Construction Clients' Group
Seminar 15 May 2013

Best Value Contracting – From Collaboration?

Michael Weatherall

Partner

21553243

Simpson Grierson
www.simpsongrierson.com

Overview of Session

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- Evolution of Alternative Contracting Strategies
- Different “Collaborative” Models:
  - Partnering
  - Alliancing
  - Early Contractor Involvement (ECI)
- Best Value?

Direct Trade Contracting

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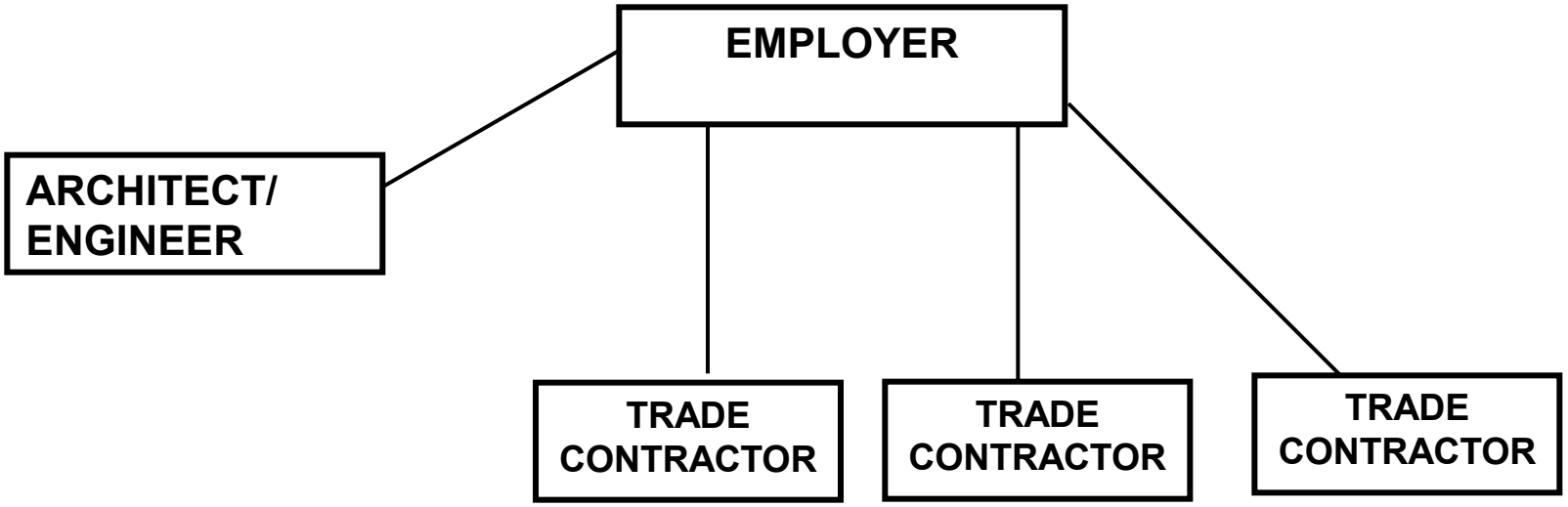
Architect/Engineer undertakes all design, management and co-ordination of trade contractors (historic to present day)



General Contracting

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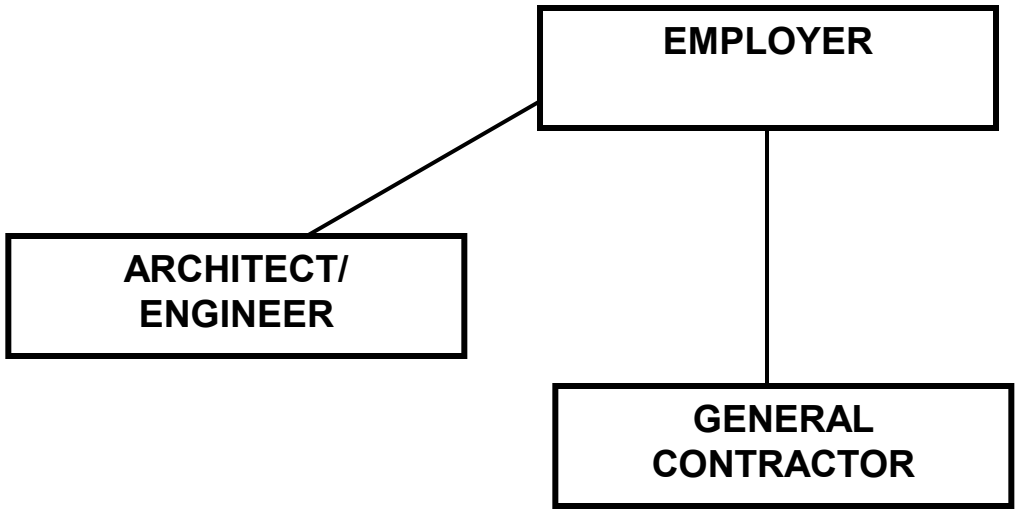
(Cubitts in London first offered the services of a General Contractor in 1870)

Construction Management by General Contractor able to undertake all or most aspects of the Building Works



Traditional General Contracting

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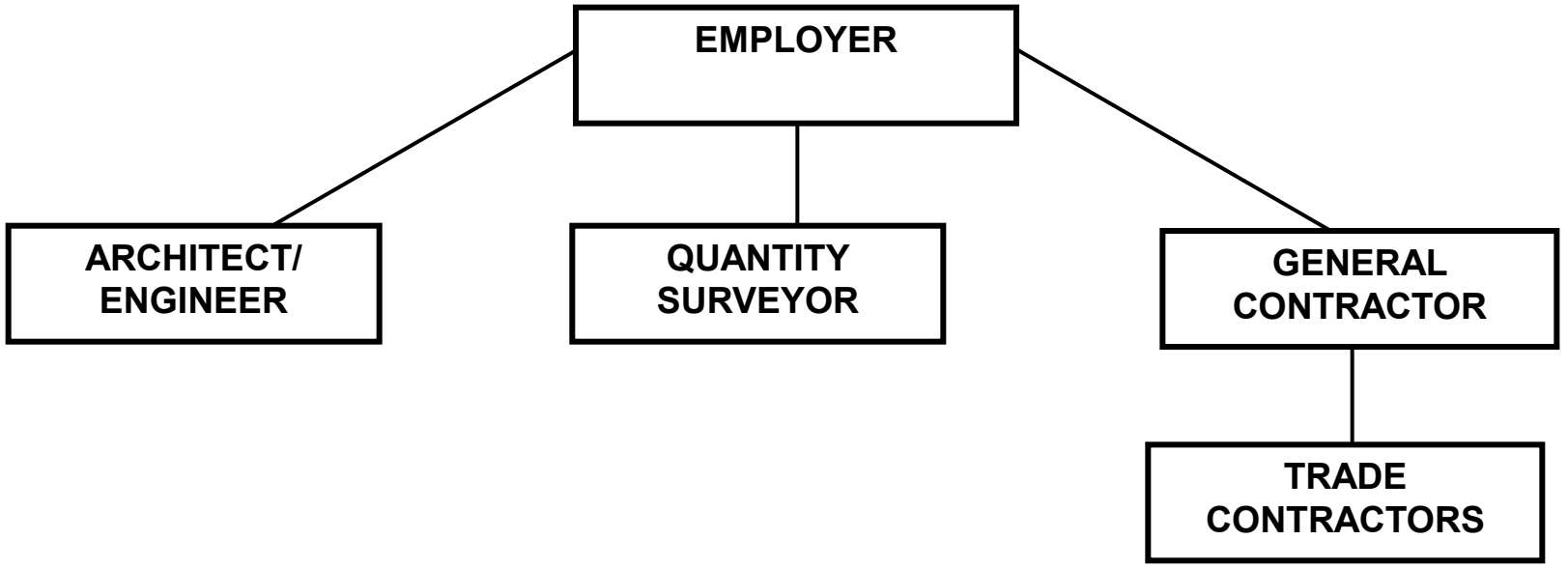
Quantity Surveyor to measure and value works in progress General Contractor increasingly sub-contracts specialist work to trade contractors



Design & Build (or “Turnkey”) Contracting

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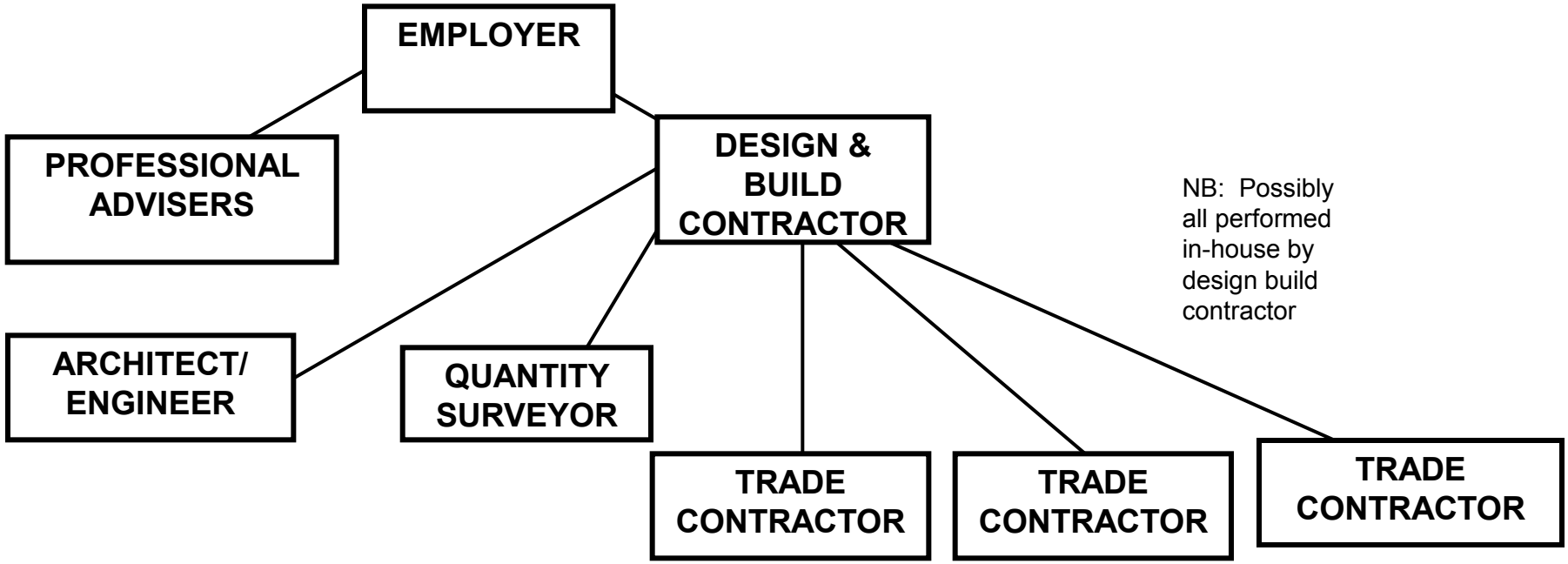
Contractor undertakes design and management



Problems with "Traditional" Contract strategies

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- Adversarial – conflicting objectives
- Principal can *minimise risk* (e.g. Turnkey D&C) but:
  - Principal loses control
  - *Higher price* (if inappropriate risk allocation)
  - (or inappropriate price if inappropriate pricing of risk)
- Can *maximise control* (e.g. cost +) but *higher risk*
- **Collaborative Contracting attempts to *optimise risk, price and control***

Different “Collaborative” Models

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- Partnering
- Project Alliances
- Early Contractor Involvement

Partnering

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- "Relationship" provisions as overlay to more traditional contract
- Communication Protocols
- Good faith/open book
- Performance incentives
- Often incorporated into "Partnering Charter"
- Contract usually takes precedence

Project Alliance

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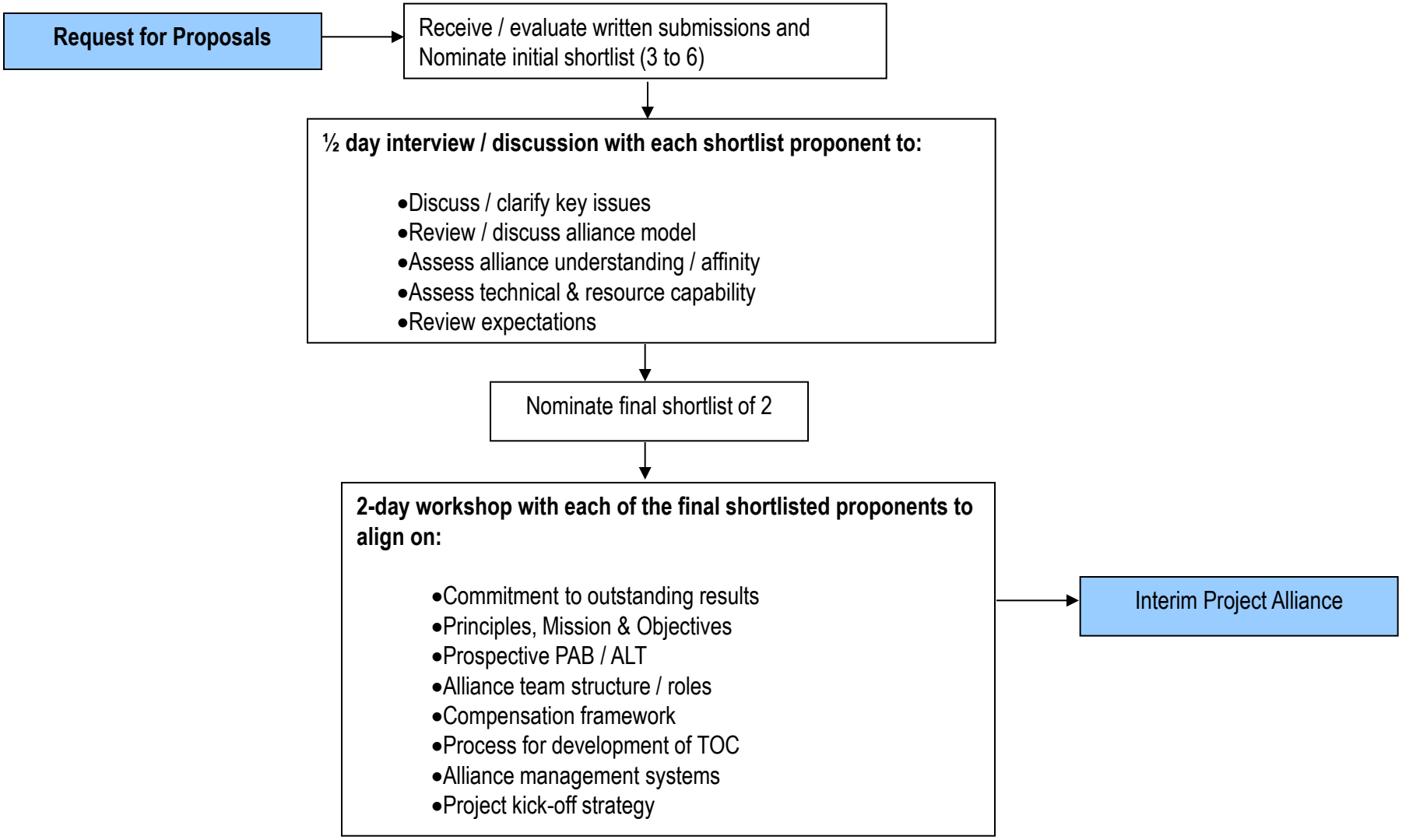
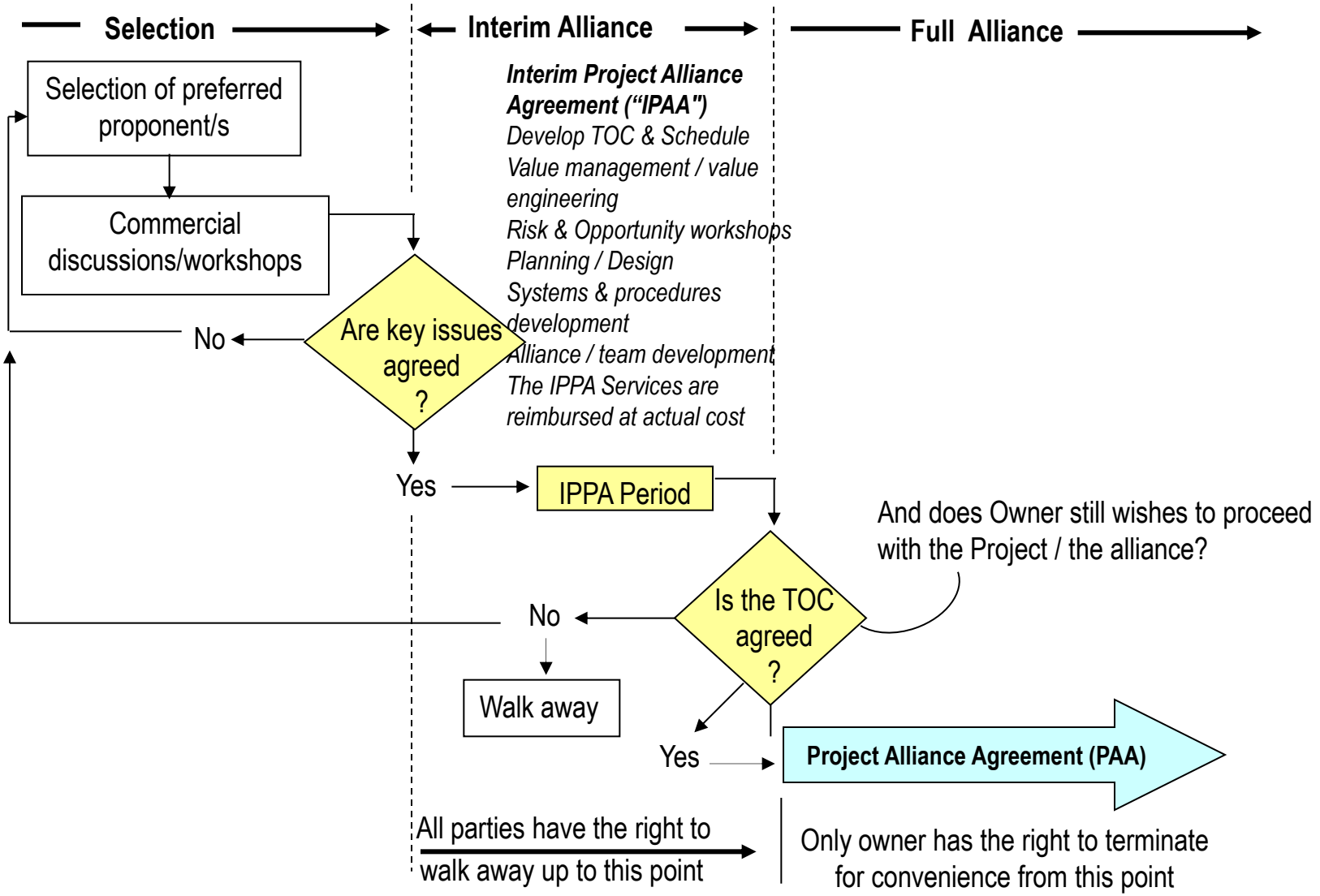
- Specific “Project Alliance” contract model
- No traditional underlying contract
- Fairly “standard” Alliance Model:
  - Contractor Selection Process
  - IPAA followed by PAA
  - Cost + Painshare/ Gainshare
  - Alliance Management Structure

Project Alliance Selection Process



IPAA/PAA


Selection
Interim Alliance
Full Alliance
Selection of preferred proponent/s
Commercial discussions/workshops
Are key issues agreed ?
No
Yes
Interim Project Alliance Agreement ("IPAA")
Develop TOC & Schedule
Value management / value engineering
Risk & Opportunity workshops
Planning / Design
Systems & procedures development
Alliance / team development
The IPPA Services are reimbursed at actual cost
IPPA Period
And does Owner still wishes to proceed with the Project / the alliance?
Is the TOC agreed ?
No
Walk away
Yes
Project Alliance Agreement (PAA)
All parties have the right to walk away up to this point
Only owner has the right to terminate for convenience from this point

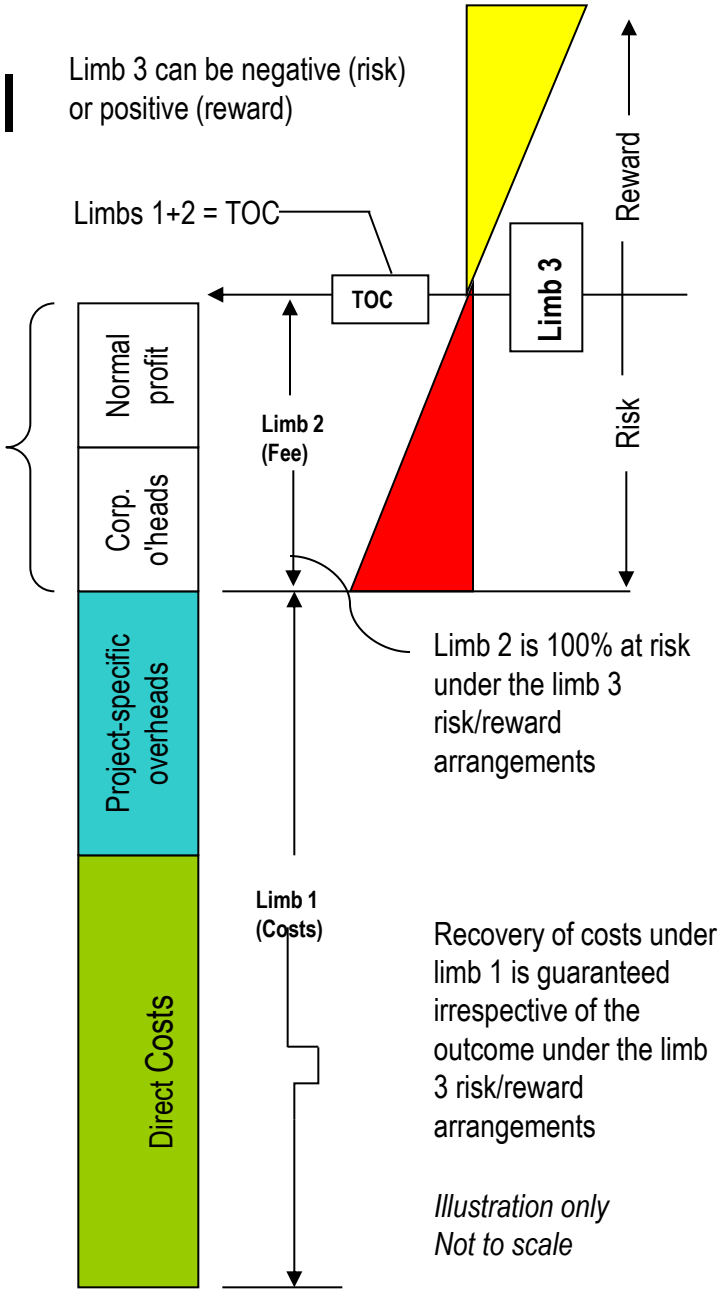
Alliance Compensation Model

The non-owner participants are typically compensated in accordance with the following "3-limb" model:

Limb 1 100% of what they expend directly on the work including project-specific overheads.

Limb 2 A fee ("Fee$") to cover corporate overheads and profit.

Limb 3 An equitable sharing between all Alliance Participants of gain/pain depending on how actual outcomes compare with pre-agreed targets in cost and various non-cost key result areas (KRAs),



Alliance Painshare / Gainshare Model

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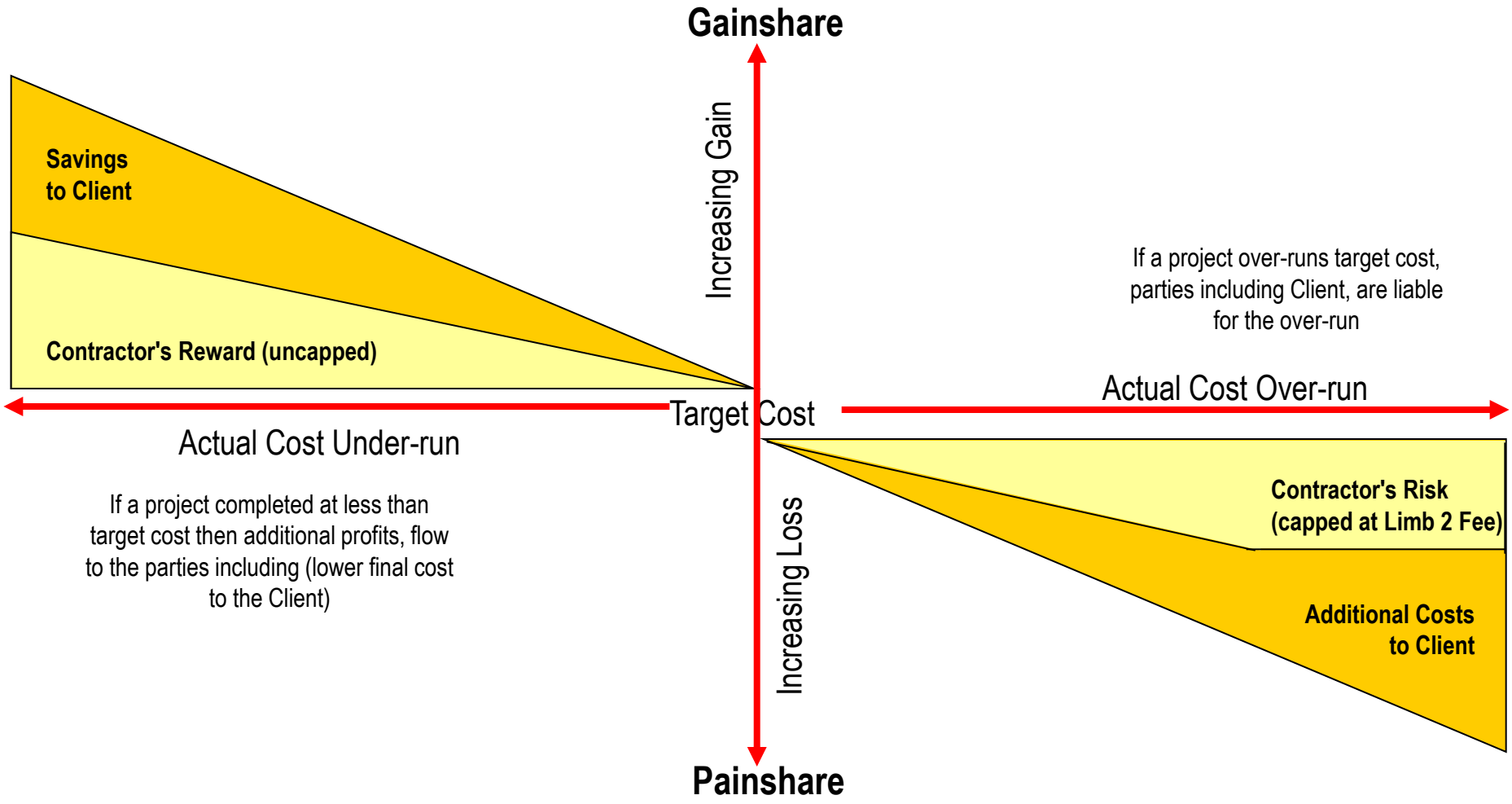

Project Alliance Management Structure

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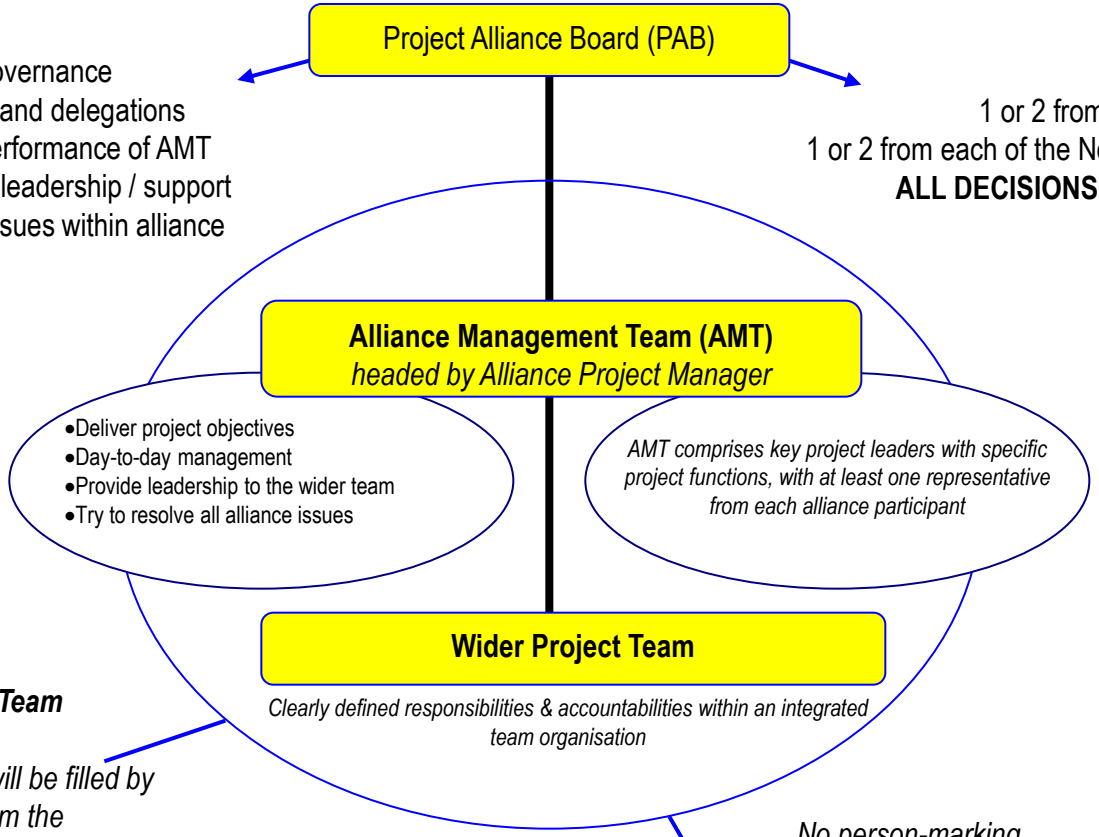

"IPT"
Integrated Project Team

All roles in the IPT will be filled by personnel drawn from the resources of the alliance participants on a "best-for-Project" basis

No person-marking
No duplication of roles or systems

Key Features of “Project Alliance”

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- One team – “In Sourcing”
- One goal – Objectives aligned and incentivised
- Collaborative communication/project management
- Remuneration linked to cost +/- performance
- No blame/no disputes
- Cost risk lies with Client
- Discretionary termination

Evolution of “Competitive Alliance”

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- Select 2 Consortia to enter into IPAA (in Australia called the “Two TOC” Model)
- Select 1 Consortia to enter into PAA
- Addresses concern re absence of competitive pricing at IPAA stage (even though payment still based on actual cost)
- Can inhibit collaborative/alliance behaviours during IPAA stage
- Recent examples include Transpower Grid Upgrade Project and NZTA Waterview Tunnel

Early Contractor Involvement (ECI)

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- Types of ECI
- The 2 (or 3) stage contract model of ECI
- Advantages/disadvantages of ECI
- When to use ECI
- Future evolution of ECI

Evolution of types of ECI

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- Phone call!
- Management Contracting
  - Contractor selected on fixed P&G & margin
  - Contract Price = actual (tendered sub trade) cost + tendered P&G & margin
- GMP Contracting
  - Similar to Management Contracting but contract price subject to GMP

Evolution of types of ECI cont…

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- 2(or 3) Stage Contract
  - Stage 1 – Preliminary Design & Price (NZTA splits into 2 stages)
  - Stage 2 – Final Design & Construct (NZTA 3rd stage)
  - Transition Provisions – varying degree of discretion/certainty re transition from Stage 1 to Stage 2

The 2 (or 3) Stage ECI Model

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Contractor Selection

- Non price selection process (can request margins and some costs/rates to be tendered)
- Similar to Project Alliance selection process
- Usually interactive

The 2 (or 3) Stage ECI Model

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Stage 1 – Design Development / Pricing

- Usually up to outline design phase (but can be up to preliminary design)
- Should include risk management and value engineering
- Must align and specify deliverables programme for consultants, contractor and principal
- Basis upon which price to be set must be clear

The 2 (or 3) Stage ECI Model

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Stage 2 – Design & Construct

- Involves finalising detailed design and construction
- ECI Stage 2 in UK often “Target Cost” and painshare / gainshare (similar to Aus/NZ PAA)
- ECI Stage 2 in Aus & NZ usually lump sum traditional Design & Construct Contract
- In NZ often NS3910 based

The 2 (or 3) Stage ECI Model

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NZTA Standard ECI specified 3 stages:

*"**Separable Portion 1** consists of investigation, further development of the scheme assessment, development of a Preliminary Design, and preparation and lodgement of planning documents. The Preliminary Design will be subject to a Stage 1 road safety audit."*

The 2 (or 3) Stage ECI Model cont…

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*"**Separable Portion 2** shall include the refinement of the Preliminary Design, developing it into a Specimen Design, obtaining of all consents and Designation changes, planning for land acquisition requirements, and preparation of the construction funding application. The Specimen Design will be subject to a Stage 2 road safety audit, design peer review and value engineering review by external parties.*

***Separable Portion 3** shall include the Detailed Design, Construction Works and undertaking any works required during the Defects Liability Period."*

The 2 (or 3) Stage ECI Model

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Transition Provisions

- Stage 1 can be a stand alone “Pre-construction Agreement”, or all stages in one contract (NZTA model) subject to transition provisions
- Principal may reserve complete discretion to progress from Stage 1 to Stage 2 (NZTA)
- Important to clearly stipulate targets and objectives of Stage 1
- Contractor needs to be incentivised!

Advantages of ECI

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- Includes the Contractor at stage that most value can be extracted
  - risk identification
  - value engineering
  - omission of errors and omissions
  - control over design deliverables
- Reduces Tender Costs
  - only one process
- Relational/Collaborative behaviour motivated

Advantages of ECI cont…

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- Principal retains control
  - selects consultants
  - selects contractor
  - involved collaboratively in Stage 1
  - discretion to enter into Stage 2
- Contractor incentivised
  - collaborative Stage 1 induces “buy in” to project
  - Stage 2 incentive
  - discretion to proceed “keeps contractor honest”

Disadvantages/criticisms of ECI

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- Takes edge off competitive pricing
  - proper management and transparency ensures competitive pricing (sub-contracting) and no hidden gains
  - ensure efficient time for value engineering in Stage 1
  - Conditional Stage 2 keeps up the tension
- Only worked when competitive tendering didn't (overheated contracting market)
  - more attractive to Contractors even in cooler market

Disadvantages/criticisms of ECI cont…

- Takes too long
  - can accelerate process because design/construct concurrent rather than consecutive

When to use ECI?

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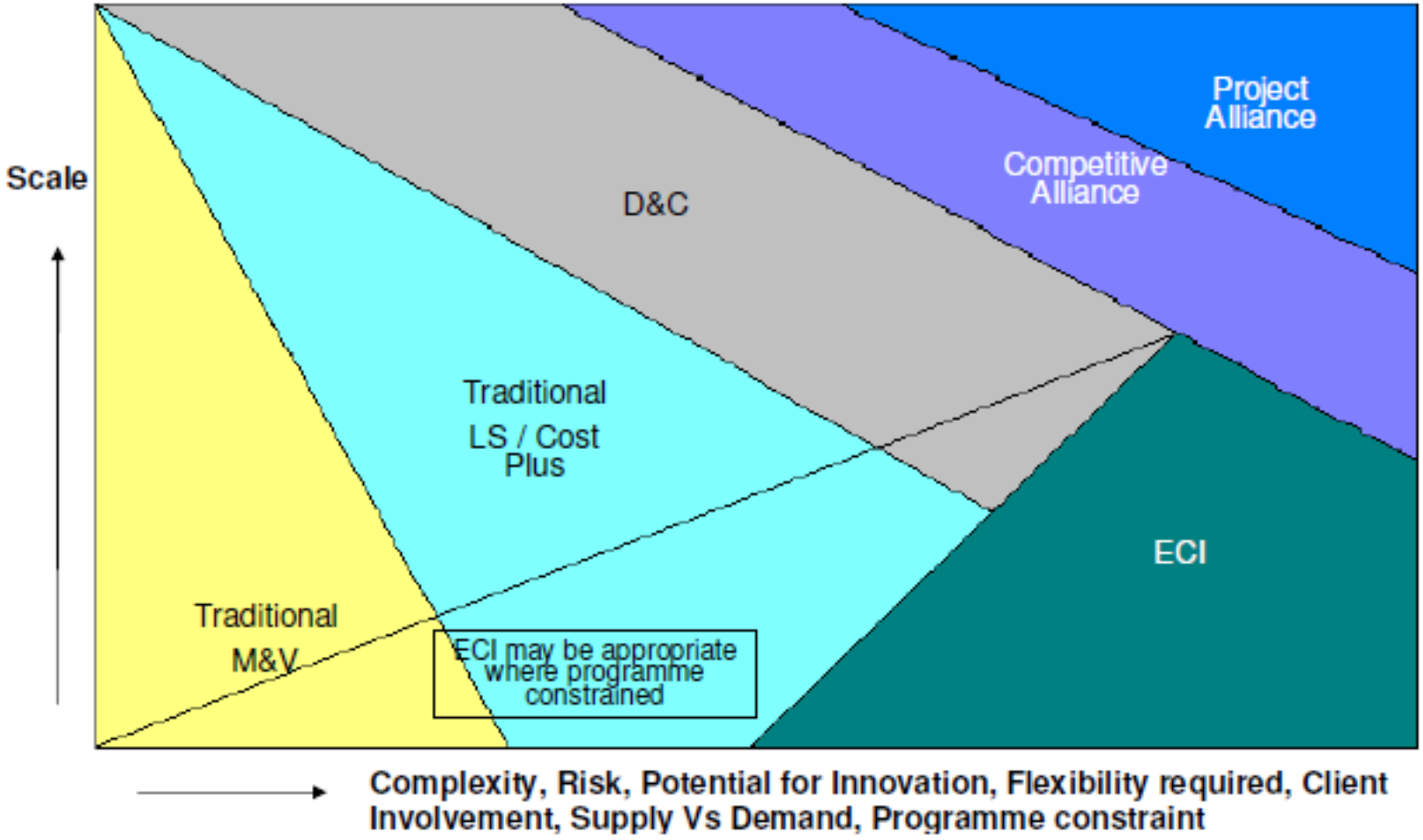

Future Evolution of ECI

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- ECI and Alliancing currently evolving along divergent paths:
  - Alliancing moving to “Competitive Alliance”
  - ECI staying with single contractor
- Where to next:
  - “Competitive” ECI?
  - ‘Framework” ECI?

Summary – Best Value?

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- Natural Evolution – “survival of the fittest”
- Model that delivers low risk, low cost and high control to Principal (ie Best Value) will survive
- Collaboration can reduce risk and cost, and allows Principal control (through collaboration)
- Market seems to be placing more value on early stage (‘IPAA’ or ‘Stage 1’) collaboration with concerns re admin requirements at construction stage (‘PAA’ or ‘Stage 2’)
- Both Alliancing and ECI seem to be fit and well!

QUESTIONS?

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