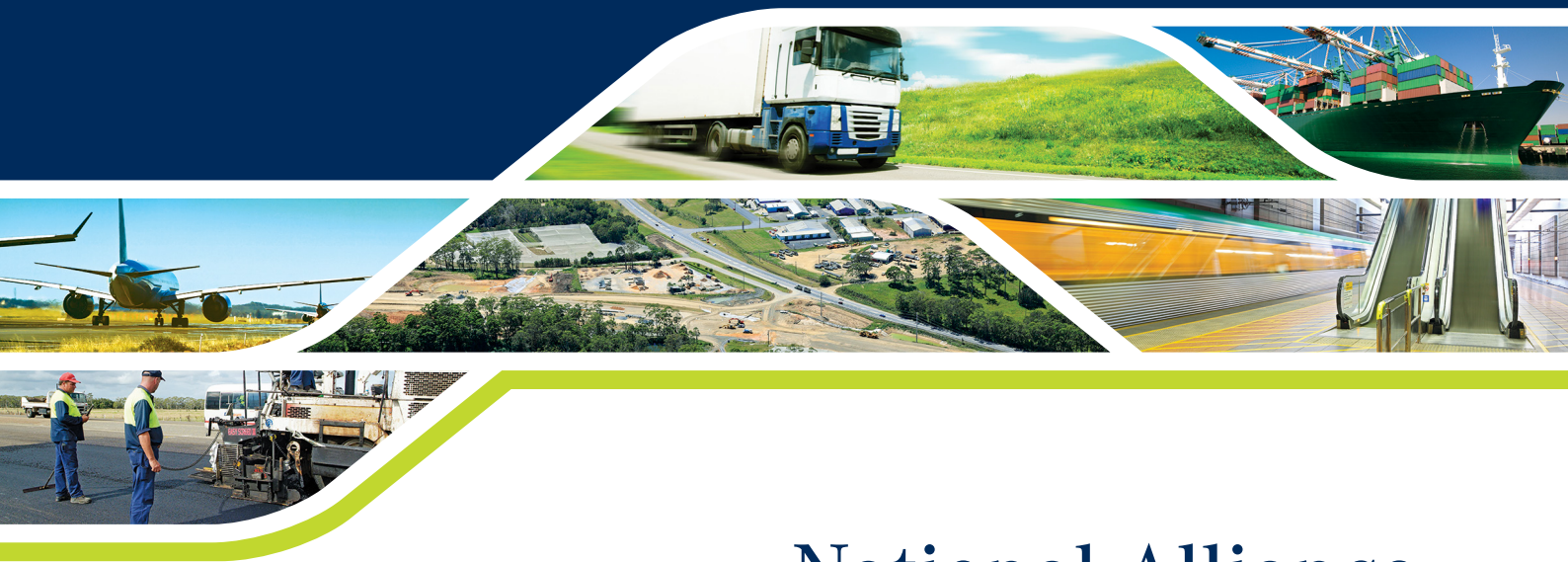




Australian Government

Department of Infrastructure and Regional Development



National Alliance Contracting Guidelines

Guidance Note 1 Language in Alliance Contracting: A Short Analysis of Common Terminology

September 2015



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Document Updates

This Guidance Note will be updated from time to time to reflect evolving best practices and lessons learned.

Document change	Date
Exposure Draft published by the Department of Treasury and Finance (Victoria) for comment	August 2009
Final version published by the Department of Treasury and Finance (Victoria)	December 2009
National Guidance Note published (with a refresh and update of the August 2010 publication)	July 2011
Republished with updates to other documents in the series	September 2015

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ISBN 978-1-925216-67-7

September 2015/INFRA2603

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Note

Governments in each jurisdiction will have their own individual approval processes for capital investment projects, as well as policies (e.g. probity) and legislation that will impact on all capital works delivery. These over-arching jurisdictional requirements are precedent to the alliance practices covered in this document.

Acknowledgement

This Guidance Note is based on the guidance note of the same name prepared under the sponsorship of the Inter-Jurisdictional Alliances Steering Committee with membership from:

- Department of Treasury and Finance, Victoria (Chair)
- Treasury, New South Wales
- Treasury, Queensland
- Department of Treasury and Finance, Western Australia
- Department of Infrastructure and Regional Development, Australian Government

The production of the Guidance Note was led by the Department of Treasury and Finance Victoria, with the assistance of Freehills, 101 Collins Street, Melbourne.

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1 Preamble

This guidance note was prepared to assist public officials undertaking alliance contracting to clarify the value proposition, or benefit, of using alliance agreements.

Governments¹ seek to achieve a very broad range of social, environmental and economic objectives on behalf of the community. This normally results in an equally broad diversity of capital and infrastructure projects. There are a number of mature and emerging project delivery methodologies that can cater well to this project diversity on a 'fit-for-purpose' basis, the selection being on a careful and knowledgeable analysis of project characteristics and risks.

Increasingly, governments are using alliance contracting to procure significant infrastructure.

A key value proposition of alliancing is that government entities trade-off their traditional contractual rights (under a 'risk transfer' contract) in exchange for Non-Owner Participants bringing to the project their 'good faith' in acting with the highest level of *integrity* and making 'best-for-project' decisions.

To deliver on this proposition, alliances need to have a clear mechanism to understand and implement this 'trade-off'. For each project, the terminology, and the commercial elements that apply in each alliance agreement need to be clearly understood and must reflect the meaning agreed by the Participants.

The legal position and the government's commercial exposure must always be transparent and understood, regardless of any aspirational or 'assumed' meaning of terminology or risk allocations under alliance agreements, which may be based on previous experience or interactions with proponents of alliance contracting.

Like all contracting methodologies, alliancing should also make continual improvements. This guidance note aims to show how a close examination of the language underlying alliance agreements can further improve both the agreements and the value alliancing brings to the public interest.

¹ Unless otherwise stated, the expression 'government' is used to denote all the government entities of Australia, which include the Commonwealth of Australia and all Australian state governments and territories.

2 Overview

The objective of this guidance note is to consider the use and meaning of key phrases commonly used in alliancing practice and agreements—phrases such as 'no fault – no blame', best-for-project and 'risk sharing'—and how such phrases may be applied in practice (or legally) where the aspirations or objectives of the alliance come under stress, e.g., if there is a dispute between the parties.

This guidance note seeks to:

- analyse some of the key phrases commonly used in alliancing practice and agreements and promote discussion;
- identify any discrepancy between the legal or commercial implications of terminology used in alliance agreements and its aspirational use in, e.g., alliancing workshops; and
- identify key risks or factors that can result in the practical or commercial outcome of alliance contracting falling short of the aspirations behind some of these key phrases.

3 Outcome of the analysis

The review of terminology set out in this guidance note has helped identify some areas where alliance agreements could be improved to enhance, articulate and demonstrate the value proposition to the state.² The review shows there is a potential risk of a 'disconnect' between the aspirational use of alliancing terms and the practical application of these terms where a project becomes 'distressed'.

Three principal areas for attention, to help minimise this risk, emerged from the review and discussions.

(a) **Standard alliance practice and terms need to be challenged periodically**

The procedures for the procurement of alliance contracts risk become increasingly 'business-as-usual'. The forms, structure and content of alliance contracts are generally well understood by alliance Participants, and for this reason have remained relatively static. On one hand this is a strength—it provides industry Participants with certainty and reduces the lead time and cost of procurement. However, it also carries with it a risk that Participants may not sufficiently test their understanding of:

- terminology used (and whether the 'aspirational' meaning of terminology meets the actual or legal meaning);
- the commercial framework and its appropriateness for the individual project and Participants; and
- the risks that they as an Owner (and in turn the state) will bear under the Commercial Framework.

(b) **Proposal—a formal Charter of Alliance Behaviours**

This guidance note proposes the use of a 'charter of behaviours' to which alliance Participants will commit. Although most alliance agreements include a set of alliance principles on which the culture of the alliance is based, the proposed formal charter of behaviours would move away from broad 'motherhood' statements towards more objective and understandable behavioural criteria.³ These behaviours would help define good faith and best-for-project conduct for the alliance Participants, providing more certainty about many of the mechanisms in the alliance agreement that use those definitions.

(c) **More emphasis on risk analysis**

The fact that alliance Participants may act in good faith and in a way that is best-for-project does not mean that where a project becomes distressed, governments do not need to be concerned about the consequences. Although project risks are partly 'shared' between the alliance Participants, beyond a certain point (agreed as part of the Risk or Reward model) the state bears the impact the distress.

² The expression 'state' here is used to denote all the government entities of Australia, which include the Commonwealth of Australia and all Australian state governments and territories.

³ National Alliance Contracting Guidelines Guidance Note 3: Key Risk Areas and Trade Offs; and National Alliance Contracting Guidelines Template No 1: Model Project Alliancing Agreement, Schedule 2, provide a template form of a standard or generic alliance charter that can be detailed and tailored to meet the requirements of an individual project and which can be finalised during commercial negotiations.

This is not a criticism of the alliance methodology. However, it is a feature of alliance contracting that needs to be fully understood and accepted. Public sector agencies should be better placed under alliance contracts to understand the risks they face (and the potential consequences if these risks arise) than under traditional 'risk transfer' contracts. To this end, a thorough risk analysis at the pre-award stage is an important step towards a successful alliance project.

4 Analysis

The terms explained and analysed in this section are:

- 'no fault – no blame'
- best-for-project
- 'risk sharing' and 'collective assumption of risk'
- 'outstanding outcomes' and 'breakthrough or gamebreaking performance'
- 'Risk or Reward'
- 'we will agree'

4.1 No fault – no blame

Meaning

Under the no fault – no blame principle, each alliance Participant agrees that that it has no right to bring any legal claim against any other Participant in the alliance (usually, except in limited circumstances of fraud or wilful default).

The aspiration behind the no fault – no blame approach in alliance contracting is that it:

- encourages the Participants to take calculated and agreed risks in pursuing cost savings and enhancing project performance, without fear of legal liability if they fail;
- results in increased innovation and, consequently, in cost savings and increased Value-for-Money that could not be achieved in a traditional contracting environment;
- focuses the parties on solutions rather than who is to blame; and
- means that resources are not diverted away from the project itself.

Practical application and potential areas for improvement

Despite the advantages of a no blame culture, no blame regimes in alliance agreements do raise legal or commercial trade-offs that need to be well recognised and understood:

- 1) The fact that parties cannot exclude all their liability, even if that is their commercial intention, e.g., liability to third parties, which arises under statute: Although an alliance agreement can regulate the liability between the Participants, it cannot restrict the rights of third parties who may wish to bring a claim against one or more of the Participants.
- 2) *Issues with obtaining insurance*: For example, given that insurance policies are triggered on the existence of a liability, such policies will not respond where a Participant is not liable for any loss. This has given rise to the development of alliance-specific, project-based insurance policies.⁴
- 3) *Whether no blame regimes will be construed as legally ineffective, on the basis that the jurisdiction of the courts cannot be ousted*: This is because the no blame clauses claim to prevent the alliance Participants from litigating for breach of contract or other legal wrongs associated with the project - which is against public policy. In *Dobbs versus the National Bank of Australasia Ltd* (1935, 53 CLR 643), Justices Rich, Dixon, Evatt and McTiernan said regarding, parties attempting to oust the court's jurisdiction:

⁴ See National Alliance Contracting Guidance Note 2: *Insurance in Alliance Contracting: Selling Insurable Risks*

'... It is not possible for a contract to create rights and at the same time to deny to the other party in whom they vest the right to invoke the jurisdiction of the courts to enforce them'.

This means that an undertaking by alliance Participants not to sue may be legally void, to the extent that it purports to prohibit litigation in relation to wrongs.

As well as the legal issues, there are also a number of practical implications of a no blame approach. Under such a regime, the Owner Participant is effectively ultimately liable for the behaviour and performance of the Non-Owner Participants. These are beyond its control. If Non-Owner Participants fail to perform their obligations in line with the alliance agreement, or the delivery of the project does not meet the required standard, the Owner Participant has no legal recourse against the Non-Owner Participants (except in cases of fraud or wilful default). This means that the impact of deficient performance rests with insurers, the Owner Participant and/or the Non-Owner Participants, via the Risk or Reward regime. (Section 4.6 has a more detailed discussion of Risk or Reward regimes.)

The legal and commercial implications of no blame should also be addressed by carefully considering the extent to which alliance Participants can resort to litigation. For instance:

- Will only wilful defaults give the alliance Participants the right to resort to litigation?
- Will the Participants have legal rights to enforce confidentiality undertakings or intellectual property warranties (even if only infringed by conduct that is not 'wilful')?
- What other processes (if any) must the alliance Participants go through before the right to litigate is available to them?

These matters need to be individually agreed and included in the alliance agreement. The alliance Participants' decision on these issues must also be considered in the context of the insurance policies put in place under the alliance agreement, as the decisions may have a significant impact on whether or not those policies will respond to events or claims as anticipated.⁵ Ideally, insurance advisers should be involved in discussions during the commercial workshop stage, so that the implications of the no fault – no blame regime are well understood and to ensure that insurers 'sign-up' to this value proposition before the terms of the alliance are implemented.

The approach to subcontracts for the project may also be structured to address the risks which may arise in connection with the no fault – no blame principle. In particular, the alliance agreement may reserve the Owner's right to enter into any subcontracts for delivery of the works (either in its own name, or by appointing one of the Non-Owner Participants as an agent of the Owner to enter into the subcontracts on its behalf), rather than leaving subcontracts to be entered into directly by the Non-Owner Participants. This enables the Owner to preserve its contractual rights under the subcontracts, which will often be traditional 'risk transfer' contracts. In addition, this approach gives greater control to the Owner to ensure that the Non-Owner Participants comply with any applicable procurement rules.

⁵ See National Alliance Contracting Guidance Note 2: *Insurance in Alliance Contracting: Selling Insurable Risks*

Charter of alliance behaviours

This guidance note proposes the use of a charter of acceptable standards in alliance behaviours to guide the conduct of the alliance Participants. This is another way that the value proposition of the no fault – blame proposition could be improved. Any breach by an alliance Participant of the behaviours set out in the charter could be characterised as a ‘wilful default’. This would give Non-Owner Participants some comfort that, if the behaviour is not adhered to, there is a mechanism the Owner Participant can use to enforce its bargain.

4.2 Good faith

Meaning

The aspirational view of good faith is tied to the general behaviours and shared cultural values that the alliance Participants aim to achieve in their project. These usually relate to cooperation and communication between the Participants, and a requirement to always be fair and honest and act with integrity.

To give effect to the aspirational concept of good faith, alliance agreements usually set out an exhaustive definition. Generally, the requirement to act in good faith includes:

1. an obligation on the parties to cooperate in achieving the contractual objectives (loyalty to the promise itself);
2. compliance with honest standards of conduct;
3. compliance with the reasonable standards of conduct, having regard to the interests of the parties.

Practical application and potential areas for improvement

There are a number of legal implications of the good faith concept that may not be clear to alliance Participants when this concept is discussed in an aspirational way (rather than with reference to a specific definition). In particular, it is important for alliance Participants to understand that:

- Including an obligation to act in good faith in an alliance agreement will have the effect of importing that legal duty and the requirement for reasonableness into all provisions of the agreement.
- As noted above, an alliance agreement needs to exhaustively define what is meant by good faith—in its context. If the concept of good faith is not defined, then a court may be left to rule on its requirements, and this would be undesirable.
- The good faith obligation may not be terminated if legal proceedings begin between the parties, noting the unlikelihood of this occurring in the general no fault context (see section 4.1 above). This means that the parties may be required to continue to act in good faith during a dispute. However, it is also important to note that the obligation to act in good faith should generally be limited to the performance of the collective obligations and responsibilities of the alliance, rather than attaching to the Owner Participant’s unilateral obligations, rights and entitlements (e.g., payment and issuing directions).

From a practical and commercial perspective, even if the alliance Participants meet their obligation to act in good faith, this does not change the outcome or financial implications of their performance under the Commercial Framework or Risk or Reward regime. Good faith may be fundamental to the success of the project, and it is important that the alliance Participants understand what good faith means so that they can meet the required standard of conduct. However, whether or not good faith has been exercised in the decision-making process, the cost and time objectives of the project will still need to be achieved, and the actual cost and non-cost outcomes will be dealt with via the Commercial

Framework. Ultimately, the Owner will bear the consequences of the project's outcomes regardless of the exercise of good faith by the alliance Participants.

As discussed, one of the key value propositions of alliancing is that governments are willing to forego the traditional contractual rights that would apply (under a traditional 'risk transfer' contract) in exchange for Non-Owner Participants bringing to the project their 'good faith' in acting with the highest level of integrity for the best of the project.

The question therefore becomes how to enforce the good faith bargain. Most alliance contracts seek to do this. Failure to act in good faith is treated as a wilful default. However, identifying what is not good faith can be difficult (as is the case with identifying what is best-for-project). The concept is perhaps easier to say than to define. The proposed development of an agreed charter of behaviours could allow for a more objective test of the conduct of the alliance Participants.

4.3 Best-for-project

Meaning

Best-for-project is a common expression that is usually defined in alliance agreements. It is typically understood as the alliance Participants directing their decisions towards the shared, collective vision and objectives of the alliance (including time, cost, quality and reputation), rather than narrow self-serving goals (such as maximum profit). Best-for-project has been described in alliance agreements as actions and decisions that:

- fit with the alliance principles developed by the Participants and incorporated in the alliance agreement;
- drive the delivery of outstanding outcomes in all project objectives; and
- are made in a way that reflects the Participants' behavioural commitments under the agreement.

Practical application and potential areas for improvement

A best-for-project approach is intended to drive all decision-making processes. However, it is not a guarantee that the actual outcome of a relevant decision will be best for the project. That is, whether or not the alliance Participants regard a decision (at the time it is made) as best-for-project, this does not change the practical effect of the decision on the Commercial Framework, or the financial impact of the decision under the Risk or Reward regime. This is not intended to be a criticism of the best-for-project concept. Rather, it is simply to recognise the distinction between:

- the intent or guiding principles behind the decision-making process; and
- the outcome—the risk of which is dealt with under the risk sharing provided for in the Commercial Framework.

Public sector agencies should ensure that this distinction is understood and recognised, that using the phrase best-for-project will not necessarily make it so, and that Owner Participants should ensure they are clear about:

- *what best-for-project will mean*: The definition must not be too narrowly focused on just the physical work to be performed by the Non-Owner Participants. It should include examples, and should reflect the Participants' specific behavioural obligations under the agreement (given that the concept is closely tied to the decision-making process).
- *what the 'project' is*: The definition needs to be broad enough to capture all the Owner Participants' aspirations and the objectives of stakeholders

(much of this should be captured in the agency's Business Case for the project and the Owner's Value for Money (VfM) Statement⁶).

- *how the risk/reward framework applies and what it means if, despite the aspirations, some outcomes are not the 'best'.*

A common definition used in alliance agreements (which attempts to address each of these issues) is as follows:

An approach, determination, decision, outcome, solution or resolution that is consistent with our alliance principles, facilitate gamebreaking performance, is value for money for the State and which is arrived at or taken for the ultimate purpose of providing fit for purpose assets to the State.

However, even where care is taken to define best-for-project, it is still difficult to measure qualitatively whether an outcome is the best for the project. Alliance Participants need to understand that the concept only has limited use as an objective test for their performance, and the structuring of the Risk or Reward regime is an important tool for ensuring that the alliance achieves the relevant goals.

The obligation to adopt a best-for-project approach also requires the alliance to recognise that although a decision may be 'best' for the individual Non-Owner Participants' commercial interests, that decision may not facilitate the 'best' outcome for the Owner. For example, the Owner may need to take 'whole-of-state' network considerations and the wider community into account. For this reason, alliance agreements will often set out a number of discretions which are reserved for exercise by the Owner. This is intended to ensure the Owner has the right to override any decisions which may 'collectively' be viewed as best-for-project, but which do not align with the Owner's objectives for the project.

4.4 Risk sharing/collective assumption of risk

Meaning

The concept of collective assumption of risk in alliance contracts is that all risks are borne equitably (as opposed to equally) by the alliance Participants. The aspiration behind this approach is that, unlike standard construction contracts, 'pure' alliance agreements do not assign project delivery risk to any one party. Both (or all) parties jointly assume and manage the risks within the terms of the alliance agreement. The aspiration behind this approach to risk is that it:

- allows the risks to be better managed than where they are allocated to one party; and
- is more appropriate for large, complex infrastructure projects or circumstances where there are many unknowns and the risks are ill-defined—making the cost of risk transfer uneconomic.

Practical application and potential areas for improvement

Agencies should recognise that risk sharing under an alliance agreement only applies to the extent contemplated by the Risk or Reward regime agreed by the Participants, and that, practically, the Owner Participant will always bear the ultimate risk of the project's success or failure. That is, at some point, the Non-Owner Participant's 'painshare' will reach its limit, and from that point, all further pain is borne by the Owner Participant.

⁶ See National Alliance Contracting Guidance Note 4: *Reporting VFM Outcomes in Alliance Contracting*.

For example, where the alliance Participants fail to keep costs below the target cost and a cost overrun occurs:

- The Owner Participant bears the risk that actual costs will exceed the target cost.
- Some of this risk is shared with the Non-Owner Participants—typically, the Non-Owner Participant's margin is at risk, but in other cases just profit and/or overhead will be at risk.
- Once expended, all direct costs must still be paid to the Non-Owner Participants. At this point, the risk rests entirely with the Owner Participant. Non-Owner Participants are always entitled to be reimbursed for all direct costs, even in the case of delay, negligence, cost overruns or defective design (except where caused by 'wilful default').

Therefore, although there is 'collective' assumption of risk between the alliance Participants from an aspirational standpoint, in practice, an Owner Participant needs to recognise that the degree of risk they may bear if the project is in 'distress' (e.g., if critical timelines are not met or the project exceeds approved funding) is significantly greater than the risk that is borne by the Non-Owner Participants. The Owner will always bear the financial consequences of cost overruns, whereas the Non-Owner Participants will always have their direct costs reimbursed (and will usually have their painshare capped at a certain point). The impact of this can be magnified because of the no fault – no blame principle (see section 4.1 above), which means the Owner Participant also loses its 'insurance of litigation', i.e., the right to begin legal proceedings against the Non-Owner Participants for substandard performance, if that is what caused the increased costs. That said, it is also important to recognise that in most cases, it is the public sector agency that is the most exposed to the risk of litigation.

The implications of the risk sharing under alliance agreements means that the Commercial Framework and Risk or Reward regime need to be carefully structured. There is no one-size-fits-all Risk or Reward regime, and this is the key mechanism which allows Owner Participants to manage the practical impact of the risk sharing approach. For example, depending on the nature of the project, certain risks can be excised from the general pool of shared risks, and allocated to the key Non-Owner Participant(s). These latter could also be required to face financial consequences for particular events that are treated differently from the general Risk or Reward mechanism. Owner Participants can also manage the implications of collective assumption of risk by engaging in detailed risk analysis with the alliance Proponents during the selection process and at the target cost development stage.

Legally, it is also important for alliance Participants to understand that some risks cannot be shared. Even where the alliance agreement regulates liability as being shared between the alliance Participants, third parties will still have the right to bring a claim against one or more of the Participants. This risk needs to be addressed separately from collective risk sharing and no blame regimes commented on above, e.g., through a project-based insurance policy or the inclusion of cross-indemnities and limits on liability. Alternatively, the alliance may also agree that third party claims are recoverable as a direct cost under the Commercial Framework (including for a period of time after the relevant works have achieved final completion). This will obviously impact the Non-Owner Participants' entitlements under the Risk or Reward regime (see section 4.6 below).

Practically, the alliance agreement can also be drafted to reflect the distinction between the relevant agency acting as the 'Owner', rather than as the 'Owner Participant' in the alliance. This approach is designed to ensure that the agency is positioned to exercise greater control over the key project risks. For example, key discretions such as termination for convenience or approval of the target cost can be reserved for the Director or Chief Executive Officer of the agency, with other discretions (such as certification of payment claims and the decision-making

performed by the Alliance Leadership Team) reserved for exercise by the agency as the Owner Participant.

Finally, as discussed above, the fact that alliance Participants may act in good faith and in a best-for-project way does not mean that governments do not need to be concerned about the consequences if a project becomes distressed. In order to improve Owner Participants' understanding of potential risks, agencies should analyse risks thoroughly at the pre-award stage, but as a minimum, at the time the target cost is signed-off.

4.5 Outstanding outcomes and breakthrough or gamebreaking performance

Meaning

A key aspiration behind alliance agreements is that—where business-as-usual performance is not sufficient—this contractual model is better at overcoming extreme challenges and achieving breakthrough results or gamebreaking performance. Most alliance agreements include bonuses for breakthrough performance and, in some cases, there are penalties for failing to meet stated goals.

However, the obligation to achieve such results and performance, and the contractual mechanisms for assessing and enforcing this obligation, must be carefully considered, and included in the alliance agreement. A number of issues need to be considered.

Practical application and potential areas for improvement

The key issue regarding whether achieving outstanding outcomes and breakthrough/gamebreaking performance is an enforceable obligation is that if one of the parties to the alliance agreement does not substantially perform, the alliance agreement:

- releases all claims (through the no blame regime); and
- compels all parties to strive for a common goal of gamebreaking performance.

From a strict legal perspective, it needs to be recognised that this is only an incentive, and there is no legal consequence for not achieving it.

Measuring outstanding outcomes

For the Risk or Reward regime to create outstanding outcomes, considerable time needs to be devoted in the alliance development processes to defining what an objective performance of this standard looks like. For example, there may need to be a systematic way of measuring whether this obligation has been met, with a financial consequence for an alliance Participant who achieves or fails to achieve the requisite standard of performance built into the Risk or Reward regime. Also, care must be taken to define outstanding outcomes for each project and not just replicate those from previous projects. This is essential for ensuring that continuous improvement or year-on-year improvement is recognised and is not inappropriately rewarded as an outstanding outcome.

4.6 Risk or Reward

Meaning

The Risk or Reward regime is the key mechanism in the alliance agreement for encouraging and rewarding superior performance and addressing poor performance. The Non-Owner Participant agrees to put all or a certain percentage of its profit and/or corporate overhead at risk—tied to its performance against the target cost and other project objectives. The regime will usually

incorporate cost and non-cost components. For example, actual cost overruns or savings (as compared to the target cost) are shared between the alliance Participants in an agreed percentage. The Risk or Reward regime is always particular to the project, and is developed and proposed by the Owner as part of the tender documentation released to the bidders; and is then enhanced and finalised during the TOC development phase of establishing the alliance.

Practical application and potential areas for improvement

Agencies should ensure that all Risk or Reward regimes specifically target the outcomes required for the project at hand, and drive them. However, the Risk or Reward regime should not be seen as a solution to all issues related to the alliance Participants' performance. Ultimately, although it is intended to give effect to the alliance concept that performance risks are collectively assumed by the alliance Participants (see section 4.4 above), the Risk or Reward model will never fully translate to an equal sharing of either positive or negative outcomes as between all Participants. In particular, it is important to recognise that the model does not relieve Owner Participants of the additional risks that are assumed under an alliance approach. However, it can still be structured to ensure that Owner Participants are comfortable that the project risks are manageable.

Ideally, the alliance Participants should model the agreed Risk or Reward regime before signing the alliance agreement, to ensure that it achieves their desired commercial outcomes. Where possible, the alliance agreement should include worked examples of the application of the Risk or Reward regime. This regime may be structured in a number of ways to address the Owner Participants' concerns, and to incentivise the alliance Participants to achieve certain cost or non-cost project objectives.

For example, the amount of the cost overrun or cost saving might be varied by assessing the Non-Owner Participants' performance(s) against agreed non-cost performance indicators. Alternatively, the Owner may establish a bonus pool to reward the Non-Owner Participants for performance against these indicators. The inclusion of non-cost performance indicators or gainshare 'modifiers' in an alliance agreement is designed to take into account the Non-Owner Participant's performance in the non-cost areas of the project that are important to the Owner Participant. For example, Risk or Reward regimes may often include a modifier for safety and environment that operates to reduce or eliminate Non-Owner Participants' entitlement(s) to any share of the bonus pool if a 'major' safety or environment event occurs (such as a fatality on site).

The Risk or Reward profile may also be used as a mechanism to address the issue of Non-Owner Participants setting a 'soft' target cost, which is often discussed as a key risk for Owners in alliance contracting. For example, the Owner Participant may offer to top up the bonus pool if the alliance achieves a certain level of underrun against the target cost. This approach is designed to ensure that the amount that will be achieved in a cost underrun scenario is captured at the outset and applied to the performance Risk or Reward regime (rather than just being distributed as cost gainshare).

Ultimately, however, it is paramount that the Owner Participant has carefully considered the setting of the target cost and the contingencies which may be built into the target cost.

Agencies should take a continual improvement approach to the evolution of the Risk or Reward mechanism, particularly at the alliance tender stage. For example, tenderers may be challenged to see whether they would be prepared to put more of their profit at risk than other tenderers. In the absence of a competitive (or at least comparative) process for alliance contracts, it is difficult for clients to determine whether the margins, the Target Outturn Cost (TOC), the 'at risk' amounts or the Risk or Reward model are set at the right point. Those projects adopting a more rigorous approach to risk assessment before alliance contract award are better placed to ensure that the painshare/gainshare limits actually drive the behaviours and project outcomes that the government is trying to achieve.

It is also important to understand that in any Risk or Reward regime, the Non-Owner Participants are not sharing in 'profits' or 'losses' of the project or the delivery requirement. Instead, the alliance Participants are sharing in the outcomes of the project. From a cost perspective, a positive outcome will be achieved where there is a saving against the target cost. However, it needs to be recognised that such savings do not represent a collective profit for the alliance Participants.

From a legal standpoint, the Risk or Reward regime should also not describe cost savings or cost overruns as 'profits' or 'losses', as this could give rise to questions about whether the relationship between the Owner Participant and Non-Owner Participant(s) is one of principal and contractor or something different, such as partners or joint venture Participants. Owner Participants need to be careful to ensure that the relationship between them and the Non-Owner Participant remains that of principal and contractor, given the legal consequences that flow from this difference in relationship.

4.7 We will agree

Meaning

Alliance agreements often contain clauses in which the alliance Participants 'agree-to-agree' certain matters. For example, they may agree that the alliance board will agree its governing procedures at its first meeting or the alliance Participants may agree that the project timeline will be agreed at a later point. The clauses are designed to give the alliance the flexibility to deal with issues case-by-case. Generally, Participants may not view the agreement to agree clauses as posing a legal risk. On the basis of the general behavioural commitments of the alliance Participants and the cooperative alliance 'culture' which they aim to implement for the project, the notion of agreeing to agree does not appear problematic.

Practical application and potential areas for improvement

A key issue for alliance contracting is that clauses containing 'pure' agreements to agree are not legally enforceable. This means that such clauses may only be effective when the Participants uphold the alliance ideals and act in line with agreed alliance principles (i.e., they actually come to an agreement, as contemplated).

In the absence of any clear charter of agreed and objectively measurable behaviours, this may be difficult to prove. Also, if one of the Participants does not uphold the alliance ideals by not agreeing to a matter covered by a clause such as this, there is very little the other Participant(s) can do in the circumstances. Not only is the clause not enforceable, but the operation of the no fault – no blame principle may prevent the aggrieved Participant litigating. In this context, if an alliance Participant's breach of a charter of agreed behaviours was characterised as a 'wilful default', it would help improve the value of using 'agree-to-agree' clauses.

Ultimately, however, alliance agreements need to include as many of the terms agreed between the Participants as possible, while maintaining the flexibility for the alliance to evolve. Even if the parties have not yet approved precise terms, a settled process for agreement can be inserted to strengthen the argument that the Participants intend to be bound by the agreement. Despite this, if the parties are unable to come to an agreement about the stated issue, a court may hold that there is no agreement between the parties about the subject matter of the clause and therefore that the clause is unenforceable, at least in part.

