



Alliance Contracting in Australia: a brief introduction

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Introduction

Modern-day “alliancing” has its origins in the UK where it was first used in the early 1990s to deliver step change improvements in the delivery of complex offshore oil and gas projects. “Alliance contracting” has been developed and refined in Australia (and New Zealand³) to a point where it is now widely used in both the private and public sector to deliver projects and operate/maintain assets. While it originated elsewhere, the author’s understanding is that alliance contracting has been developed further and is used more widely in Australia than anywhere else in the world.

This article gives a brief overview of alliance contracting as practiced in Australia and aims to provide insights that may help those who wish to learn and/or draw from the Australian alliance experience.

There are many different types of situations and relationships referred to as “alliances” – as illustrated in Figure 1 below. This article deals only with the situation where an owner (referred to as the “owner participant”) enters into a legal/commercial arrangement with one or more service providers (designers, contractors or suppliers - referred to as non-owner participants or “NOPs”) for the delivery and/or operation/maintenance of a project/asset.

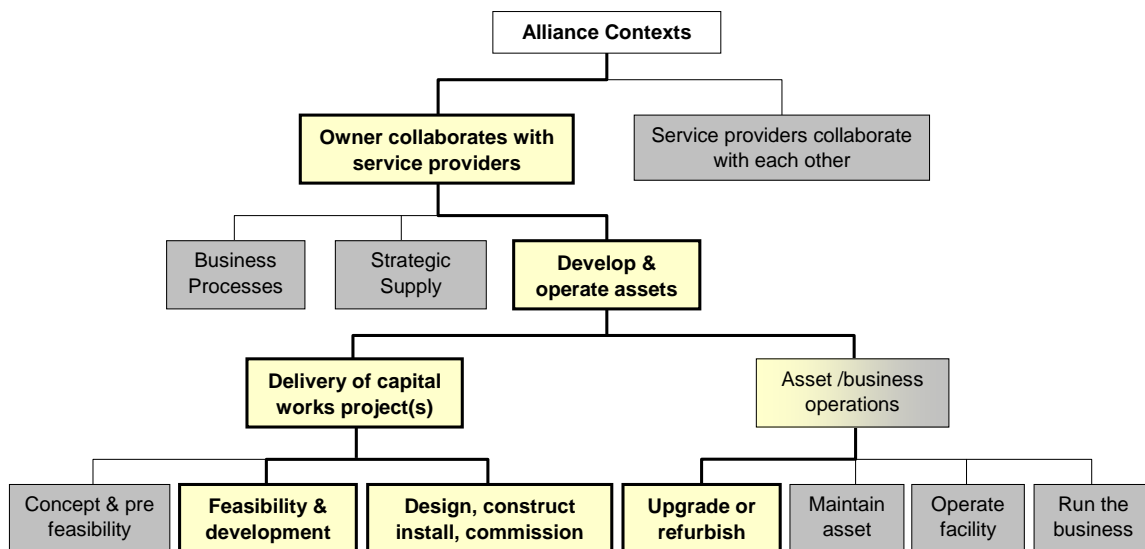


Figure 1 - Alliance Contexts

³ Alliancing has evolved at a similar pace in New Zealand (as in Australia) and the New Zealand experience has made a significant contribution to the body of alliance knowledge. For simplicity this article will only refer to Australia. However in most cases references to Australia can be read to mean Australian and New Zealand.

Key features of Australian-style alliances

Within this narrower context there are many different types of legal/commercial relationships in use (in Australia and around the world) that are referred to as “alliances”. These range from traditional risk-transfer arrangements undertaken in a collaborative manner to “pure alliance” arrangements where nearly all risks (and opportunities) are shared amongst participants. In Australia most of the alliances undertaken have been at the pure alliance end of the spectrum.

Under traditional “risk-transfer” forms of contract, different parties have specific individual obligations and risks are generally allocated to the party considered best able to manage them. There are commercial/legal consequences where a party performs poorly or fails to fulfil its obligations properly. Contrast this with a pure alliance, where the alliance participants assume collective ownership of the risks/opportunities and responsibilities associated with delivery of the project, with equitable sharing (in pre-agreed ratios) of the “gain” or “pain”, depending on how project outcomes compare with pre-agreed targets. Although risks (and opportunities) are collectively “owned”, and are not directly linked to the performance of individual alliance participants, the quantifiable impact of these risks and benefits is still clearly allocated through the gain/pain arrangements which should be set out in precise detail in the Project Alliance Agreement (PAA). Figure 2 below depicts the difference in risk allocation between traditional contracts and pure alliances.

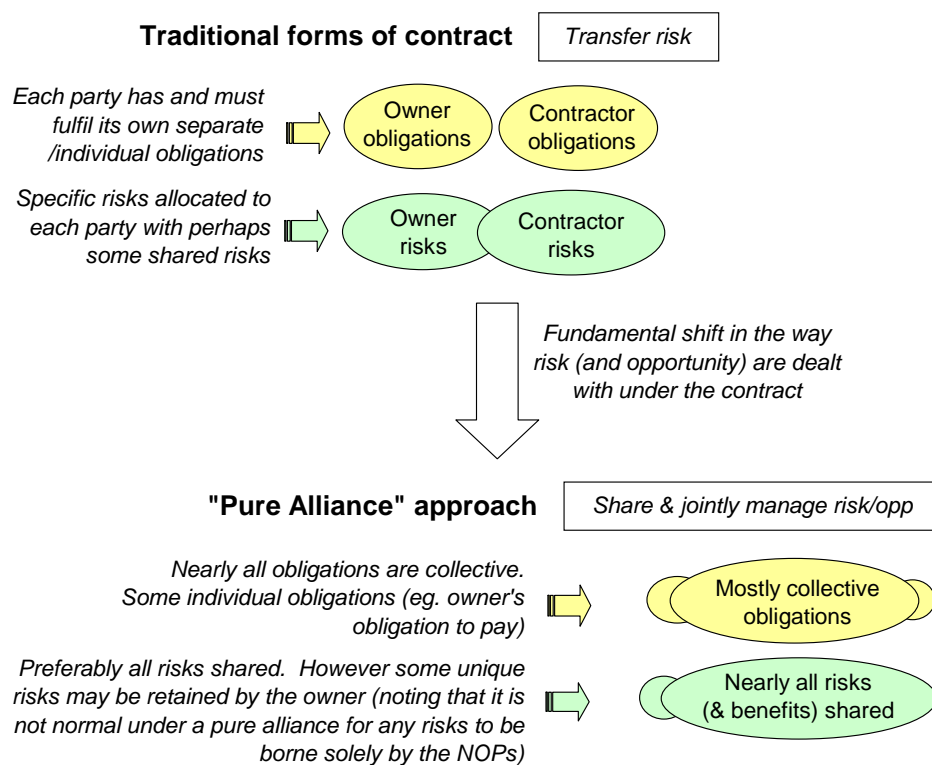


Figure 2 - Collective sharing of risk/opportunity

The concept of collective responsibility is fundamental to creating the commercial/legal foundation which has underpinned the success of alliancing in Australia. While a contract may have an alliance-like compensation regime (ie. open book, target cost with performance incentives) and may be referred to as an alliance, if the obligations of the contractor(s) remain distinct from those of the owner it is unlikely to create the kind of one-team “virtual organisation” that has been a key characteristic of most Australian alliances.

Figure 3 below shows the life-cycle for a typical project alliance. Performance targets, including the target cost (usually referred to as the target outturn cost or “TOC”), are developed and agreed by the participants during the project development phase. The alliance participants then work as a fully integrated team through the implementation phase (and the defects correction period) with the aim of meeting or bettering the agreed targets. If the outcome is worse than the agreed targets in any area then it is seen to be a collective problem of the alliance, not the fault of any individual participant. This mindset of “*your success is my success, your failure is my failure*” is underpinned by the compensation model because the allocation of gain/pain is already pre-determined (and set out in the PAA) and is not linked to (perceptions of) how any particular participant has performed.

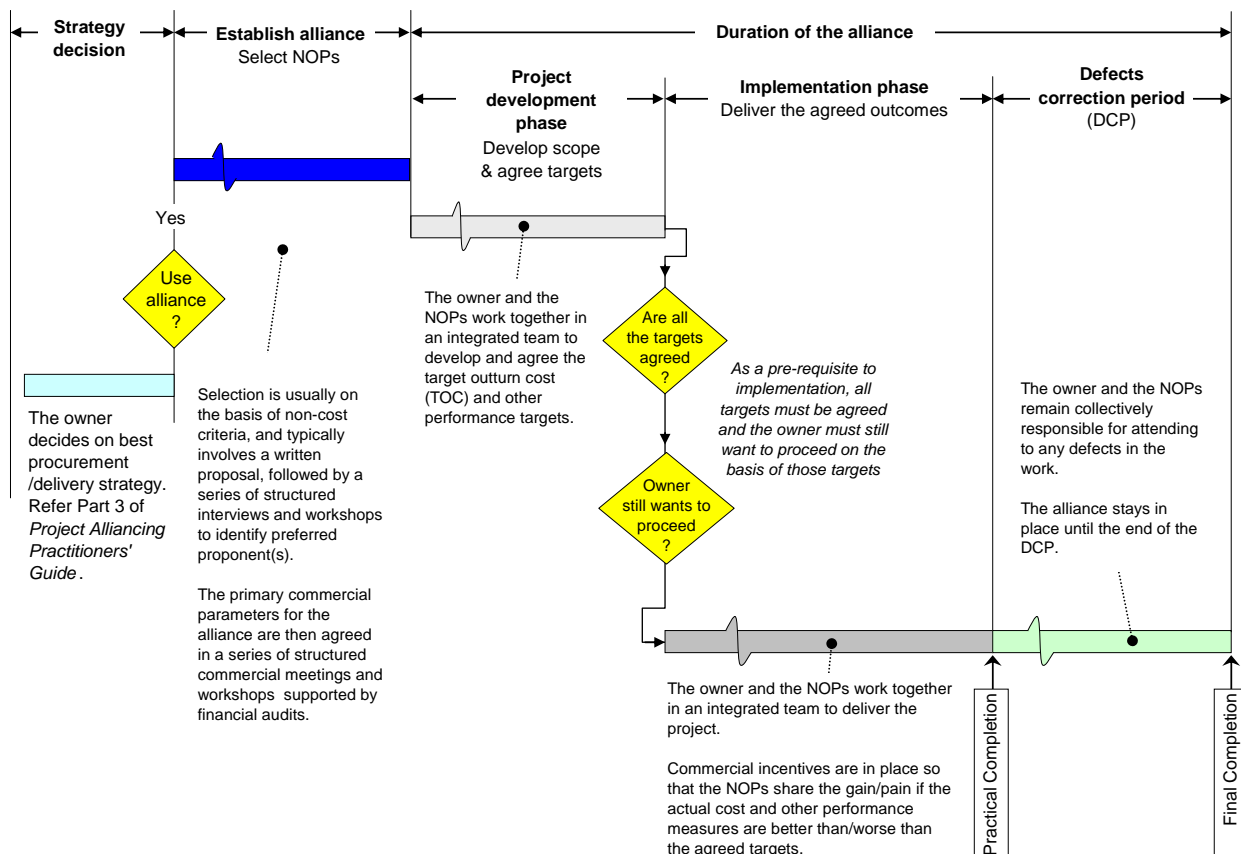


Figure 3 - Typical life-cycle for a project alliance

The *Project Alliancing Practitioner's Guide* (Victorian Department of Treasury and Finance, 2006, page 2) defines a project alliance as a commercial/legal framework between an owner (the "owner participant") and one or more "non-owner participants" (NOPs) for delivering a capital works project, characterised by:

- collective sharing of (nearly) all project risks
- no fault, no blame and no dispute between the alliance participants (except in very limited cases of default)
- payment of NOPs for their services under a "3-limb" compensation model comprising:
 - reimbursement of NOPs' project costs on 100% open book basis
 - a fee to cover corporate overheads and normal profit, and
 - a gainshare/painshare regime where the rewards of outstanding performance and the pain of poor performance are shared equitably among all alliance participants
- unanimous principle-based decision-making on all key project issues
- an integrated project team selected on the basis of best person for each position.

To take full advantage of the alliance model the governance, leadership and management structures need to reflect and support the intentions of the relationship and the underlying legal/commercial arrangements. Figure 4 below shows the typical governance, leadership and management framework used on Australian alliances.

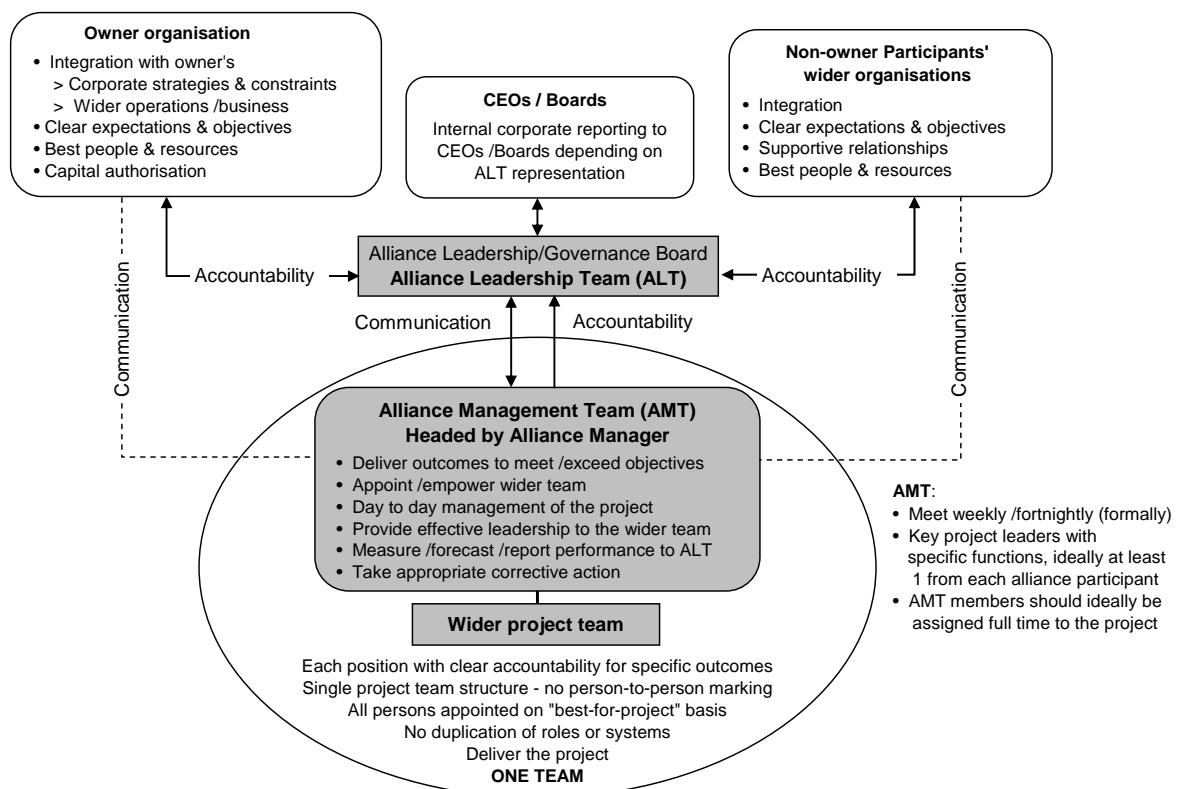


Figure 4 - Typical governance, leadership & management framework

The role of the Alliance Leadership Team (ALT), sometimes referred to as the Alliance Board, is crucial to the success of an alliance. Figure 5 below gives an overview of the key duties and characteristics of a typical ALT.

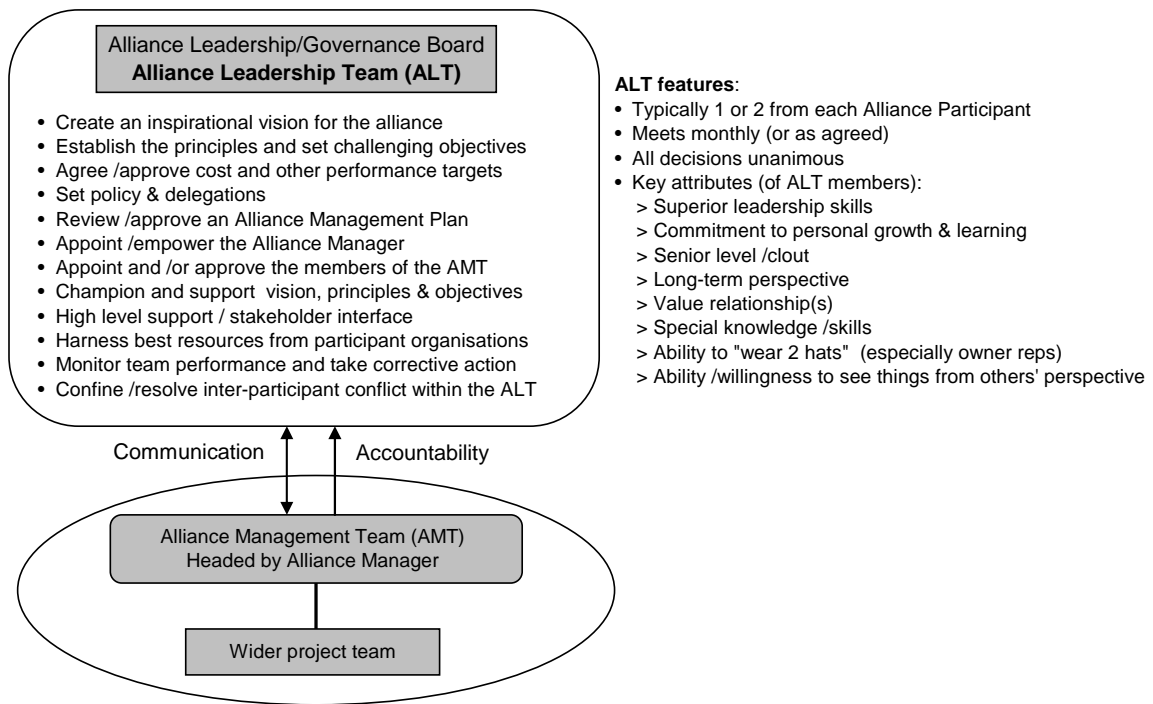


Figure 5 - Alliance Leadership Team duties & characteristics

The *Introduction to Project Alliancing* series of articles by the author ([Ross 2000, 2001, 2003](#)) provides an evolving snapshot of the thinking at the time on the mechanics of project alliancing and the rationale for using alliancing. [Greenham \(2007\)](#) provides a good overview of current-day alliancing in Australia. In *Alliancing – a participant's guide* [Morwood, Scott and Pitcher \(2008\)](#) present some great insights into alliancing in practice with a treasure trove of case notes from actual alliance projects.

Evolution of alliancing in Australia

Alliancing was introduced into Australia in the mid 1990's against a background of growing dissatisfaction with the increasingly adversarial nature of traditional contracting models. Project alliances were first used to deliver some major oil and gas projects in WA in the early 1990s. As reported by [Henderson and Cuttler \(1999\)](#) Sydney Water, a public sector agency, used an alliance model to deliver the ~\$460 million Northside Storage Tunnel project in the late 1990s. This was the first use of a pure alliance model to deliver a public infrastructure project by a government agency in Australia (and perhaps the world).

Since its first use on the Northside Storage Tunnel the use of alliancing in the public sector has increased exponentially as illustrated in Figure 6 below, taken from the 2008 report on public sector alliances in Australia (and New Zealand) by the Alliancing Association of Australasia (AAA) (2008, pages 12 and 13):

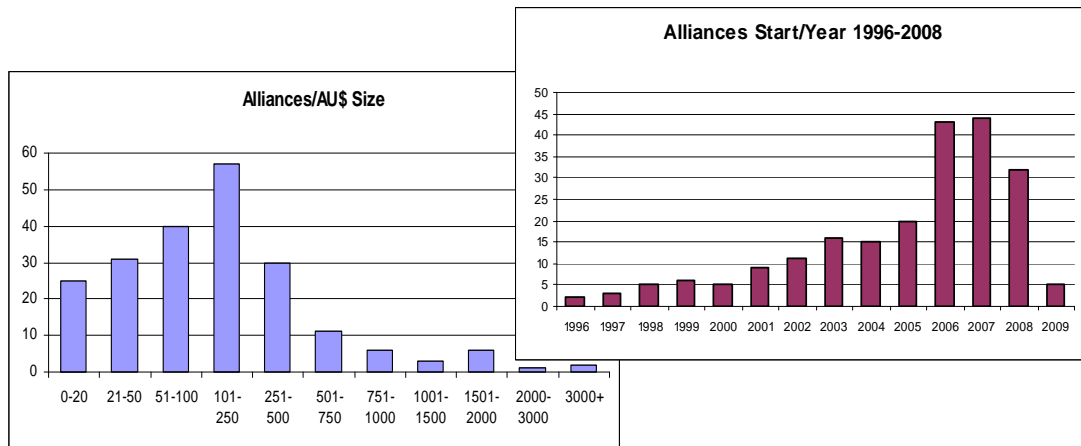


Figure 6 - Alliance statistics from AAA's 2008 Report

Criteria and motivation for using an alliance

Traditionally project owners aim to transfer as much of the risk as possible to others – eg. insurance companies, designers and constructors. Many of the more extreme examples of adversarial conduct under contracts occur because the owner, when setting up the contracting arrangements, attempts to transfer risks to parties who are not in the best position to manage those risks. It is generally accepted that risks under a contract should be borne by the party that is best able to manage those risks. Where risks can be clearly allocated and kept separated without undue interference by the contracting parties then a conventional (non-alliance) contract with appropriate allocation of risk is appropriate. In such circumstances, while an alliance would still deliver the project effectively, it is likely that any relative advantages of alliancing would be outweighed by the costs associated with establishing and maintaining the alliance. However where there are:

- numerous complex and/or unpredictable risks,
- complex interfaces,
- difficult stakeholder issues,
- complex external threats,
- very tight timeframes,
- high likelihood of scope/constraint change,
- a need for owner interference or significant value-adding input by the owner, or
- threats and/or opportunities that can only be managed collectively, etc.,

any attempt to allocate the risks to different parties, no matter how well intentioned, may be little more than an illusion and can give rise to an adversarial culture that may threaten the success of the project. Under these circumstances, as illustrated in Figure 7 below the project outcomes are more likely to be achieved (or exceeded) if all the key participants, owner and contractors, assume collective responsibility for delivering the project under an arrangement where they all win or all lose together depending on how the actual project outcomes compare to the agreed targets.

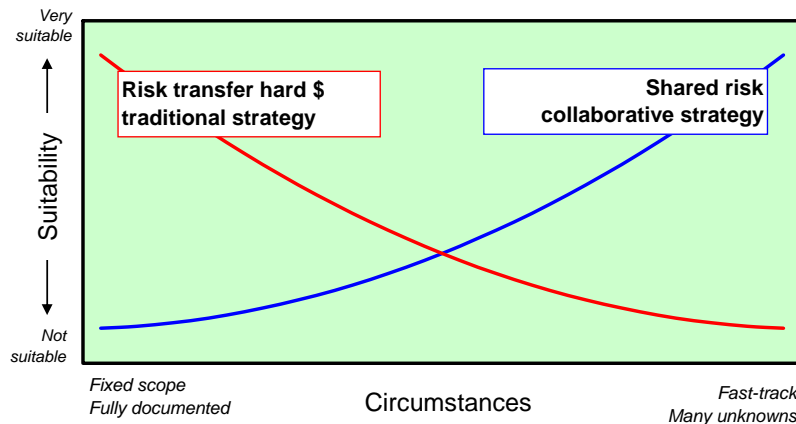


Figure 7 - Suitability of alliancing as a delivery method

Put simply owners tend to choose alliances when they believe an alliance offers the best chance of achieving their objectives for the project.

What does it take to make sure it works well?

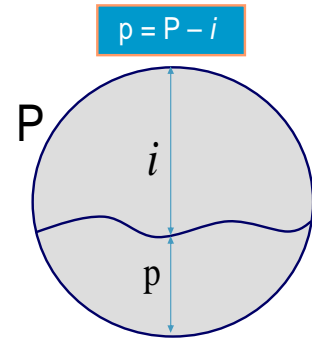
As with any delivery strategy, alliancing provides no guarantee of optimum value for money. Selecting an alliance for the wrong reasons or without stakeholders sufficiently understanding the drivers of success or potential risks, significantly increases the likelihood of disappointment. However, when applied under the right circumstances, it is a powerful means of overcoming adversity and achieving outstanding outcomes.

This is because “pure alliances” are designed to enable and drive organisational peak performance by employing principles-based frameworks to align the commercial interests of the corporate players. They also use advanced leadership practices to create an environment free from the contractual barriers and agendas that typically prevent or limit the powerful relationships required to deliver complex infrastructure projects successfully.

In theory, these techniques deliver a “best for project” qualified team that functions as a totally aligned peak performing project organisation delivering (and exceeding) the agreed outcomes in the most efficient manner possible. In practice, achieving this dream state and all that it promises can be elusive.

Consider the following formula, adapted from Gallwey’ (2000):

- $p = P - i$ where
 - p = actual performance level
 - P = true potential, and
 - i = interference.



According to this formula, realising the full potential of a project team (peak performance) requires identifying and systematically eliminating the interference preventing the team from reaching its true potential. Based on close involvement with over 50 alliances the author has concluded that, in the first instance, adopting an alliance commercial/legal framework does eliminate a significant part of the “i” (interference) by removing commercial misalignment and contractual barriers. However, while significant, this is not sufficient on its own to deliver peak performance. An alliancing framework on its own does not reach the “higher” parts of the “i”, which relate to human behaviour. This is the realm of emotional intelligence and “human emergence” and presents the real leadership challenge: understanding managing the complex array of individual human drivers – thoughts, feelings, mental models, beliefs and assumptions, needs and yearnings, sense of identity and purpose.

If projects focus on the framework but ignore leadership, they create the right commercial and contractual environment but fail to exploit it, leading to sub-optimal outcomes. By contrast, if projects try to focus on leadership without a suitably enabling framework, contractual obstacles are likely to prevent the team from operating near its full potential. The full potential of the team can only be mobilised by a strategy that effectively combines both – in effect a balance of yin and yang.

While the potential benefits may make the choice of a “pure alliance” seem self-evident, in practice there are many reasons why it may not be appropriate. In some situations a hybrid framework may be more suitable or may be the only option available. However, in such circumstances, a prudent owner must appreciate the implications and limitations of a hybrid framework. Owners adopting hybrid forms of alliance in the expectation that they will deliver the kind of outstanding outcomes seen on pure alliances will be disappointed. Hybrids rarely create an environment that drives and supports peak performance.



Morwood et al (2008, pages 110 - 124) provides a valuable discussion on some of the current thinking on developing and sustaining a high performance culture in Australian alliances.

Tips for new players

For many people, working on an alliance is a career highlight – sometimes even leading to a personal epiphany, transforming the way they see and relate to the world. There remains a risk that for some the experience will be a disappointment, falling well short of the hype and the promise. To ensure the alliance experience lives up to its promise – for industry as a whole, for corporations and for individuals:

A. Owners, when deciding to use, establishing and/or implementing an alliance should:

- 1) Be fully informed on both the benefits and the risks before embarking on an alliance – it should not require a “leap of faith”.
- 2) Be sure the selection process reveals prospective partners for who they really are.
- 3) Be careful of relying on feasibility budgets that lack rigour – be prepared to see the project development phase of an alliance as an investment in driving out uncertainty.
- 4) If possible use an alliance framework that provides the right foundation for development of a peak performing team. If using some hybrid form of alliancing – fully understand and appreciate its implications.
- 5) Let your actions during the selection process show that you understand and practice alliance principles.

B. Proponents & non-owner participants when seeking selection and/or participating in an alliance should:

- 1) Avoid seeing alliancing as a marketing ploy to secure work – the risks for you are too great in the longer-term!
- 2) Take the time to understand the underlying principles and start deploying the relevant leadership and communications skills you learn on alliances throughout your operations.
- 3) Adopt a long-term strategic view (beyond the limits of the project itself) – this might call for you to make a “sacrificial play” occasionally.



C. All players should:

- 1) Agree on core “principles of operation” and then act and make decisions in line with those principles.
- 2) Invest in people and leadership – focus on value, not the cost. Remember leaders create and sustain the environment that produces the results. Effective leaders know that inspiration is the wellspring of personal energy and that energy is the fuel of high performance.
- 3) Learn and practice “real” conversations (Scott, 2002) – by drawing on our capacity for self-disclosure and ownership of each situation we build trust, intimacy and powerful relationships.
- 4) Be prepared to commit to targets without knowing how to achieve them but in your enthusiasm for breakthroughs don’t lose sight of proven systems and practices.
- 5) Use alliancing as a training ground for development of a new breed of super-leader.



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