

Project Alliancing



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Project Alliancing

Part 1

Executive Summary

Since the 1990s, there has been a growing trend towards the use of collaborative business relationships for the delivery of major projects.

Project alliancing is about embracing risks. Instead of being concerned with risk transfers amongst the project participants, it is about embracing and managing risks within a flexible project delivery environment.

The type of alliance entered into often depends on the industry involved and not every project is going to suit the project alliancing model.

Introduction

For those in the construction industry, the term “project alliancing” is a well known term. Since the 1990s, there has been a growing trend towards the use of collaborative business relationships for the delivery of major projects. Both State and Federal governments have used project alliancing in the development and implementation of major construction projects such as road, rail, port and wastewater infrastructure, hydroelectricity generation and building.

The following are just a few examples of Australian projects completed under the project alliancing model:

- Northside Storage Tunnel, Sydney, New South Wales
- Norman River Bridge, Normanton, Queensland
- New Perth-Bunbury Highway, Western Australia
- Trevallyn Upgrade Project, Tasmania
- Gippsland Water Factory, East Gippsland, Victoria
- The National Museum, Canberra.

So, what precisely is project alliancing? What are the drivers for this type of business relationship? How does project alliancing compare with traditional forms of business relationships? These issues and more will be considered in Part 1 of this Liberty White Paper Series on Project Alliancing.

What is Project Alliancing?

The term project alliancing covers a whole range of business relationships between parties to a project. Careful attention needs to be given to the alliance contract to determine precisely the type of alliance intended.

The type of alliance entered into often depends on the industry involved. For instance, the alliance arrangements suitable for an IT project or a conventional construction project may be quite different to that necessary for a more risky oil and gas construction project.

In general terms, project alliancing is a form of co-operative business relationship where the owner and non-owner participants of a project collaborate to take a project from the developmental stage to the delivery stage. The central idea is that all participants share the responsibility for the project risks and the benefits of achieving or exceeding the project objectives. All the decisions are made on a unanimous basis between the project owner and the non-owner participants.

Project alliances are typically described as either pure alliances or hybrid alliances. Pure project alliancing is based on a commercial framework where all the participants share the “pain” and the “gain” of the project depending on their collective performance in achieving the final outcome. Accordingly, the participants share in managing risks inherent in the project, the decision-making in relation to the project and, ultimately, the benefits from the project.

The corollary of this ideal is that the participants agree not to bring legal actions against each other (subject to limited exceptions) should the project not go according to plan. The issues that may rise from this “no blame, no dispute” agreement will be discussed in more detail in subsequent parts of this White Paper series.

Hybrid (or impure) alliances are similar to pure alliances in terms of management structure. Their remuneration structure is also similar (usually based on performance measured against key performance indicators or KPIs). And there are similar obligations of co-operation and good faith.

Their key difference is that they typically require the non-owner participants to retain discrete liability for breaches of their obligations under the alliance contract. These obligations can be specifically enforced by legal action should they be breached.

For the purposes of this White Paper Series, we shall be focusing on pure alliance projects. Given the complexity of this topic, our aim is not to examine in detail the full mechanics of how project alliances are formed or to analyse all the legal and commercial ramifications that arise from such alliances. Instead, we aim to raise an awareness of the growing trend for project alliances and to highlight some of the commercial, legal and insurance issues that arise from this delivery model.

What is the Rationale Behind Project Alliancing?

In order to understand this trend, we need to examine and understand the more traditional forms of business relationships as a means of project delivery.

The Traditional Approach

Under the traditional design/construct or the combined design and construct forms of contract, risks are allocated to different parties and each party is responsible for its own risk management. The architect is responsible for design risks; the engineering firm responsible for the engineering risks; the construction company for the construction risks and so on.

The contract would set out the rights and obligations of each party and in negotiating the contract each party adopts an adversarial approach. This approach is understandable for business reasons – each party would like to minimise risks and liabilities in return for maximum gain. In short, traditional methods of contracting are adversarial in nature and are mostly about risk transfers.

For instance, it is common to have project owners entering into a fixed term and fixed price contract for the delivery of a project. The risks of delay, uncertainty, technology issues and cost overruns are passed on to the contractors. The owner would then typically require the contractor to effect insurance to cover their liability both at law and under the relevant contract.

This transfer of risks would inevitably lead to increases in project costs for the owner because, understandably, contractors would seek a higher return for assuming a higher level of risk under the contract. A higher risk contract may also lead to higher insurance premiums for the project and all this needs to be factored into the project price.

Furthermore, whilst the generally accepted view is that risks should be borne by the party best able to manage them, it is not always easy to allocate risks. For instance, some capital projects have inherent political, environmental, industrial, technological or engineering uncertainties and contractual disputes can arise from inappropriate risk allocation.

Instead of the parties working together in a “best for project” approach, parties to a traditional contracting method are more individually focused. This can sometimes inhibit innovation and a best possible outcome for the project. More worryingly, contractual disputes can often take place between the parties in order to shift responsibility for loss from one party to another. Ultimately, all parties lose from this approach – in terms of time, efficiency, reputation, goodwill, innovation and professional satisfaction.

A New Approach

In the late 1980s, a group representing a cross-section of governmental and private sector interests in the Australian construction industry met and concluded that claims and disputes had become endemic in the construction industry and there was no indication that the incidence of claims and disputes was decreasing.¹

What could be done to ameliorate this situation?

In the early 1990s, a number of initiatives around the world had been taken in order to reduce the number of disputes between parties to construction projects. The aim was to improve efficiency and inter-party relationships.

The project alliance model began in the construction industry with North Sea oil and gas projects in the United Kingdom. British Petroleum formed an alliance with seven other partners and planned and executed the development of the Andrew Field project, located 230 kilometres northeast of Aberdeen. This alliance of project partners resulted in cost savings of 20 to 30 percent and time savings of approximately six months. The savings were shared amongst the alliance partners. This project showed that if all parties to the project were willing to work together, pooling their collective resources and ideas, each party could walk away winners.

In Australia, one of the first project alliances was the Wandoo Alliance which was used to deliver major oil and gas projects in Western Australia in the early 1990s. In the late 1990s, Sydney Water used a project alliance to deliver the Northside Storage Tunnel Project.

Around the same time the Australian Construction Association developed and promoted a concept called “relationship contracting”. They encouraged those in the industry to have a relationship management process in place “that aims to remove barriers, encourage maximum contribution and allow all parties to achieve success.”² Business relationships such as partnering and other strategic alliances are examples of this relationship contracting model.

There is no doubt that, in the past decade or so, there has been a significant interest in project alliancing in Australia and overseas amongst those in the construction industry. With the right alliance, it is possible to have an integrated project team where there is sharing of resources and ideas in order to optimise project returns and minimise the risks of protracted contractual disputes.

Key Features of Project Alliancing

As mentioned above, the main feature of a traditional business contract is one of risk allocation. In contrast, project alliancing is about *embracing* risks. Instead of being concerned with risk transfers amongst the participants, it is about embracing and managing risks within a flexible project delivery environment.

Footnotes

(1) See: Barrell, T et al, *Strategies for the Reduction of Claims and Disputes in the Construction Industry*, unpublished, 1988.

(2) See: Australian Construction Association, *Relationship contracting – Optimising Project Outcomes*, www.constructors.com.au/pages/site_frame.htm, 1999.

The other key features of project alliancing are as follows:

1. All the participants have aligned objectives.
2. Instead of a fixed lump sum contract price, the general remuneration arrangement is that the project owner pays the non-owner participants (e.g. the construction company) on a 100% open book compensation model. This means that they will pay the direct project costs and overheads, a fee to cover corporate overheads and a “normal” profit. Furthermore, the project owner also allocates an equitable share of the pain (risks of loss or liability, for instance) or gain (successful outcome) to each of the non-owner participants depending on the outcome of the project.
3. There is joint and several liability amongst the participants.
4. The project alliance is led by a joint body typically called the Project Alliance Board or Project Alliance Leadership Team. This body would comprise senior members of the owner participant and each of the non-owner participants. They all have a peer relationship and have equal say in the decision-making of the project. All decisions must be unanimous.
5. The management team is supported by other integrated project teams who all work together within a “best for project” culture. Some project alliance teams are so strong they have their own business cards and T-shirts made so as to enforce the idea of integration. This psychological element of an integrated team - where the driving force is an absolute commitment to meeting the project objectives - is essential to success.
6. The participants work together on the project in an environment of trust, open and honest communication. All transactions are transparent.
7. The participants agree to have a “no-blame, no dispute” culture where, should any loss occur, the parties agree to shoulder that loss equally.
8. There is usually an alliance facilitator who helps to create the flexible project delivery environment which encourages innovation.

Painshare and Gainshare

The idea behind project alliancing is that all the participants have a “painshare and gainshare” philosophy in order to avoid litigation between the participants.

Just what precisely is a “pain” or a “gain”? What makes an alliancing project fail? What makes a project a “success”? Is it when the participants meet or exceed budget? Or is it when the participants manage to avoid political or environmental embarrassment? Much, of course, depends on the nature of the project and who the participants are. The concept of “pain” and “gain” can be a subjective element. That is why it is so important to ensure aligned goals.

It is also important to bear in mind that not every project is going to be suited to this project alliancing model. If the project risks can be clearly identified and allocated, then perhaps project alliancing is not the most suitable model. These issues – the big questions about when and where project alliancing works - will be discussed in more detail in later parts of this White Paper Series.

Part 2

Executive Summary

Project alliancing has many practical advantages, principally, that it provides an incentive for minimising loss and maximising gains. It works best with projects that have varied and complex risks and interfaces.

Project alliancing has been used on major oil and gas exploration projects as well as at all government levels and is increasingly acknowledged to be an effective delivery system.

As with all systems, project alliancing has its negatives – including its potential impost on resources and management.

Value for money for the project owner is key and is generally addressed by an in-place value for money strategy and the implementation of robust performance and outcome cost targets.

Introduction

In Part 1 of this White Paper Series, we examined the concept of project alliancing and highlighted some of its fundamental features.

In Part 2, we discuss some of the benefits and risks inherent in project alliancing. When should this type of business relationship be adopted as a structure for project delivery? What are some of the risks involved in project alliancing and what does “value for money” mean in the project alliancing context?

The Benefits of Project Alliancing

In Part 1 we identified the general benefits of project alliancing. More specifically, and from a practical standpoint, project alliancing has the following benefits:

- There is a “best for project” focus amongst the owner and non-owner participants which means that all parties have to align their objectives and use a suitable project delivery strategy. There is a common interest in achieving a successful outcome which benefits all parties.
 - Project alliancing involves an equal or peer decision-making process. Senior management from each participant is involved early in the developmental and cost planning stage. This provides a more informed and experienced platform for decision-making.
 - Since all the participants have to share the risks amongst themselves the management of those risks is likely to be better because each participant will have an incentive to proactively – and co-operatively – mitigate and manage those risks. All parties have a *common* interest in minimising loss or liability.
 - Given the “no blame, no dispute” premise upon which this framework is based, fewer resources go into managing and resolving contractual disputes. The time and effort saved can be channelled towards delivering the project.
 - In combining resources and ideas, the participants also gain an insight into each other’s organisational processes and practices.
 - This model delivers transparency and accountability for the owner participant. This is particularly important for public sector projects.
- Project alliancing can mean superior returns and enhanced reputation for non-owner participants if the project is successful.
 - Given that there is usually a cap on exposures to risks of loss of profit and corporate overheads, the gain to the non-owner participant could far exceed the costs and risks involved.
 - Since the success of the project is shared by all the participants, there is an incentive for the parties to be results focused and innovative.

When Should Project Alliancing Be Used?

Given the benefits discussed above, when should project alliancing be used as a project delivery model?

Projects with the following characteristics may be suited to project alliancing¹:

1. The project is large – and involves numerous complex and unpredictable risks with complex interfaces
2. There are external threats or opportunities that can best be managed on a collective basis
3. The output specification cannot be clearly defined at the outset because of issues such as technological change, political or environmental influences
4. There is a very limited timeframe.

Project alliancing is **not** suited to cases where the project risks can be clearly defined, costed and allocated between the parties.

Some Examples of Project Alliancing

Given these characteristics, we can see why oil and gas projects such as those in the North Sea and the Australian Wandoo and East Spar projects are suited to the project alliancing model.

In the Wandoo case, the operator built and installed the Wandoo B Platform using an alliance of four construction and design companies. In the East Spar offshore project, the operator formed an alliance with several engineering and construction contractors in the design and construction of two subsea wells, a subsea gathering system and multiphase pipelines.

More recent examples of project alliancing include Sydney Water’s Northside Storage Tunnel and the National Museum of Australia in Canberra.

Footnotes

(1) See: Victorian Department of Treasury and Finance’s *Project Alliancing Practitioners’ Guide*, April 2006, page 19.

In recent years, Queensland's Department of Main Roads has used project alliancing as a delivery structure for a number of projects. For instance, The Port of Brisbane Motorway Alliance (PBMA) was formed to design and construct the first stage of the Port of Brisbane Motorway, a project which included five kilometres of motorway, 14 major new bridges and a multi-level interchange over Brisbane's Gateway Motorway.

It is interesting to note that the PBMA was the first public works infrastructure project in Queensland to have a certified Occupational Health & Safety management system from SAI Global. This highlights the ability of a well managed alliance to integrate and align the different systems and cultures of the participants involved.

The NSW Roads & Traffic Authority (RTA) Cooperbrook to Herons Creek Project highlights the way in which the project alliancing model is often used when compressed timeframes are involved.

This project involves the design and construction of a single continuous 32 kilometre length of the Pacific Highway between Cooperbrook and Herons Creek. Commonwealth funding was conditional on the work being completed no later than 17 December 2009. The RTA has acknowledged that the timeframe for the completion of this project is the primary reason for using a project alliancing model.

The Risks Inherent in Project Alliancing

What are the risks inherent in project alliancing? Some of the factors that make project alliancing so attractive can also be negatives for the project owner or other participants.

- The risk sharing concept means all participants are required to embrace a broader range of risks than they would normally accept. They are liable for risks over which they may have little or no control - such as the performance of other participants.
- Project alliances usually require more involvement by senior management. Whilst this can be a benefit, it can also drain resources.
- Individual participants take on a high potential risk because they have no recourse to litigation in the event of a dispute with other project participants (except for acts of wilful default and acts of insolvency).
- Aligning the common objectives of the various project participants may not be easy. Much management time and effort is required to ensure that the project alliance works.

- From the owner participant's perspective, project alliancing usually means no cap on the potential cost of the project. There may also be an unfair or inflated allocation of costs to the alliance. At the end of the day, the owner participant needs to ensure that they receive value for money.
- From the non-owner participants' perspective, there is a risk of loss of profit and corporate overheads but, more significantly, there could be serious damage to reputation if the project is not successful.
- For designers and consultants the cost of tendering may be higher because of the greater commitment required from senior management.
- Project alliancing requires an honest and trusting relationship between participants. A project owner may need to tell a project participant that they need to "lift their game" to ensure peak performance. Without high quality monitoring and performance evaluation there is a risk the project outcome will not be achieved.
- Probably the most significant risk to a successful project alliance is an insufficient recognition of the human elements. There needs to be serious strategic focus on people, relationships and team building.

Value for Money

What is meant by "value for money" and how is it achieved? Public sector agencies are generally required to adhere to strict policies and guidelines in the procurement of works and services. One of the important factors is whether there is value for money in a project.

In tabling its performance audit report on the Northside Storage Tunnel Project, (the first major public sector project alliance in Australia) the NSW Auditor-General said that there was insufficient evidence to support the view that the project provided value for money for the government. However the Auditor-General concluded that:

"In our opinion, the outcome of the project suggests that an alliance approach, when applied to a suitable project and managed appropriately, can support a positive outcome."

Clearly, obtaining value for money is not only a desired outcome for the public sector.

In order to ensure that the project provides value for money for the owner participant, there is usually a specific value for money strategy in place. For instance, during the participant establishment and selection process, the owner participant needs to create a budget estimate that is as rigorous as possible.

It is important to remember that, in project alliancing, non-owner project participants are selected not on price but on their expertise, their ability to work within an alliance framework and their ability to achieve project objectives. They are also chosen on their understanding and commitment to the value for money strategy proposed by the owner.

The expected cost of the project is not considered until after the preferred tenderer has been selected. The project owner and the other non-owner participants must then align their objectives under the proposed value for money strategy. At the developmental stage of the project alliance, all participants need to put aside their self interest and, as an integrated team, put forward a Target Outturn Cost (TOC) which is a reasonable estimate of what it should take to deliver the agreed work.

Once that TOC has been agreed upon, all participants need to ensure that the TOC and performance targets are robust.

At the end of the day, a project alliance arrangement provides value for money for the owner participant when the project objectives are achieved or exceeded for an amount under the TOC.

Part 3

Executive Summary

Project alliancing is typically characterised by a number of phases ranging from the selection of contract participants through to the completion of the correction period.

The existence of a formal contract is a crucial part of a successful alliance. It does not remove the elements of trust and good-will that are necessary for a pure project alliance, nor does it alter the integrity of the “no blame, no dispute” culture. Instead, a formal contract provides a crucial reflection of intentions.

A project alliance contract structure is generally all-encompassing and typically incorporates principles, objectives and obligations. Additionally, a “no dispute” clause is usually present but is likely to contain an exception for willful default and acts of insolvency.

Introduction

In Parts 1 and 2 of this Liberty White Paper Series, we explained what project alliancing is and discussed some of its risks and rewards.

So what do we need to do in order to put together an alliance project and what are the processes involved? In Part 3 of this Series, we consider the various phases of an alliance project and discuss the need for an alliance contract.

Phases of an Alliance Project

What follows is an overview of the typical phases of an alliance project¹.

1. Establish the Alliance

In this early phase, the project owner selects the other participants. Selection is typically based on non-cost criteria. It usually involves a written proposal by the non-owner participants followed by a series of structured interviews and workshops with the project owner. This process enables the project owner to select the appropriate participants.

Once the alliance participants are selected, the primary commercial parameters are agreed.

2. Project Development Phase

The second phase is the development of the scope of the works and the agreed project targets. All participants work in an integrated team to develop and agree the TOC and other performance targets for the project.

When the targets have been agreed by all participants then they move to the implementation phase.

3. Implementation Phase

During this phase, participants must work together to deliver the project. Typically, the alliance management team would formulate a plan that incorporates work related policies, procedures and systems. At this phase good governance and control over the project are key. Clear commercial incentives by way of the gainshare/painshare regime also help to ensure that all participants work together to deliver peak performance.

4. Practical & Final Completion

Once there is practical completion of the project all participants remain responsible for any defects in the work during the defects correction period stipulated in the contract.

Now that we have examined the various phases of an alliance project, we can look at a key issue – the role of the contract.

Do You Need a Formal Contract for Project Alliancing?

Given the “no blame, no dispute” premise upon which project alliancing is typically based, one could legitimately ask; “is there a need for a formal contract?”

The existence of a formal contract does not remove the elements of trust and good will necessary for a pure project alliance, nor does it alter the integrity of the “no blame, no dispute” culture. Instead, a formal contract reflects the parties’ intentions. The contract can specify the type of alliance that the parties intend and detail their rights and obligations. In short, having a formal agreement assists in the operation of the alliance and provides the parties with certainty because all the expectations, rights and obligations of the parties are clearly specified.

A Case in Point

There should be a formal agreement drawn up between the parties and in that document their intentions must be made clear. The case of Doric Building Pty Ltd v Marine & Civil Construction Co Pty Ltd clearly demonstrates why.

The Shire of Busselton in Western Australia invited tenders for the design, construction and installation of an underwater observatory at the Busselton Jetty. In its tender submission, Doric Building Pty Ltd (Doric) proposed that it would lead an alliance team, including Marine & Civil Construction Co Pty (Marine), to complete the project.

Doric had previously agreed with Marine that they would operate together as an “alliance or joint venture” so as to save on overheads and contingency costs. However, Doric’s sub-contract agreement with Marine contained a few unusual clauses. It specified the contract price as “0” and expressly provided that the parties formed an “alliance” and would share all the profits or losses equally. However, the alliance contract also had a standard contract (ie a General Conditions of Subcontract For Design and Construct, AS 4303) attached to it. The terms of such a contract are inconsistent with the alliance approach.

The standard contract required, for example, that Marine give a warranty as to the execution of the works and that, when completed, the works would be fit for the purpose for which they were built. Furthermore, the contract stated that Marine was liable to Doric for liquidated damages if there was late completion.

Doric’s tender submission for the Shire of Busselton project was successful and Doric entered into a design and construct contract with the Shire incorporating the AS4300-1995 General Conditions of Contract (the head contract).

Footnotes

(1) See: *Project Alliancing: Practitioners Guide*, April 2006, Department of Treasury and Finance, Victoria.

Prior to the start of construction, the design of the marine ground anchors connecting the underwater observatory to the sea bed was found to be inadequate. This resulted in extensive design changes and an increased construction cost of approximately \$1 million. A dispute then arose between Doric and Marine. Doric said that the contract with Marine was quite simple; Marine had given a warranty under the sub-contract which it had breached and it was therefore liable for breach of the design warranties and the consequential delay costs. Marine argued that they had an “alliance” or “joint venture” agreement which meant that any profit or loss on the contract would be shared equally between them.

The matter went to arbitration and, ultimately, to the Supreme Court of Western Australia. The court decided in Marine’s favour and said that Marine and Doric had a joint venture at law. The specification of a “0” contract price and the statement that the parties would share the profit and losses equally made that intention quite clear. The provisions in the standard design contract which were inconsistent with this intention were therefore found to be unenforceable.

Given the original aim of an alliance arrangement, Doric clearly could not attempt to obtain the benefits of both an alliance and a conventional contract. This case shows the importance of a properly drawn up contract and of selecting the right alliance team.

The Structure of an Alliance Project Contract

There are many ways to structure an alliance contract. However, most typically include:

- The alliance principles which govern the relationship between the parties
- The commonly aligned goals and objectives of the alliance participants
- The commitments, rights and obligations of the participants including a “no dispute” clause
- The establishment of an Alliance Leadership Team (ALT) and/or an Alliance Management Team (AMT); provisions as to meetings and how personal and corporate conflicts of interest are to be resolved
- The development and delivery of the TOC and what the TOC documentation will incorporate

- Payment entitlements – non-owner participants are usually entitled to:
 - direct costs
 - margin
 - amounts determined by the ALT under the “gainshare regime”
 - GST, and
 - any other amounts for which the owner participant has agreed to indemnify them
- The scope of the proposed works dealing with the standard of performance expected and how variations are to be dealt with
- Provisions setting out the gainshare/painshare regime
- Ownership and licensing of intellectual property rights enhanced or developed during the project
- The requirements of workplace health and safety, industrial relations and environmental protection
- Default provisions
- Insurance requirements
- Termination provisions which typically give the project owner a right to terminate the project subject to entitlements under the contract.

The above list is clearly not comprehensive. The full range of provisions would depend on the nature of the project and the type of alliance intended.

This brings us to the importance of the alliance principles. These principles govern the relationship between the parties and are typically set out in a mission statement style. For instance, the participants may agree to the following principles:

- To be innovative and to challenge convention
- To promote shared learning
- To recognise and reward exceptional performance
- To give and seek feedback to enhance performance
- To produce outstanding results in the successful execution of the works
- To establish and maintain an integrated team environment which encourages honest, open and timely information-sharing
- To implement risk management practices whilst maximising opportunities

- To share equitably the rewards and the risks that the participants encounter
- To make all decisions on a “best for project” basis
- To commit to a culture of no fault and no dispute so as to avoid disputation and litigation.

These principles form the human foundation upon which the alliance is based. However, as in any successful organisation, the drive and commitment must come from those in senior management. Both the ALT and the AMT play a critical role in the success of an alliance project. The primary role of the leadership team is to create and sustain an environment in which the objectives of the projects can be achieved or exceeded.

Wilful Default

A pure alliance project contract usually includes a “no dispute” clause which, depending on the precise wording, provides that participants agree not to pursue recovery rights they may have against each other in respect of any act or omission. However the agreement not to pursue recovery rights typically excludes an act of insolvency or acts of “wilful default”.

“Wilful default” usually includes:

- deliberate or reckless conduct which the participant knew or ought to have known would cause harm to another participant
- failure to honour an indemnity
- failure to make a payment that has fallen due under the agreement
- material failure to effect required insurances
- intentional failure to honour “open book” audit obligations
- intentional breach of obligations in respect of third parties’ intellectual property rights; and
- fraudulent conduct.

In any of the above examples, the participant in default would be in breach of their obligations under the alliance agreement and could be the subject of a liability claim by the other participants.

In the absence of any wilful default, however, the negligence or defective work of a participant will be subject to the “no dispute” clause. The parties need to

engage in open and frank discussions to resolve the problem on a “best for project” basis.

The Gainshare/Painshare Regime

One of the fundamental features of a pure alliance project is the way in which the non-owner participants are remunerated for their contributions. A non-owner participant is usually remunerated under three discrete components:

Limb 1: Direct costs – the reimbursement of the participant’s project costs on a 100% open book basis.

Limb 2: A fee – to cover the participant’s normal profit and corporate overheads.

Limb 3: Gainshare/painshare allowances - where the rewards of outstanding performance and the burden of poor performance are shared equitably amongst participants.

The gainshare/painshare regime gives the non-owner participants the incentive to strive for outstanding results. Clearly, in order to ascertain whether there has been a “gain” or “pain”, we need to look at the performance of the alliance against the objectives set out in the contract.

The project objectives usually include the timing for the completion of the project, the costs for the project and also a range of other Key Result Areas (KRAs) such as community and stakeholder management, safety, environmental issues, quality and whole of life costs. These are commonly referred to as performance KRAs.

The cost objective is probably the simplest in that the non-owner participants usually share an agreed proportion (say, 50%) of the cost overruns or underruns against the TOC. Naturally there could be variations to this position depending on the intentions of the parties.

The time objective is dealt with on a project specific basis since much depends on the nature of the project. If, for instance, the project is to build an asset which cannot be used until another asset is complete then early completion may add little value. However, late completion could lead to significant loss.

Measuring performance KRAs can be difficult because they are not always clear cut. Some can be measured with relative ease – for instance, road-side safety can be measured by the quality of workmanship. However, some project objectives can be quite subjective – for instance, is there community satisfaction with the project?

Therefore, in respect of each performance KRA, an alliance contract would usually provide for:

- agreed performance benchmarks
- methodologies for measuring performance, and
- final measurement mechanisms.

As far as the painshare element is concerned, the total amount payable by the non-owner participants is usually capped at their fee entitlement. This means they put at risk their profit and contribution to overheads, but not their direct costs.

The Price of Painshare

It is worth noting that the pain of the participants could include not only liability or loss caused by defective performance by one or more of the alliance participants; their pain could also include liability to third parties.

This raises a number of issues. Who bears the financial loss if such risks of loss or liability cannot be transferred to an insurer through the alliance's policies? Would that loss be borne by all the participants through the painshare regime? If the cap for that painshare regime has been reached, the risks of financial loss would presumably be borne by the project owner. This is clearly an issue that must be considered by the parties when drafting their alliance contract.

Part 4

Executive Summary

The “no dispute” clause is a key feature of the project alliance contract and whilst its purpose is simple, its ramifications are broad – particularly in light of the painshare/gainshare regime.

The incorporation of the “no dispute” clause does not remove all liability from the alliance participants. Some liability simply cannot be excluded or limited by contract.

Given the concepts of project alliancing, it is logical that such contacts should be governed by good faith. Participants need to carefully consider the existence of a possible fiduciary relationship.

A termination for convenience clause is typically included in alliance project contracts. This clause usually gives the project owner the right to terminate “without cause and for any reason at any time at its absolute and unfettered discretion”. Non-owner participants need to understand the revenue and workload implications of this clause.

Introduction

In Part 3 of this Liberty White Paper Series, we considered the various phases involved in project alliancing and the legal framework for an alliance project contract. We concluded that it is important to have a properly drawn up contract that clearly reflects the type of alliance structure and the rights and obligations of all the participants.

In Part 4, we examine more closely some of the legal issues that ought to be considered carefully when drafting an alliance project contract.

The “No Dispute” Clause - Its Ramifications & Limitations

This clause is one of the key features of a pure alliance project contract. Its purpose is to allow alliance participants the freedom to pursue outstanding, innovative results – without the fear of being sued if they fail.

This clause does not prohibit disputes from arising. It simply provides that, except in the case of willful default (which is usually narrowly defined) or an act of insolvency, each participant agrees not to bring legal actions against another participant. An alliance project contract usually provides that, if an alliance participant is professionally negligent in performing its obligations under the contract and remedial work is required, the participants are to work together to carry out remedial action and the additional costs become an alliance cost. All disputes are to be resolved on a unanimous resolution basis. The ultimate goal is to do what is “best for project”.

Whilst the purpose behind this clause is simple, its ramifications are broad. If we bear in mind that the other key feature of a project alliance is the gainshare/painshare regime, a failure by one participant to meet their performance expectations will adversely affect the gainshare of their fellow participants.

For the project owner, this clause also means they will have no remedy under the contract against the other alliance participants for losses suffered as a result of their negligence or defective performance. It is fair to say that a vast majority of litigation under traditional project delivery methods involves owners/principals suing contractors for defective workmanship or negligent performance of the contract.

For this reason, some project owners might decide to adopt an alliance structure without the “no dispute”

clause or widen the definition of the “willful default” exception. In doing so, however, they may be weakening the integrity of a pure alliance project model. The incorporation of a “no dispute” clause may be a necessary incentive if a high level of innovation is a desired project objective.

If, on the other hand, innovation is not a key objective, there might be questions as to whether or not this clause should be incorporated or at least amended so that it allows the parties to achieve their aligned commercial interests whilst placing the cost of a failed performance back on the non-owner participant. Clearly, this is an issue that project owners and other participants need to consider with their legal advisers.

One thing that must be remembered, however, is that the incorporation of the “no dispute” clause does not remove all liability from the alliance participants. Some liability simply cannot be excluded or limited by contract.

Some Rights of Action Cannot be Excluded

The participants’ liability under section 52 of the Trade Practices Act 1974 (Cth), is one clear example.

This section, commonly known as the “misleading or deceptive conduct” provision, prohibits a corporation from engaging in conduct that is misleading or deceptive. Liability under this section is “strict” in that it is not necessary to show an intention to mislead or deceive. It is enough if the effect of the relevant act or omission is to mislead or deceive. Silence itself may constitute misleading or deceptive conduct if the failure to reveal certain facts has the effect of misleading or deceiving the person to whom that silence is directed.

Furthermore, a promise to waive a right under this section cannot be enforced.

This section can therefore be invoked by anyone, who is, or is likely to be, misled or deceived by the relevant conduct of another member of the alliance team. So, whilst the initiation of an action under section 52 of the Trade Practices Act may be in conflict with the intention of the “no dispute” clause, the alliance participants retain this right of legal action. There is an equivalent provision to section 52 of the Trade Practices Act in each State and Territory.

Furthermore, apart from this statutorily imposed standard of fair conduct, there are other legal basis of actions (such as the equitable doctrine of estoppel) which could be used by alliance participants. Much depends on the wording of the “no dispute” clause. If the clause provides that the participants cannot enforce any obligation “at law or in equity”, it can have the

effect of removing the right of a participant to bring any claim against another member of the alliance team.

Be that as it may, this clause will not have removed the rights of the participants to bring an action under statutory provisions which impose standards of fair conduct and whose operation cannot be excluded or limited by contract.

We should also remember that an agreement between the alliance participants only binds the parties to the contract. It does not prohibit third parties from bringing an action against one or more of the alliance participants arising out of the conduct of an alliance participant.

As a result many pure alliance contracts include insurance requirements to cover the alliance team members' liability to third parties. This issue will be further discussed in Part 5 of this Series.

The Enforceability of the “No Dispute” Clause

One fundamental issue that requires serious consideration is the enforceability of the “no dispute” clause. Does this clause in the contract have any “teeth”? Can it be enforced in the courts if necessary? The answer depends very much on the wording.

Generally, these clauses provide that, except for willful default (as defined in the contract) or an act of insolvency, the parties agree not to pursue the recovery of any costs, loss, expenses or damage arising out of or in connection with any act or omission by an alliance participant in performing work under the alliance agreement. In short, any act or omission which does not amount to a willful default or an act of insolvency “will not give rise to any enforceable obligations at law or in equity”.

Whilst the intention of the clause is clear, it is not clear whether this type of clause would offend the basic contract rule which says that: “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.” As a matter of public policy, a court would not enforce a provision of a contract which purports to oust the jurisdiction of the courts.

This Scott v Avery rule may be familiar to those in the construction industry. This case law basically denies a clause which prohibits the parties to a contract from seeking to enforce their rights (which are vested by the contract itself) through an appropriate court. However, we can have a mechanism by which these rights can be

enforced through some pre-condition. One example of such a pre-condition is for the parties to go through an arbitration process before seeking the assistance of the courts.

So, if a “no dispute” clause purports to exclude the jurisdiction of the courts by saying that a failure to perform an obligation does not give rise to any enforceable obligations at law or in equity (subject to limited exceptions), there is a real issue as to whether that clause is enforceable. It might have no legal effect.

Alliance participants are therefore advised to consult their legal advisers to ensure that their “no dispute” clause is carefully drafted. One suggestion is to have a well drafted wide exclusion of liability clause which purports to exclude all liability whatsoever for any breaches of obligations except for breaches involving willful default or acts of insolvency. Alternatively, a wide release clause could be included in the contract which provides that each party agrees to release the other from any liability whether at law or in equity for any act or omission in performing their respective obligations under the contract (provided the act or omission does not result from willful default or an act of insolvency).

Agreement to Agree

In the case of a dispute, the alliance participants are typically obliged to agree on a plan to resolve the dispute through the ALT. What if the members cannot unanimously agree on an appropriate plan? This brings us to another key legal issue – is the agreement to agree on a dispute resolution plan too uncertain to be enforceable?

One of the criteria for the enforceability of a contract is certainty. Generally, an “agreement to agree” cannot be enforced because the courts say it is too uncertain. How can the courts enforce a contract when the parties have not agreed to the terms themselves? In short, the courts cannot enforce an uncertain agreement.

When is an agreement so uncertain so as to be unenforceable? Generally, the courts will do all they can to enforce an agreement which looks to be uncertain, but which the parties regard as a contract. The rule is that only uncertainty in relation to an essential term will result in the contract being rendered void. Furthermore, even if there is an element of uncertainty, this uncertainty may be cured. The courts have shown a willingness to make generous interpretations of procedures set out in contracts for resolving an apparent uncertainty. Recourse may be had, for instance, to a scheme included in the contract as a way in which uncertainty can be cured.

A Case in Point

The recent Baycorp case was the first Australian case to consider the enforceability of a clause in a Directors and Officers (D&O) policy mandating the allocation of defence costs between the company and the directors and officers. The New South Wales Supreme Court said that the clause was not uncertain because it provided a mechanism for resolving a dispute in the case of non-agreement. The court said that the existence of a “best endeavours clause” had the effect of making all the parties use their best endeavours to resolve their dispute. For this reason, this clause was not too uncertain to be enforceable.

In a pure project alliance, the contract usually provides that, in the event of a dispute, the ALT will proactively deal with the dispute on a best for project basis in accordance with the alliance agreement. The ALT may decide whatever action it determines as necessary, on a best for project basis, to achieve unanimous resolution. The meaning of “best for project” would be defined in the alliance agreement and usually means that the outcome or resolution must be consistent with the alliance principles and objectives and represent value for money. It could therefore be said that such a mechanism for resolving disputes provides sufficient certainty for the purposes of enforceability of the contract.

Furthermore, since most pure alliance project agreements include a requirement of good faith amongst the project participants, this may be regarded as another mechanism by which the parties can resolve any disputes. The better view, therefore, is that an agreement amongst the project participants to resolve a dispute on a best for project basis is not too uncertain to be unenforceable.

Good Faith & Fiduciary Obligations

Given the concepts of trust and honest communication, and the sharing of ideas and resources that are integral to a successful alliance project, do the parties owe each other a duty of good faith? Furthermore, do they owe each other fiduciary obligations? Indeed, what does “good faith” mean and what do “fiduciary obligations” involve?

The term “good faith” is commonly understood in the context of an insurance contract. An insurance contract is governed by the principles of “good faith” between the insurer and the insured. This is enshrined into the insurance contract by a statutory provision in the Insurance Contracts Act, 1984 (Cth). The courts have not yet defined in precise terms what “good faith” means but they have instructed on what acts of “bad faith” are. In the insurance context, a deliberate non-disclosure by an insured of facts that would influence the insurer’s decision to insure is an act of “bad faith”.

Given the premise upon which a successful pure alliance project is based – where trust, honesty and open discussions are an intrinsic part of the contract – the more logical view is to say that a pure alliance project contract is governed by the principles of good faith. Indeed, some alliance project contracts specifically include a “good faith” provision to reflect the commitment and expectations of the alliance participants. This would usually include a commitment by the participants to perform their obligations fairly, reasonably and properly so as to enable each other to perform their respective obligations under the contract and to give effect to the spirit and intent of the alliance contract.

What about fiduciary obligations? Do project alliance participants owe each other fiduciary obligations? Fiduciary obligations are commonly understood in the context of the duties that are owed by directors to their company. Directors must act in the best interest of the company and must not allow their personal interests to conflict, or have the potential to conflict, with those of the company.

Commercial relationships can, of course, be fiduciary relationships. The relationship between a principal and an agent is a classic example. Relationships such as partnerships and joint ventures can also be regarded as fiduciary relationships. Each transaction must, however, be examined on its own merits to see if they manifest the characteristics of fiduciary obligations. The reality is that there may be some aspects of a relationship that are fiduciary in nature whilst other aspects are not.

A number of factors are said to be indicative of a fiduciary relationship: a relationship of trust and confidence; and relationships where the exercise of a power or discretion would affect the interest of another person in a legal or practical sense so that the other person is especially vulnerable to abuse.

Let us consider the nature of the relationship between project alliance participants. It is a relationship where each participant commits to an honest and trusting relationship, agrees to use their best endeavours to achieve their common objectives and typically agree to a gainshare/painshare regime. So we could say that project alliance participants are in a fiduciary relationship because each party relies on the other to perform its role in good faith and for the common good.

If the alliance participants do owe each other fiduciary obligations, what does that mean in practice? It means that each project participant must not exploit the relationship for its own benefit, they must not allow personal interest and duty to conflict and they must co-operate to do all things necessary for the common good of the project.

Fiduciary obligations are onerous. It is one thing to have a contractual agreement where the parties agree to act in good faith and for the common good; it is another to owe each other fiduciary obligations. For instance, if a participant wants to take advantage of an opportunity obtained as a result of the alliance, could they do so without having to disclose details to the other participants? The advantage may have nothing to do with the project itself but be obtained as a result of being in the alliance. Would taking up that opportunity amount to an exploitation of the relationship? The relevant participant would have to consider whether there might be any actual or potential conflict of their interest with other participants. If the participant does owe the other team members fiduciary obligations, this would make the alliance relationship a particularly onerous one from a commercial standpoint.

To avoid any confusion or doubt, it is advisable to ensure that the project alliance contract precisely states the nature of the relationship between the parties. If the parties do not intend a fiduciary relationship nor intend to owe each other any fiduciary obligations, the contract should provide to this effect.

Termination for Convenience

A termination for convenience clause is typically included in alliance project contracts. This clause usually gives the project owner the right to terminate “without cause and for any reason at any time at its absolute and unfettered discretion”. The project owner can therefore terminate the contract without any breach of obligations or willful default on the part of any of the alliance participants. This clause gives the project owner the right to abandon the project, or part of it, permanently or temporarily, at any time.

Given the unfettered discretion this gives the project owner, the clause also usually includes a compensation regime for the non-owner participants who are typically paid up for work carried out to the point of the termination. Typically they would not be compensated for loss of anticipated profits. Non-owner participants obviously need to carefully examine the contract to ascertain their termination entitlements.

Part 5

Executive Summary

It is usual for an alliance project contract to provide insurances for public and product liability; contract works and professional indemnity. Depending on the terms of the agreement, the AMT would negotiate suitable limits of indemnity, the appropriate deductibles for each policy and the terms of the individual insurance policies.

The increasing use of the pure alliance project model has caused the insurance industry to respond, with policies now available that provide PI cover on an effective “first party” loss basis.

Concerns about issues like insurance excess costs and the effect on an insurance claims history may make participants unwilling to activate a claim. However, these issues need to be balanced against the possible loss of revenue under a gainshare/painshare arrangement if participants need to make good the loss themselves.

Alliance participants need to understand the importance of run-off cover to protect themselves from financial impacts if latent defects are discovered after construction is complete.

Introduction

In this White Paper Series we have introduced the concept of project alliancing and highlighted some of the commercial and legal issues that need to be considered when using it as a model for project delivery. The final part of this Series is concerned with liability protection for the alliance project team.

In Part 4, we discussed the implications and ramifications of a “no dispute” clause. We noted that it is one thing to have a “no dispute” clause in a contract; it is another to deal with a failure of professional duty by one participant. Do all participants share in the cost of that failure through the “painshare” regime or can the alliance participants transfer that risk, or part of it, to an insurer?

Furthermore, a “no dispute” clause does not prevent third parties from bringing legal actions against the alliance participants. What if an action is brought by a third party against the alliance for personal injury or property damage resulting from the project works? Would a traditional public and products liability policy cover these risks? And in what ways are such policies amended to accommodate the intentions of the alliance participants as set out in their alliancing agreement?

Insurance Requirements

In a pure alliance project arrangement, extensive risk management analysis would typically be conducted at the beginning of the project to quantify the target costs. This exercise takes into account the risks that must be shared by the alliance participants and those that can be transferred to an insurer.

It is usual for an alliance project contract to provide for the following types of insurance coverage:

1. a public and products liability policy to cover liability from third party claims for personal injury or property damage
2. a contract works policy to cover the loss and damage to the project works under the agreement, and
3. a professional indemnity policy to cover the alliance participants' liability arising from an act, error or omission in the performance of their professional services.

The agreement would normally require that all the alliance participants be named as an insured under each policy. Unless the alliance itself is an incorporated legal entity it cannot be named as an insured under the policy. Accordingly, each alliance participant organisation must be individually named.

The participants who are named as insureds under a policy are usually the project owner, the head contractor and the head designer. Depending on the nature and size of the project, other non-owner participants may be named. For instance, if there is a major project in which the construction works can be divided into two parts (say, a road component and a tunnel component), then the project may require one contractor to be responsible for one component and another contractor to be responsible for the other. In such cases, both of these non-owner participants would be named as an insured.

Depending on the terms of the alliance project agreement, the AMT would negotiate the suitable limits of indemnity, the appropriate deductibles for each policy and the terms of the individual insurance policies. In negotiating the terms of these policies, the AMT would need to demonstrate to the insurer the risk management system, practices and procedures that have been put in place to minimise relevant risks. This is crucial if they are to negotiate the best terms possible for the transfer of risks.

In addition, most alliance project contracts would usually require other insurances such as workers compensation insurance and comprehensive third party liability motor vehicle insurance to be effected by the participants on their own behalf until the expiry of the defects liability period.

General Public & Products Liability Insurance

The purpose of a General Public and Products Liability Insurance Policy (GPL policy) is to cover the alliance participants from any claims of liability by third parties for death, injury or property damage arising from alliance activities. A simple example would be where a person who is delivering goods to the site suffers personal injuries as a result of a negligent act by an employee of an alliance participant.

For an alliance project, it is important to ensure that the participants are all insured under the one GPL policy. This would avoid the risk of a legal action between two or more alliance participants via subrogated actions by their respective insurers.

It is common to find the following type of clause in a standard GPL policy:

“If you have entered into any agreement which excludes or limits a right which you may have against any party, then, subject to the Insurance Contracts Act 1984, we will not be liable for any claim under the Policy to the extent of such exclusion or limitation.”

A clause to this effect would clearly be inconsistent with the “no dispute” clause in a pure alliance project agreement and would need to be deleted or, at the very least, an exception made in respect of this alliance agreement.

The fact of the matter is that a GPL policy, like any other insurance policy that is effected under the terms of the pure alliance project agreement, must be consistent with and reflect the intentions of the alliance participants. For instance, a GPL policy is sometimes amended so as to provide cover for personal injury or property damage resulting from a breach of professional duty. This policy would not, however, cover liability for financial loss resulting from such breach because this loss should be covered under the alliance participants’ professional indemnity liability policy.

Professional Indemnity Insurance

The most serious exposure that is faced by alliance participants is probably the failure by one or more of the alliance team members to fulfill their professional obligations. What if one team member has carried out their work negligently which caused delay to the project works? What if the defects are latent and are not discovered until several years after the completion of the project works?

Traditional professional indemnity (PI) policies cover professionals for any act, error or omission on their part in the performance of their professional services. These policies are insured on a “claims made” basis which means that the “trigger” for the operation of the policy is a liability claim (usually defined broadly in the policy) by a third party against the insured professional for loss arising from their act, error or omission. For instance, a principal may initiate an action against a contractor for loss as a result of the negligent performance by that contractor.

In the case of a pure alliance project, however, the operation of a traditional PI policy will not be triggered except in the case of wilful default or an act of insolvency. The main issue here of course is the inclusion of the “no dispute” clause. The effect of this clause, as discussed in Part 4 of this Series, is essentially to release each project participant from any liability for a failure to perform their obligations under the contract. This clause prevents the project owner - the party who would usually suffer a loss from defective performance - from bringing a liability claim against the other non-owner participants for breach of professional duty. In the absence of a liability claim against an insured participant, a traditional PI policy would not respond.

So, if there is negligent performance by one participant and remedial action is required by all the participants, and a traditional PI policy cannot be triggered because of the “no dispute” clause, what options are available to the alliance participants?

Given the structure of a pure alliance project where all the decisions are made on an unanimous basis, who is to say that the project owner itself may not have contributed to the negligence which ultimately resulted in the financial loss?

To ask an insurer to cover insured participants for a loss which they suffer as a result of their own act, error or omission is, effectively, to ask for “first party” loss coverage. This is not an easy hurdle to overcome both conceptually and as a matter of commercial practice. How does one provide liability coverage without the

existence of a liability in the first place? In the absence of a liability claim, there needs to be a “trigger” for the operation of an alliance-based PI liability policy. What should this “trigger” be?

The Alliance-Based Professional Indemnity Policy

This type of coverage has not been available until recent years. Since the use of project alliancing has increased however, some insurers have decided to meet the demand. It is now possible, on a specific project basis, for alliance participants to purchase PI insurance on an effective “first party” loss basis. What does that mean and how does this policy work?

A PI policy that caters specifically for pure alliance projects would typically cover the following:

1. claims against the insured for their legal liability to pay for loss incurred by a third party as a result of an act, error or omission in their provision of professional services in respect of the project, and
2. claims by the insured for loss which they incur or suffer as a result of an act, error or omission on their part in the provision of professional services in respect of the project.

The first part is the traditional professional indemnity coverage which requires a claim to be made against the insured. This can arise, for instance, where a claim is made against the insured by a person or entity who is not a party to the alliance agreement.

The second part caters specifically for a loss by the alliance as a result of defective performance by an insured participant in their provision of professional services. The “trigger” is the loss which results from their defective performance. The rationale is that, but for the inclusion of the “no dispute” clause in the alliance agreement, a claim might and could have been brought against the insured for breach of professional duty in the provision of their professional services. The insured would have been liable for the breach and would have been covered under a traditional PI policy but for the absence of liability on the part of the insured due to the “no dispute” clause.

In practice, any member of the named insured could initiate a claim under the policy. Much, of course, depends on the terms of the alliance project agreement and the terms of the insurance policies. As with any decisions that concern the alliance, however, unanimity between the participants is required before a claim can be made under the policy.

A non-owner participant may be reluctant to initiate a claim for the following reasons:

1. a participant’s insurance claims record is one factor to be taken into account in a tender evaluation process and their competitive edge may be lost in future bids if a claim is made under the policy
2. a claim may tarnish the claim record of that participant and may result in higher premiums for their future insurances, and
3. the payment of the insurance excess by the alliance would affect the profits that can be shared by the alliance team.

Whilst those may be legitimate concerns, we should reiterate the fact that a specific alliance-based PI policy would usually name all the alliance participants as insureds under the policy. In keeping with the alliance culture most, if not all, insurers would usually not assign blame to any particular insured in the event of a claim. This should allay any fears in relation to adverse claims records.

Having said that, for the purposes of their disclosure obligations in future insurance proposals, an alliance participant may need to disclose that they were part of an alliance team which lodged an insurance claim. The circumstances of the claim would need to be examined for disclosure purposes in order to ensure that they have duly complied with their obligations.

Secondly, if a claim is not made under the policy, then the actual loss resulting from the defective performance would need to be extracted from the alliance’s gainshare provisions. Either way, the alliance participants would need to pay for the defective performance – by way of the insurance excess or through the painshare regime.

Run Off Cover

Finally, we should note that the policy period for an alliance-based PI policy is not annually based as is typically the case for a traditional PI policy.

The alliance-based PI policies that are currently available in the insurance market provide for a total period of cover of up to ten years. This period of insurance would cover any loss or liability (to third parties outside the alliance agreement) during the project construction phase and the remaining period would operate as the run-off period. Once the construction of the project has been completed, the policy operates effectively as run-off coverage since there would be no further activities relating to the project. For instance, construction might take four years to complete. A ten-year policy would therefore cover four years construction and six years of run-off cover.

It is important to have a period of cover that extends well beyond the actual construction phase because some latent errors do not manifest themselves until well after the project has been completed and the alliance “disbanded”. The Third Runway at Sydney Airport is an example of this type of latent defect. Whilst not a pure alliance project, it is a good example of latent defects that manifest after the completion of the project.

In that case, it became evident that the seawall protecting the runway would not last a period of 50 years as was specifically required by the contract. There was a design error in the joints of the seawall which allowed a small amount of backfill to be washed out each time a wave pushed up against the wall. The relevant insurers were notified of this problem several years after the runway had been in operation but within the policy period.

The settlement of the claim was not finalised until many years after the policy had expired and the full effects of the design error were realised. The insurers paid a total of \$50 million under the policy. The total loss to the insured was in the vicinity of \$65 million.

This is a useful reminder of the importance of a well drafted alliance-based PI policy and the protection it provides to the alliance, particularly the project owner, in shifting the burden of financial risks from the project participants to the insurer.

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