Alliance Contracts: The Strategic Advantage of Shared Risk and Reward

by Carla Ciepliski

Alliance contracting mitigates the risks of massive multiyear projects with an 'all for one and one for all' approach.

Risk is an inevitable part of any major project, whether the deliverable is infrastructure or an urban development, a transportation system or a healthcare facility. The stakes are high. The costs, scale and complexity are significant. Timelines are often longer than anticipated and the talent needed is in demand, making the right people hard to come by.

All of these were realities well before COVID-19 upturned global supply chains. Today, the lingering effects of pandemic disruption are compounded by an economic and geopolitical climate in which uncertainty often seems to be the only thing you can count on. Project risk is higher than ever, and that’s not likely to change anytime soon.

Tackling the challenge of risk

Every project model comes with its own ways of attempting to mitigate risk. The design–build approach, for example, puts the onus of risk on the contractor, centralizing risk with one party. In public–private partnerships (P3s), risk assessment is built into the process and contracts are often performance-based, incentivizing as-planned delivery. In all traditional delivery models, risk is ‘sold’ downstream transactionally and managed in isolation, leaving each party to protect itself individually.

There are pros and cons to each of these models. One common drawback is that more traditional delivery models can lead to increased adversarial relationships between delivery parties. Disputes, claims and potential litigation become everyone’s primary concern, all of which are costly and time-consuming.

Traditional contracts rely on detailed stipulation and specifications to pin down details for each of the parties involved. However, the bigger, longer and more complex the project, the harder it becomes to control the variables and manage the interrelationships between scopes. Adding to this dynamic are the uncertainties surrounding supply chain and craft labour. The result of all of this can be an increasing number of change orders, which today are commonplace. It is well known that a single contract can see hundreds of change orders, which erodes cost certainty from an owner’s perspective.

Projects owners may be pressured to stick within tight parameters that are often unrealistic, out of step with information flows and decision-making processes. To manage these conditions and guard against cost overruns and performance penalties, participants build appropriate buffers into their budgets, which can further inflate project costs for owners.

With traditional delivery models running aground on these kinds of challenges for some projects, demand for alternatives is growing. Collaborative contracting methods are providing methods specifically designed for the joint and collective management of project risk and overall performance. The Alliance approach, for example, is a specific collaborative contract especially well suited to large and long-duration projects. It has been generating surprising results, helping prove that there are more options open to owners seeking to best manage risk.

The term ‘collaborative contracting’ is often used to indicate that the contract itself has been adapted to a more relational versus transactional structure. This includes a pre-planning period with all major parties at the table, no-fault clauses and some type of a joint management structure which creates a collective responsibility for the full project delivery. Integrated Project Delivery (IPD) and Alliance are the most commonly known models in this category, followed by the execution of select Progressive Design Build (PDB) projects.

The Alliance approach is the most recent to enter Canada and is especially well suited to large and long-duration projects. It has been generating surprising results, helping prove that there are more options open to owners seeking to best manage risk.

What is Alliance contracting?

The Alliance contracting model has gained traction in Canada, mostly in the wake of the COVID-19 pandemic. It emerged out of the United Kingdom in the 1990s and was developed further in Australia shortly thereafter for high-risk major projects.

The Alliance model binds all critical parties in a single contract with shared risk/reward, a no-fault clause and a joint management structure. In those ways it is similar to the Integrated Project Delivery (IPD) model, although the joint management systems administration of Alliance contracting is more robust, roles are defined more specifically, and the Alliance model has some different pain/gain share mechanisms.

Within the Alliance structure, project consultants and contractors are referred to as Non-Owner Parties or NOPs. Under the no-fault clause, NOPs cannot take legal action against each other except in willful default. This allows NOPs to collaborate and focus on solving a project’s biggest challenges alongside the owner in a non-adversarial environment, to determine the best design, scope, method and approach to create the best value for the intended purpose.

Collaboration and proactive joint management on all key performance indicators (KPIs) are critical to success for Alliance teams so that the owner’s needs are met and NOPs’ profits can be realized. Sharing pains and gains tied to both cost and non-cost indicators incentivize NOPs to work with each other and the project owner to meet expected outcomes, and to optimize budgets and schedules. This type of collaboration satisfies the true intention of value engineering within the model structure.

The emphasis on ‘win together and lose together’ sets the stage for more adaptive and proactive ways of working. It also lays the foundation for innovation in practice and design because all parties are aligned and invested in the same outcomes.

New roles, new expectations

It is critical to note that owners play an active role on the Alliance team as part of the joint project management structure. Their engagement begins right at the start, in development (pre-planning), where they sit with designers and builders to provide deep, meaningful input and solve problems together — bridging the historical divide between owners and design/construction in early-stage planning.

This more active owner's role does require a shift in mindset and, in many cases, organizational changes as well. This is also true for NOP team members who often need to get broader buy-in throughout their organizations even to simply adopt a collaborative approach.

The Alliance model specifically requires owners to identify roles, adjust internal leadership, reset decision-making structures, and adapt procurement policies and other processes so they can work directly with NOPs on scoping, budgets and schedules. These adjustments are also needed for owners to be able to explore more beneficial and progressive engineering designs with their NOPs, to consider phased permitting, and to allow for the corresponding insurance and legal requirements expected within the Alliance contract.

For NOPs, the Alliance model demands unprecedented openness. They are expected to be fully transparent about their pricing, costs, schedule assumptions and profits, to be accountable to the full Alliance team, and be compliant with the joint operating governance.

NOPs also need to be willing to participate in integrated design and planning processes and be open to concurrent construction planning and cost modelling. This is quite a shift from traditional contracting models. Instead of focusing on protecting their individual profitability, NOPs need to adopt 'best for project' thinking, accounting for the owner's interests and allow profitability to be addressed by the model structure.

Because it represents such a change, there has been resistance to the Alliance model, as well as other collaborative contracts. However, as more positive stories are shared within the Canadian market about non-adversarial environments and good outcomes resulting from collaborative contracting — including Alliance contracting and IPD — interest is growing.

Owners' interest comes from the increased understanding that these contract models can generate more value for less money, with less risk and improved internal stakeholder engagement. As the collaborative contracting movement grows, exploring this route is becoming less and less of a choice for those who don't want to risk missing opportunities.

What an Alliance looks like

Alliance contracts include a pre-planning phase called the Development Phase, with a structured work output that validates the project scope, success metrics, budget and schedule expectations as well as management system governance.

Budget development is referred to as a Target Outturn Cost (TOC), which is essentially the agreed-upon estimated project cost including all direct construction and design costs, risk contingencies, overheads and profit margin expectations. Accurate TOC planning naturally implies a certain degree of design work.

With unanimous agreement from all parties including the owner, the Development Phase ends with the signing of a full Alliance agreement to complete the remaining detailed design and construction. Pain/gain share outcomes are based on the performance in this follow-on Executional Phase.

Aside from this fundamental phasing structure, Alliance projects can look different in procurement structures, referred to by some Alliances as a Single TOC or a Double TOC.

1. Single TOC

- One preferred proponent is selected after multiple qualifying stages to engage with the owner for the Development and Executional phases. The selection criteria prioritize demonstrated collaborative behaviours and a financial evaluation outcome based on proposed rates, corporate overhead and profit.
- Only one TOC is developed during the Development Phase. With the signing of an agreement, the project moves directly into remaining delivery execution.
- No design work is undertaken during the selection/Request for Proposal (RFP) phase.

2. Double TOC (also referred to as a Competitive Alliance)

- Two proponents are selected through a Request for Qualifications (RFQ) stage, with the same Single TOC requirements. Both proponents are invited to participate in the Development Phase.
- Development becomes part of the RFP process, whereby an estimated TOC and corresponding technical concept/schematic design are produced. Both proponents generate comprehensive written proposals with a focus on technical solutions and corresponding budgets.
- The successful candidate is selected based on the Development work and invited to finalize the TOC and engage in the Executional Phase.
- Both parties are compensated for the design work during the RFP process, with higher stipends than are commonly offered in other models.

Regardless of the procurement strategy used to engage in Alliance contracts, participants are obligated to act in good faith as defined by the joint governing agreements to manage the project as a collective.

Getting started with Alliance contracting

Collaborative project delivery models are still relatively new to Canada. They can feel like unfamiliar territory for project owners and participants who are used to more transactional and bilateral models. For that reason, many organizations seek practical guidance from experienced partners the first time they select a collaborative contract.

It is important to note that although Alliance and IPD are sometimes referred to interchangeably, they are different. While both models require players to put profits at risk for the sake of the project, there are some key differences that help determine which option is right for a specific project. Those differences can be explored with proper, objective advisory support.

Most often, the Alliance model is used for larger, more complex multiyear projects with billion-dollar budgets. As a result, there are more extensive, contractually stipulated management structures, additional pain/gain share mechanisms and a robust auditing regime.

In IPD, risk and reward are shared with respect to profits. Similar to the Alliance model, liabilities are waived. However, IPD affords more flexibility for developing a joint project management practice, setting up governance, and selecting financial auditing options according to project size and complexity.

In any event, choosing between the Alliance model and IPD should be based on the needs of the project, not because a particular expert advisor prefers one over the other. There are proponents eager to aggressively compare and contrast the two models, with a focus on 'selling' a particular one. Owners should be aware of this and evaluate the two objectively. The reality is that both can be great alternatives to traditional project delivery models.

If you'd like to learn more about collaborative contracting options, including Alliance contracting, please reach out to Colliers Project Leaders. We focus objectively on supporting owners and are uniquely positioned to provide support.