Alliancing – it’s all for one and one for all

Will Buckby and Andrew Croft of Beale and Company review the operation of alliancing type procurement which major industry clients like Thames Water and Network Rail are increasingly adopting.

In December 2012 Thames Water announced that it will deliver a significant proportion of its AMP 6 programme using alliancing agreements. This appears to be part of a trend towards the use of alliancing agreements: Network Rail and a number of other public bodies are also procuring infrastructure projects using the alliancing model.

In the context of construction and engineering projects, alliancing is essentially a way for two or more parties to work together to achieve a common goal. It is generally used on major projects or where there is to be an ongoing relationship over a number of different projects. The alliance may include consultants, contractors (the participants) and the client. It can be structured either by incorporating a special purpose vehicle in which all the relevant stakeholders have a shareholding, or by forming a quasi-alliance where the stakeholders simply adopt the behaviours of an alliance.

As explained below, a key feature of alliancing is that the project team ‘wins together and loses together’ and there are a number of benefits and risks associated with this approach.

Shared liability
It is typical to alliancing that the participants are jointly and severally liable to the client for any breach. This is an excellent example of the ‘win together/lose together’ notion. Under a joint and several liability arrangement, any of the participants could be liable for the other participants’ breaches, even if the participant has not contributed to the liability. The participants are ‘in it together’ and potentially bear each others’ risks and liabilities. One advantage of such an arrangement is that it encourages the parties to collaborate as they have a vested interest in assisting the other participants in performing their obligations.

Where joint and several liability amongst the participants exists, it is important that participants

KEY POINTS
- There is a growing trend towards the use of alliancing to procure infrastructure projects
- Alliancing is underpinned by the idea that the alliance members ‘win together and lose together’
- The way in which this approach is reflected in alliance agreements promotes collaboration
- There are a number of risks associated with the alliancing model and there is an element of uncertainty as to the enforceability of some of the key provisions (particularly the ‘no blame culture’)
- If parties are willing and prepared to ‘win together and lose together’, alliancing is an ideal way of documenting that intention

Queensland Australia for over ten years, and in the last five years National Grid has used alliancing for its capital expenditure projects relating to sub-station work.
agree the basis on which liability for any claim by the client will be apportioned between them and include a mechanism to achieve any agreed apportionment. One way of apportioning liability is to agree that any liability, whether to the client, a third party or another participant, will be shared equally, regardless of fault. This is a ‘true’ ‘win together/lose together’ scenario, as notwithstanding how the losses arise, they are shared by the parties. This does result in important insurance considerations (i.e., whether a professional indemnity insurance policy is required to pay out where there is no notifiable ‘claim’ by the insured under that policy because the insured has not caused the loss) which are not addressed in this article.

Cross indemnities as between the participants serve as a useful tool to ensure that the division of risk is in accordance with the agreed shares. However, they need to carefully drafted given the potential liabilities which may arise under the agreement – the participants could be liable to the client, third parties or as between themselves. Further, indemnities are only of any value if the parties to the indemnity have sufficient assets and/or insurance to meet them.

**Gainshare/painshare mechanism**

Under an alliancing contract the participants are generally paid in accordance with a ‘gainshare/painshare’ mechanism. The payment mechanism under an alliance agreement is thus another example of the ‘win together lose together’ notion.

The participants’ entitlement is usually broken-down into three elements: (i) direct costs actually incurred in relation to the project (reimbursable costs); (ii) a fee for corporate overhead and profit; and (iii) a gainshare/painshare amount, calculated in accordance with an agreed mechanism.

The gainshare/painshare mechanism usually operates by reference to a target cost, which is collectively agreed by the participants at the start of the project. If the alliance members’ total reimbursable costs are less than the target cost, they share any savings and the participants are entitled to a gainshare amount; whereas if their total reimbursable costs exceed the target cost the losses are shared between the alliance members and the participants must pay the client a painshare amount.

Whilst a clear advantage of this payment mechanism to the client is that it aligns the profit recoverable to the success of the project and encourages the participants to work in a way which benefits the project as a whole rather than the participants’ individual interests, there are real risks to the participants – the participants have limited control over whether they ultimately make a profit and they may become liable for painshare solely as a result of the actions of one alliance member.

Alliancing agreements often include a relatively short defects liability period of two years. Whilst participants typically recover the cost of remedying defects during this period as reimbursable costs, it should be noted that any such costs can be taken into account in determining the gainshare/painshare amount.

**Shared decision-making**

Alliancing contracts often provide for the setting up of an alliance leadership or management team. This comprises representatives from each of the alliance members, including the client, and provides strategic direction for the alliance. Typically, unanimous agreement is required before the management team can make decisions, and there is usually no deadlock drafting. This is another example of how the ‘win together/lose together’ approach is reflected in the contract. If the parties are unable to agree to decisions ‘together’, the risk is that the progress of the project will be stunted and the overall future of the project put in jeopardy. In such situations the parties will lose together. On the other hand, if they can agree all management decisions ‘together’, the project will progress and hopefully be successful (i.e., a win).

It is important to note that if the management team is required to make unanimous decisions this will need to be carefully managed by both the client and participants. The client and participants will need to wear a collaborative hat and always have the success of the project in the back of their minds. Achieving unanimous decisions could be problematic, particularly given the number of parties involved – the participants will of course have different interests to that of the client and the contractors may have alternative interests to the consultant.

Deadlock provisions would be ideal in order to resolve any situation where agreement cannot be achieved. However, they are considered to contradict the ‘win together/lose together’ notion as they could
result in some members of the alliance achieving a different solution to that sought by another.

**Good faith and alliance charter**

Under alliancing agreements, the participants will often agree to act in good faith in performing their obligations. This is clearly to encourage co-operation and help establish the ‘win together/lose together’ approach.

However, whilst ‘good faith’ obligations are relatively common in construction contracts (the NEC3 requires the parties to act in the ‘spirit of mutual trust and co-operation’) and have received some judicial consideration (see *Compass Group UK and Ireland Ltd v Mid Essex Hospital Services NHS Trust [2012] EWHC 781* where it was held that an obligation to co-operate in good faith required discretion to be exercised in a manner which was not arbitrary, capricious or irrational), there is still some uncertainty as to the true effect of such obligations. The client and participants will need to look past such phrases and focus on successful delivery together, which may be easier said than done.

Further, alliancing agreements often also include an obligation to act in accordance with an alliance charter, which sets out a number of shared project goals. This reflects the ‘win together/lose together’ approach as it encourages parties to work and behave in a way which best benefits the project. However, charters often contain vague requirements, which are aspirations rather than obligations, and reflecting this in the drafting can be problematic. It is common that such terms are subject to disagreement and misunderstanding as to their interpretation, which has the potential to cause a dispute. *Birse Construction Ltd v St David Ltd [1999] EWHC (TCC) 253* demonstrates the uncertainty surrounding such arrangements. The court considered a non-binding partnering agreement as an aid to the construction of the formal contract on the basis that its terms were ‘clearly intended to provide the standards by which the parties were to conduct themselves and against which their conduct and attitudes were to be measured’. Following an extensive and costly litigation, the court held that there was no formal contract but only a ‘practical commercial resolve’.

**No blame culture**

A distinguishing feature of alliance agreements, and another embodiment of the ‘win together/lose together’ approach, is a commitment to a ‘no blame culture’, including an agreement that the alliance members (including the client) will not commence proceedings for any breach of the alliance agreement except in limited circumstances, such as on termination for material breach, wilful default and non-payment.

This is clearly attractive to clients as it encourages parties to focus on resolving issues by negotiation and discussion as and when they arise, which should reduce delays and additional costs as a result of any dispute. It is also appealing to the participants as there will be limited situations when claims can be brought. Collectively, the client and participants may also be more willing to be open and collaborate without the fear of proceedings.

However, as identified above, there are often a number of exclusions from the no blame culture and therefore the participants could potentially incur significant liability in connection with the alliance. This is not a ‘true’ no-blame culture and the parties should not rely on it as being one.

One real uncertainty as to the ‘no blame culture’ and the agreement not to sue is the extent to which these can be enforced if tested before the courts. Much is likely to depend on the precise wording of the alliance agreement, but some practitioners consider that such clauses are simply ‘agreements to agree’ and are therefore unenforceable for lack of certainty.

**Conclusion**

Alliancing agreements and the ‘win together/lose together’ ethos which they embody can be extremely beneficial to all parties involved. They enable the client to play an active role in the project and encourage parties to work in an open and collaborative manner and in a way that benefits the project rather than their individual interests. The ‘no blame culture’ is also very attractive to all parties as it aims to remove the risk of disruption to the project and of additional costs being incurred as a result of a dispute between the parties.

However, alliancing can require a significant level of commitment and investment from the parties, not just in time and money but also in mindset. It is therefore not appropriate for all projects. Furthermore, if the alliance is unsuccessful there are a number of potential risks for both the participants and the client, and it is unclear how certain provisions would be construed in the event of a dispute.