

The Case for Alliances – The Next Generation of Partnering

By Janette Keiser

Problems relating to a construction project cannot be solved by the application of technical skills alone. Technical skills must be coupled with effective communications so problems can be discussed and resolved. Communications are difficult unless there is trust between the parties. It is easier to build trust between the parties if the parties perceive that they have common goals. This combination of factors: communications, trust and common goals constitute the “business culture” of a project. Traditional partnering programs help project teams build an effective business culture by focusing on facilitating communication, establishing trust, and identifying common goals. The parties are then able to use their technical skills to solve problems, in the context of this business culture.

Sometimes this focus on the business culture is enough. Sometimes, it is not. There have been many projects where traditional partnering was employed and the projects became contentious and claims-oriented anyway. Why?

Traditional partnering fails to address commercial reality

Projects fail when the parties fail to acknowledge the impacts of commercial reality. Parties to a contract will only perform well when it is in their best interests to do so – this is commercial reality. If the parties feel that they are being taken advantage of, they will no longer have incentive to perform well because they will feel that it is not in their best interests to do so. In one example, a government owner specified it would provide various key support facilities. When the government failed to adequately fulfill its obligations, the contractor’s schedule and costs were impacted. The contractor submitted a claim for its extra costs. The government refused the claim, not because the government disagreed with the legitimacy of the claim, but because the government had no more money. The government representatives could not engage in effective problem solving because they could not, even if they wanted to, acknowledge the contractor’s commercial reality. The contractor had no further incentive to perform well and predictably, the project failed, suffering cost overruns, schedule delays, hot tempers and litigation.

This example, and other examples of partnering failures, demonstrates that a traditional part-

nering program is not complete unless it includes a component for commercial reality. Partnering programs should, as a minimum, engage the project teams in discussions about topics that affect money – change order processes, payment methods, contingencies, project budgets. Even with this added component, traditional partnering programs are not complete because the parties have little ability to change the contract to enhance commercial reality. The parties might be able to establish good will and trust with each other and if they can, they will enjoy enhanced collaboration and cooperation. This might happen; but then, it might not. The parties are called “partners”, but only figuratively. They are not tied together financially in the same way that a true partnership is tied together. There is no incentive beyond the parties’ intangible goals for success for them to find a balanced approach to commercial reality. Sometimes this is enough. Sometimes it is not.

Ein neues Vertragsmodell: „Allianzen“ – Die nächste Generation des Partnering-Konzepts

„Projekt-Partnering“ ist ein Mittel zur Vermeidung und Klärung von Konflikten in der Bauindustrie, das auf der Verbesserung der Kommunikation zwischen den Beteiligten fußt, damit diese die auftretenden Probleme identifizieren und lösen können, ehe daraus Nachtragsforderungen oder gerichtliche Klagen werden. Partnering verändert das Vertragsverhältnis zwischen den Beteiligten nicht. Partnering führt nicht immer zum besseren Verständnis der Beteiligten für die kaufmännische/finanzielle Realität und wird oft wirkungslos, wenn es um Geld geht.

Die als „Allianz“ bekannte Vertragsmethodik führt das traditionelle Partnering einen Schritt weiter, indem sie das Vertragsverhältnis zwischen den Parteien ändert und die finanzielle Realität beeinflusst. In diesem Artikel wird anhand eines großen Design-Build Tunnelprojekts in Sydney, Australien, beschrieben, wie die Methodik der Allianz funktioniert.

“Project partnering” is a means of dispute prevention and resolution in the construction industry that relies on facilitating communications between the parties so they can identify and solve problems before they become claims or lawsuits. Partnering does not change the contractual relationship between the parties. Partnering is not always effective in enhancing the parties’ perceptions of commercial reality and often breaks down when money becomes an issue.

The contract methodology known as the “alliance” takes traditional partnering a step further by actually changing the contractual relationship between the parties and affecting commercial reality. This paper describes how the alliance methodology works, using, as a case study, a large design-build tunnel project in Sydney, Australia.

The alliance methodology embraces the concept of commercial reality

Alliancing is partnering evolved. The alliance method takes partnering a step further by setting forth a balanced approach to commercial reality in the contract documents. The parties become “partners” in the real sense of the word, financially and contractually tied to each other’s successes and failures, not just “partners” in the figurative sense as in traditional contracts where project partnering is used.

The alliance method was developed from the oil industry to build drilling platforms in the North Sea. It has been used in Australia since about 1994, for some high profile public sector projects including the Northside Storage Tunnel Project, the new National Museum of Australia and many others. Alliance agreements differ from project to project but they share these characteristics:

- ◊ The Alliance Agreement contains a clear definition of commercial reality, which typically specifies that direct costs are guaranteed to be covered, but payment of margins, overheads and profit are subject to an equitable system of reward and penalty for exceptional and poor performance.
- ◊ The Alliance Agreement equitably allocates risk between the parties and provides for project-wide risk management, usually through project-wide insurance.
- ◊ The Alliance Agreement specifies a clear decision-making process, which is grounded on what is “best for the project”.

The Northside Storage Tunnel Project, owned by Sydney Water, is a project where the alliance methodology was used. The purpose of the project was to build a tunnel, which would intercept four major sewer lines that discharged into Sydney Harbor in Sydney, Australia, during heavy rain. The new tunnel would store the runoff and overflow from the sewer lines until the flow could be processed at an underground treatment plant. The goal was to complete this project before the 2000 Olympics. Sydney Water and their planning consultants realized that they needed a fast-track approach to contracting. They wanted “to establish a single entity through which the planning, design, accounting, administration, construction, commissioning and closing out of the contract would be managed as one entity, thus ruling out double, and triple administration and accounting costs” (1). They chose the alliance method of contracting.

Sydney Water, through a competitive procurement, hired an alliance facilitator, JMJ Associates and a law firm, Mallesons Stephen Jaques, to assist in the establishment of the alliance, and particularly, in the development of the alliance agreement. With these resources, Sydney Water developed a direct cost framework, a risk-reward structure, a draft alliance agreement, selection criteria, a proposal evaluation process and tender docu-

ments. In September 1997, Sydney Water issued a call for Proposals. One of the criteria was “an understanding and affinity for operating as an alliance partner”. In October 1997, eight consortia submitted proposals to Sydney Water. By January 1998, a selection had been made and an Alliance Agreement was signed with the consortium consisting of: Transfield, a large Australian construction company; Montgomery Watson Group (MWG) and Connell Wagner, a tunnel design specialist.

The Alliance Agreement paid close attention to the organizational structure. Specifically, the organizational framework was as follows:

- ◊ The Integrated Project Team (IPT) handled the day to day management of the project.
- ◊ There was an Alliance Implementation Team (AIT), comprised of department managers and members of the IPT, responsible for managing and maintaining the alliance relationship.
- ◊ There was also a Project Alliance Leadership Team of senior executives of the alliance participants who monitored the performance of the IPT and provided guidance and support to the AIT. There were eight members of this leadership team, two members from each of the four alliance participants: Sydney Water, Transfield, MWG and Connell Wagner.

This organizational structure showed that close attention was paid to issues regarding the organizational behavior and the human element of the alliance. Rigorous attention was also paid to training the alliance participants with workshops relating to team orientation, problem solving, brainstorming. These were important functions. Experience with traditional design-build projects has shown that failure to pay adequate attention to these elements is a key reason why these traditional projects fail, even when partnered. One team participant, a member of the design firm, said that managing the human element of the alliance, because of the new paradigm that people had to adopt, was the most difficult element of the program.

The Alliance Agreement identified various performance objectives relating to cost, time, environment, community relations and safety. These objectives are very similar to the goals and objectives that are developed for a typical partnered project. What makes an alliance different is that in an alliance, achievement of these objectives results in tangible, financial rewards; failure to achieve them results in tangible, financial penalties. Specifically, the savings that are achieved at the end of the project are available for distribution to all alliance participants, based on how well the participants achieved the alliance objectives. This is true commercial reality.

Alliances comply with public accountability standards

A key issue that has emerged since alliances have been used in Australia has been the issue of public accountability. The question is: How does a

government agency ensure that public accountability is satisfied when traditional competitive bid processes are set aside? The Australian National Audit Office (ANAO) asked this question in the context of their audit of a major alliance project, the National Museum of Australia. The Parliamentary Standing Committee of Public Works (PWC) authorized the use of Alliancing on the museum project but expressed concern about

- ◊ the cost of the project,
- ◊ the cost of the design brief and submissions and
- ◊ the relatively new alliance method of construction contracting (2).

To address these concerns, the ANAO undertook an audit of the museum project, specifically studying these issues:

- ◊ The project's compliance with Australia's public procurement requirements,
- ◊ The effectiveness of project management.

The ANAO focused on the museum project but "was mindful of the broader applicability of project alliancing to the Commonwealth (of Australia) as a whole".

The ANAO reached the following major conclusions:

- ◊ The procurement processes substantially complied with Australia's public procurement requirements.
- ◊ Successful project alliancing depends on skillful management of the particular risks involved. The financial incentives that were in place were appropriate to encourage "best for project" behavior.
- ◊ Project alliance offers potential benefits over traditional construction contracting methodology but it raises new and different risks that have to be managed – in particular, determining the appropriate balance between managing the spirit of the alliance and protecting the Commonwealth's financial interests.
- ◊ The alliance partners had sound processes and procedures in place to monitor appropriately the progress of construction and manage the cost, time, quality requirements, and other project risks in a timely manner.

The alliance was effective

The Northside Tunnel Project attracted the attention of a team of researchers from two universities in Australia: The Australian Centre for Construction Innovation at the University of South Wales and the School of Management at the University of Technology in Sydney. This team studied the project for almost two years: distributing questionnaires, interviewing project participants, management and leadership meetings, making field observations. They reported their findings in (3). The paper reports that the alliance was effective. The project suffered from various problems. For example, due to schedule constraints, the team was required to procure the tunnel-boring machine before the soil investigation report was complete. As a

result, the tunnel-boring machine was not well suited for the soils that were encountered during construction. This resulted in schedule delays and extra costs. Also, the tunnel alignment went through one of Sydney's most expensive neighbourhoods, the residents of which were hostile, complaining regularly about the project, again causing delay and extra costs. The researchers speculated that if the alliance had not been in place, the contractor might have walked off the project because of these problems. Despite these difficulties, the project achieved the following goals:

- ◊ The project budget when the alliance commenced was \$453 million (Australian dollars). The final cost was approximately \$465 million, for a cost overrun of approximately 2.6 %. Considering the problems that were suffered on the project, this is a remarkably low cost overrun.
- ◊ The schedule goal was achieved. The team was able to complete the project, which would normally take six to seven years to complete, in less than three years.
- ◊ The project's safety record compared favourably with, or was better, than the industry standards. For example, the average weeks lost per lost time injury was 4.6 weeks compared to 11.6 weeks for the construction industry overall.
- ◊ Community relations improved as the project team developed better management systems to distribute information and address concerns. For example, when the project started, this factor earned a performance rating of 15.4 of 20 possible points. At the end of the project, the rating was 18.25.

The researchers concluded that the alliance method "allowed the project team flexibility and gave it the focus necessary to solve problems and to bring the project in at a cost and in a time-frame that no other contractual arrangement could have done."

Conclusion

The alliance method allows the uncertainties of a large complex project to be managed in the best interests of the project and effectively addresses commercial reality. Because of these characteristics, the alliance method could be advantageous for large, complex projects where uncertainties abound.

References

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