Best Value Contracting – From Collaboration?

Michael Weatherall
Partner
Overview of Session

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

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

(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
Quantity Surveyor to measure and value works in progress. General Contractor increasingly sub-contracts specialist work to trade contractors.
Design & Build (or “Turnkey”) Contracting

Contractor undertakes design and management

- EMPLOYER
- DESIGN & BUILD CONTRACTOR
- TRADE CONTRACTOR
- TRADE CONTRACTOR
- TRADE CONTRACTOR
- PROFESSIONAL ADVISERS
  - ARCHITECT/ENGINEER
  - QUANTITY SURVEYOR

NB: Possibly all performed in-house by design build contractor
Problems with “Traditional” Contract strategies

• 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

- Partnering
- Project Alliances
- Early Contractor Involvement
Partnering

• “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

- 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

Request for Proposals

Receive / evaluate written submissions and Nominate initial shortlist (3 to 6)

½ day interview / discussion with each shortlist proponent to:

- Discuss / clarify key issues
- Review / discuss alliance model
- Assess alliance understanding / affinity
- Assess technical & resource capability
- Review expectations

Nominate final shortlist of 2

2-day workshop with each of the final shortlisted proponents to align on:

- Commitment to outstanding results
- Principles, Mission & Objectives
- Prospective PAB / ALT
- Alliance team structure / roles
- Compensation framework
- Process for development of TOC
- Alliance management systems
- Project kick-off strategy

Interim Project Alliance
IPAA/PAA

Selection

- Selection of preferred proponent/s
- Commercial discussions/workshops

Interim Alliance

- 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

- Are key issues agreed?
  - Yes: IPPA Period
  - No: Walk away

- Is the TOC agreed?
  - Yes: Project Alliance Agreement (PAA)
  - No: Only owner has the right to terminate for convenience from this point

Full Alliance

- And does Owner still wishes to proceed with the Project / the alliance?
  - Yes: Project Alliance Agreement (PAA)
  - No: Walk away up to this point
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),

Limb 3 can be negative (risk) or positive (reward)

Limbs 1+2 = TOC

Limb 2 is 100% at risk under the limb 3 risk/reward arrangements

Recovery of costs under limb 1 is guaranteed irrespective of the outcome under the limb 3 risk/reward arrangements

*Illustration only*
*Not to scale*
Alliance Painshare / Gainshare Model

- **Savings to Client**
- **Contractor’s Reward (uncapped)**

**Target Cost**

- If a project over-runs target cost, parties including Client, are liable for the over-run.
- Additional Costs to Client
- Contractor’s Risk (capped at Limb 2 Fee)

**Actual Cost Under-run**

- If a project completed at less than target cost then additional profits, flow to the parties including (lower final cost to the Client)
"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.

---

**Project Alliance Board (PAB)**

- Provide governance
- Set policy and delegations
- Monitor performance of AMT
- High level leadership / support
- Resolve issues within alliance

**1 or 2 from owner**

**1 or 2 from each of the Non-Owner Participants**

**ALL DECISIONS UNANIMOUS**

**Alliance Management Team (AMT)**

*headed by Alliance Project Manager*

- Deliver project objectives
- Day-to-day management
- Provide leadership to the wider team
- Try to resolve all alliance issues

**AMT comprises key project leaders with specific project functions, with at least one representative from each alliance participant**

---

**Wider Project Team**

Clearly defined responsibilities & accountabilities within an integrated team organisation

---

No person-marking

No duplication of roles or systems
Key Features of “Project Alliance”

• 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”

- 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)

- 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

• 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...

• 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

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

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

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
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.”
“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

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

• 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...

- 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

• 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?

Complexity, Risk, Potential for Innovation, Flexibility required, Client Involvement, Supply Vs Demand, Programme constraint

ECI may be appropriate where programme constrained
Future Evolution of ECI

- 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?

• 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!