Keeping the Options Open: Alliancing and Other Forms of Relationship Contracting with Government*

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Much has been said and written of the way in which project delivery in the construction industry can be genuinely altered by addressing the fundamentals of the relationship between owner and contractor. The concept of co-operative or relationship contracting is a means of attacking the wastefulness of the conventional adversarial positions of parties to a construction contract. While this concept is broad and inclusive, the discussion has tended to focus initially on partnering, and more recently on project alliancing, to the exclusion of other means of relationship contracting.

The experience so far in Australia indicates that project alliancing in particular may bring real benefits to projects which, for instance, involve fast track design, or otherwise require flexibility during delivery. However, it is well to keep in mind that relationship contracting encompasses other options which may be more suitable to a particular project. Furthermore, the appropriate approach in any given case may involve a judicious combination of some elements of relationship contracting and others of conventional contracting.

This paper first examines the phenomenon of relationship contracting. It then distinguishes project alliances from partnering. Thirdly, it looks at other emanations of relationship contracting, and finally discusses some particular challenges which are faced with the use of project alliances in the public sector.

Table of contents

Introduction

Relationship contracting generally

It is increasingly recognised that the "zero-sum" mentality — "your gain is my loss" — which traditionally characterises the construction industry is counter-productive. The belief that any profit made is at the other party's expense is structurally enshrined in the conventional construction contract and generates a variety of inefficiencies. At best, it creates a culture of defensiveness. Significant amounts of time and money must be put into the routine of each party defending its contractual

position. Even where the parties are on relatively good terms, project management costs will include, for instance, full and detailed documentation in case of later dispute. Where problems do arise, they will be dealt with by blame-allocation rather than by a collaborative search for solutions. Differences of opinion escalate into disputes and claims, as the informal adversarial attitudes of the parties harden into formal conflict. This reappears as defensiveness in the general context of contractual negotiations, which become an exercise in each party attempting to transfer more risk onto the other.

Moreover, the conventional construction contract is not an instrument which facilitates excellence of outcome. The delivery of the project itself 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 expense of producing substandard results. Design work is not a matter of exploring the best solution for the owner's purposes, but rather of the inflexibility prompted by cost constraints. Importantly, the 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 contractual requirements: there is little in a traditional construction contract to reward outstanding work or to encourage the contractor to strive for an excellent result.

It is in response to this state of affairs that "relationship contracting" has developed. This term embraces a wide and flexible range of approaches to managing the owner-contractor relationship, based on recognition that there is mutual benefit in a cooperative relationship between owner and contractor. This is often expressed in the literature 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, parties may well find they have arrived at solutions to areas traditionally characterised by divergence of their interests.

In one sense, the realities of project delivery have always necessitated relationship contracting. As one commentator states:

> "In truth we [already] have a large volume of relationship contracting. We sign tough contracts but then all the parties put them in the bottom drawer and get on with the job."[1]

However, 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 owner and contractor. The Australian Constructors Association (ACA), for instance, has heavily 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."[2]

Allowing for the ACA's rose-coloured presentation of relationship contracting as a general panacea, some key 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 non-conformance.

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

Project alliances and partnering

By now, the relationship contracting method of

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[1] J Service, "Alliancing: For Richer, For Poorer" (1999, July) *Chartered Building Professional* 8 at 9.

[2] Australian Constructors Association, *Relationship Contracting: Optimising Project Outcomes* at 5.

partnering will be familiar to most people involved in the construction industry. Partnering is an informal understanding between the client and contractor as to how they will conduct business. The parties will typically sign a partnering charter which sits behind the standard construction contract, setting out a moral framework of commitment, equity, trust and mutual goals. The usual criticism with such a "gentlemen's agreement" is that it is non-binding and outside the construction contract,[3] but partnering has at various times been much hyped as a potential solution to the problems of project inefficiencies and construction claims and disputes.

Similarly, *project alliancing* is becoming increasingly explored as a means of solving entrenched problems in the construction industry. It may be seen as an approach which takes the ideas behind partnering and renders them more commercially and legally robust. Without going into great detail, this robustness derives from two primary elements of alliancing: the formal alignment of commercial objectives and the provision for "no blame, no disputes".

It is true that all relationship contracting involves some kind of alignment of objectives (given that relationship contracting is essentially an attempt to identify a win-win solution). However, alliancing is distinctive in that the alliance agreement will structure the contract such that commercial risk and reward is shared and it is in all parties' business pecuniary interests to work co-operatively. This is primarily achieved by a performance-or incentive-based remuneration structure. The owner will agree to meet all the direct costs and some overhead incurred by non-owner participants and provide additional reward at risk. The establishment of a target cost and risk/reward curve will allow benefits of any savings or the burden from any overrun to be shared according to a prearranged formula. Performance is measured against the target cost and any other Key Performance Indicators (KPIs) which suit the owner (but are negotiated amongst the alliance members). Key Performance Indicators might include, for instance, environmental or safety standards. Outstanding performance as against the KPIs may result in extra reward for the non-owner participants.

The second distinctive feature of a project alliance is the "no disputes" clause. All disputes are to be resolved by the alliance board (the alliance's governing body). Participants will agree not to use arbitration or litigation as a dispute resolution technique, and that no participant has a legal or equitable cause of action against any other participant except in the case of wilful default or possibly insolvency. The rationale is obviously avoidance of an adversarial climate; typically the alliance board will be required to reach unanimous decisions. The concept of "no blame, no disputes" is considered to be inherent to project alliancing.[4]

These features of project alliancing represent a high-water mark in the relationship contracting: the agreement expressly provides a strong legal and commercial basis for the principles of co-operative project delivery.

A qualified thumbs-up

There are arguable benefits to public sector agencies in utilising alliancing as a method of project delivery, in respect of both meeting the demands of budgetary austerity and of ensuring 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 or requires many circumstances and practices which 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.
- There is incentive to strive for best practice

[3] For discussions of problems associated with partnering, see, for instance, J Dorter, "Implications of Partnering for Mining and Construction" (1996) 12 BCL 174; G Dennehy, "Partnering in the Construction Industry — Is it the Answer?" (1997) 54 ACLN 37; P Davenport, "Partnering — the Next Step?" (1994) 36 ACLN 55; and J Tyrril, "The Dark Side of Partnering" (1998) 9 ADRJ 165.

[4] A Abrahams and A Cullen, "Project Alliances in the Construction Industry" (1998) 62 ACLN 31 at 35.

and outstanding results, rather than to do merely the minimum required to avoid a penalty.

These factors add up, in the avoidance of dispute and all kinds of waste, to an enormous potential for the project alliance to bring the project in at (or under) cost and on schedule, a fact recognised by its increasing implementation by various Australian government agencies.[5]

Additionally, project alliances allow public agencies to more rigorously assure performance in respect of the non-cost objectives which may be crucial to the owner. Intense scrutiny of the delivery of public works projects by stakeholders and the public at large make it overwhelmingly desirable to the owner that it can strictly monitor such non-cost objectives as environment and safety. Furthermore, the flexibility of the benchmark mechanism is such that the kinds of objectives which the owner can entrench as performance measures are limited only by what can be broken down into an objective measurement scheme. 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 the employment of indigenous people. This demonstrates that the project alliance structure can be adapted to meet the circumstances of the particular owner and project.

However, while project alliancing is a promising approach to the delivery of certain kinds of projects, it should be kept in mind that relationship contracting encompasses more than project alliancing and partnering. Different strands of relationship contracting may be more applicable to different kinds of projects, or different policies or plans adopted by the individual owner. Some approaches may be subtle but important variations on the approaches already discussed; others may seek to combine the best aspects of relationship contracting with the best of conventional contracting. The examples of strategic alliancing and the managing contractor model, are two such distinct approaches, discussed in the following section "Other options".

Other options

Strategic alliance model

Strategic alliancing as long-term alliancing

As is indicated by the name of this approach, the strategic alliance shares some fundamental characteristics with the project alliance. They both make provision for performance risks and incentives and are founded upon the parties' stated intention to work co-operatively on a non-adversarial, 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 as a long-term relationship between the participants, enduring beyond any single project.

As such, strategic alliances operate on a distinct rationale and employ a rather different form of resource allocation. Essentially, the appeal of strategic alliancing is most apparent where the owner's requirements involve the performance of routine and ongoing work, or a series of similar or related projects and where there is impetus for the owner to decrease its engineering and/or maintenance departments. 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. In particular, the reasons for instituting a long-term alliance structure include:

- The longer term allows the contractor to train its staff and gear up in the confidence of a reasonable amortisation of its investments.
- The longer term facilitates a more complete fruition of the attitudinal aspects of alliancing: the development of trust, intimacy and co-operation between the participants, and the adoption by the contractor of a more "owner-like" attitude.
- Where the work involved is, for instance, infrastructure, the duration of the strategic alliance encourages the contractor to use foresight in its planning and solutions to problems which may arise.

[5] On the general level of acceptance of project alliancing in government bodies, see J Prately, "Project Alliancing: Does it Work?" (1999, July) *Building Australia* 33.

- Subject to probity considerations,[6] under a strategic alliance the costs of tendering and transition are significantly reduced.
- Improvement in performance will be continuous across projects.

Given that the contractor under a strategic alliance will be committing resources on a long-term and perhaps indefinite basis, it will as compensation for this risk 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 5-7 year period.[7] There has been discussion of how much of a contractor's total resources should be committed to a strategic alliance, and 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".[8]

Illustration: Rail Access Corporation IWMP alliances

Illustrative of strategic alliancing are the Infrastructure Works and Maintenance Services Provider (IWMP) contracts let by the NSW Rail Access Corporation (RAC). RAC owns and maintains the NSW Rail network on behalf of the NSW Government. The subject matter of IWMP contracts is 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 client. The initial plan was that RAC split the rail network into 13 bundles of work, which would be tendered on the open market (such that Rail Services Authority, 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 strategic alliance, with the work to be carried out on a co-operative, profit-at-risk basis for a term of 5-7 years (that is, encompassing any project within the scope of IWMP works within that period). In particular, the strategic alliance approach suited RAC for the following reasons:

- Because the entire scope of works is unknown at the outset, a strategic alliance structure is appropriate in providing more flexibility, and hence cost reductions, as the scope becomes known.
- Benchmarking between projects facilitates continuous improvement.
- Maintenance tasks durations are reduced leading to enhanced track availability.
- Because costs are reimbursable, the IWMP is not encouraged to "cut corners" on quality and safety.
- The potential for cost blowout is reduced because changes to the scope of works are handled within the alliance, rather than by variation to the contract. Similarly, intrusive issues are handled quickly within the alliance and without major cost impacts.
- A long-term alliance partner (IWMP) will be able to better understand and thus contribute to RAC's asset management process.
- The longer term allows the IWMP to take on the attitude of owner.

Performance is measured against KPIs negotiated between RAC and 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 (for example, train path availability, possessions and timetabling);
- value for money;
- reduced elapse time for tasks;
- safety;
- asset reliability and availability.

Remuneration comprised three elements: reimbursable costs, fixed overheads and fee. Reimbursable costs included salaries/wages, material, equipment and subcontract costs. Fixed overhead was those costs which were site/contract specific, excluding corporate overhead. Each of these were covered by RAC. All fee, on the other hand, was put at risk and paid according to achievement under the KPIs. Poor KPI performance could lead to significant reduction in fee earned, possible term reduction and even termination of the IWMP if poor performance endured over a period.

[6] See below under "Probity issues".
[7] B Loriane and R Flint, "The Requirements of Partnering", in NECD, *Partnering: Contracting without conflict*, Report June 1991.
[8] Ibid p 56.

However, unlike under a project alliance, KPIs were subject to re-focusing/re-evaluation by the Alliance Board on an annual basis.

An example of an apparently successful tender is the Blacktown-Richmond line bundle, which was let to the Rail Infrastructure Alliance (RIA), an alliance formed between Theiss 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 October 1997-December 2002. To date, the IWMP's performance has been consistently excellent against all KPIs.[9]

Risks or disadvantages of strategic alliances

As should be clear from the foregoing explanation, a strategic alliance has more specialised applicability than does a project alliance. In particular, certain risks and disadvantages are faced by parties who enter a strategic alliance. From the perspective of the contractor:

- There may be a possible loss of business from other clients because of a perceived special relationship with participating clients.
- Although the contractor is guaranteed a workload (the core work program), the margins are lower.
- If the core work program does not materialise, or is too variable, the commitment of resources by the contractor may prevent it obtaining adequate return on its personnel assets.
- A possible "blurring" of contractual rights and obligations may give rise to the owner requiring work without documentation.

From the perspective of the owner:

- The absence of competitive bidding may reduce the benefit to be gained from any market turndown and remove the market pressure upon contractors to keep costs down.
- There may be possible contractual uncertainty as to the contractor's obligations.

On the whole, a strategic alliance requires a higher degree of trust from all parties than that required under a project alliance. The invitation to form a strategic alliance is likely to come out of a situation where the parties have a history of working together harmoniously.

Defence CMC model

Mixing models

Perhaps the owner is not in the position to be able to evolve an existing harmonious relationship with a service provider into a strategic alliance, or perhaps, for whatever reason, possible fiduciary implications,[10] or the owner's unwillingness to accept virtually all risk for work undertaken by the contractor, makes "all-out" alliancing 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.

The Department of Defence's Comprehensive Maintenance Contract (CMC), is an example of mixing 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 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 in-the-one contract.

Managing contractor element

The GB&FM component of the CMC continues to be executed under the managing contractor model. 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 to actually deliver the works, but to engage

[9] However, industrial disputes (arising as it emerged that RSA was not able to secure the predicted amount of tenders and was only awarded IWMP work when applying in alliance with a private sector contractor) resulted in a moratorium being placed upon further maintenance contracting.

[10] See "General liability issues" below.

subcontractors to do this 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 sits squarely with Defence.

The contractor, as manager, is reimbursed the costs which are properly and actually payable to the subcontractors under the terms of the subcontract, 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.

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, so as 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 the defect falls into one of two limited categories — either:

- where the occurrence of the defect is beyond the contractor's control (force majeure work); or
- where responsibility for the defects 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 a failure by the contractor 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 non-conformances from Defence to the Contractor under an agreed risk-sharing approach; and
- achieve a shift from traditional reactionary and task-oriented maintenance to a proactive and performance-oriented maintenance strategy.

This is primarily achieved through performance monitoring and incentives. Performance is monitored against Evaluation Criteria provided by Defence and agreed to by the contractor which identify areas of paramount importance to Defence in the performance of maintenance work. They specify quantitative and qualitative assessment mechanisms to enable the parties to measure performance against specified targets. 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.

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 strengthen 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 pre-emptive maintenance, cost-saving and continual improvement. This occurs within the context of pre-established, "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.

Issues to keep in mind

Having looked at various approaches within the broad understanding of relationship contracting, it is nonetheless important to note some issues and potential risks inherent in the adoption of relationship contracting by government bodies. The probity issues discussed below relate specifically to situations in which the owner is a public body or agency. However, general issues of liability are also addressed. The following discussion primarily focuses on issues arising under project alliancing, but most aspects will be applicable to relationship contracting generally.

Probity issues

The public sector is unlike the private in that it is accountable to the public and subject to audit and political scrutiny. Thus a particular issue in respect of public sector project alliances is the need to demonstrate probity in three particular areas:

- the procurement process;
- the establishment of a target cost and other KPIs; and
- the assessment of performance.

It should be apparent that the arrangement observes the core principles of value for money, open and effective competition, fair dealing and accountability and reporting.[11] This is more complicated where selection does not include valuation of lump sum contract prices. Furthermore, it must be clear that there is no taint of collusion between alliance members in a structure where adversarial scrutiny is replaced by collaboration not only in establishing the project cost, but in assessing the criteria for remuneration.

It is possible to adopt procedures to meet these concerns.[12] 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 able to be met by ensuring an open and transparent process. The publication and release to the industry of the call for proposals and the basis of selection represents no significant departure from current practice. A further strategy to maximise competition can be found in the Northside Storage Tunnel example of the owner's "keeping the runner-up on the backburner" — that is, even while entering detailed negotiations with the preferred contender, a runner-up is kept on hold in order to maintain alternative options right up until the deal was signed. And the requirement of securing best value for money is achieved 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 respect of procurement for the National Museum of Australia project.[13] Assessment was conducted on a number of factors including the quantum of variation claims on past projects, credible suggestions for cost savings on the Museum project and the methodology 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 in two ways. First, by independent verification of the BAU estimates provided by participants against industry norms. Secondly, by assessing the target cost against a probabilities-analysis estimate of tender prices had the project gone to conventional tender. This 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

[11] Commonwealth Department of Finance and Administration, *Commonwealth Procurement Guidelines: Core Policies and Principles* (1998) at 3. See also, for example, New South Wales Government *Policy Statement: NSW Government Procurement*, White Paper (1999).

[12] A strategic alliance is more open to the criticism that it is merely a "cosy" relationship between the parties: see R Palles-Clark, "Objective Assessment and Selection of Partners by Government" (1998) 14 Const LJ 240.

[13] G Caine, "Ensuring Accountability in Your Alliance Contract — National Museum of Australia Experience", paper presented to Business Law Education Centre Conference, *Government Contracting 2000*, August 2000, at 3.

and other KPIs, the alliance will have to ensure either independent assessment of performance or independent verification of performance assessment undertaken by alliance members. It is crucial to develop a detailed and comprehensive assessment regime with objectively quantifiable benchmarks, such that the transparency and accountability principles are satisfied. There are, therefore, effective techniques which ensure probity in a project alliance, but they will involve significant cost, incurred in both the time taken to develop KPIs and benchmarks,[14] and in the requirement of independent scrutiny.

General liability issues

In addition to the probity issue (which as we have seen relates specifically to public sector owners), any participant must consider general liability issues which arise under a project alliance and sometimes under other forms of relationship contracting. The issue of the contractor's liability under a project alliance is a potentially contentious one. As seen above, the "no blame, no disputes" clause in an alliance agreement will generally free the participants of liability in respect of everything except wilful default, which is usually given a very narrow definition, such as:

> "such wanton or reckless act or omission as amounts to a wilful and utter disregard for the harmful and avoidable consequences thereof, including without limitation failure to pay within 30 days of demand moneys payable pursuant to the terms of this Alliance Agreement, but shall not otherwise include any error of judgment, mistake, act or omission, whether negligent or not, made in good faith by that Alliance Participant or by any director, officer, employee, agent or subcontractor of that Alliance Participant."[15]

While the express list of exceptions to the general renunciation of the right to sue may not be exhaustive, unless there is a breach which comprises wilful default, the innocent party will probably be left without any remedy.

This means that the owner will have no remedy against the other participants for damages or losses or expenses suffered by it as a result of a non-owner participant's negligent, inefficient or other defective performance of its obligations under the agreement. Of course, it works both ways, but given that the non-owner 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. This, it should be remembered, occurs within a general structure in which the owner pays all actual costs incurred by all participants, such that the most non-owner participants risk for substandard performance is some or all profit. 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 still be liable for those risks clearly within its control.[16] This may be a prudent move, as it is arguable whether the incentive structure alone is robust enough a mechanism to ensure satisfactory performance. This is especially questionable given that there have been instances in Australia where the contractor has included hidden profit in its representation of BAU direct costs. In the case of *Theiss Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd*,[17] the parties entered into a mining contract on a risk-sharing basis.[18] The remuneration structure was established according to the contractor's representations as to direct costs it would incur in carrying out the mining. As time went on, the owner had reason to become suspicious of the contractor's cost estimate and required the contractor to tender for the outstanding work at the existing mines. The

[14] Also to ensure that proper weighting is given to each benchmark: the NSW Auditor-General found that in the case of the NST, the schedule objective may have been allowed to overshadow other objectives, such as community consultation. See NSW Audit Office, *Auditor-General's Report to Parliament 1999 Volume Three*, at 856.

[15] Clause 1 of the Acton Peninsula (National Museum of Australia) alliance agreement.

[16] M Misko and M Fielding, "Performance-based Contracts: Some Legal and Contractual Issues", paper given at FMA Australia *Performance Contracting Workshop*, May 1999.

[17] (unreported, WA Sup Ct, Ipp, Steytler and Wheeler JJ, 14 April 2000).

[18] In the judgment, this is called a "partnering" contract, but it comes closer to the present definition of a project alliance, with the contractor being paid its direct costs plus an agreed profit under an arrangement to share the risk of cost fluctuations.

evaluation showed that not only was the cost estimate higher than the tender price, it was substantially higher than other contractors' tenders. The owner terminated the alliance and the contractor sued for loss of profits. The owner counterclaimed that the contractor was under an express obligation to act in good faith, and that the contractor breached this obligation by giving direct cost estimates which deliberately contained elements of profit. The court found in favour of the owner. The contractor's requirement to provide genuine historical data as to its operating costs was an important element of the agreement.

While this case does indicate a possible avenue of remedy for owners where an alliance participant has concealed a profit margin in its representation as to direct costs, the agreement in question was a very early specimen of relationship contracting.[19] The intervening development of alliancing as a technique may have some bearing on the ability of a owner to run such an argument in respect of a contemporary project alliance. For one thing, the intense process of scrutinising potential alliance members, not only on historical costs structures, but on a comprehensive range of criteria, will probably mean that the owner takes on such responsibility for the direct costs estimate that it cannot establish reliance on the representations of the contractor. For another, the facts of *Theiss* were that the risk-sharing contract merely replaced a pre-existing conventional contract: there was no bidding process (the contractor was already in place) and no schooling as to the culture of relationship contracting. In other words, there was generally far less control exercised by the owner. However, the case remains an indication that the courts may recognise false representation of cost estimates as acts of bad faith under painshare/gainshare arrangements. Taking these factors into account, the problem of hidden profit should not be taken out of context but it should be kept in mind that the mechanism of putting the contractor's profit at risk may prove a limited driver.

Finally, it may sometimes be the case that the alliance agreement 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 accepting responsibility for tasks clearly within the contractor's control. Such clauses have yet to be judicially tested.

[19] Entered into in 1991.

Specific aspects of risk allocation

Risk allocation remains a crucial aspect of a project alliance. Although it has been said that alliancing requires an attitudinal revolution on the parts of lawyers as well as of the parties to the agreement,[20] it should be remembered that the primary task of a lawyer charged with drafting a contract is to provide clear and certain risk allocation. A good alliance agreement will legislate for risk in certain circumstances. Risk allocation issues are discussed below under the following headings:

- cost-related liabilities; and
- relationship-related liabilities.

Cost-related liabilities

As described above, each non-owner participant is paid on a cost basis and they are paid their direct costs and some (off-site) overheads regardless of whether the project comes in under or over budget. They will also be paid their costs in respect of, for instance, work which had to be performed twice due to a design fault, or rectification work due to a non-owner participant's negligence. Thus the risk of increased or unforeseen costs lies with the owner, subject to any agreement on the part of a non-owner participant to manage a particular risk.

If the contractor performs defective design or construction work, it must of course be rectified.

[20] Graham Thomson writes that "A good alliancing lawyer is very much in a facilitator role ... The initial reaction of many lawyers is cynical and/or negative, which is unfortunate": G Thomson, "Project Alliances", paper given at AMPLA Annual Conference, July 1997, at 12. However, it has been strongly argued that this statement confuses the roles of the lawyer and the manager. "The concept that a lawyer operates as a 'facilitator' to achieve some higher goal of alliancing places the lawyer outside the area of his/her core competency, as many of the alliancing projects have demonstrated ... It is management's role to ensure that cohesive and effective teams are built from different organisations": A Stephenson, "Alliance Contracting, Partnering, Co-operative Contracting — Risk Avoidance or Risk Creation?", paper presented to Clayton Utz *Major Projects Seminar*, October 2000, at 11.

Absent wilful breach, the rectification costs will be borne by the owner. The same applies in respect of design. Obviously, the cost consequences of defective or late design can be significant, both in terms of the delay or rectification costs and possible operating costs arising from failure of the project to achieve design criteria.[21] These sorts of risk under an alliance rest firmly with the owner.

This is reinforced by problems which arise in respect of design insurance. Most insurance available to designers is "liability insurance", which means the insurer will not pay unless the designer is "liable". Given that the alliance agreement will state that the designer (like all participants) is not liable except for wilful default, a normal policy is unlikely to respond at all because:

- pursuant to the contractual arrangements, the designer is not responsible for its own negligence; 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 risk where the person who will primarily carry out the task does not carry any personal responsibility.

Relationship-related liabilities

The issue of relationship-based liability applies equally to partnering, project alliances and strategic alliances. 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, or, for that matter, a partnering charter. 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 and possible fiduciary relations.

An alliance agreement will invariably impose an express or implied obligation of good faith upon the participants. Although the contractual basis of partnering is different to alliancing, it too will involve a good faith undertaking. 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 widely, to act reasonably in all circumstances.

Moreover, it has been said that project alliances may have the potential to inadvertently create fiduciary obligations owed mutually between the participants because such arrangements rely on participants acting in each others' interests.[22] Fiduciary relationships arise in situations of partnership and under some kinds of joint-venture. If the concept of fiduciary obligations is applicable to alliancing,[23] it would render the respective obligations of the participants significantly more burdensome. Participants would be obliged to, among other things, disclose all relevant acts and circumstances, act in the utmost good faith and not permit their own interest to conflict, or potentially conflict, with the interests of the other participants. It would also expose participants who breached a fiduciary obligation 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 them in the alliance agreement.

Conclusion

In order to reap the rewards available from project alliances it is necessary to take a balanced approach to the delivery method. It is also critical to regard it as a valuable, but nevertheless only one of a number of instruments in the toolbox of relationship contracting.

[21] Provisions, as in the NMA alliance, which seek to ensure compliance with design by including design integrity as a KPI do not address the problem of having a late or defective design in the first place.

[22] Misko and Fielding, op cit n 16, at 13. Their reasoning here is based on an analogy of alliances to joint ventures. For the fiduciary implications of joint ventures, see A Komesaroff, "An Overview of Business Structures for Resources Projects", seminar paper, January 2000, available at http://www.corrs.com.au/ccw1.nsf/alldocsbyid/30D32878B18E3C494A2568770020AD63.

[23] This may depend on whether participants have actually given an undertaking to act for or on behalf of another participants: L Griggs, "Joint Ventures, Partnerships and Fiduciary Obligations" (1994) 24 *Queensland Law Society Journal* 77 at 81.