the objective of employment of indigenous people. Clearly, the project alliance structure can be adapted to meet the circumstances of the particular owner and project.

A. Liability Issues

Notwithstanding the advantages mentioned, there are special liability issues that arise under a project alliance which would not arise in conventional contracting and tendering processes to which the owner must give serious consideration. Where the owner is a government agency, probity issues come heavily into play as discussed below.

(1) Probity Issues

Public sector project alliances must demonstrate probity, or integrity, in the procurement process, the establishment of a target cost and KPIs, and the assessment of performance. Demonstrating value for money, fair dealing, and accountability is more difficult where the tender criteria are "soft dollar" criteria and where performance assessment criteria are established collaboratively with the contractor, but it is possible to adopt procedures to meet these concerns. It is important to remember that the project alliance is conducted in the context of open-book accounting, but there are also specific techniques which do much to ensure probity. In relation to the selection of participants, the requirement that the process be competitive is met by ensuring an open and transparent process. The publication and release to the industry of the call for proposals and of the basis of selection

[3]On the general level of acceptance of project alliancing in government bodies, see Pratley, Project Alliancing: Does it Work?, Building Australia Magazine, 33 (1999).

represents no significant departure from current practice. A further strategy to maximise competition is exemplified by the Northside Storage Tunnel owner's "keeping the runner-up on the backburner"—that is, even during detailed negotiations with the preferred contender, a runner-up was kept on hold, in order to maintain options right up until the deal was signed. Also, the requirement of securing best value for money can be satisfied by application of the proper selection criteria. For instance, the criterion of "demonstrated ability to minimise project capital and operating costs without sacrificing quality" was acceptable to the Australian National Audit Office as sufficient observation of the value for money principle in the procurement for the National Museum of Australia project.[4] Assessment was conducted on a number of factors including the quantum of variation or change order claims on past projects, credible suggestions for cost savings on the Museum project, and ways in which competitors proposed to minimise costs without sacrificing quality.

A key issue is how to assess the probity of the target cost arrived at by the participants. This will generally be evaluated both by independent verification against industry norms of the "business as usual" (BAU) estimates provided by participants during the competition and by assessing the target cost against a probabilities-analysis estimate of tender prices expected in a conventional tender. This evaluation may necessitate the downward revision of the target cost initially arrived at by the participants. In respect of the evaluation of performance against the target cost and other KPIs, the alliance will have to ensure either independent assessment of performance, or independent verification of performance assessment undertaken by alliance members.

In some circumstances, the project alliance participants enter into an interim alliance contract allowing preliminary work (usually not construction work) to be undertaken whilst these matters are developed. This may significantly increase the cost of the tendering process to the owner, particularly the expense of engaging suitably skilled professionals (such as lawyers and accountants) to provide advice. There is also no doubt the need for significant additional time and resources to be employed by the owner in familiarising itself with this alternative form of delivery system.

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[4]Caine, Ensuring Accountability in Your Alliance Contract—National Museum of Australia Experience, paper presented to the Business Law Education Centre Conference: Government Contracting, (Canberra, August 29 2000).

(2) General Liability

The issue of a contractor's liability under a project alliance is potentially contentious. The "no blame, no disputes" clause will generally free the participants from liability for everything except wilful default. This means that the owner will have no remedy against the other participants for damages, losses, or expenses suffered as a result of negligent, inefficient, or otherwise defective performance of nonowner participants' obligations under the contract. Of course, it works both ways, but given that the nonowner participants are going to be carrying out most or all of the work, the clause impacts the owner much harder than it does the other participants. Thus the owner inevitably takes a "leap of faith" in initiating a project alliance and should do so only where it has a high degree of confidence in the alliance participants and the success of the project.

It has been suggested that there is no reason why under a performance-based contract the contractor should not be liable for those risks clearly within its control.[5] Retaining such liability may be a prudent move, as it is arguable whether the incentive structure alone is robust enough to ensure satisfactory performance, especially since there have been instances in Australia where the contractor has included hidden profit in its representation of direct performance costs.[6]

Finally, it may sometimes be the case that an alliance contract expressly vests responsibility for such things as design, procurement, testing, and defects liability in "the Alliance." As the alliance is a notional entity with no legal standing, this usage is conceptually confusing. It may be taken to mean a reciprocal responsibility of participants to each other, but this again would entail the owner's accepting responsibility for tasks clearly within the contractor's control. Such clauses have yet to be judicially tested.

(3) Cost-related Liability

As described above, nonowner participants are paid on a cost basis and paid their direct costs and some (off-site) overheads regardless of whether the project comes in under or over budget. They are paid the cost of, for instance, work which had to be performed twice due to a design fault or rectification work due to

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[5]Misko and Fielding, Performance-based Contracts: Some Legal and Contractual Issues, paper presented to FMA Australia: Performance Contracting Workshop (Sydney, May 27, 1999).

[6]See, e.g., Placer (Granny Smith) Pty Ltd v. Theiss Contractors Pty Ltd, unreported (Supreme Court of Western Australia, 14 April 2000).

a nonowner participant's negligence. Thus the risk of increased or unforeseen costs falls on the owner, subject to any agreement on the part of a nonowner participant to manage a particular risk. If the contractor performs defective construction work it must of course be rectified. Absent wilful breach, the rectification costs will be borne by the owner. The same applies to defective design services.

This result is reinforced by problems which arise in respect of design insurance. Most insurance available to designers is "liability insurance," under which the insurer will not pay unless the designer is "liable." Where an alliance agreement states that the designer (like all participants) is not liable except for wilful default, a normal policy is unlikely to respond at all because coverage may exist for professional negligence, but there is no liability for it, and most policies exclude liability for wilful default. Accordingly, if the owner is to have any comfort in this area, it will require some tailored form of insurance. Unfortunately for the owner, insurers are generally reluctant to assume the risk of insuring a party which is exculpated from any personal responsibility.

(4) Relationship Liability

There is still a great deal of uncertainty as to the legal and contractual effects of entering into the sorts of relationship contracting commitments involved in a project alliance. Committing to such things as honesty, trust, and sharing may fundamentally alter the parties' legal obligations. Particular care is needed in the areas of good faith undertakings and possible fiduciary relations.

An alliance contract invariably imposes an express or implied obligation of good faith upon the participants. This may result in an obligation upon the participants to, for instance, do all things within their power to give effect to the agreement's spirit of good faith or, less broadly, to act reasonably in all circumstances.

Moreover, project alliances may have the potential to create unintended fiduciary obligations owed mutually among the participants because such arrangements rely on participants' acting in each others' interests.[7] Such an outcome would render the obligations of the participants significantly more burdensome, obliging them, among other things, to disclose all relevant acts and circumstances, to act in the utmost good faith, and not to permit their own interests to conflict, or potentially conflict, with

[7]Misko and Fielding, *supra* n. 5, 13. The authors' reasoning here is based on an analogy of alliances to joint ventures.

the interests of the other participants. Participants which breached a fiduciary obligation would also be exposed to the widest range of remedies available to the court.

The common law relating to good faith and fiduciary obligations is a long way from settled in the context of relationship contracting and alliancing in particular. To avoid uncertainty in such areas, it is by far the best policy to have anticipated and dealt with such obligations in the alliance contract by, for example, expressly providing whether a fiduciary relationship is created and whether the obligation of good faith creates any liability separate from the specific performance obligations under the contract.

V. Strategic Alliancing—The Long Term Relationship

The other side of the alliancing coin is strategic alliancing. The strategic alliance shares some fundamental characteristics with the project alliance; both make provision for performance risks and incentives and are founded upon the parties' stated intention to work cooperatively on a nonadversarial, open-book basis in order to achieve an agreed set of objectives. However, the strategic alliance is distinguishable from the project alliance in a fundamental respect, from which all other points of distinction flow: it is conceived of as a long-term relationship between the participants, enduring beyond any single project.

As a consequence, strategic alliances employ a rather different form of resource allocation. This form of relationship contracting is appropriately employed where the owner requires the performance of routine and ongoing work, or a series of similar or related projects, and seeks to develop a close and long-term relationship with the contractor which assumes these responsibilities. In such circumstances, a strategic alliance is the outsourcing of work to a contractor on a continuing basis and on terms where the participants agree to pursue mutual goals and share the benefits of the alliance. Reasons for instituting such a long-term alliance structure are various:

- The commitment allows the contractor to train its staff and gear up with confidence in a reasonable payoff on investments.
- The duration of the arrangement encourages the contractor to use foresight in its planning and solutions to problems which may arise.
- The costs of tendering and transition are significantly reduced.
- The contractor will accrue expertise and knowledge of the owner's requirements, allowing continuous improvement over the entire term of the contract.

Obviously, it is desirable that a long-term relationship of this kind between owner and contractor is an amicable one. The strategic alliance is a contractual model which is crafted precisely to maximise the sustainability of good and intimate relations between the parties over a long period.

Essentially, the arrangement is the outsourcing of services on a cost-plus basis with built-in incentives for meeting the owner's objectives. However, the strategic alliance arrangement is structured so that the attitudinal aspects of relationship contracting—the development of trust, intimacy, and cooperation between the parties—are encouraged by commercial incentives built into the contract. Without actually affecting ownership of the project, a strategic alliance facilitates the cultivation of an "ownerly" attitude on the part of the service provider toward the facility it is maintaining. Ideally, a strategic alliance should be embarked upon by parties which genuinely see the arrangement as the formation of a new (if nominal) entity—the alliance—established on near-collegial terms. The strategic alliance agreement will incorporate an express duty assumed by participants to act in the best interests of the alliance and to act honestly and in good faith, a "no disputes" clause, providing that all differences of opinion are to be resolved unanimously and within the alliance, and a leadership board administering the alliance, comprising representatives of each participant.

The attitudinal aspects of strategic alliancing can have a genuine impact on cost reduction because an important feature of the alliancing environment is the capacity and willingness to handle changes to the scope of works within the existing contract. Participants are less likely to resort to variation of the contract, reducing both the cost of the works and the costs of disputation over variation claims. Similarly, intrusive events such as latent conditions and industrial disputes are as far as possible handled quickly within the alliance, since the appropriate party is more likely to assume such risk, avoiding the major cost impacts of disputes as to who bears the risk.

One of the distinguishing features of the strategic alliance is the idea of a "core workload." As compensation for the contractor's commitment of resources on a long-term, and perhaps indefinite, basis, it will be allocated or guaranteed a certain amount of work—a core workload—for the period of the alliance. The core workload is regarded as essential to a strategic alliance and is

normally estimated with reasonable certainty over a five-to-seven-year period.[8]

Responding to the issue of how much of a contractor's total resources should be committed to a strategic alliance, it has been considered that "no single [strategic alliance] should utilise more than 30% of the contractor's office resources," and its "total commitment to [the alliance] should not utilise more than 50% of its total technical and managerial resources."[9]

VI. Managing Contractor—The True Contractor

The managing contractor method of project delivery is an innovative structure which shares some of its characteristics with the Design and Construct (or D&C) delivery system, referred to in the U.S. as Design-Build, and others with the agency relationships of construction and project management. The managing contractor model has been extensively used by Department of Defence and private sector owners, and participants in the industry now profess expertise in this field as a result. As always, terminology is not uniform and a number of different models are known by the name "managing contractor." Essentially, however, the managing contractor is a D&C contractor which is responsible for the delivery of the project from feasibility evaluation right through to the commissioning stage. In the sense that it takes responsibility for delivery of the project, rather than merely managing others' delivery of the project, the managing contractor is to be distinguished from a construction or project manager. It is a "contractor" in the true sense of the word. The managing contractor model is suitable to both the design and construction phase and the operation and maintenance phase of a project. The structure for the managing contractor model is shown in Appendix 3.

A managing contractor differs from the more common lump sum D&C contractor in two main respects: *role* and *risk*.

A. Role

The managing contractor's key role is to take ultimate responsibility for the delivery of the project, though not to self-perform the design or construction of it. The managing contractor usually subcontracts out all of its design and construction obligations. The only services carried out by the managing contractor itself, using in-house resources, are the management

[8]McGeorge, Palmer, and London, Construction Management: New Directions, 242 (2002).

[9]McGeorge et al., *supra* n. 243.

and advice services provided throughout the project and the provision of preliminaries, such as hoardings, plant, sheds, etc.

In this respect, the practical difference between a managing contractor and a D&C contractor may not be great, since modern contractors tend to subcontract rather than self-perform most of their obligations, irrespective of the basis on which they have been contracted. The difference is that subcontracting is carried out in close consultation with the owner, which has the ultimate right to select subcontractors (consistent with the subcontract price being reimbursable). Furthermore, the managing contractor often provides more services to the owner in the way of general project management and advice than a D&C contractor.

A managing contractor arrangement for the delivery of a project would proceed as follows:

- The owner invites tenders under which, at the inception of the project, potential contractors must quote prices for management services and defined common site facilities.
- The successful tenderer coordinates the feasibility stage of the project, including hiring any consultants required, and provides any relevant advice to the owner. If the project does not get past feasibility stage, the managing contractor contract may be terminated.
- The managing contractor manages the design phase, from concept through to detailed documentation, in all stages consulting closely with the owner, which has the final say as to all decisions made. The managing contractor prepares a brief, which must be approved by the owner before tenders are called, and recommends a tenderer for the design work, but the final choice is subject to the owner's approval. The owner also approves the design before it is constructed. This procedure is to be distinguished from a turnkey arrangement, under which the owner keeps its involvement in the design phase to a minimum for fear of diluting the contractor's design liability and affecting any warranty for fitness of purpose.
- During the construction phase, the managing contractor:
    - advises on the appropriate contract strategy for each package;
    - manages the tender process and award of packages;
    - engages subcontractors to execute the construction work;
    - programs the construction work;
    - supervises construction in accordance with design;
    - manages and administers the subcontracts;
    - institutes a system of cost control;
    - manages community relations; and

- manages industrial relations on the project.

The process of selecting subcontractors is again consultative, so as to provide considerable control to the owner.

- The final stage of the project, as far as the managing contractor is concerned, is commissioning, during which the managing contractor coordinates the project's handover and rectifies any defects which become apparent during the defects liability period.
- The managing contractor is paid a lump sum to cover its profit and the cost of management services and defined common site services which it provides.
- The managing contractor is reimbursed the amounts actually payable to design consultants and construction subcontractors, excluding the cost of unauthorised variations and of any work carried out to rectify defective work, amounts payable due to breach of contract or wrongful act by the managing contractor, and any other expense not properly incurred.

B. Risk

The other feature distinguishing the managing contractor is the risk it bears, which is lower in terms of both cost and quality than that to which a lump sum D&C contractor is exposed.

In respect of cost, while a D&C contractor normally receives lump sum remuneration, a managing contractor is, as demonstrated above, paid a combination of lump sum and reimbursable components. Management services and site facilities are paid for by way of lump sum, but the monies paid to subcontractors and consultants for their services are reimbursable by the owner, subject to a number of limitations designed to make sure that the managing contractor is not reimbursed for any costs incurred unreasonably. In essence, the managing contractor receives cost-plus remuneration. It is crucial that the owner administers the contract skilfully if it is to take advantage of this scheme. This is not a contract structure for inexperienced owners.

In respect of quality, the managing contractor is not subject to the fitness for purpose warranty normally provided by D&C contractors. Its obligations in respect of design and construction are separated from one another. The managing contractor must ensure that the design consultancy services are carried out with the appropriate level of care and skill, and is not relieved of this obligation by having subcontracted the consultancy services. It thus plays the role of a prime contractor. As regards the construction phase, the managing contractor bears a number of risks re-

lating to coordination, defective work, and subcontractor default. The managing contractor may also have a soft completion deadline.

This risk profile is used in order to minimise the commercial tension with the owner and enhance the "relationship" character of the delivery method.

C. Pros and Cons

The managing contractor strategy seeks to capture the benefits of D&C project delivery while providing a significant amount of flexibility and control to the owner. Should an owner choose this model, it will enjoy the following advantages over conventional project delivery:

- There is single point responsibility. In administering the contract, the owner need only look to the managing contractor, with which its sole contractual relationship exists (aside from any independent consultant engaged by the owner).
- The owner has a high degree of control over the management of the project, especially by means of its right ultimately to choose which consultants and subcontractors are used, and its right to approve design.
- Despite the limited risk imposed on the contractor, accountability is achieved through the requirement that costs incurred by reason of the managing contractor's fault will not be reimbursed.
- The contractor can influence the design of the project and thus take "buildability" considerations into account. Furthermore, the fact that the owner has significant input under this model obviates the D&C contractor's lack of incentive to provide for long term "maintainability" in design. In terms of design, therefore, the managing contractor model affords the owner the best of both worlds.
- The owner can harness the contractor's management skills. Whereas under traditional project delivery, the contractor's management skills go towards containing costs so as to produce a margin for itself, a managing contractor ideally produces savings for the owner.
- The managing contractor structure is appropriate for a project whose final project costs cannot be predicted at the outset.
- The financial interests of an owner and a managing contractor are more closely aligned than under more traditional contracts. This makes it possible to minimise adversarial behaviour and the costs of defending each party's contractual position and to build a team approach.
- The large reimbursable component of the contract price

keeps the contractor's risks low so that few risk premiums will be included in bid prices and tenders will be competitive.

- The reimbursable element is established by market testing and costs are both accountable and transparent.

Disadvantages to the owner where a project is delivered by a managing contractor include these:

- Very little work is tendered at the time the project is committed, giving the owner little confidence in the estimated final cost at the time of commitment, cost control being one of the managing contractor's deliverables.
- The owner's risk exposure is greater than under traditional construction contracts, although this of course means that the owner is able to manage its risks as it wishes.
- The extensive consultative process required in making decisions as to the design and identity of consultants and subcontractors may add to the cost and duration of the project.
- Considerable skill is required in the owner's contract administration in order to eliminate all nonreimbursable costs incurred by the managing contractor.

VII. Case Studies in Australia

Perhaps the owner is not in a position to be able to evolve an existing harmonious relationship with a service provider into a strategic alliance, or perhaps, for reasons including fiduciary implications or the owner's unwillingness to accept virtually all risk for work undertaken by the contractor, "all-out" alliancing is simply an inappropriate approach. This does not mean that the owner must settle for conventional contracting. A creative outlook can combine elements of different contractual models to suit the project or works at hand.

A. Defence CMC—A Combination of Models

The Department of Defence's Comprehensive Maintenance Contract (CMC) is an example of mixed models. In 1993, Defence embarked upon a new maintenance contract strategy, commercialising its requirements for general building and facilities maintenance management (GB&FM) and fixed plant and equipment maintenance (FP&EM).

Originally involving two separate contracts, the GB&FM works were conducted under a managing contractor model and the FP&EM services under a performance-based model, which incorporates various notions of relationship contracting. The new CMC combines the two into one contract.

1. Managing Contractor Element

The GB&FM component of the CMC continues to be executed

by a managing contractor. The nature of GB&FM works encompasses unplanned maintenance works (small property repairs and improvements) and planned works, identified and detailed as part of an annual facilities appraisal process.

The contractor's role in relation to GB&FM is not directly to deliver the works, but to engage subcontractors to do so and then assist Defence in planning, organising, and managing the works. Typically the maintenance work is reactive, rather than predictive or preventative. Accordingly, the contractor does not assume risk of defects; such risk remains squarely with Defence. The contractor, as manager, is reimbursed for costs which are properly and actually payable to the subcontractors under the terms of the subcontracts, on top of which it is paid a GB&FM management fee (as part of the CMC lump sum fee). The contractor therefore does not assume any risk in its management fee, except to the extent that the value of the GB&FM work exceeds the level which it initially anticipated in submitting its fee.

2. Performance-based Element

By contrast, the FP&EM services are performance-based and incorporate a mixture of predictive, preventative, and reactive maintenance measures. Defence's role here is to identify performance requirements and set them out in a specification. The contractor is expected to plan and carry out its maintenance activities in light of the specification and correct all defects in performance to ensure that the plant and equipment operate as required throughout the term of the contract.

The contractor is paid a fixed fee (as part of the CMC lump sum fee) for all of these activities. The fixed fee covers the costs of correction of all defects, unless the contractor can demonstrate that the work required to correct a defect falls into one of two limited categories:

- where the occurrence of the defect is beyond the contractor's control (force majeure work); or
- where responsibility for the defect is "grey" (latent conditions work). Here the contractor accepts the first portion of the cost risk, up to a cap; to demonstrate entitlement to the cap, the contractor must show that the need for the rectification work was not due to its failure to plan or execute maintenance work under the contract.

The FP&EM component is the "visionary" aspect of the maintenance strategy, designed to:

- provide a strong incentive for the contractor to reduce unplanned maintenance, by carrying out an optimal level of

predictive and preventative maintenance, and to establish a continuous improvement cycle;

- encourage a "one-team approach" between Defence and the contractor and build a long-term relationship;
- transfer a sensible proportion of the risk of breakdowns and nonconformances from Defence to the contractor under an agreed risk-sharing approach; and
- achieve a shift from traditional reactive and task-oriented maintenance to a proactive and performance-oriented maintenance strategy.

These ends are primarily achieved through performance monitoring and incentives. Performance is measured against Evaluation Criteria, provided by Defence and agreed to by the contractor, which identify areas of paramount importance to Defence and specify quantitative and qualitative assessment mechanisms. The contractor is furthermore required to identify cost savings during the term of the contract which would result in a reduction of the CMC fee.

3. Some Conventional Aspects Retained

The most important conventional contracting aspect of the CMC is that the contract is administered by the Contract Administrator, who is an agent of Defence, and does not have an independent certification role. There are also such aspects as a defects liability period and provision for termination for convenience, each of which obviously strengthens the confidence of the owner under the contract. Furthermore, unlike under an alliance, dispute resolution procedures are retained; indeed the CMC provides for a spectrum of procedures: expert determination, executive negotiation, and arbitration.

Thus it can be seen that relationship contracting, other contractual innovations (such as the managing contractor model), and conventional contracting can be eclectically combined to best implement the owner's specific strategy. Here, the relationship contracting elements of performance measures, incentives, and a "one-team" approach provide the basis for a long-term, harmonious relationship between Defence and the contractor, facilitating the contractor's role in preemptive maintenance, cost-saving, and continual improvement. These features exist within the context of preestablished, "sensible" risk-allocation, which more closely approaches conventional contracting. Where unplanned maintenance work is required, the contractor operates in "managing contractor" mode, outsourcing smaller task-based jobs. This combines to form a comprehensive strategy for maintenance in general.

B. Australian Rail Track Corporation Improvement Alliances

The Australian Rail Track Corporation (ARTC) rail network improvement alliances are prominent recent examples of the use of hybrid alliance structures for large-scale infrastructure programmes. In late 2005, the ARTC (which is responsible for the management of over 10,000 kilometres of interstate rail track in Australia) entered into:

- the North Coast Improvement Alliance (indicative value A$220 million) for the upgrading of the North Coast rail corridor, with a joint venture between Barclay Mowlem and Balfour Beatty; and
- the Southern Improvement Alliance (indicative value A$560 million), for the upgrading of the Sydney-Melbourne freight rail line, with a consortium led by John Holland, MVM Rail and O'Donnell Griffin.

Both alliances have an initial term of three years, with the possibility of extensions, and cover a number of individual improvement projects of varying sizes, so are probably better described as program alliances rather than project alliances, or perhaps as a hybrid of the two concepts.

In terms of remuneration, the North Coast and Southern Improvement Alliances adopt the basic form of the pure alliance model by requiring the ARTC to pay the contractors' direct costs, other than those arising from defects or a contractor's failure to comply with the contract, a percentage of the contractors' direct costs for profit and contribution to corporate overheads, and 50% of any net savings against the overall budget of each alliance programme to be shared between the other alliance participants in a proportion determined by their representatives on the alliance board.

However, the remuneration structure is also somewhat different from that of many other alliances in that the contractors' fee payments are not a lump sum but rather a percentage of the direct costs and only 10% of the contractors' fee payments are at risk, and this 10% is subject only to a limited number of KPIs (against which the contractors' performance is measured on a quarterly basis).

The reason that a relatively low percentage of the contractors' fees are at risk, and are assessed against a limited number of KPIs, is that the alliances also depart from the pure alliance model by omitting the no blame, no disputes clause (though the contracts do emphasize that disputes should be resolved on a nonadversarial and mutually beneficial basis). The absence of the

no blame, no disputes provision allows the ARTC to pursue claims against the contractors if they fail to meet the requirements of the contract, particularly those other than in respect of cost or time, so that the owner need not rely entirely on deductions from contract payments in order to incentivise the contractors and align their interests with its own. This is a good example of the way in which, in a hybrid alliance, a change to or the removal of one of the "core" pure alliance features may allow, or even necessitate, a change to another.

The decision-making structures for the alliance hew closer to the pure alliance model. For each alliance there is an alliance board (responsible for the high-level management of the alliance projects and the alliance as a whole) and an alliance management team (responsible for the specifics of project management), both comprised of representatives of the ARTC and of the contractors. Decisions of the alliance boards require the unanimous agreement of the board members (though the ARTC may unilaterally amend individual projects or the works programme as a whole) and there is no contractual deadlock breaking mechanism.

C. Rail Access Corporation IWMP Alliances

Illustrative of program alliancing within the rail sector are the Infrastructure Works and Maintenance Services Provider (IWMP) contracts let by the then New South Wales (NSW) Rail Access Corporation (RAC) in the mid to late 1990s. At the time, RAC owned and maintained the NSW rail network on behalf of the NSW Government. The subject matter of IWMP contracts was the programmed and periodic maintenance of existing rail infrastructure, the design and construction of new capital works, and signal and communications work as directed by the owner. The initial plan was that RAC split the rail network into 13 bundles of work, which would be tendered on the open market (so that the Rail Services Authority (RSA), then the maintenance arm of the State Rail Authority, would have to compete with the private sector to obtain maintenance work).

RAC's chosen approach was that of a program alliance, with the work to be carried out on a cooperative, profit-at-risk basis for a term of five to seven years and encompass any project within the scope of IWMP works within that period. In particular, the program alliance approach suited RAC for the following reasons:

- Because the entire scope of works was unknown at the outset, a strategic alliance structure provided more flexibility, and hence cost reductions, as the scope became known.
- Benchmarking between projects facilitated continuous improvement.

- Reduced durations for maintenance tasks led to enhanced track availability.
- Because costs were reimbursable, the IWMP was not encouraged to cut corners on quality and safety.
- The potential for cost blowout was reduced because changes to the scope of works were handled within the alliance, rather than by variation to the contract. Similarly, intrusive issues were handled quickly within the alliance and without major cost impacts.
- A long-term alliance partner was better able to understand and thus contribute to RAC's asset management process.
- The longer term allowed the IWMP to take on the attitude of owner.
- Performance was measured against KPIs negotiated between RAC and a preferred IWMP prior to entry into the agreement. The essential aspects by which performance was measured were flexibility to change operating requirements to suit user needs (e.g., train path availability, possessions, timetabling), value for money, reduced elapse time for tasks, safety, and asset reliability and availability.

Remuneration comprised three elements: reimbursable costs, fixed overheads, and fee. Reimbursable costs included labor, materials, equipment, and subcontract costs. Fixed overhead costs were site/contract specific, excluding corporate overhead. RAC covered these two elements of cost. All fee, on the other hand, was put at risk, and paid according to achievement of the KPIs. Poor KPI performance could lead to significant reduction in fee earned, possible contract term reduction, and even termination of the contract if poor performance endured over a period. However, unlike those established under a project alliance, KPIs were subject to refocusing/re-evaluation by the Alliance Board on an annual basis.

An example of an apparently successful tender was the Blacktown to Richmond line bundle, which was let to the Rail Infrastructure Alliance, an alliance formed between Thiess and the RSA. This bundle comprised a $90 million contract for the provision of infrastructure works and maintenance services on the Blacktown-Richmond line for the period from October 1997 to December 2002. The IWMP's performance was consistently excellent against all KPIs.[10]

[10]However, industrial disputes (arising as it emerged that RSA was not able to secure the predicted volume of tenders, and was only awarded IWMP

VIII. Conclusion

The concept of relationship contracting ranges broadly from sensible project management irrespective of the contract terms (partnering) to a radical contract model (project alliance). Within this wide church there are many means by which the undesirable aspects of adversarial lump sum contracting can be ameliorated. Unfortunately developments in the area have been attended by "fads" which when promoted unthinkingly can lead to unintended consequences and thus to criticism of useful concepts which if not trivialised or oversimplified can be drawn upon to add great value to project delivery. This phenomenon is not always assisted by the industry's continual hankering after standard forms which, though valuable in repetitive, well-understood situations, can lead to the stifling and sometimes the perversion of innovation.

Informed debate on the concepts and options is critical and it is hoped that this article may make a contribution to the debate.

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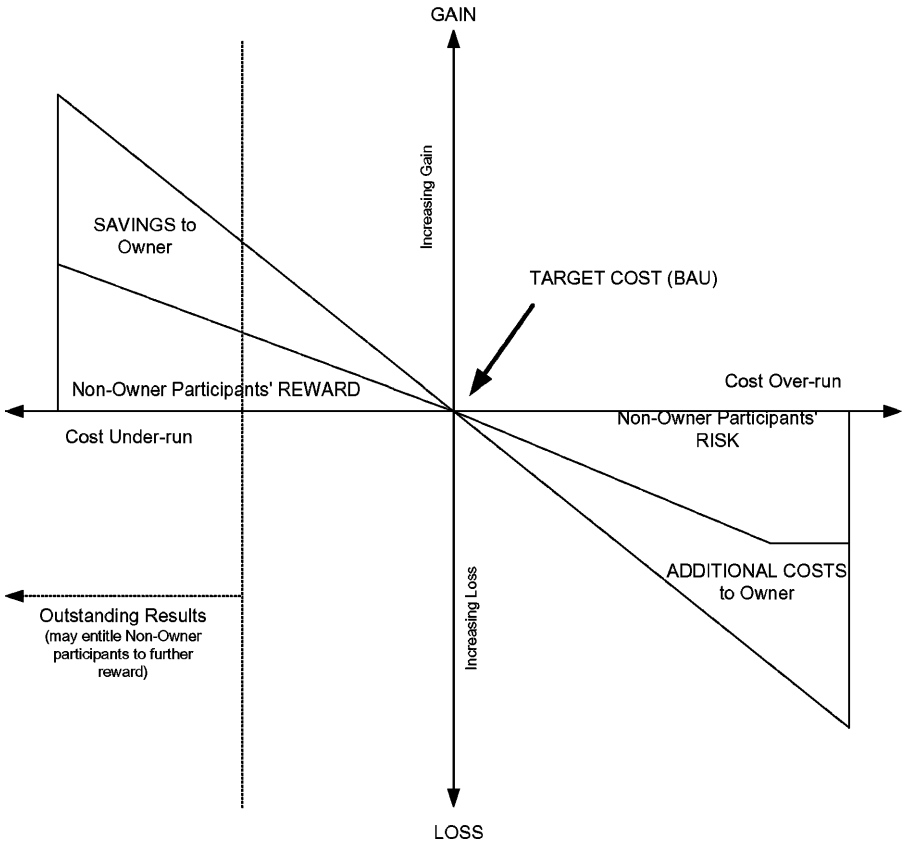
work when applying in alliance with a private sector contractor) resulted in a moratorium being placed upon further maintenance contracting.

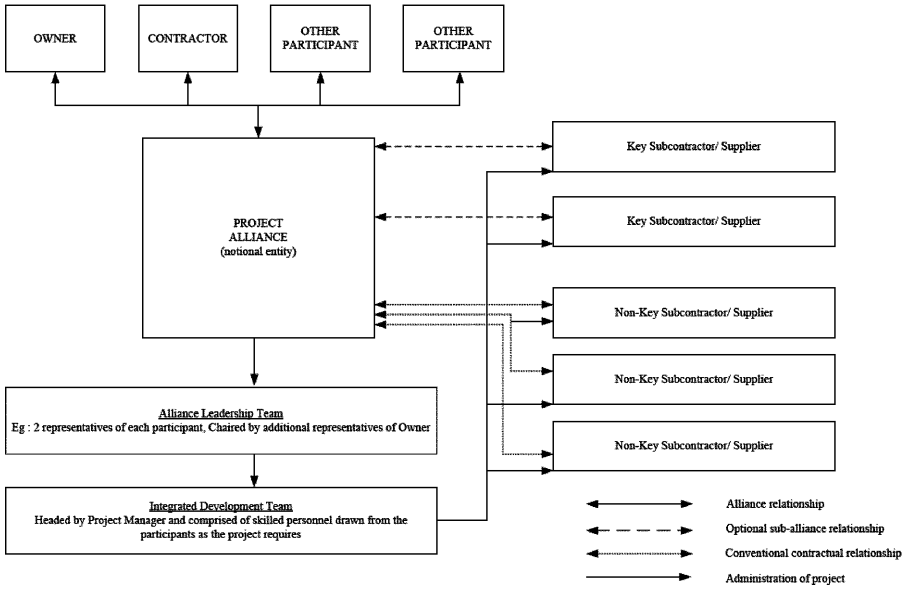
Appendix 1

BASIC RISK / REWARD CURVE

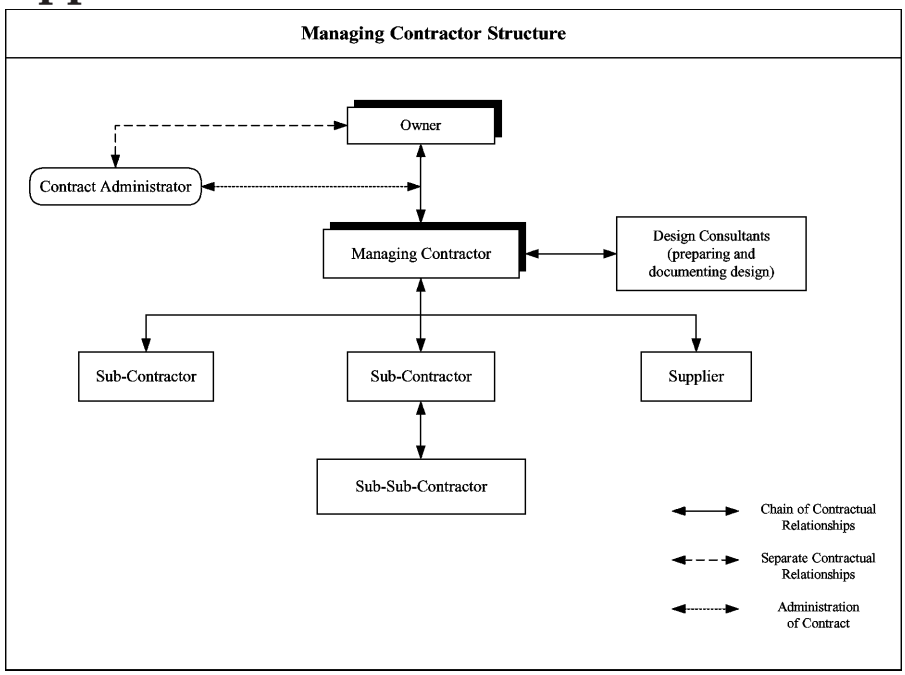


Appendix 2

PROJECT ALLIANCE STRUCTURE



Appendix 3


Managing Contractor Structure
Owner
Contract Administrator
Managing Contractor
Design Consultants (preparing and documenting design)
Sub-Contractor
Sub-Contractor
Supplier
Sub-Sub-Contractor
Chain of Contractual Relationships
Separate Contractual Relationships
Administration of Contract