



## **Alliance Framework**

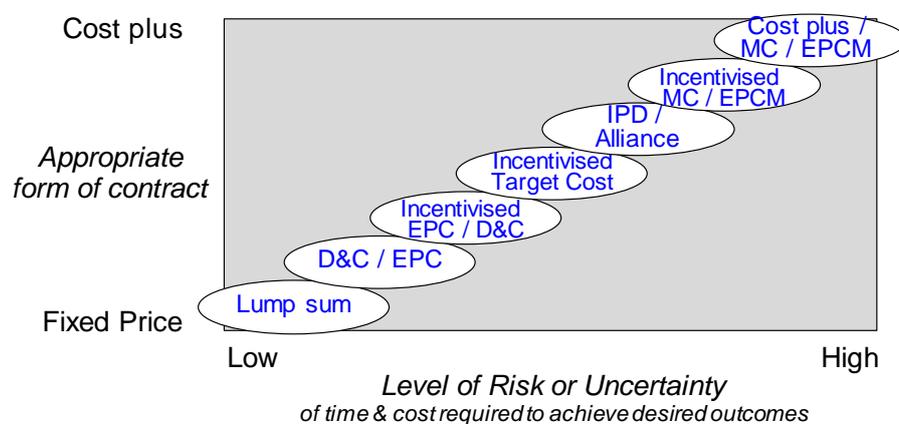
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## Table of Acronyms

ADA	Alliance Development Agreement
AE	Adjustment Event
AEG	Adjustment Event Guidelines
AF	Alliance Framework
ALT	Alliance Leadership Team
AMS	Alliance Management System
AMT	Alliance Management Team
DCP	Defects Correction Period
FA	Financial Auditor
KPI	Key Performance Indicator
KRA	Key Result Area
MCOS	Minimum conditions of satisfaction
NOP	Non-Owner Participant
PAA	Project Alliance Agreement
PC	Practical Completion
PCF	Proposed Compensation Framework
TOC	Target Outturn Cost
TPE	Third-party Estimator

## 1 Introduction

- 1.1 The Province of British Columbia is introducing alliance contracting as an option to be considered for projects where the level of risk and uncertainty is such that conventional risk-transfer contracting is unlikely to achieve best outcomes.
- 1.2 Alliances and similar forms of contract have been successful in many parts of the world in circumstances where a conventional contract would limit market participation, drive inefficient risk premiums, or threaten the success of the enterprise when difficulties arise. In a conventional (risk-allocated) contract each party is motivated to protect its own interests, and when risks eventuate the actions required to protect individual positions can easily overwhelm the actions which would improve project outcomes. The central feature of alliance contracting is that most risks are borne collectively, so when difficulties (or opportunities) eventuate all parties are motivated to optimize the collective outcome because they all ‘sink or swim together’.
- 1.3 An alliance contract occupies a position somewhere near the mid-point on the spectrum of fixed price (all financial risks borne by the contractor) to cost-plus (all financial risks borne by the Owner in order to mitigate non-financial risks) – enabling a balance of cost- and non-cost incentives which aligns contractor objectives with the Owner’s objectives. This alignment of commercial interests means the parties will pull in the same direction regardless of the difficulties encountered. Experience shows that contractors are more willing to tackle difficult projects under an alliance contract because the probability of good outcomes for all parties is much improved.



## 2 Purpose of this document

- 2.1 The purpose of this Alliance Framework (AF) document is to inform potential Owners and industry participants about the key principles and typical arrangements for a project alliance. Specifically, this document sets out Partnership BC’s thinking on the behavioural, organisational, legal and commercial arrangements between the Owner and Non-Owner Participant (NOP) entities that would be parties (collectively “Participants”) in an alliance contract.
- 2.2 This AF is generic in nature and not structured around a particular project. That said, a good understanding of the concepts outlined in this document will inform decisions regarding specific projects and enable rapid development and execution of the relevant agreements.

- 2.3 This document does not detail the process for establishing an alliance, which requires a careful approach to establish collaborative behavioural foundations whilst ensuring the Owner’s Objectives are met. However, for context readers should make the following general assumptions:
- (a) There will typically be between one and a handful of Non-Owner Participants in an alliance, depending on the breadth of skills and resources required to self-perform or manage critical elements;
  - (b) Where consortia are required (e.g. design skills and construction skills) the Owner will normally expect the market to form consortia prior to entering the selection process;
  - (c) Partnership BC intends, in most circumstances, to establish alliance contracts via a ‘competitive-TOC’ process in which the two finalists each work interactively with the Owner to develop a detailed Project Proposal, including binding Target Outturn Cost (TOC) and other performance targets;
  - (d) Although price competition is critical in such a process this does not mean that price will be the sole (or even the main) criterion for identifying the preferred proponent. Among other things an Owner is generally seeking to maximize value over the life of the asset (not minimize capital cost), also the high-risk-nature of projects suitable for alliancing means that the ability of a proponent to manage risk and respond well in the face of uncertainty is also valuable.
- 2.4 This document covers various legal concepts but it is not intended to be legally precise; instead to explain in plain English the key legal and commercial foundations of a project alliance.

### 3 Alliance contract overview

3.1 The core function of a traditional contract is to set out the respective rights and obligations of the contracting parties. Typically, the contract will prescribe the scope of obligations, form of payment, and commercial or legal consequences where a party fails to fulfil its obligations. The process for establishing and administering such a contract, and the behaviours of the parties, all reflect this context. Under an alliance contract most risks and opportunities are shared. This is a big departure from traditional risk-transfer forms of contract, as illustrated below:



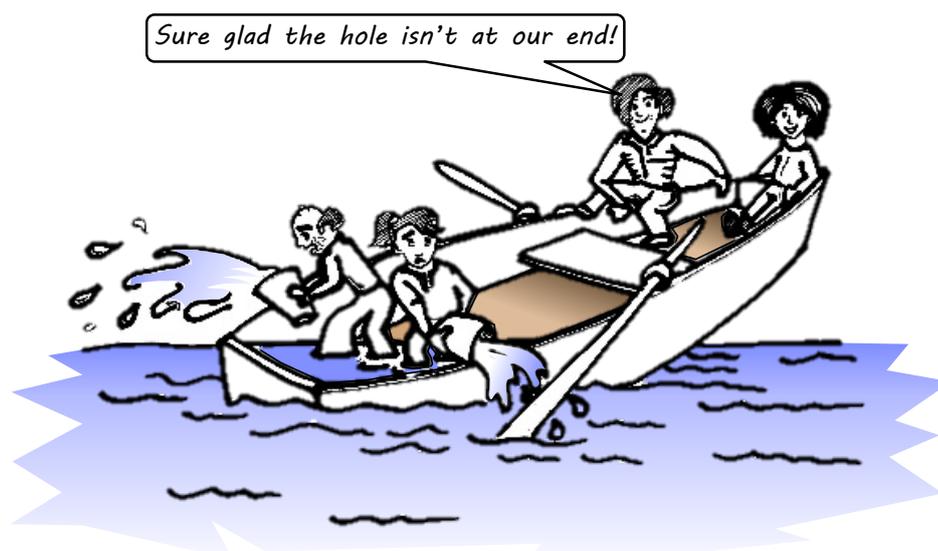
3.2 The key features of an alliance contract are as follows:

- (a) The Participants take **collective responsibility** (in the full legal sense) for full delivery of the project, aiming to meet (or beat) pre-agreed targets which typically cover both cost and non-cost performance aspects.
- (b) The agreement establishes a **'no-blame' commercial environment** in which the Participants have no enforceable legal rights against each other except in the extreme case of a 'Wilful Default' (e.g. insolvency, fraud, criminal conduct, deliberate and reckless misconduct).
- (c) The NOPs are paid for their services under a **'3-limb' compensation model** comprising:
  - Limb 1: reimbursement of project-specific costs on a fully open-book basis;
  - Limb 2: a fee to cover corporate overheads and normal (risk-adjusted) profit, and
  - Limb 3: incentive payments which may be positive or negative, reflecting an equitable share of the 'gain' or 'pain' if outcomes are better or worse than agreed targets.

The 3-limb compensation model is further detailed in **Appendix 1**.

- (d) Governance arrangements create a **peer relationship between Participants** with decision-making based on agreed 'Alliance Principles' and requiring unanimity among the Participants, consistent with commercial arrangements in which all Participants 'sink or swim together'.
- (e) The project delivery **team is fully integrated** – typically comprising members drawn from each Participant organisation – with each position filled on the basis of 'best candidate' (not on the basis of employer) since the goal is best collective performance rather than protection of individual Participant positions.

3.3 In combination, the arrangements outlined above are designed to create a situation in which the alliance Participants “win together or lose together” – there is no possibility of win/lose outcomes.



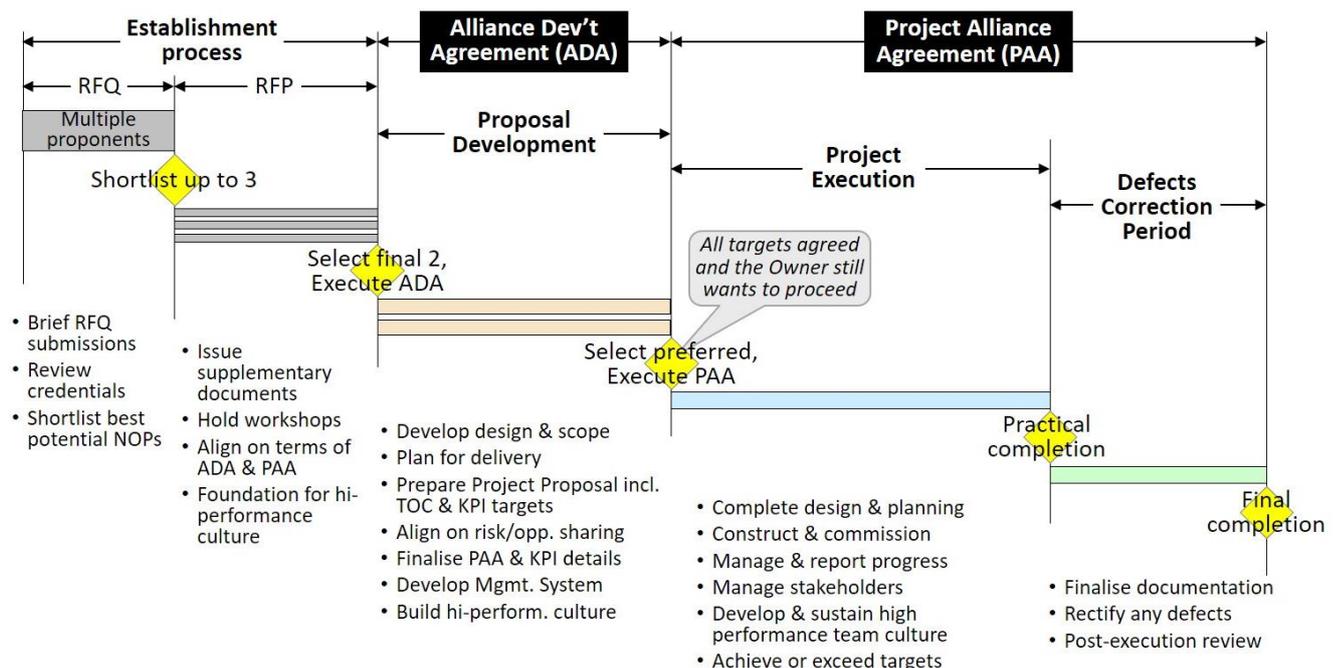
3.4 Alliance Participants are typically obliged to act in Good Faith (as defined in their agreements). In addition, they will normally develop and agree the principles to govern their dealings and behaviours, as the process of joint development is important in ensuring commitment and ownership. Typical ‘Alliance Principles’ are outlined below:

- (a) All Participants win, or all Participants lose, depending on outcomes actually achieved.
- (b) A peer relationship where all Participants have an equal say (recognising the Owner’s unique role in certain decisions).
- (c) Collective responsibility for performance, with an equitable sharing of risk and reward.
- (d) Full access to 'best-in-class' resources from all Participants.
- (e) A focus on innovative thinking and a commitment to achieve outstanding results.
- (f) Clear responsibilities within a no-blame culture.
- (g) Open, straight and honest communication between all Participants.
- (h) All transactions are fully open-book.

3.5 Alliance activities are governed in two stages under two agreements:

- (a) The **Alliance Development Agreement (ADA)** governs the proposal development phase during which the two provisional NOP teams will work (separately) with the Owner to develop detailed Project Proposals;
- (b) The **Project Alliance Agreement (PAA)** governs the delivery phase, commencing once the Owner selects the preferred Project Proposal, and continuing through to the expiry of the Defects Correction Period (DCP).

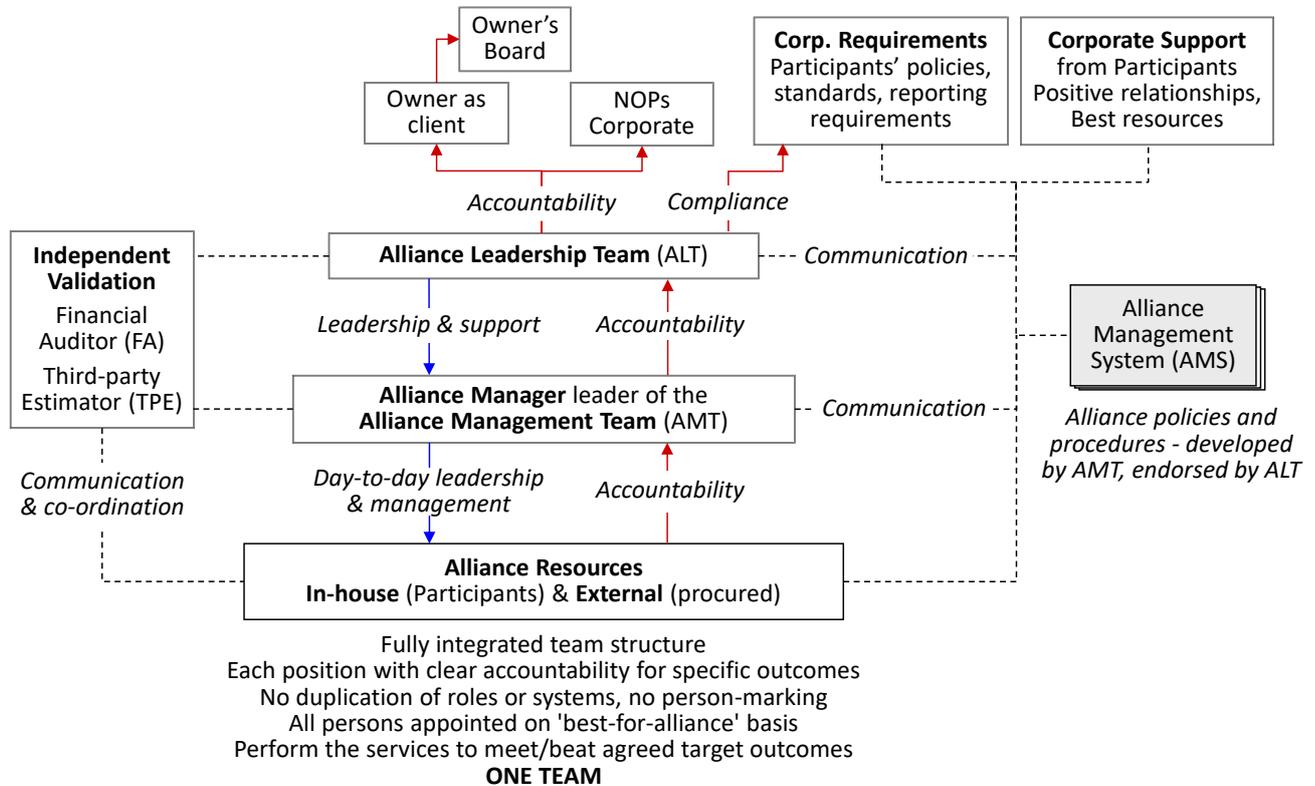
3.6 The diagram below outlines the alliance lifecycle, including tenure of these agreements and key activities in each phase.



- 3.7 An overview of the scope, structure and terms of the ADA is shown in **Appendix 2**. A summary of distinctive legal features of the PAA is shown in **Appendix 3**.

#### 4 Alliance organisation and governance

4.1 The following diagram outlines the typical alliance governance and organisational structures.



#### 5 Building and sustaining a high-performance delivery culture

5.1 Under a traditional contract where obligations and risks are mostly unilateral, although the parties may declare a commitment to shared project objectives, the reality is that their commercial interests are not aligned and each party must participate in a way that protects its own commercial position. This underpins the nature of key behaviours on the project, limiting possibilities for close collaboration and in some cases resulting in adversarial relationships and poor outcomes.

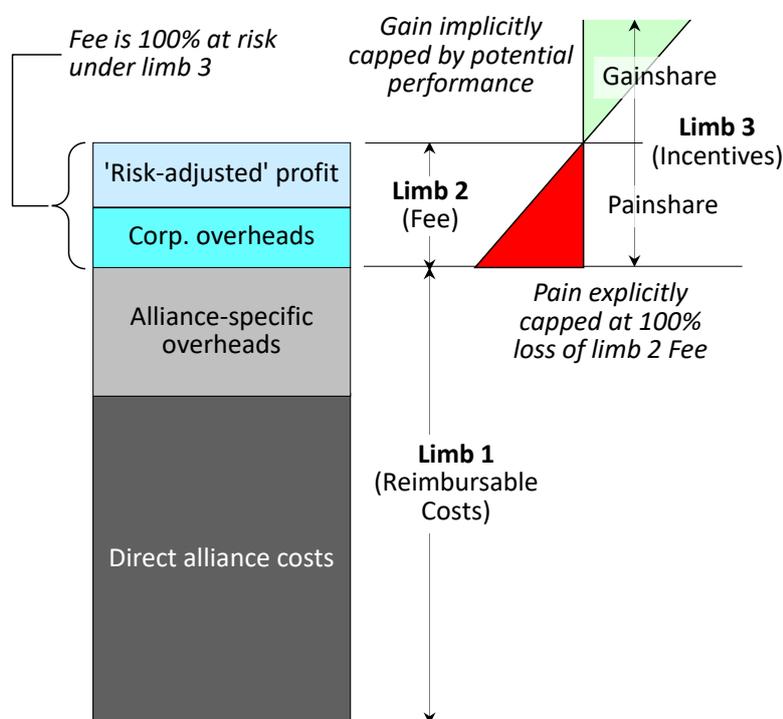
5.2 An alliance contract creates the (commercial) conditions where traditional barriers to cooperation are substantially diminished or eliminated. However, while this creates the potential for genuine collaboration, it does not make it certain. Key individuals may be used to operating in more adversarial contracting environments, and the behaviours that enable strong team performance do not necessarily arise automatically just because the alliance aligns the parties' commercial interests. To maximize this potential there must be a clear intention and a consistent effort to develop true collaboration. Steps to overcome this limitation often include:

- (a) Engaging an experienced alliance facilitator during the establishment process to ensure that the Owner is clear about their collaborative intentions, and when engaging proponents behaves in a way that is likely to foster genuine cooperation and trust;
- (b) Introducing behavioural training or coaching – particularly at the leadership levels and during the formative stages of the alliance – to help the Participants build and sustain a high performing collaborative culture.

- 5.3 Further discussions on alliance structure, management and culture, including roles of the Alliance Leadership Team (ALT), Alliance Manager. and Alliance Management Team (AMT) are provided in **Appendix 4.**

## Appendix 1: 3-limb compensation model

The 3-limb compensation model (illustrated below) lies at the commercial heart of the alliance as it governs how the NOPs are paid and incentivized under the PAA.



The three limbs are as follows:

- **Limb 1 Reimbursable Costs:** Expenditure on the work under the alliance (including mistakes, rework and wasted effort) and project-specific overheads related to the alliance work is reimbursed at actual cost subject to audit;
- **Limb 2 Fee:** A mark-up to cover (risk-adjusted) profit and a contribution towards recovery of corporate (off-site) overheads;
- **Limb 3 Gainshare / Painshare:** A share of the collective 'gain' arising from out-performing agreed targets or 'pain' associated with under-performing against those targets.

Further details of these three components are provided below.

In relation to **Limb 1**:

- Rules and principles for Limb 1 Reimbursable Costs are defined in detail under the PAA, with the overriding principle being reimbursement of costs specifically incurred for the alliance work (i.e. costs which would not have been incurred if the NOP had not won the contract). This includes reimbursement of costs associated with mistakes and rework (noting that sharing of cost under/overruns under Limb 3 motivates each NOP to minimize wasted effort and rework).
- Limb 1 does not include any recovery of corporate overheads or profit.
- In the lead-up to establishing the alliance the Owner appoints a third-party Financial Auditor (FA) to conduct 'Establishment Audits' on prospective NOPs to resolve any ambiguity associated with Limb 1 recovery and prepare for reimbursement of payment claims with minimal fuss.
- Reimbursement of Limb 1 costs is performed on a fully open-book basis. The FA will undertake routine audits under the PAA to verify that payments are in accordance with the agreement.

In relation to **Limb 2**:

- Limb 2 is normally agreed as a simple mark-up percentage applied to actual Limb 1 costs. Other methods are sometimes used but the complexities introduced (for example by having a fixed \$ value for Limb 2 regardless of actual Limb 1 costs) generally outweigh the apparent benefits.
- Establishment Audits will be conducted by a third-party Financial Auditor (FA) to provide information on historic actual margins to overcome information asymmetry when the Owner and prospective NOPs agree Limb 2.
- It is important to note that Limb 2 is not locked in until the other terms of the PAA are agreed (i.e. once the overall risk profile is clear) – including for example scope of Limb 1 turnover attracting Limb 2 mark-up, extent of risk sharing, and rate at which potential painshare / gainshare will accrue.
- It is equally important that the NOPs see the process for establishing Limb 2 (indeed the overall terms of the agreement) as fair and reasonable, to avoid creating a situation where NOPs need to recover reasonable margin by resorting to adversarial behaviours later in the project lifecycle.

**Limb 3** incentives are directly linked to project outcomes, so the NOPs are all highly motivated to ensure the alliance performs as well as possible:

- Performance targets (i.e. no gain, no pain) are sometimes referred to as the minimum conditions of satisfaction (MCOS).
  - If aggregate performance is poorer than targets then Limb 3 will be a negative sum ('painshare'), capped in the worst case at a value equal and opposite to Limb 2 (although such an outcome is rare).
  - If aggregate performance is better than targets then Limb 3 will be a positive sum ('gainshare'), with the upside not expressly capped, but implicitly capped by the limits of potential performance.
- Critically, sharing of gainshare or painshare amongst the NOPs is (normally) proportional to their respective Limb 2 in dollar terms, meaning that each NOP feels the same degree of gain or pain relative to their business model and initial commercial expectations.
- If the incentive regime reasonably reflects the 'gain' or 'pain' suffered by the Owner (when actual outcomes diverge from target) then all Participants "win together or lose together" – win/lose outcomes cannot arise – so regardless of how difficult the circumstances, the Participants are united in their efforts to optimize outcomes.

The Limb 3 gainshare / painshare regime will include two components:

Component	Description
1. Cost	Comparing Actual Outturn Cost (AOC) to TOC and sharing under/overrun between Owner and the NOPs collectively (normally on a 50/50 basis)
2. Non-cost KPIs	Incentive payments determined by performance against agreed key performance indicator (KPI) targets within key result areas (KRAs), by applying agreed payment 'rates' for over/under-performance per KPI

These incentive components work in parallel (i.e. independently).

Other underpinning principles for the compensation model include:

- Because all Participants "win together or lose together" under the 3-limb model, anything which is best-for-project is also best-for-Participants.

- Since Limb 3 is based on collective performance – regardless of which Participant(s) contributed to good or poor performance – there is no need for divisions or competing objectives between Participants.
- The overriding painshare cap provides mutual benefits as follows:
  - The worst possible outcome for a NOP is a negative Limb 3 payment which is equal and opposite to the Limb 2 Fee, leaving the NOP with a guarantee that – unless it commits a ‘Wilful Default’ – It will always recover costs incurred in continuing delivery (i.e. Limb 1);
  - NOPs are more likely to consider potentially high-value-adding innovations because their self-protecting risk-aversion is moderated by removal of extreme downside risk;
  - Even if the project gets into extreme difficulty, NOPs have no reason to withdraw resources and every reason to strive for better performance. Hence the downside cap – whilst protecting NOPs from worst-case financial outcomes – also protects the Owner from the extremely poor non-cost outcomes which eventuate all too often in distressed hard-dollar contracts.
- Payment claims (generally for actual Limb 1 costs plus associated Limb 2 mark-up) are generally paid “on account subject to audit” so that the NOPs are substantially cashflow-neutral, subject to any statutory withholding requirements (such as the Builders Lien Act). There are generally no milestone-related payments or earned value assessments required for payment, which means that the requirement for (and costs associated with) security instruments or reliance on NOP balance sheet strength is significantly reduced under an alliance.
- The timing of payments to/from the NOPs in relation to Limb 3 is typically structured as follows:
  - Provisional payment following Practical Completion based on a conservative estimate of potential costs to attend to defects during the Defects Correction Period.
  - Final reconciliation and payment following Final Completion (i.e. after Defects Correction Period has fully expired).

## Appendix 2: Scope and key features of the Alliance Development Agreement

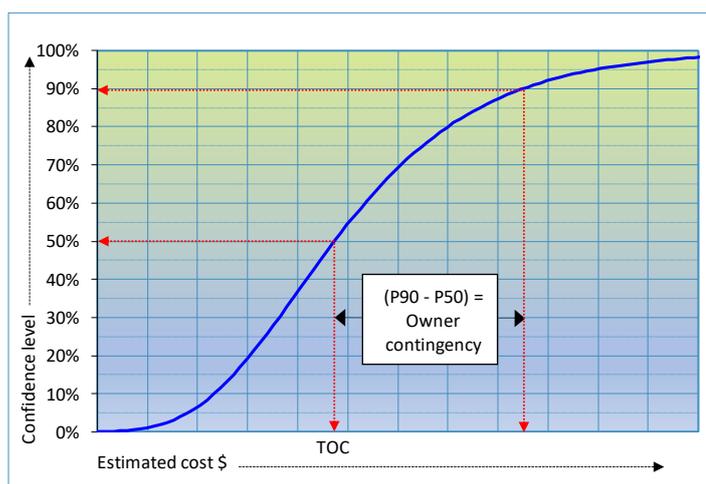
The Owner will work with each provisional NOP team under their respective ADAs to develop detailed and fully costed Project Proposals. The ADA is a relatively simple services agreement under which the NOPs are reimbursed by the Owner for participating as part of an integrated team doing all the things necessary to develop, prepare and submit a Project Proposal that maximizes value to the Owner. The terms of the ADA (summarised below) reflect this context.

**Scope of services under the ADA** will typically comprise the following:

- Review and clarify the Owner’s requirements and develop a detailed understanding of the scope and technical requirements;
- Develop the project design (typically to 20-30% level of completion);
- Undertake value management, value engineering and constructability studies;
- Plan for procurement, including identifying key suppliers / subcontractors, deciding on form of supplier engagement, and (where critical) preliminary engagement with key suppliers (including selected pricing activities where critical to the TOC);
- Develop detailed project execution and delivery plans, including thorough investigations of processes for obtaining the various approvals and consents that the alliance must secure;
- Work to identify risks and opportunities, and to develop strategies for managing these;
- Interact with Owner team representatives and other Owner-side stakeholders to understand project needs and constraints, to test key ideas and options, and to seek guidance as to whether various approaches or ideas will be capable of acceptance;
- Participate in an interactive process to develop Adjustment Event Guidelines (AEG) with the Owner’s project team, to build a clear understanding of the extent to which risks will be shared (further detailed in **Appendix 3**);
- Develop a comprehensive resourcing plan to ensure the project can attract and retain quality resources in the prevailing construction market;
- Prepare a detailed cost estimate for the delivery of the project to meet the Owner’s performance targets including schedule and other KRAs, including uncertainty analysis and provision for both foreseen and unforeseen risks;
- Participate in cost and schedule review / validation workshops with the third-party Estimator (TPE);
- Develop the framework for the Alliance Management System (AMS) covering key systems and procedures as appropriate for successful delivery of the project (e.g. delegations, procurement, communications / stakeholder management, information / configuration management, people management / alliance culture development etc. – further detailed in **Appendix 4**);
- Participate in interim ALT meetings to govern development-phase activities;
- Continue to build a high performing collaborative project delivery culture whereby the whole organisation operates at the peak of its potential;
- Prepare to obtain insurances as required for the PAA;
- Finalise the PAA, including further details of the limb 3 regime in relation to KRAs and KPIs.

Key aspects of **TOC development** include the following.

- The TOC estimate must be based on execution strategies consistent with the achievement of the MCOS performance targets for non-cost KPIs and must not include provisions for out-performance of these targets.
- The TOC estimate will typically include some elements that are best quantified via a Monte Carlo uncertainty analysis, resulting in a cost outturn probability distribution which reflects the level of uncertainty within the estimate, as illustrated below.



- One of the principles governing targets agreed during the ADA phase is the ‘P50’ principle – that there must be a 50/50 probability of out-performing or under-performing targets (at the time when they are established). This principle means that the ‘target’ for Limb 3 is zero, and the NOP Limb 2 should represent a fair and reasonable reward for achieving target outcomes.
- Among other things this means that the TOC will not be the same as the Owner’s internal business case budget – which may be set at (say) a P90 level. Differences between the TOC and the Owner’s budget are required to allow for alliance cost overruns, and for risks which the Participants agree will be retained unilaterally by the Owner (see item 7 of **Appendix 3**).

**The ‘right’ TOC:** In a competitive-TOC alliance establishment process the Owner is unlikely to be seeking lowest ‘headline’ price (acquisition cost), instead is typically looking for the ‘right’ price as follows:

- Direct price competition in alliance establishment is fairly unusual in private sector alliances but has proven to be the only widely accepted way of satisfying public sector Owners and stakeholders that alliance procurement represents value for the Owner.
- Price competition creates pressure on proponents to minimize the TOC, which is helpful in driving efficiency, but can also result in conscious (or sub-conscious) minimisation of scope, under-pricing risk, or using an unrealistically low Limb 2 mark-up in the hope that profit can recover via gainshare.
- An informed Owner will seek to avoid these pitfalls by encouraging proponents to develop proposals which offer optimum value (cost/benefit ratio) hence will seek the ‘right’ TOC rather than the lowest TOC.
- Typically the Owner will engage a third-party Estimator (TPE) to help verify that Project Proposals and TOCs cover all required scope and are consistent with the requirements of the PAA. Whilst the TPE’s duty of care is to the Owner, their brief will be designed to ensure that the TOC is properly constituted – to the benefit of all Participants – so their views and concerns will be shared with all Participants.

- Regardless of whether the Project Proposal and TOC are developed competitively or sole-sourced, the Owner will need to test assumptions and conduct due diligence activities on all aspects of the emerging Project Proposals. Ideally this work will be performed substantially in conjunction with the provisional NOP teams, to minimise post-submission concerns. Whilst the Owner is protecting its own interests through this due diligence process (and must form its own views) it is also in the NOPs’ interests to maximise value and acceptability, so in this sense the parties’ objectives are aligned, hence this process will be collaborative.

Owners normally provide **ADA-phase payments** to the NOPs in consideration for services provided under the ADA. In deciding on form of payment the Owner may seek guidance from industry re likely NOP costs in providing the ADA services, and consider whether likely market participation will be improved by reducing self-funded tender costs. Whilst some Owners may be tempted to limit (or even avoid) payments under the ADA this is likely a false economy as:

- A realistic level of payment is likely to correlate to higher-quality Project Proposals, not least because the proponent will devote higher-quality resources to more attractive prospects; and
- A realistic level of payment is more likely to foster a respectful and collaborative relationship between the parties – whilst difficult to quantify this is potentially very valuable.

Typical features of an alliance ADA are tabulated below.

Area		Main ADA features
1	General obligations	As with any professional services agreement the NOPs are required to provide competent resources, exercise reasonable endeavours etc. and in the alliance context may be required to act in Good Faith (as defined).  The NOPs collectively (per consortium) are obliged to provide the ADA services to the Owner and the Owner is obliged to pay for those services.
2	Payment to the NOPs	Typically where payment is made, it is paid on a pre-agreed basis, which can take several forms. The simplest is a lump sum declared by the Owner at the outset of the market engagement process.  It is common for ADA payments to fall due after submission of Project Proposals subject to certain conditions, for example nil or reduced payment in case of: <ul style="list-style-type: none"> <li>• Failure to provide the ADA services substantially as anticipated, or failure to develop a genuine Project Proposal which seeks to maximize value to the Owner (e.g. giving up mid-way)</li> <li>• Failure to act reasonably in negotiating any remaining details of the PAA e.g. where the engagement process does not enable full PAA alignment and the ADA requires NOPs to enter a PAA “substantially in the form of the draft”.</li> </ul>
3	Intellectual property rights	The Owner retains any intellectual property rights in material developed under the ADA from both successful and unsuccessful NOP teams, and is free to use whatever it can from that work. However, it releases the unsuccessful team from any liability for their ADA product, and if any aspects are incorporated into the eventual project solution the PAA Participants collectively assume risks and opportunities associated with that ADA product.
4	Insurances	One of the key tasks during the ADA is to arrange appropriate insurances for the alliance which will be required promptly upon PAA execution. Until such time as PAA insurances are in place the Participants normally rely on pre-existing insurances (consistent with traditional professional services requirements) to cover any liabilities arising out of the work under the ADA. If alliance-specific insurance is necessary under the PAA this will typically require professional indemnity insurance to retrospectively cover ADA work.

Area		Main ADA features
5	Inter-NOP provisions	The ADA does not normally establish any direct rights and obligations between the NOPs themselves (i.e. within the consortium), and the Owner relies on the fact that the NOPs are bound together in their attempt to develop the preferred Project Proposal. In this context it is relevant to note that – where ADA services are not fully funded by the Owner – the Constructor NOPs generally have to pay professional services NOPs for their ADA services, which can have a legacy effect on NOP relationships under the PAA. Some Owners require transparency of arrangements between NOPs to ensure no adverse impacts.

### Appendix 3: Distinctive legal features of the Project Alliance Agreement

Distinctive features of a Project alliance Agreement are outlined in the following table.

Area		Notable PAA features
1	Collective responsibility	The obligations to perform are generally collective on all Participants, not individual. Risks and opportunities are shared amongst the Participants precisely in pre-agreed proportions through the operation of the Limb 3 gainshare / painshare regime, not by assigning individual responsibilities and individual consequences (or individual legal liability in the event of a failure to perform). Each Participant – both Owner and each NOP – is commercially exposed to the collective performance of all Participants (except in case of a Wilful Default as outlined below). For the NOPs this exposure is effected by the incentive regime which delivers proportional gainshare or painshare on all alike.
2	Good faith	The PAA typically includes an express commitment to act in Good Faith and on a ‘Best-for-Project’ basis (as defined) including with mutual respect in relation to the rights of the other Participants, and in accordance with the agreed Alliance Principles.
3	ALT decision-making and Owner Reserved Powers	The PAA formally establishes the Alliance Leadership Team (ALT) – comprising one or more senior representatives from each Participant – and sets out its duties and responsibilities. All decisions of the ALT must be unanimous, except for certain decisions that are inherently Owner’s decisions (‘Owner Reserved Powers’) – for example decisions on functional requirements, suspension of works, etc. Where those Reserved Powers are exercised the decision on any adjustment to TOC or other limb 3 targets rests with the ALT (sometimes subject to Owner endorsement) but not unilaterally with the Owner.
4	Dual role of Owner	In various parts of the PAA a distinction is made between the Owner in its role as Participant (for example bound by unanimous decision-making obligations) and the Owner in its role as client/customer (for example able to exercise Owner Reserved Powers). This concept is further explained in <b>Appendix 4</b> .
5	Limitation of rights of action	The ALT deals with any differences that arise between the Participants (where these cannot be resolved at a lower level) and there is no right of arbitration or litigation between the Participants on any matter, except as noted below. Each Participant waives all rights of action against the others whether in contract, under indemnity, in tort including negligence, in equity, under any statute, or otherwise, arising out of any act or omission in connection with the PAA, except in the case of matters defined as ‘Wilful Default’ which typically include: <ul style="list-style-type: none"> <li>• bankruptcy / insolvency etc.;</li> <li>• failure to pay moneys due to another Participant;</li> <li>• breach of certain specific warranties expressly provided in the PAA (not general warranties such as adequate skill etc.);</li> <li>• refusal to grant reasonable access to the Financial Auditor (FA), or fraudulent dealings with another Participant;</li> <li>• failure to take out or maintain a required insurance policy;</li> <li>• an intentional act or omission in breach of a material duty, obligation, condition, or stipulation arising out of the PAA, carried out with reckless disregard for the harmful consequences to another Participant, but excluding any error of judgement, mistake, act or omission, whether negligent or not, made in Good Faith.</li> </ul> <p>Importantly, a non-defaulting NOP is not liable for a Wilful Default committed</p>

Area		Notable PAA features
		by another NOP.
6	Payment to NOPs	<p>The NOPs are paid on an open-book basis in accordance with the ‘3-limb’ compensation model described in <b>Appendix 1</b>. The terms of compensation are detailed in a comprehensive schedule to the PAA, typically including detailed worked examples covering a range of potential scenarios, to ensure clarity.</p> <p>All financial transactions are subject to audit by the Financial Auditor (FA).</p>
7	Risk/opportunity sharing and Adjustment Events (including scope changes)	<p>Under an alliance there are only two options for risk (and opportunity) allocation:</p> <ul style="list-style-type: none"> <li>• the risk / opportunity is shared by all Participants; or</li> <li>• the risk / opportunity is borne unilaterally by the Owner.</li> </ul> <p>An alliance aims to share almost all risk/opportunity so that the Participants' instinctive response to unexpected circumstances is to optimize collective outcomes rather than protect/advance their individual interests. However, each shared risk requires a contingency provision within the TOC, and it may be better for the Owner to bear some risks alone, for example high-consequence low-probability events which would inherently require a change in the Owner's budget or program.</p> <p>The PAA default position is that all risks and opportunities are shared unless they are pre-agreed to be ‘Adjustment Events’ (AEs) – regardless of whether they were (or reasonably could have been) foreseen or allowed for in the TOC. Where risks or opportunities eventuate – including circumstances which may require a change in scope or approach – there is no change to TOC or KPI targets (hence the risk / opportunity is shared) <u>unless</u> the ALT determines that an AE has occurred, in which case the relevant targets will be adjusted to neutralize commercial impact to the NOPs from that event. In determining potential AEs the ALT must act in accordance with the Adjustment Event Guidelines (AEGs).</p> <p>AEGs are developed via a careful process designed to achieve clear understanding of – and commitment to – sharing / allocation of risks, as follows. During the development phase and well before TOCs are locked in the Owner participates in a rigorous process (separately with each NOP team) to consider a very wide range of project-specific risk and opportunity scenarios (including those surfaced by the development work in hand), managed so as to reach informed alignment on the types of risk and opportunity that will be shared, and the types which will be retained unilaterally by the Owner. The output from this process forms the AEGs attached as a schedule to the PAA. In a context where proponents may be tempted to ‘bid low then maximize variations’ it is critical to run this process thoroughly and authentically so that proponents understand that both competing Project Proposals and TOCs will be constructed on the basis of near-comprehensive assumption of shared risks, and that the Owner is seeking the most reliable (not necessarily the lowest) TOC. A TOC must not contain provision for risks which are agreed to be borne by the Owner alone, and when reviewing each TOC the TPE verifies that this is the case.</p>
8	Completion	<p>The alliance is responsible for the delivery of the full scope of the project through to final completion, including a Defects Correction Period (DCP). In some projects there may be a requirement for progressive handover of the alliance works to the Owner, or for a commissioning process.</p>

Area		Notable PAA features
9	Defective work	The Alliance Participants are collectively responsible for attending to any Defects that arise within the DCP following Practical Completion – typically two years but sometimes longer. The definition of Defects will exclude damage caused by other parties outside the control of the alliance after Practical Completion (including the Owner in its capacity of asset owner / user). Costs incurred attending to Defects will be reimbursed and accounted for in accordance with the 3-limb compensation model, so a reasonable allowance for such costs is required in the TOC (as it would in a fixed price estimate).
10	Suspension, termination and default	<p>The Owner has the right to suspend and order recommencement of the alliance works by written notice to the NOPS.</p> <p>The Owner has the unilateral right to terminate the PAA for convenience, in which case it must pay the NOPS for all costs, accrued liabilities, and entitlements up to the date of termination, but not for any loss of prospective profits. NOPS can take comfort in the fact that (assuming the project is still required) the owner will not terminate arbitrarily or without significant reasons to believe that the alliance is no longer the best way to deliver the project.</p> <p>The Owner has the right to expel a NOP which commits a defined Event of Default (and fails to remedy it), although the Owner will generally require the consent of non-defaulting NOPS to do so. In most PAAs a NOP will have the right to withdraw where the Owner commits an Event of Default (and fails to remedy it), but NOPS do not have the right to withdraw for convenience.</p>
11	Joint & several liability	<p>NOPS are not required to be jointly and severally liable to the Owner under the PAA. For example if a NOP owes money to the Owner (e.g. under Limb 3) the other NOPS are not liable for that payment.</p> <p>However, the PAA makes all Participants (including the Owner) collectively responsible for performing the work under the alliance – in effect a joint obligation – and actions or failures by any Participant affect the compensation of all NOPS (through the operation of Limb 3).</p>
12	Resolution of disagreements	The ALT deals with any differences that arise between the Participants (other than a Wilful Default which is not remedied). Many PAAs are silent on how the ALT proceeds if it is unable to reach agreement on an issue – meaning that the ALT must find a resolution – but some PAAs contain processes for non-litigious resolution of ALT deadlocks.

## Appendix 4: Further discussion of alliance structure, management, and culture

### Overview of Alliance Governance

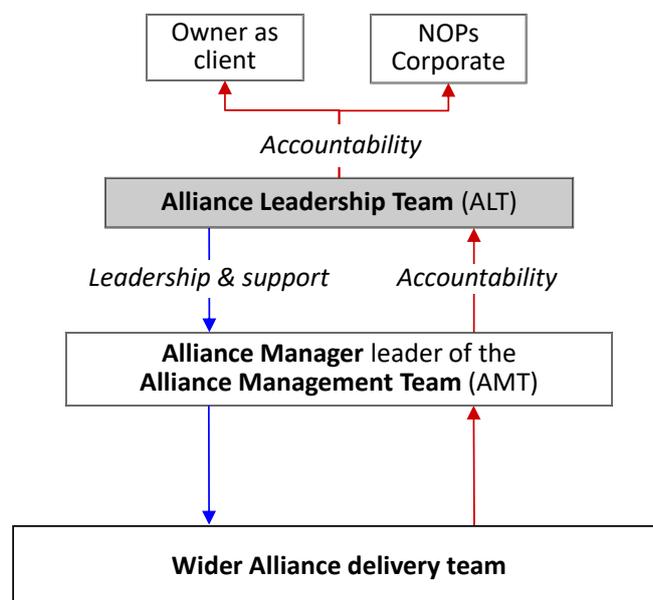
Under traditional forms of contract each party operates within its own leadership and management structure with various processes and protocols to enable communication and decision-making across contract interfaces. Invariably, and appropriately, this entails a significant amount of ‘person-marking’ where Owner representatives and corresponding contractor personnel ‘mark’ each other – to communicate their respective expectations, protect their own interests, and to ensure that the other party is fulfilling its obligations.

Under an alliance this type of ‘person-marking’ is redundant and counter-productive. In the delivery phase (under the PAA) the selfish commercial interests of each Participant will be best served by meeting or exceeding alliance performance targets. The alliance governance and organisational structure (illustrated in section 4) takes full advantage of this empowering context while providing both inspiring leadership and robust governance for the enterprise.

### Alliance Leadership Team (ALT)

The ALT is typically accountable to the Owner’s CEO (or their delegate) and to equivalent people in the NOP organisations, to ensure that the Participants fulfil their obligations under the PAA, satisfy their respective corporate requirements, and meet or exceed agreed alliance targets.

The ALT typically comprises two senior representatives from the Owner organisation and one or two senior representatives from each NOP. Consistent with the general alliance principle of “a peer relationship where all participants have an equal say” all decisions of the ALT within the scope of the alliance are required to be unanimous (except for ‘Owner Reserved Powers’).



The role of the ALT is to provide strategic direction, governance and oversight, and high-level leadership to the alliance. Its governance role is similar to an executive project board in some respects. However, in the context of an alliance, it also provides effective and visible leadership, and will take steps to create and sustain the kind of inspiring environment and culture whereby it becomes inevitable that the alliance achieves (or betters) all of its target objectives.

Key responsibilities and functions of the ALT include:

- Create an inspirational vision for the alliance;
- Establish and ‘role-model’ the Alliance Principles (often building on the Owner’s initial draft principles) and set challenging objectives;
- Review, challenge and approve (or recommend for Owner approval) target cost and other performance targets;
- Endorse policies and delegations, and review / approve the Alliance Management System comprising policies, plans and procedures to effectively control all critical aspects of alliance operations;

- Appoint and empower the Alliance Manager and appoint or endorse the structure and appointments in the Alliance Management Team (AMT);
- Provide high level support including influence outside the alliance;
- Harness best resources from Participant organisations;
- Monitor actual and forecast alliance performance and take corrective action when appropriate;
- Confine and resolve inter-Participant conflict within the ALT.

Although the legal and commercial context of the ADA phase is very different to that under the PAA, the intention is that the same players (i.e. future members of the ALT) provide high-level leadership and governance as an ‘interim ALT’ under the ADA. The performance of the Participants during that period will determine, for better or worse, the ‘DNA’ of the alliance and the eventual outcomes achieved by the alliance.

To enable the ALT to function effectively the individual ALT members must possess appropriate attributes, including:

- Knowledge and experience in an enterprise governance role;
- Superior leadership skills – including an awareness of how their leadership style impacts those around them, an ability to challenge their own pre-conceived ideas, and a commitment to further develop their leadership capabilities through the alliance;
- Authority to make the necessary decisions, and willingness and skill to use that authority appropriately – specifically delegated authority to make ALT decisions (and the ability to secure decisions from their parent organisations for ALT matters that exceed delegated authority) – and ability to lead their organisation through the cultural change that is necessary to participate effectively in a successful alliance;
- A long-term perspective on the aspirations and strategies of their respective organisations;
- A high regard for the value of the relationships with other Participants – to ensure that they take proper account of the impact of ALT behaviour on longer-term interests of their respective organisations;
- Specific skills that will add value to the alliance, and a willingness to personally champion certain aspects of the alliance.

ALT members must also be available. The following table provides a rough guide to the inputs required from ALT members through a typical alliance life cycle.

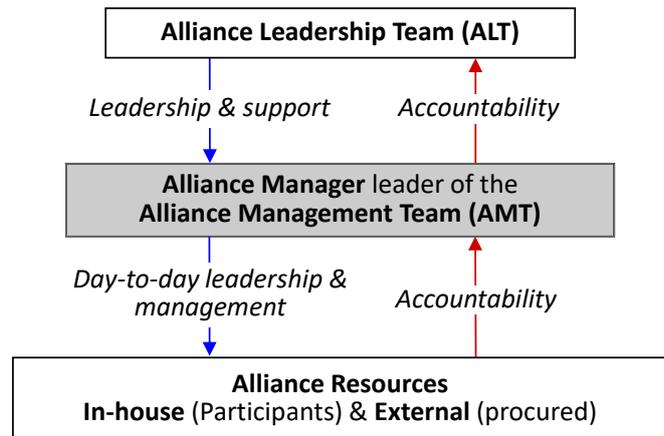
Type of input	Days per month in each phase			
	Pre-alliance	ADA	PAA (pre- PC)	DCP
Development and understanding of proposed ADA / PAA	2 – 3			
Establishing the alliance & leadership development	2 – 3	1 – 2	0.5	
Prepare for and participate in ALT meetings		1 – 2	1 – 2	0.25
Special meetings reviewing evolving Proposal and TOC		1 – 2		
Providing more direct high-level support (being a champion, support on specific issues)		1	1	0.25
<b>Typical days per month - total</b>	<b>4 - 6</b>	<b>4 – 7</b>	<b>2.5 – 3.5</b>	<b>0.5</b>

### Alliance Manager and Alliance Management Team (AMT)

The Alliance Manager leads the AMT, which in turn leads, manages and coordinates day-to-day activities of the alliance.

The Alliance Manager reports to the ALT and usually attends ALT meetings, but is not a member of the ALT. Key duties of the Alliance Manager (supported by the AMT) include:

- Be accountable to the ALT for ensuring that the alliance meets or exceeds all agreed objectives while operating within the policies and delegations set by the ALT;
- Appoint and empower the wider alliance team (subject to ALT delegation / approval);
- Provide day-to-day management and leadership of the wider alliance team, ensuring duties and accountabilities of each team member are clear (including Participant-employed resources and subcontract resources);
- Monitor actual and forecast performance of the alliance and take corrective action when appropriate, reporting to the ALT as required.



While the Alliance Manager is authorized to make decisions within their delegated authority without unanimous support of the AMT, they normally have the kind of leadership skills and empowering management style that ensures full AMT support.

Typically, each alliance Participant is represented on the AMT, but that is not essential and does not take precedence over the principle that each role will be appointed on a ‘best candidate’ basis. In most cases AMT members are dedicated full time to the alliance but depending on the role this is not obligatory.

### Alliance Management System (AMS)

One of the first priorities of any alliance is to develop and document its policies, procedures and management systems into a comprehensive Alliance Management System (AMS) for review and endorsement by the ALT. Much of the AMS can be drafted during the ADA phase but a competitive-TOC establishment process tends to leave some AMS development and approval until after execution of the PAA. The AMS is developed by the AMT under the guidance of the ALT, normally drawing heavily on pre-existing procedures and policies from the Participant organisations.

Among other things the AMS will specify:

- Delegations of financial and general authority and protocols for review and update of delegations;
- Aspects of the AMS that can be amended with the approval of the Alliance Manager and aspects that require ALT approval.

The AMS must satisfy the corporate requirements of all Participants, not just the Owner. A well-structured AMS is critical for effective governance and leadership of the alliance and the ALT will normally undertake a robust review of its various management plans and procedures before approval. Typically, individual ALT members review selected AMS elements in their areas of competence, to ensure that the various AMS plans and procedures give the required assurance required by their organisation.

In a high-performing alliance the AMS meets a tougher test than merely satisfying each parent organisation's assurance requirement. In this respect:

- A good AMS is robust, efficient and effective, providing the right information at the right time in a user-friendly form.
- Formal ALT reports will enable the ALT to fulfil its alliance-facing leadership and governance functions and simultaneously enable ALT members to satisfy their individual (outward-facing) corporate responsibilities and provide their parent organisations with assurance that risk and opportunity is being managed effectively.
- Most alliances generate a monthly ALT report which is a comprehensive 'single source of truth', providing all the information required to satisfy each Participant's corporate requirements, including current and forecast performance and associated commercial projections.

### **Independent monitoring and auditing**

In a high performing alliance with a well-functioning AMS there is no intrinsic need for the Owner (or any Participant) to set up a separate audit or performance monitoring function outside the alliance – although there may be statutory or similar Owner-side requirements for specific independent review processes. However, an effective alliance QA function will incorporate appropriate levels of objectivity (including independent verification where required) such that each Participant can rely on the alliance reports. If a Participant feels the need for its own audit and verification function, this indicates failure at the governance level to secure sufficient visibility and confidence through the AMS, weakening the 'one-team' culture that is critical to high performance.

There are some assurance functions that necessarily reside outside the alliance – specifically the Financial Auditor (FA) and third-party Estimator (TPE). These roles are engaged by the Owner, and while they communicate openly with all Participants, they are primarily designed to provide assurance to the Owner as follows:

- The FA is engaged to audit open-book operation and ensure that payments (Reimbursable Costs in particular) are in accordance with the PAA;
- The TPE is engaged to ensure that the TOC and other estimates are soundly constructed, cover all anticipated scope, and represent good value in terms of the stated Owner's Objectives. Under a competitive-TOC alliance establishment process there is a risk that a TOC is lower than the P50 level, which could inappropriately influence the choice of preferred proponent and expose the Owner to unnecessary risks. The TPE may also advise on the valuation of any Adjustment Events.

### **The human dimension of alliancing**

While we have focused this paper of the key commercial and legal features of the alliance model, it must be said that adopting the commercial/legal framework on its own is not sufficient to guarantee peak alliance performance. While traditional contracts are based on prescribed enforcements of obligations and rights, alliance contracts are based on cooperation and choice. This sets the stage for a set of relationships within the team and between the Participants which is based on collaboration and trust rather than obligation. Hence, to fully exploit the potential of the alliance model requires not only shifts in perspectives and mindsets but also in attendant skillsets and behaviours.

Participants must be prepared to invest in nurturing and developing the critical alliance skills of inspirational leadership, trust, collaboration, creativity and a win-win mindset in all of its people and particularly, in its ALT and AMT. Whilst discussion of these critical skills goes beyond the scope of this paper, it is intended to highlight the equal, if not more important, human dimension of alliancing.