

The Project Alliancing and Relationship Contracting Experience

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Overview

Over the last 200 years there has been a slow evolution in the way the commercial sector has managed its contractual relationships. These changes have been driven by the need for commercial profit in constantly changing times, the need to deal with the growing complexity of commercial life and the pressures caused by technological advances. The legal profession has played a key role in advising on and documenting these relationships.

The courts have often been called to rule on such commercial arrangements. In this sense the law tends to follow the lead taken by the commercial sector. The common law has developed out of courts reviewing prior events and agreements in a way that, where possible, seeks to give business efficacy to those arrangements. The trigger for this judicial intervention is the unresolved dispute.

What would be the effect in law if all parties, when entering into a joint commercial venture, were to agree to a fundamental term that they would, as a group, benefit equally, or in the case of losses, lose equally as a result of performing the contract? In other words, if the parties were to agree to limit themselves to either a win/win or a lose/lose situation.

What would happen if the win/lose scenario, which is most often the result when using the litigation method of dealing with unresolved disputes, were to be contractually abandoned? Such an agreement would specifically abandon the right of any one party to take civil action against another except in cases of personal fraud or limited wilful misconduct? The parties, in contracting not to allow a dispute to remain in an unresolved state, effectively limit the opportunity of the courts to review their commercial activity.

This approach is at the heart of Project Alliancing and Relationship Contracting approach. Whilst still early in its evolutionary phase the success of a number of projects to date does indicate a movement towards reappraising the adversarial approach to conflict resolution and the role of the courts.

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Project Alliancing

Project Alliancing draws its origins from the Andrew Project undertaken in the early 1990's by British Petroleum (BP) in the North Sea. BP was looking at a possible exploration site that had many difficulties and the prospects for success were at best marginal. The traditional approach would have been for BP to invite interested contractors to take part in a competitive tender process. The contractor with the most competitive tender would have been chosen and would have entered into a standard commercial contract prepared by BP in which all the risks for the performance would fall on the contractor. However, as the Andrew Project had so many risks and uncertainties it was felt that a new approach to contracting had to be found for there to be any chance of success.

The new approach adopted by BP marked a radical departure from the standard project delivery system at that time. Its distinctive characteristics included :-

- The equitable sharing of risks between all parties, including BP
- The immediate and in-house handling of all conflict, disagreements and disputes
- A guarantee that all parties would receive 100% of all their project outgoings and agreed profit
- The agreement by all parties to work to a standard better than normal business practice and receive rewards for bettering the agreed standard and penalties for falling below that standard

The result for BP was the satisfactory completion of the project with savings in development capital costs of between 20%-30% on projects worth over AUD\$600m (Gallagher and Hutchinson, 2001).

The most remarkable feature of this approach was the removal of competitive price tendering as a criterion for selection. It was essential that the selection process be designed to maximise the chances of selecting the right mix of people for this risky project. It was felt that a selection process based solely on the traditional competitive tendering approach would not have achieved this aim.

Project alliancing introduced the concept that parties should be chosen predominately on the ability of their personnel to work in a high performance, no blame integrated team culture. In other words, the project was to be driven by relationship building strategies rather than by competition for money. It is partly for this reason that the Australian Constructors Association refers to project alliancing as "Relationship Contracting" (Australian Constructors Association, 1999).

The lessons drawn from BP's experiences with the Andrew Project have been applied to a significant number of major infrastructure projects in Australia and have formed the basis of what is known as Project Alliancing and Relationship Contracting.

Managing Conflict within the Commercial Relationship

Conflict is a naturally occurring phenomenon, which, if not dealt with in a timely manner, can lead to a dispute. The traditional approach for dealing with unresolved disputes has been to call in outside experts such as lawyers, arbitrators and mediators in order to facilitate a resolution. The issues and drivers that have lead to the initial conflict are often lost as the conflict escalates and moves externally into the court system or external ADR (Alternative Dispute Resolution) processes.

Yet, the issues that drive conflict can reveal valuable insights into the workings of an organisation. The heat generated by the participants often hides the issues at the heart of a particular conflict. The real issues that are driving the conflict, if revealed to management, can act like a weather vein pointing to an organisation's level of performance and to changes that might need to be made. Valuable information and lessons can be lost to management if the carriage of managing the conflict/dispute is handed to outside experts and processes.

There is an emerging view that conflict resolution should not be isolated from the day-to-day management of organisations. This trend to manage conflict in-house can be seen in the increased use of internal processes such as Dispute Resolution Boards and Senior Executive Appraisal.

Some organisations involved in highly competitive and complex development projects are reassessing the real costs of using the adversarial court system to resolve their conflict. It is not just the time it takes to get a resolution nor the financial and personnel costs of litigation that is prohibitive. It is the disruption to the commercial relationship that causes the greatest commercial damage. This disruption can place an organisation at risk of falling behind its competitors.

The commencement of a commercial venture or a new alliance between existing organisations can provide a unique opportunity for the participants to plan an effective system for managing and resolving conflict. The development of project alliances in Australia since 1994 has provided examples of how organisations working on a common project can design effective ways to relate to each other and to resolve differences in-house and on the spot.

Dispute Resolution Clauses

A unique aspect of project alliances is that there is no specific alternate dispute resolution clause written into the project alliance contract. This is not a rejection of the need for dispute resolution. It is instead an acknowledgement that it is an integral part of the normal day-to-day management of the project. It is so fundamental to the contract that it does not need to be placed in a separate clause. It is something that should not be capable of being severed from the rest of the contract. The project alliance agreement is structured in such a way that it is not possible to deal with conflict in any way other than by facing it and resolving it immediately.

The following is an example of a clause limiting the right of parties to an alliance to make a civil claim against each other.

“A failure by any alliance participant to perform any obligation or to discharge any duty under or arising out of this agreement will not give rise to any enforceable obligation at law or in equity whatsoever save and except to the extent that the failure also constitutes wilful default”

WILFUL DEFAULT is defined as:

“An intentional act or omission by an Alliance Participant carried out with utter disregard for the harmful consequences for another Alliance Participant, but does not include any error of judgment mistake act or omission made in good faith whether negligent or not by an Alliance Participant.”

(Ross, 2000)

The Project Alliancing approach places great importance on selecting the right mix of people and supporting them through the relationship building stages. The relationship aspects are further highlighted by the fact that the formal contractual agreement is developed over a number of meetings and focuses on risk sharing and relationship building strategies. Standard pro-forma contracts, such as the Australian Standard AS2124 contract, are abandoned in favour of allowing the final black letter contract to evolve out of these meetings.

The final contract is built on a number of principles including: - a fair day's pay for a fair day's work, a “no blame” culture, proportional sharing of the risks and rewards, all parties including the owner either

winning together or losing together and all parties performing to a standard which is better than “business as usual”.

There is a growing use of project alliances in the oil and gas and construction industries in Australia. The Australian Federal and Queensland State Governments have started using this project delivery system for major infrastructure projects. The Pacific Motorway in Queensland, which involved both relationship contracts and project alliances, and the National Museum in Canberra are examples.

THE PROJECT ALLIANCING PROCESS

The Exclusion of Money from the Tender Process

There are a number of steps in the formation of a project alliance. The first is at the tender stage of the project where the potential contractors are required, in no more than 40 pages, to nominate how they will manage their relationships with all other parties involved in the project (Queensland Motorways, 2000). The tender documents make no mention of money nor do they seek competitive priced tender bids. Parties are required to demonstrate the quality of their personnel and their ability to work in a high performance team culture.

Once the preferred alliance partner is selected the parties enter into an interim project alliance period in which all of them work to discover the *real costs* of the project. All variables, including the weather, have to be factored into the total cost, as once the figure is set it cannot be changed. These discussions are based on the principle that once a final costing is settled then each party will be guaranteed full 100% payment of its component of those costs. In addition, the parties will receive an amount for their profit, based on a pre-agreed percentage of the total cost. The parties are then bound to bring the project in at that cost with additional rewards for coming in under the amount and penalties for exceeding it.

The work done by all parties during the interim alliance period to scope and place a realistic monetary value on the whole project is crucial to the success of the project alliance. From the owner’s perspective it brings some commercial reality into the costing process. This knowledge provides a better foundation on which to commence a project than just relying on an artificial amount generated by a competitive tender process. It is important for all parties to know if the final cost of the project is likely to be thirty million dollars rather than fifteen million. A substantial blowout of the cost of the project can have serious ramifications for all parties.

This interim project alliance period is a very challenging part of the process as it tests the capacity of the parties to engage in robust debate, to resolve differences and to develop a sense of collective responsibility for the project. This is the true relationship building phase. If things fall apart at this stage then any party can withdraw.

The competitive tender approach, whilst appearing very simple, can lead to a number of unintended negative consequences. Firstly, no contractor can accurately guess the final cost of the project especially when you add in the number of variables that exist in the life of these projects. The foundations of a competitive tender approach are based on the very uncertain premise that the estimated costs submitted at the beginning of the project reflect the true cost of the project at its completion date.

The exclusion of money from the initial stage of the project alliancing process is deliberate. The aim is to remove the need to undercut rival bidders on price in order to win the tender. These bids do not reflect the true costs of the project and set up an artificial and inherently false commercial relationship. Once the tender is won then the focus tends to move to re-examining the contract in the search for variations. This

embeds an adversarial culture based on claims and counter claims and creates a misalignment of interests between the owner and contractors. The effect of this misalignment is highlighted by the fact that many projects using the traditional competitive tender process overrun the winning tendered price by an average of between 17% and 30% (McLennan, 2000)

This uncertainty is compounded if the owner uses a standard pro-forma commercial contract, which seeks to transfer all the risk of not meeting the tendered costs onto the contractors. This is a recipe for encouraging the competitive tendering process to continue well into the project delivery phase. The successful tender will, from day one, look to find ways to recoup moneys from the owner for items they say were not included in the original agreement. This situation is not conducive to establishing a stable commercial relationship and has the potential to introduce even more uncertainty into the project.

The alternative is to accept and deliberately embrace those uncertainties. The removal of the pressure placed on contractors to guess/estimate the cost of the project in order to win the tender is an important first step in this process. It forces all parties, including the owner, to realistically examine the scope of the project, its pitfalls and variables at this pre-contract stage.

The added expense for the owner of engaging in these pre-contract processes can be more than offset by not having to rectify defects that might otherwise have come up once the project has commenced. It is much easier to rectify a problem in the planning stage than when the structure is half built. A number of project alliances have been able to produce outcomes that exceed a 20% reduction in the target cost estimate (McLennan, 2000).

The Benchmark for Performance- Business as Usual

One of the main tasks undertaken in the pre-contract period (the Interim Project Alliance Period) is for all parties to agree to set standard benchmarks for performance in various categories. The term that is used is “business as usual” and is roughly defined as what would be considered as the normal industry standard for completing that category of work. However, in project alliancing “business as usual” is nothing more than a benchmark. Parties are chosen primarily because they have demonstrated an ability to perform to a standard that is better than “business as usual” in a number of key areas. The project alliancing approach is based on selecting people who want to work at a level above what is considered a standard performance. They are people who can work within a team framework and are able to identify and deliver what is often referred to as ‘stretched’ goals.

Some of these key performance areas include bringing the project in under the agreed cost, doing this by a certain date, causing minimal environmental damage, deaths or injury, creating good public relations, overcoming difficult site conditions and anything else that is important to the project. These are what are called stretched goals or key performance indicators (KPI’s). All parties agree on these KPI’s and agree that all will receive an extra reward if they better them or all will lose some of their profit if they do not.

What makes this process unique is that the owner will accept half of the risk of meeting or not meeting the KPI’s. The owner will take 50% of this risk with the remaining 50% being shared on a pro-rata basis by the contractors, designers and sub-contractors. This division aims at achieving an equitable sharing of the risks and rewards. It also reduces the opportunity of any one party seeking to gain an advantage by threatening litigation against another party. It supports the principle that parties either all win together or all lose together. There cannot be a situation, as exists in the standard commercial contract, where one party can win and one party can lose. Project alliancing is designed to create a true alignment between all parties and the project outcomes.

The workshops, which facilitate setting these stretched goals, take place during the interim project alliance period. They involve all parties working on benchmarking performance levels for a variety of possible problems. These negotiations over costing and variables provide a test of the ability of all parties to work as a team. This is extremely important, as each party, on signing the final agreement, will be placing their trust in the other parties to achieve the benefits of the *gain* provisions of the alliance as well as avoiding sustaining losses as a result of the *pain* provisions. It is during this interim stage that the true work on relationship building takes place.

The black letter contract that is signed by all parties at the end of the interim period has a more organic quality as a result of the participatory processes of its creation. There is a true alignment between the relationship imperatives and the written contract that underpins the project.

At the completion of the interim project alliance period the parties will sign the formal project alliance agreement. The result is the creation of a virtual company incorporating the owner and all the project participants. From that time onwards all decisions by the group have to be unanimous with no abstentions. Everyone is forced to focus on the project and to try to better the KPI's. There is no point competing with each other because the contract provides that everyone either wins or loses together.

Project alliancing is an approach that seeks to counter the traditional approach of the owner trying to pass the commercial risks onto everyone else. This is risk avoidance strategy and can lead to a misalignment between the commercial interests of the participants. It is this inbuilt misalignment that leads to defensive tactics, self-interested decision-making and a breakdown in trust and human relationships. Parties can tend to lose focus on the end product and start concentrating on strategic manoeuvres (and the black letter law contract) so as to preserve their own commercial position.

Project alliancing is based on an agreement that the risks will be borne by the party best able to manage those risks. This is a risk embracing strategy. Risks can be better managed if they are identified and embraced. The owner taking on half of the risk reinforces this strategy.

It also removes the financial pressure placed on contractors by being forced to artificially undercut their profits in order to win a competitive tender. This is a problem not unique to our times.

“In recent years a considerable number of projects have not been finished, nor will they be finished. This disorder, Sir, is caused by the depressed prices frequently obtained for your works:...these cut prices are illusionary, especially as a contractor who is working at a loss is like a drowning man who clutches at straw. In the case of the contractor this means he does not pay his suppliers, cheats everyone he can, underpays his men, getting the worst, not only using the most inferior materials, but quibbling over everything and always begging forgiveness over this and that. Abandon [this type of competitive tendering] Re-establish good faith, give the estimation of the work and not refuse a reasonable payment to a contractor who will fulfil his obligations. That will always be the best transaction you will be able to find.”

Marshal Vauban (1633 – 1707), Chief of Fortifications for Louis XIV (Construction Queensland, 2001)

Relationship Contracting

When a commercial relationship breaks down the parties are often left with a choice of either seeking a compromise or pursuing litigation. The decision about which path to take involves an exercise in risk assessment.

For the litigation option the risk assessment includes not only assessing the chances of success whilst factoring in the costs in time and lost opportunity, but also, more importantly, whether the likely decision is going to advance the commercial objective that the original agreement sought to achieve. There is also an effect on relationships with members of the same industrial or commercial group that you might in future have to work with on other projects.

Seeking compromise has the advantage of being a circuit breaker of unproductive conflict. However, if the breakdown is over fundamental core issues, has been continuing for a substantial period of time and involves a significant breakdown in personal relationships then compromise may also fail to advance the original commercial objective.

Relationship contracting is an alternate approach. Put simply, it requires all parties to agree to place their existing contractual agreement, together with all rights and obligations that flow from it, into the top drawer and shut it. The parties then enter into a without prejudice renegotiation of their commercial relationship using the principles of project alliancing.

These negotiations take place in the shadow of the existing contract with all parties free at any time to take the existing agreement out of the drawer and pursue their rights.

The advantage of this approach is that it shifts the focus away from defending a particular version of the black letter agreement and back onto the ultimate goal of all parties profiting from the successful completion of the project. It is directing the focus away from the past and onto the future.

Once this new relationship based agreement has been presented and accepted then the parties can agree to reopen the top drawer and novate the old agreement or, if they choose, leave the agreement in the drawer and proceed in the shadow of the old agreement.

This process was used successfully by the Queensland Department of Main Roads in turning around the then failing one billion dollar Gold Coast Motorway Project. A number of the six major sections contracted out to various groups were so badly mired in adversarial stalemate that it was decided that the relationship contracting approach was the only way forward. The Department of Main Roads fixed a date on which existing contracts would end. All parties were paid up to that date.

As of the next day the parties started afresh focusing on completing the project using the principles of project alliancing set out below. The climate of blame and counter-blame ended immediately. All parties were so relieved to be out of a no-win situation that they embraced the core principles of Project Alliancing. The relief was harnessed into a new collective drive to complete the works within agreed costing and time limits. This was achieved. The 1,500 claims made against the contract prior to the change to relationship contracting were subsequently resolved out of court using the “Senior Executive Appraisal” model of in-house conflict resolution.

The following are examples of the core principles incorporated into most project alliances and relationship contracts (Ross, 2000):

- a change in culture from a ‘master-servant’ to a peer relationship.
- all risks and rewards are shared on an agreed equitable basis- sharing the pain and the gain.
- outcomes where all parties either win or lose.
- a collective responsibility for the project.
- all parties have an equal say and all decisions must be ones that are the best for the project.
- a ‘no-blame’ integrated team culture.

- full access to the resources, skills and expertise of all parties.
- a philosophy of delivering optimum commercial benefits and outstanding outcomes to all parties.
- a high performance culture with encouragement for innovative thinking.
- open and honest communication with no hidden agendas.
- support rather than blame and the honouring of all commitments made.
- an express commitment to resolve all issues within the alliance without recourse to litigation except in the case of wilful default.
- all transactions to be fully open book.
- unconditional and visible support from the top level of the participating organisations.

Embracing the Uncertainties of the Commercial Relationship

The traditional approach to drafting a commercial contract is based on the desire to create as much certainty as possible in contract arrangements. It is presumed that a tightly drafted contract will provide clarity in relation to rights and obligations and thereby work to ameliorate the normal uncertainties inherent in large projects.

Attempts have been made to introduce relationship building and teamwork strategies into these contracts under the concept called “Partnering”. However these agreements still rest on the foundation of the traditional win/lose contract such as the AS2124 standard contract. There remains a fundamental misalignment between relationship building and teamwork aims and the competitive win/lose standard contract.

The Project Alliancing and Relationship Contracting approach differs by removing that misalignment and replacing it with a collective responsibility and a “no-blame” integrated team culture. This culture is reinforced by a “black letter” contract that strictly limits the right of inter party litigation. This is the foundation of a true alignment wherein the written contract supports the culture and the culture in turn supports the written contract.

Towards the Future

There is a view that the tradition of commercial lawyers designing complex legal agreements to avoid future litigation (and a professional negligence claim) hinders the creative fluidity that is needed to sustain commercial alliances and to produce outstanding results.

In my view this attitude is not based on any anti-legal bias nor can it be passed off as just another example of lawyer bashing. I believe that the commercial sector still has a high regard for the need for good legal advice and for the courts to be there as a final arbiter of disputes.

I suspect that Project Alliancing and Relationship Contracting is evidence of a major cultural shift towards seeing teamwork as more important than competitive behaviours. This approach not only challenges the legal profession but also the principles behind competition policy. Competition still exists but it is directed away from inter party competition. Competition is now between the alliance participants as a united group and the elements (as represented by the key performance indicators) so as to deliver optimum commercial benefits and outstanding outcomes.

I believe that the legal profession does have a role to play in these new project delivery systems. But it will have to work within a relationship based culture where individual rights and responsibilities are merged into the collective responsibility of the group as a whole.

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AUSTRALIAN PROJECT ALLIANCES 1994-2005
1994-96 Wandoo B Oil Platform WA \$377m - \$13m under budget – completed 7.5 months less than industry standard. Winner of two national awards.
1994-97 East Spar Project WA \$250m– Winner of Aust. Institute of Engineers highest award.
1996-99 Hot Briquetted Iron WA (BHP) – Three separate fabrication/ construction alliances
1997-00 Northside Storage Tunnel Project (Sydney Water) \$465m- The project was fast tracked with cost over runs and unpredicted construction problems limited by cost saving initiatives. A number of design enhancements were made during the course of the project.
1998-01 National Museum of Australia ACT \$155m– World first Project Alliance for a Building Construction Project. Achieved target opening date within tight time and budget constraints.
1999-02 Woodman Point Wastewater Treatment Plant Amplification WA \$140m –
1999 Clean Fuels Project Qld \$350m -
1998-1999 Penola West Project SA \$6m – Completed ahead of schedule despite numerous externally imposed delays – 13% cost overrun.
1999-00 Pelican Point Project SA \$22m – Completed months earlier than worlds best practice. 6% under budget.
1999 Norman River Bridge QLD \$5m - Completed weeks earlier than tight target date - under budget.
2000 Inner Northern Busway Sect 1 QLD \$70m – Alliance terminated due to outside budget and political factors however alliance performed well and responded to external factors without suffering undue commercial loss.
2000 Pacific Motorway QLD \$1 billion – Package 4. A distressed project was converted in mid-stream, to a Project Alliance to overcome severe scheduling difficulties and regular scope changes. The Alliance completed work to the value of \$62 M ahead of the target schedule and near to the target cost.
2000-02 Awoonga Dam Rising Project \$150m-
2001 Department of Defence, Project DJIMINDI Alliance - The Anti- Submarine Warfare Lightweight Torpedo project.

2001 Department of Defence, ANZAC Ship Generation Alliance > \$1 billion–
An alliance to deliver change to ANZAC Class ships to improve capacity of missile systems.

2000 Port of Brisbane Motorway Qld \$100m–

Completed 6 months ahead of schedule plus adding an extra bridge while still coming in about 10% under its construction budget. It achieved excellent performance on a number of non financial objects related to the environment, the community, quality and traffic. No disputes to resolve nor claims for variation.

2001-04 Sydney Water, Sewer Fix Pumping Station Program \$358m–

Completed upgrading of 250 pumping stations. Overall savings rate of 15% against target cost estimates, a saving of almost \$30m plus \$3m worth of program savings in the form of station improvements.

2003 Burnett River Dam Alliance \$150m –

Half way through the Burnett Water Dam project, the foreign parent company of the construction alliance partner went bankrupt. An alliance partner met construction obligations and the project continued without loss of production days. This was made possible due to the strength of the alliance contracts.

2003 North Queensland Gas Pipeline \$140m –

Pure alliancing model helped deliver the project on time, under budget, with stakeholder satisfaction, and no disputation.

2002-05

- Inner Northern Busway Qld \$35m,
- Brisbane Water Enviro Alliance \$140m,
- Wivenhoe Dam Spillage Upgrade Qld \$70m,
- Burnett River Dam Alliance Qld \$150m,
- Lawrence Hargrave Drive Alliance NSW \$45m,
- Travailyn Upgrade Project Tas \$35m,
- Roe Highway Stage 7 WA \$70m,
- Northern Gateway Alliance NZ \$200m,
- Tullamarine Calder Interchange Vic \$140m,
- Tugan Bypass Alliance Qld \$300m.
- Gippsland Water Factory Vic \$300m
- New Perth Bunbury Highway WA \$370m
- Great Eastern Highway Alliance WA \$30m
- Grafton Gully Free/Flow Alliance NZ \$100m

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