Alliance Contracts and Public Sector Governance

John Paul Davies
BEng (Hons 1), LLM, MBA, MSc

Griffith Law School
Griffith University

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Abstract

Alliances are novel procurement options providing governments with the opportunity to engage in collaborative arrangements with industry and sharing risks and rewards and at the same time eliminating disputes. Most alliances incorporate unanimous decision-making protocols, a commercial arrangement where there is no recourse to the courts for dispute resolution, and a remuneration system where the contractor and principal share cost overruns and underruns. This arrangement offers substantial benefits for the procurement of high-risk projects, but there are substantial disadvantages.

The first Australian public sector alliance contract appeared as recently as 1998. Within a decade, the use of alliances grew to over a 100 projects worth over $25 billion. What has sparked such overwhelming interest in this relatively new procurement option, and are these procurement options effective? This empirically based study answers these questions by first exploring what typical alliance contracts look like, where they are used, and why they are used; and second, examining the governance arrangements of these alliances including the dimensions of accountability, integrity, stewardship and transparency.

Alliances attempt to incorporate a robust governance structure with emphasis on open book financial reporting and the mandatory use of probity auditors and independent auditors. Despite these efforts, there are several failings in both the performance and compliance aspects of public sector governance. In particular, this study demonstrates that most alliances, despite their popularity, fail to demonstrate value for money for the public sector, and fail to comply with other public sector governance objectives including accountability, integrity, and transparency.

This study also demonstrates that alliances focus on treating the symptoms of the failings of conventional contracts, namely poor contract documentation, inappropriate risk allocation and poor estimation of project cost. Consequently, the benefits of alliances are significantly overstated by alliance protagonists. The main benefit provided by alliances is the ability to attract industry involvement. The current undersupply of construction and engineering services is driving governments to soften risk allocation in contracts to ensure competitive bids are received to requests for
tender. This study demonstrates that this is one of the key, but undocumented, reasons for governments’ use of alliances.

This study also examines some of the criticisms raised by legal commentators on alliances. These include the absence of price competition, the potential for the creation of fiduciary obligations, the absence of recourse to the courts should an alliance project go awry, the risks of deadlocks occurring as a result of the alliance no disputes clause and the problems created with the alliance no liability provisions and project insurance. Many of these criticisms are overstated. This study demonstrates that the issues of fiduciary obligations, deadlocks and project insurance will not create any substantial risks to the public sector when embarking upon an alliance with industry. Nevertheless, the alliance no-disputes provisions place the public sector in an inappropriate situation should an alliance participant fail to perform adequately. The alliance contract is largely a ‘faith based’ contract as the public sector places considerable emphasis on contractor representations and promises, rather than enforceable guarantees.

Though current alliances fail to comply with many of the governance objectives of the public sector, many of these failures are also found in conventional fixed price contracts. Nevertheless, fixed price contracts better demonstrate value for money and promote arms-length commercial relationships between governments and industry. The incorporation of price competition into some alliance models addresses these concerns.

In concluding, this study demonstrates that alliances are appropriate for delivering outcomes in the public sector in some circumstances, particularly where project risks are extreme and competition is limited. Nevertheless, there is substantial scope for improving the governance arrangements of these procurement options. Accordingly, this study recommends improvements in how governments define and measure value for money, how governments treat risk in procurement, how governments consider market forces in procurement and how governments conduct tender evaluations.
Statement of Original Authorship

This work has not previously been submitted for a degree or diploma in any university. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

In the course of researching and writing this thesis, I published and presented some of my preliminary findings. These publications and presentations include:

Davies, John, ‘Alliances, Public Sector Governance and Value for Money’ (2007) 113 Australian Construction Law Newsletter

Davies, John, ‘Alliance Demographics and Risk Management’ (presentation to the Alliance Contracting Conference, Institute of International Research, Brisbane, 20-22 November 2007)

Davies, John, ‘Insurance Under an Alliance’ (presentation to the Alliancing Association of Australasia, Brisbane, 19 February 2008)

I was also invited by the Queensland Government to develop a better purchasing guide to assist procurement agencies in the selection and use of alliance contracts. This guide incorporates many of my recommendations for reform, and was published in July 2008.


John Davies
28 August 2008
# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table of Contents</td>
<td>iv</td>
</tr>
<tr>
<td>List of Figures</td>
<td>vii</td>
</tr>
<tr>
<td>List of Tables</td>
<td>vii</td>
</tr>
<tr>
<td>Codes</td>
<td>x</td>
</tr>
<tr>
<td>Referencing Style</td>
<td>xi</td>
</tr>
<tr>
<td>Chapter One - Alliance Contracts: Research Aims, Background and Methodology</td>
<td>1</td>
</tr>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Alliance Contract Defined</td>
<td>2</td>
</tr>
<tr>
<td>Alliance Variations</td>
<td>4</td>
</tr>
<tr>
<td>The History of Alliance Contracts</td>
<td>5</td>
</tr>
<tr>
<td>Government’s Reliance on Contract</td>
<td>7</td>
</tr>
<tr>
<td>Conventional Contract Characteristics</td>
<td>10</td>
</tr>
<tr>
<td>Novel Procurement Options</td>
<td>12</td>
</tr>
<tr>
<td>Alliance Literature</td>
<td>17</td>
</tr>
<tr>
<td>Origins of the Research Question</td>
<td>22</td>
</tr>
<tr>
<td>Alliance Governance Risks</td>
<td>24</td>
</tr>
<tr>
<td>Research Aims and Research Question</td>
<td>27</td>
</tr>
<tr>
<td>Methodology</td>
<td>32</td>
</tr>
<tr>
<td>Research Outcomes and Thesis Outline</td>
<td>39</td>
</tr>
<tr>
<td>Chapter Two - Government Procurement, Alliances and Their Use</td>
<td>43</td>
</tr>
<tr>
<td>Introduction</td>
<td>43</td>
</tr>
<tr>
<td>Procurement Situation - Past, Present and Future</td>
<td>45</td>
</tr>
<tr>
<td>Conventional Contracts</td>
<td>45</td>
</tr>
<tr>
<td>Risk Allocation with Conventional Contracts</td>
<td>48</td>
</tr>
<tr>
<td>Novel Procurement Options, Partnering and Risk Transfer</td>
<td>51</td>
</tr>
<tr>
<td>Government Procurement – Market and Disputes</td>
<td>53</td>
</tr>
<tr>
<td>Supply and Demand in the Australian Engineering and Construction Market</td>
<td>54</td>
</tr>
<tr>
<td>Competition and Procurement Option Selection</td>
<td>57</td>
</tr>
<tr>
<td>Disputes in Construction and Engineering projects</td>
<td>62</td>
</tr>
<tr>
<td>Alliance Contracts – Terms and Conditions</td>
<td>67</td>
</tr>
<tr>
<td>When Do Australian Governments use Alliances?</td>
<td>73</td>
</tr>
<tr>
<td>Alliance Numbers, Locations and Level of Government</td>
<td>74</td>
</tr>
<tr>
<td>Alliance Project Costs</td>
<td>77</td>
</tr>
<tr>
<td>Alliance Chronology</td>
<td>79</td>
</tr>
<tr>
<td>Alliance Classification</td>
<td>80</td>
</tr>
<tr>
<td>Conclusion</td>
<td>82</td>
</tr>
<tr>
<td>Chapter Three – Why do Governments use Alliances?</td>
<td>85</td>
</tr>
<tr>
<td>Introduction</td>
<td>85</td>
</tr>
<tr>
<td>Why Do Governments Use Alliancing?</td>
<td>86</td>
</tr>
<tr>
<td>Alliance Benefits and Costs – Literature and Procurement Guides</td>
<td>87</td>
</tr>
<tr>
<td>Guides on Procurement Option Selection</td>
<td>90</td>
</tr>
<tr>
<td>Alliancing and the Benefits of Relational Contracts</td>
<td>92</td>
</tr>
<tr>
<td>Relational Contract Theory</td>
<td>93</td>
</tr>
</tbody>
</table>
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I am also indebted to all the public servants who participated in this study. Their selfless contributions proved priceless in gaining a practitioner’s view of alliance contracts and government procurement in general.
Glossary

**Alliance** - A commercial arrangement involving close collaboration, sharing of risks and rewards, and a framework that discourages disputes.

**Alliance Owner** - The alliance customer (analogous to the principal of a project). For this study, the alliance owner is government.

**Competitive TOC alliance** - An alliance where tenderers are selected primarily on the basis of price competition. Typically two tenderers are funded by the alliance owner to develop a design, target cost and schedule for a project. The outcomes of this funded activity is used for the selection of the preferred tenderer after which an alliance is entered into for the delivery of the project in the same manner as a pure alliance.

**Early Contractor Involvement** - Early Contractor Involvement contracts are contractual agreements used for the delivery of projects involving negotiated risk allocation using a two stage design and construct procurement model.

**Hybrid alliance** - An alliance model that deviates from a pure alliance by either: incorporating deadlock breaking mechanisms into the alliance, retaining liability between alliance participants, capping project costs, or allocating specific risks to alliance participants.

**Non-owner alliance participant** - The commercial participants to an alliance. Non-owner participants are analogous to ‘contractors’.

**Open tendering** - A procurement method where all interested suppliers may submit a tender.

**Pure Alliance** - A pure alliance is an alliance that adopts tenderer selection on a non-price basis, has no deadlock breaking mechanisms, share all project risks and retains no liability between alliance participants.

**Selective tendering** - A procurement method where the procuring entity determines the suppliers that it will invite to submit tenders.
Acronyms

ALT  Alliance Leadership Team
AMT  Alliance Management Team
ANAO Australian National Audit Office
APS  Australian Public Service
AWD  Air Warfare Destroyer
BOOT Build Own Operate Transfer
CEO  Chief Executive Officer
CFC  Construction Forecasting Council
D&C  Design and Construct
DBO  Design Build Operate
ECI  Early Contractor Involvement
GBE  Government Business Enterprise
GOC  Government Owned Corporation
NEC  New Engineering Contract
PAA  Project Alliance Agreement
PFI  Privately Financed Initiative
PPP  Public Private Partnership
RFT  Request For Tender
SOC  State Owned Corporation
SOE  State Owned Enterprise
TCC  Toowoomba City Council
TOC  Target Outturn Cost

Explanatory Notes

Codes

To maintain the anonymity of interviewees and survey participants, each person was allocated a unique identifier. Interviewees are labelled from A to T are public servants involved in alliances. Interviewees U to Y are alliance industry participants. Survey participants labelled A to E comprise public and private sector alliance participants.
Referencing Style

The referencing style used in this thesis is the Australian Guide to Legal Citation (2nd ed, 2002) Melbourne University Law Review Association Incorporated.
Chapter One - Alliance Contracts: Research Aims, Background and Methodology

‘It is never wise to enter into agreements the observance of which is doubtful.’

Niccoló Machiavelli, *The Discourses, Book I* (1517), Chapter XXII

Introduction

This thesis explores the use of novel procurement options for the delivery of public sector projects. More specifically, this study examines the public sector’s use of *alliance contracts* and the governance arrangements for these procurement options. Though the Australian public sector has delivered over $25 billion worth of projects with alliance contracts, there has been little research assessing whether these procurement options deliver value for money within an appropriate governance framework. This empirically based study addresses this by examining the governance arrangements of alliances and in particular, the dimensions of accountability, integrity, stewardship and transparency. The study examines whether alliance contracts are compatible with public sector governance objectives by exploring the perceived and actual costs and benefits of alliances and comparing these to those of conventional contracts.

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2 Throughout this thesis I use the term ‘project’ to represent the delivery of capital works and major system upgrades. For example, ‘projects’ include infrastructure (rail, roads, bridges, hospitals, water treatment plants), information systems, and defence systems (ships, aircraft, and weapons).
5 See Chapter one, footnotes 86, 87.
7 Throughout this thesis I use the term ‘conventional’ contract or ‘conventional’ procurement option to refer to the class of contracts that focus on risk allocation between parties rather than risk sharing. Conventional contracts include construct only contracts (eg. AS2124-1992, AS4000-1997), design and construct contracts (eg AS4300, GC21), and project management contracts (AS4195-2002).
This chapter provides a definition of alliance contracts, an overview of the history of alliances, and a synopsis of the risks associated with these contracts. The chapter also explores the broader reasons why governments rely on contract to deliver outcomes and what other procurement options governments may use in lieu of alliances. It then outlines my central research question and the methodology adapted to address it, and provides a synopsis of my overall research findings, and a summary of the remaining chapters in this thesis.

The potentially broad nature of my research question demands a focus on specific jurisdictions. I specifically devoted my research to examining the use of alliances by the Australian public sector; hence, jurisdiction is confined to Australia. Alliance type contracts also appear in the United Kingdom and New Zealand. Some of my findings may be applicable to these jurisdictions.

**Alliance Contract Defined**

The term ‘alliance’\(^8\) conjures different meanings depending on the context used.\(^9\) For the Australian public sector, the term ‘alliance’ refers to a specific means of project delivery or ‘procurement option’\(^10\) where the principal and contractor work collaboratively to deliver the outcomes of a project. This alliance relationship is characterised by risk sharing and a no blame/no-disputes framework. Here are two useful definitions:

An ‘alliance’ may be defined as an agreement between two or more entities, which undertake to work cooperatively, on the basis of a sharing of project risk and reward,

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\(^8\) For the remainder of this thesis I use the term ‘alliance’ synonymously with the terms ‘project alliance’, ‘alliance contract’, and ‘pure alliance’ to refer to the type of contract described in this section; namely a relationship with shared risks, no liability, no disputes, shared goals, and open book financial reporting.


\(^10\) ‘Procurement option’ refers to the means of project delivery. This term is commonly used by the public sector along with the synonymous term ‘acquisition strategy’. For example, typical procurement options include: construct only contracts, design and construct contracts, managing contractor contracts and Public Private Partnerships (PPPs) to name but a few. See, eg, NSW Government, *Procurement Methodology Guidelines for Construction* (2005) 12-20.
for achieving agreed outcomes based on principles of good faith and trust and an open-book approach towards costs.\textsuperscript{11}

An ‘alliance’ is where an owner (or owners) and one or more service providers (designer, constructor, supplier etc.) work as an integrated team to deliver a specific project under a contractual framework where their commercial interests are aligned with actual project outcomes.\textsuperscript{12}

These definitions suggest that a key requirement of an alliance is the formation of a team with common goals shared between the alliance participants. The following clauses from an alliance contract illustrate this point:

The alliance participants will commit to work together to achieve the successful delivery of the project.\textsuperscript{13}

The alliance participants will, for the duration of the project, collectively develop and deliver the project.\textsuperscript{14}

The other key characteristics of alliance contracts are as follows:

a. Risk is shared equally between customer (referred to as the alliance owner) and supplier (referred to as the alliance non-owner);

b. The alliance contract typically contains a ‘no-disputes clause’ which prohibits recourse to external dispute resolution (including litigation);

c. The alliance contract precludes liability between the alliance participants for loss, damage or negligence; and

d. All transactions are of an ‘open book format’, and all cost escalations or savings are shared between the parties.\textsuperscript{15}

\textsuperscript{11} Alan Cullen, LexisNexis, \textit{Building Contracts Australia}, (2005) [64.020].
\textsuperscript{12} Jim Ross, ‘Introduction to Project Alliancing’, (paper presented to the Alliance Contracting Conference, Sydney, October 2003) 1.
\textsuperscript{13} Clause from a federal government pure alliance contract.
\textsuperscript{14} Ibid.
\textsuperscript{15}
It is important to contrast an alliance contract with other forms of procurement such as strategic alliances, joint ventures, and partnerships. All these latter procurement options involve greater risk sharing than conventional contracts. Nevertheless, as I will show later in this chapter and in Chapter two, the alliance is built on an explicit ‘no-disputes’, ‘no-liability’ framework, and a far greater emphasis on teaming than these other relationships.

Alliance Variations

Although the general characteristics of alliances can be described, there is no universal format or type of alliance contract in use as there is, for example, with the Australian Standard suite of contracts or government template contracts. Nevertheless, there has been an evolution of ‘classes’ of alliance to cater for the particular needs of projects and the specific risk management strategies of procurement agencies.

The most common class of alliance is the pure alliance. The pure alliance adopts unanimous decision-making processes (with no deadlock breaking mechanisms), retains no process for distribution of liability between alliance partners (except for wilful default), relies on development of project costs after tenderer selection and requires all project risks to be shared. Though the pure alliance has enjoyed substantial use in Australia, governments have deviated from this model to cater for some of the shortcomings of this contracting vehicle. Deviations include incorporating price competition into target cost development, maintaining a regime of liability between alliance participants to facilitate the acquisition of project insurance, incorporating deadlock breaking mechanisms into the alliance, and allocating specific

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17 See especially, Ross, above n 12, 1.
18 Arguably, the alliance owner’s ability to ‘terminate for convenience’ is a pseudo-deadlock breaking mechanism (see Chapter two).
risks to alliance participants consistent with the principle that risks should be allocated to the party best able to manage them.  

The incorporation of price competition into alliances has created a class of price competitive alliance dubbed the competitive Target Outturn Cost (TOC) alliance. Other deviations from the pure alliance model comprise ‘impure’ or ‘hybrid’ alliances. These alliances have evolved to cater for many of the governance shortcomings of the pure alliance. I discuss the various types of alliances used by Australian governments at length in Chapter two.

The History of Alliance Contracts

Alliancing first came to prominence in the private sector, more specifically in the petroleum industry in the early 1980’s. Projects in this industry were characterised by large contractual risks. British Petroleum (BP) was the first company to exploit an alliance contract in the ‘Andrew’s Oil Field’, North East of the United Kingdom, where BP decided that, ‘[o]nly by working in close alignment with contractors could we hope to make Andrew’s a success’. BP considered conventional contract forms inappropriate in this high-risk venture, because conventional risk transfer strategies would result in exceptionally high contract contingency costs.

Alliances first appeared in Australia in the 1990’s. Early Australian alliance contracts included oil and gas exploration projects, notably the Wandoo Alliance in 1994 for construction of an oil platform in Western Australia’s North West Shelf by Ampolex, and the East Spar Alliance for the development of the East Spar gas field in 1996. These alliance contracts provided for the sharing of risks and required less upfront

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effort in specification development. Alliance contracts have continued to be used in
Australia for high-risk projects such as oil exploration, novel or uncertain construction
development and projects where the scope of work is difficult to quantify (for
example software development projects and where project geotechnical risks are very
high). Despite the fact that alliances were first used by the private sector, the
Australian government is now the largest user of such contracts.

The positive reputation of alliance contracts as an improved means to manage risk has
resulted in a substantial increase in their use in Australia in the last decade.\(^{25}\) The
Australian federal, state and local governments use alliance contracts extensively to
deliver projects such as the construction of roads, bridges, waste water treatment
plants, aircraft modifications, and ship upgrades, to name but a few. These alliance
contracts vary in cost but they are typically high value endeavours.\(^{26}\)

The growth and popularity of alliance contracts has also resulted in their appearance
in Australian government policy documents and procedure manuals such as the
*Defence Policy Procurement Manual*\(^ {27}\) and guidance papers from the Australian
Government Solicitor.\(^ {28}\) State Governments also provide detailed guides on the use of
alliances.\(^ {29}\)

Alliance contracts have spawned the development of numerous companies in
Australia, with these companies offering services for the establishment, management
and assessment of alliance contracts.\(^ {30}\) The domestic importance and interest in

\(^{25}\) Davies, above n 4.

\(^{26}\) The average value of 122 public sector alliances in Australia is $208 million, ibid.

\(^{27}\) Australian Government, Defence Material organisation, *Defence Policy Procurement Manual v6.2*
(2007).

\(^{28}\) Australian Government Solicitor, ‘Relationship and Alliance Contracting by Government’
Commercial Notes No 4 (28 November 2001)
2008.

\(^{29}\) See, eg, Victorian Government, Department of Treasury and Finance, *Project Alliancing
Construction* (2005); QLD Government, *Department of Main Roads Project Delivery System: Volume
I* (2\(^ {2}\) nd ed, 2005).

\(^{30}\) See, eg, Southern Pacific Alliance Network, Project Control International, MWH Australia Ltd,
Alchimie Pty Ltd. In addition, many law firms offer services in alliance contract delivery; See eg:
Blake Dawson
<http://www.blakedawson.com/Templates/ServiceAreas/x_service_area_landing_page.aspx?id=19797
&terms=alliance> at 21 July 2008; Phillips Fox <http://www.ctlphillipsfox.com/service/28/Mining-
and-Resources> at 21 July 2008; Minter Ellisons
Alliance contracting is demonstrated by the International Quality and Productivity Centre hosting an annual conference on alliance contracting in Australia. Alliances are therefore entering the mainstream of procurement options for the public sector, but why must governments rely on contract to achieve outcomes?

**Government’s Reliance on Contract**

Alliances are one of many forms of contract available to governments for procurement. Prior to examining the use of alliancing in the public sector, a broader question arises: ‘why must governments contract at all?’ Answering this question provides valuable insight into why governments are substantially reliant on the private sector to deliver public outcomes and to explore what procurement options are available to the public sector. In this section, I briefly explain why governments are unable to rely on internal capabilities to deliver major project outcomes and how a shrinking public sector has substantially eroded capabilities in project management and engineering disciplines.

Since the 1980’s, governments have increasingly had to resort to contracting as they have pursued strategies of outsourcing and privatisation. In Australia, for example, over the past 30 years the Commonwealth government transferred $70 billion in Commonwealth assets and business to private sector owners. Though the motivation for outsourcing and privatisation stems largely from dissatisfaction with the internal provision of services (that is, with in-house capabilities), more specific aims comprise costs savings, increased competition, openness of government, improved service delivery, reduced government involvement in the decision-making of industry, ‘user-pays’ market disciplines, and the achievement of political goals.

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such as reduced union power. Savas categories the forces driving privatisation and outsourcing as follows:

a. Pragmatic. The provision of a more effective government for less cost (the efficiency argument);

b. Ideological. The desire for smaller governments and a freer market;

c. Commercial. Promotion of growth in the private sector; and

d. Populist. Providing society with more choices rather than with public sector monopolies.

In addition to the above objectives of outsourcing and privatisation there is also a requirement for governments to curtail their growth. Governments historically grow because of: demographic changes, such as population growth; greater demand for services, especially with aging populations; increased public standards and the attendant resources needed for regulation (especially environmental and occupational health and safety); and growing inefficiencies in government as a result of income growth (government collects more revenue and therefore must grow to spend this extra revenue). Privatisation and outsourcing thus offers a means to stem the growth of government in the face of these causes.

A less responsible motivation for the pursuit of privatisation is for governments to generate a once off ‘lump-sum’ windfall to offset debt, invest in other projects, or a combination of the two. The World Bank cites this as the major reason for the sale of government business enterprises.

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38 Ibid 17-29.
Chapter One - Alliance Contracts: Research Aims, Background and Methodology

The consequences of privatisation and outsourcing are the subject of an extensive literature attempting to quantify the costs and benefits of various outsourcing and privatisation strategies.\(^{40}\) This study does not examine the success or otherwise of privatisation and outsourcing simply because the current public sector environment is unlikely to change.\(^{41}\) What I do examine are the resultant capabilities and competencies of governments in this post-privatised and outsourced environment.

The capabilities and competencies of governments influence the procurement options available for the delivery of infrastructure and services. At federal, state and local government levels, governments have reduced drastically in the number of employees over the past 20 years with privatisation and outsourcing implemented on a large scale.\(^ {42}\) In the 21 years from 1984 to 2005, the public sector’s share of total employment in Australia has dropped from 26 percent to 16 percent. This represents a reduction of 171,000 public sector jobs at the Commonwealth level alone.\(^ {43}\)

From a procurement perspective, this outsourcing phenomenon results in governments relying on the private sector to achieve outcomes previously conducted with ‘in-house’ capabilities. A consequence of this is diminished public sector capacity and competency. Not only have outsourcing and privatisation stripped governments of the ability to conduct projects with in-house personnel, but governments have also lost key skills in designing, estimating, planning and implementing projects.\(^ {44}\) Governments have therefore become ‘hollowed out’ organisations with reduced skills, loss of corporate knowledge and weakened innovation skills.\(^ {45}\) The skills of government employees have also changed considerably with the public sector now

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\(^{40}\) Jensen et al, above n 31. This literature review of privatisation and outsourcing captures many of the key empirically based studies in this field.


\(^{44}\) Outsourcing is the major catalyst for government losing capability. Privatisation exacerbates this issue with government shedding non-core activities such as banking, telecommunications and private health insurance. Government’s capabilities (corporate knowledge, skills, tools etc.) is forever lost after the privatisation of these industries. Whilst many of these capabilities may no longer be relevant for governments, some skills such as contract management, information system management, project management and the like are relevant for future government operations.

needing well-educated public managers and a reduced need for low-skilled public employees.⁴⁶ Governments are therefore highly dependent on the private sector to deliver outcomes since internal provisions are no longer available.

Governments manage and govern the outsourcing or privatisation function through contract.⁴⁷ Contract law, therefore, influences how governments manage procurement. A growth in the use of government contracts,⁴⁸ and reduced in-house government capabilities (in terms of both technical competence and capacity), will drive governments to adopt innovative procurement options to deliver public sector outcomes. Alliances are one of these novel contracting options available from a range of choices, which include fixed price contracts, schedule of rates contracts, Public Private Partnerships (PPPs), joint ventures, and leases. How, then, do alliances differ from these other procurement options?

**Conventional Contract Characteristics**

Alliances have emerged as a response to dissatisfaction with conventional fixed price contracts in delivering project outcomes on high-risk projects. It is therefore necessary to summarise the general characteristics of conventional contracts and the perceived disadvantages of these delivery methods. Chapter two provides an overview of the typical forms of contracts used by governments in Australia, and in particular, the standard forms of conventional contracts. In this section, I briefly discuss the advantages and disadvantages of conventional contracts to demonstrate how alliances cater for some of the shortcomings of these procurement models.

Conventional contracts for the provision of services or products typically rely on an arms-length relationship between customer and supplier. This approach is often termed an ‘adversarial’ arrangement, in which the customer, or principal, attempts to transfer as much risk as possible to the supplier or contractor. Such risk transfer may come at a high price to the principal and will normally appear in the ‘all up’ contract price as ‘contingency’ or risk adjusted profit for the contractor. In more extreme

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⁴⁸ See Figure 2-1, Chapter two.
cases, contractors may choose not to bid on such high-risk projects as they consider the assumption of project risks unpalatable. This leaves governments with either lessened competition or no industry participants able to deliver the required outcomes.

Conventional contracts promote win or lose behaviour, where any gains by either the contractor or principal will be to the detriment of the other party. Consequently, the likelihood of disputes and claims in conventional contracts is perceived by many government managers and industry participants as relatively high with the potential for significant cost escalation, schedule delay, or performance compromise in the delivered service or product. The following statement illustrates the perception that conventional contracts promote win/lose behaviours:

…traditional and D&C [Design and Construct] Lump Sum construction contracts have become breeding grounds for disputes because the financial interests of the owner and the contractor are fundamentally opposed.49

Unsurprisingly, suppliers and buyers are exploiting novel contracting methods to alleviate the risks of disputes and claims in procurement. In the United States, 18 percent of Fortune 1000 company profits were derived from ‘non-traditional’ contracts, whilst in Europe, 30 percent of company revenues were derived from non-traditional contracts.51 The continued growth in the use of novel contracting methods suggests that both customers and suppliers are dissatisfied with the risks of disputes and claims associated with conventional contracts. Despite this, I argue in Chapter two that the incidence of disputes in the construction industry are overstated and the causes of these disputes is largely unrelated to the form of contract but are rather related to the risk management processes adopted by the parties.

Despite the claimed disadvantages of conventional contracts, there is a significant body of knowledge available to the users of these contracts with extensive case law

50 The term non-traditional in the US and European contexts refers to novel procurement such as alliances, joint ventures, partnerships and the like.
testing the operation of these contract clauses.\textsuperscript{52} This provides greater certainty to the parties in such a relationship than would be expected in an alliance, because alliances, and other novel contacts, are relatively immature forms of procurement. Uncertainty therefore exists in how the courts will interpret these contractual arrangements. At the time of writing, no Australian legislation explicitly addresses the regulation of alliance contracts, nor is there any case law that deals specifically with alliance relationships.\textsuperscript{53} Although there are cases that deal with disputes between parties that adopted some alliance style behaviours,\textsuperscript{54} these cases do not incorporate the far reaching no-disputes/no-blame clauses of the pure alliance. Consequently, there is limited guidance from the legislature or the courts on how disputes will be resolved in an alliance. The opposite is true of conventional contracts.

In this thesis, I explore whether the cited disadvantages of conventional contracts are valid and hence whether alliances offer better value for money. For example, in Chapter two I investigate whether the claimed incidence of disputes in conventional contracts is as high as that cited in the literature. In order to develop this analysis, I first define the spectrum of contracting options available to governments, for two reasons. First, a comparative analysis of contracting options assists in defining alliances, by illustrating those features unique to alliances. Second, defining the alternate contracting options provides a means to qualify the costs and benefits of alliances by comparison.

\textbf{Novel Procurement Options}

To avoid the adversarial nature of conventional contracts and to enable risk sharing between participants to a contract, several novel procurement vehicles are available to

\textsuperscript{52} For example, over 137 cases were dealt with by the Australian courts that involved contracts based on the conventional AS2124-1992 format. Austlii Search <http://www.austlii.edu.au/cgi-bin/sinosrch.cgi?query=as2124;results=50;submit=Search;mask_world=;mask_path=;callback=on;method=auto;meta=%2Fau;offset=100;view=date> at 7 February 2009.

\textsuperscript{53} There are cases that involve pure alliances such as Willoughby City Council v Sydney Water Corporation (1999) NSWLEC 131, but this case involved a dispute between stakeholders of the alliance project (the council where the project was taking place) and not the alliance participants themselves.

\textsuperscript{54} Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd (2003) 196 ALR 257. the commercial relationship in this case encroaches on alliance behaviour but does not involve a pure alliance. See also Energy Brix Australia Corporation Pty Ltd v National Logistics Coordinators (Morwell) Pty Ltd (2002) VSCA 113.
governments. Such arrangements offer access to expanded capabilities and resources, increased flexibility, wider geographic reach, shared visions and greater personal involvement.\footnote{William Bergquist, Juli Betwee and David Meuel, \textit{Building Strategic Relationships} (1995), 11-9.} Other than alliancing, the four main forms of novel or ‘non-conventional’ contract or procurement methods I will discuss are strategic alliances, joint ventures, partnerships, and public private partnerships.

a. **Strategic Alliances.** Strategic alliances are typically long-term arrangements used for the outsourcing of services or infrastructure. Strategic alliances often apply to collaborative relationships, which might require licensing, franchising, research and development, marketing, and the pooling of resources.\footnote{Benjamin Gomes-Casseres, \textit{The Alliance Revolution: The New Shape of Business Rivalry}, (1996).} Strategic alliances are suitable for vertical integration (between suppliers and distributors) as well as horizontal integration (between competitors).

The strategic alliance adopts the middle ground between a pure alliance contract and a conventional contract. Strategic alliances are better suited to lower risk endeavours in which the supplier can assume greater levels of risk, when compared to adversarial style contracts. The strategic alliance does retain a more adversarial component when compared to pure alliances, as remedies are available to the parties of the strategic alliance with disputes able to be resolved through the courts. The fact that 80 percent of strategic alliances result in a take over of one of the participants by the other\footnote{Joel Bleeke and David Ernst, ‘Is Your Strategic Alliance Really a Sale?’ in Harvard Business School (ed) \textit{Harvard Business Review on Strategic Alliances} (2002) 24.} is indicative that strategic alliances are commercial tools unsuitable for the public sector.

Strategic alliances are significantly different in operation from pure alliances since the pure alliance involves no horizontal or vertical integration. There is therefore no need to consider strategic alliances further in this study.

b. **Partnerships.** Partnerships are governed by relevant state and territory \textit{Partnerships Acts}.\footnote{See, eg, \textit{Partnership Act 1963} (ACT), \textit{Partnership Act 1892} (NSW), \textit{Partnership Act 2007} (NT) \textit{Partnership Act 1891} (Qld), \textit{Partnership Act 1891} (SA), \textit{Partnership Act 1891} (Tas), \textit{Partnership Act 1958} (Vic), \textit{Partnership Act 1895} (WA).} These business relationships may be implemented as a
partnership deed or contract. The test for whether a partnership exists is whether the parties are ‘carrying on a business in common with a view of profit’. Where a contract (conventional or otherwise) comprises parties with common goals, profit sharing, and risk sharing, such a relationship may come under the ambit of the respective partnership legislation.

In several cases, the courts may deem an agreement to be a partnership despite the intent of the parties not to create a partnership. In *Canny Gabriel Castle Jackson Advertising Pty Ltd v Volume Sales (Finance) Pty Ltd* the High Court held that a common undertaking described by the participants in their agreement as a joint venture was actually a partnership. A useful test for examining whether a partnership exists is discussed in *Avag Resources v Waihi Mine Ltd* which explains that a partnership is ‘for a product to be shared amongst parties’, as opposed to a pooling of resources that are retained by each individual member in an agreement. This test is useful since the alliance contract is unlikely to involve a product or profit to be shared amongst alliance members, especially if government is the owner. On the contrary, alliances are essentially customer/supplier relationships where governments want a supplier to deliver some product or service. Consequently, partnership law has little relevance to this study and there is no further need to consider the role of these relationships.

c. **Joint Ventures.** Although I bundle joint ventures into a class of contracting options, joint ventures may not necessarily be governed by contract at all. For example, joint venturer shareholders may be created through a body corporate, or a partnership may be established with joint venturers. Neither of these require a contract. Furthermore, the term ‘joint venture’ does not have a fixed legal meaning as Gibbs CJ noted in *United Dominions Corp Ltd v Brian Pty Ltd*:

59 See eg *Partnership Act 1892* (NSW) s53B.
60 *Partnership Act 1892* (NSW) s1, *Partnership Act 1891* (Qld) s5, *Partnership Act 1958* (Vic) s5.
62 (1994) 3 NZLR 571, 579.
63 Contra, Trevor Thomas ‘Alliance Contracts: Utility and Enforceability’ (2007) 23 *Building and Construction Law* 329. Thomas argues that partnership law may apply to alliances since the alliance involves ‘profit and cost sharing’. This argument is flawed since the alliance remuneration system simply requires the alliance owner (government) to pay more or less for the delivery of the service. There is no ‘profit’ in the sense described by relevant partnerships legislation.
The term “joint venture” is not a technical one with a settled common law meaning. The borderline between what can properly be described as a “joint venture” and what should more properly be seen as no more than a simple contractual relationship may, on occasion, be blurred.\(^\text{64}\)

Joint ventures are used extensively for projects in the mining industry and for other projects that involve sharing risks between two or more entities. Companies may also utilise joint ventures where they wish to expand into new markets using a second company that has a geographic or logistic presence in that market.\(^\text{65}\)

Joint ventures typically appear between two or more suppliers or between suppliers and distributors. Buyers do not usually enter into joint ventures with suppliers because the risks between the two are rarely the same. In Australia, governments seldom use joint ventures for this reason.\(^\text{66}\)

Alliances employ many of the features of a joint venture and it is conceivable that a joint venture could be drafted to incorporate all the terms and conditions of a pure alliance. In fact, some alliances adopt the title of ‘joint venture agreements’,\(^\text{67}\) though this moniker is not commonly used for alliances. The fundamental difference lies in the end use of such procurement vehicles. Governments use alliances for procuring construction and engineering projects whilst industry participants typically use joint ventures to pool resources and share risks with horizontal integration.

d. **Public Private Partnerships (PPPs).** Though there are no universally accepted definitions of PPPs,\(^\text{68}\) PPPs may be loosely defined as agreements between the public and the private sector for the purposes of ‘designing, planning, financing,
constructing, and/or operating projects, normally regarded as falling within the remit of the public sector.⁶⁹ PPPs are typically long term, high value endeavours that emphasise risk allocation.⁷⁰ There are many forms of PPP models ranging from Build Own Operate and Transfer (BOOT) through to Design Build and Operate (DBO).⁷¹ In most cases, PPPs involve private financing of the project in question; in fact, the term Private Finance Initiative (PFI) is often used synonymously with PPPs.⁷²

In Australia, PPPs are primarily the domain of State governments⁷³ and include projects such as the Sydney Harbour Tunnel and Melbourne’s $1.7 billion City Link Tollway. PPPs offer a means for governments to procure infrastructure at little or no initial cost by relying upon lease payments, often in the form of user-pay ‘tolls’. Although PPPs offer substantial benefits, they can result in significant political costs. For example, a public backlash against PPPs can eventuate from opportunistic price rises in tolls or degraded services.⁷⁴ In contrast to alliances, PPPs rarely embrace risk-sharing initiatives between the customer and supplier. Consequently, alliances are typically utilised for high-risk projects with governments normally using PPPs for lower risk endeavours such as toll roads, hospital, and school construction.

The above examples of novel procurement options highlight themes of relational contract (discussed at length in Chapter three). This list identifies some of the current and emerging themes of novel procurement options and alternatives to the ‘hard dollar’ conventional contracts typically used by the public sector. Some contracts may adopt elements from several of these listed categories or a principal can divide a program into discrete packages using separate contracting strategies. For example, a construction project may utilise an alliance for design activities and adopt a fixed price contract for construction (alliance front end, with traditional contract back

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⁷¹ Ibid 64.


⁷³ Pat Barrett, above n 32, 3.

Similarly, a principal may separate a program into high and low risk components with alliances used for the higher risk activities and conventional contracts used for the low risk components. The impure alliance is one such contract that embraces the characteristics of pure alliances and traditional contracts. I discuss these forms of contract at length in Chapter two.

**Alliance Literature**

An extensive literature on alliances has evolved, exploring the operation, risks and benefits of alliance contracts. The Department of Civil and Environmental Engineering at the University of Melbourne has compiled a list of 100 references covering alliance contracts and other novel procurement options. The alliance literature comprises government policy and procedures on alliancing, papers exploring the benefits of alliancing and collaborative contracts, papers exploring the legal risks of alliances, and alliance audit reports. This section provides an overview of the key alliance literature.

**Alliance Policy and Procedures.**

The growth in the use of alliancing in the public sector has spawned the development of several government guides on the use of this procurement model. The most comprehensive government guide to alliancing is the Victorian Government’s, *Project Alliancing Practitioner's Guide*. This guide explores the benefits and costs of alliancing, alliance tender selection processes, and the alliance compensation model. The NSW government has also published a whole of government guide advising when alliancing is appropriate. The NSW guide is limited to procurement option selection and therefore does not provide as much detail as the Victorian Government alliancing guide. Individual government departments also provide directions on the

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76 Sydney Water Corporation for example, has embarked on a project where the majority of the work uses a fixed price contract with an alliance used for the high-risk components.
78 Victorian Government, above n 29.
79 NSW Government, above n 29.
use of alliancing. The Queensland Department of Main Roads, for example, provides a procurement options selection guide with substantial content on the selection and use of alliances.\(^{80}\)

The alliance guides provide insight into why the public sector uses alliances in lieu of other procurement options. The NSW and Victorian guides in particular present the benefits and costs of alliances and provide indications of when alliancing is and is not suitable. Despite the content in these procurement guides, several areas are lacking. In later chapters, I demonstrate that the procurement guides fail to address the consideration of market conditions and the considerations of holistic alliance costs. A response to the weakness of current alliancing guides is the author’s recently published whole of government alliance guide for the Queensland Government.\(^{81}\) This guide addresses many of the shortcomings of other alliance guides and incorporates my recommendations for reform summarised in Chapter eight.

**The Benefits of Alliance Contracting.**

Numerous papers explore the benefits of alliancing when compared to conventional delivery mechanisms. Many of these papers originate from facilitators of alliance contracts. The most commonly cited alliancing paper is Ross’s ‘Introduction to Project Alliancing’.\(^{82}\) This paper provides substantial information on the benefits of alliancing, how alliances manage remuneration and how owners select alliance participants. Ross was also the principal author of the Victorian Government *Project Alliancing Practitioner’s Guide* and many of the themes in this later guide appear in Ross’s original paper. Other papers originating from alliance facilitators include Cowan and Davis’s discourse on competitive TOC and hybrid alliances,\(^{83}\) and Hutchison and Gallagher’s\(^{84}\) papers on alliancing and the claimed shortcomings of competitive TOC alliances.

\(^{80}\) Queensland Government, above n 29.


\(^{82}\) Ross, above n 12.

\(^{83}\) Cowan et al, above n 20, 2.

Other than the literature produced by alliance facilitators, researchers have also explored the benefits of alliancing. Walker and Hampson’s text, *Procurement Strategies: A Relationship-based Approach*,\(^\text{85}\) provides insight into the benefits associated with project alliances. This book draws on substantial research conducted into public sector alliances. Lendrum’s, *A Strategic Partnering Handbook*\(^\text{86}\) also provides guidance on the benefits available with collaborative procurement options. Other relevant research papers on alliancing include the work by Manley,\(^\text{87}\) Rowlinson and Cheung\(^\text{88}\) who draw upon several alliance case studies to illustrate the benefits of alliancing and partnering.

The papers developed by alliance proponents focus on the reasons why alliances are superior to conventional contracts. This focus comes at the expense of an exploration on the costs of alliancing such as the risks of opportunistic behaviour, absence of recourse to the courts and the additional costs associated with independent auditors and probity advisors. This study addresses these gaps in the literature by exploring the costs of alliancing and critically assessing the claimed benefits of these procurement options.

The literature also reveals divided views on pure and competitive TOC alliances. Many commentators hold polarised views about the most appropriate alliance model. Some argue that only competitive TOC alliances offer value for money, since these alliances adopt price competition. The opposing view is that pure alliances are most appropriate since this model maximises collaboration and the positive culture.

necessary for alliance success. In later chapters, I argue that both views are valid depending on the specific circumstances for a project.

**Legal Commentators**

The fact that alliances are relatively new forms of contract with a no liability and no litigation framework has attracted the attention of several legal commentators. Chew, Hayford, and Stephenson identify many of the potential pitfalls of alliancing including the risks of deadlocks, enforceability of the no-disputes clauses, the implications of fiduciary obligations, poor demonstration of value for money, and probity challenges in tendering. More recently, Thomas explored the enforceability of alliance contracts and the potential for the alliance no-disputes clause to destroy the consideration of the alliance contract. Other notable papers from legal commentators include McInnis’s comprehensive discussion on the features of novel procurement options and relational contracting, and Quick’s discussion of Early Contractor Involvement (ECI) contracts and how these ECI contracts compare to alliances.

Unsurprisingly, the perspectives of legal commentators focus on what can go wrong in an alliance rather that what is likely to go wrong. Nevertheless, several valid criticisms of alliances emerge from this literature that warrant consideration. The key issues raised are: do alliances give rise to fiduciary relationships, do deadlock breaking mechanisms disenfranchise effective decision-making, is the alliance ‘no disputes’ clause enforceable, and what are the consequences of the ‘no liability’ clause on alliance performance? This study explores these issues and examines what the likelihood and consequence of each risk occurring is since these aspects are not considered by the legal commentators.

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89 Chew, above n 15.
91 Andrew Stephenson, ‘Alliance Contracting, Partnering, Co-operative Contracting – Risk Avoidance or Risk Creation’ (paper presented to Clayton Utz Major Projects Seminar, Melbourne, October 2000).
92 Thomas, above n 63.
**Alliance Audit Reports**

At time of writing four Australian alliance projects have undergone audits by federal and state auditors general or public works committees. These four alliances include the National Museum of Australia Alliance, the Sydney Water Northside Storage Tunnel Alliance, the Queensland Department of Main Roads Tugun Bypass Alliance and the Queensland Government Gold Coast Desalination Plant Alliance. These audit reports are of particular relevance to my research since they report divided views on the effectiveness of alliance governance arrangements. For example, both the National Museum and Tugun Bypass audits report favourably upon the governance arrangement of these alliances. By way of contrast, the Northside storage tunnel audit report is critical of the governance arrangements of this alliance. In particular, the Northside storage tunnel report argues that this pure alliance failed to demonstrate value for money. Similarly, the Queensland Government audit of the Gold Coast Desalination Plant was highly critical of project governance. The Thames water alliance and Devonport Nuclear Submarine Facility alliance audit reports from the United Kingdom also provide insight into the governance arrangements of alliancing, arguing that alliances introduce probity risks that demand careful consideration.

The alliance audit reports demonstrate that some auditors general are dissatisfied with alliance contracts, especially with the demonstration of value for money. The audit reports provide an indication of where government stakeholders are concerned with the governance arrangements of alliances and these concerns are examined in this study.

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The alliance literature outside these audit reports reveals divided views of alliance contracting in Australia. The articles developed by academics and alliance contract facilitators devote substantial effort to espousing the benefits of alliances whilst providing scant discussion on the risks associated with these types of contracts. The alliance articles developed by legal commentators provide a contrasting view with arguably too much emphasis on the risks of alliances and the associated ‘legal minefield’ of a contractual framework with no liability and no disputes clauses. The polarised perspectives of alliances are most likely a reflection of the interests of each stakeholder.

This study addresses the scant literature on the costs and risks of alliances as well as exploring the likelihood and consequences of the risks identified by legal commentators. No empirically based study has yet addressed the costs and benefits of alliances, and in particular, no study has yet examined the governance arrangements of alliances.

**Origins of the Research Question**

There is no empirically based study exploring the costs and benefits of alliances and whether these contracts are compliant with the broader governance objectives of the public sector. This study examines the contrasting views of alliance contracts with an empirically based appraisal of the benefits and costs of these contractual vehicles when compared to the alternatives. This study is especially significant since alliances are relatively new forms of contract. There is no specific case law involving alliance arrangements in Australia. Consequently, the enforceability of the alliance agreement and obligations of the alliance participants are untested from a legal perspective. The risks of fiduciary obligations, diminished accountability, and a failure to demonstrate value for money are all potential alliance risks, but the literature does not quantify these risks. These governance risks provide the focal point for this study so that procurement managers are provided with an assessment of the ‘costs of doing business’ with alliances and other stakeholders are provided with an indication of the whether alliance governance arrangements are robust or not.
Despite the fact that alliances are relatively new forms of procurement, Australian federal, state and local governments are using alliance contracts extensively to deliver infrastructure and capabilities. Over the past ten years, expenditure on alliances has exceeded billions of dollars. Whilst governments use alliances extensively, the costs and benefits of using such contracting vehicles are largely unquantified. Many commentators speculate on the potential pitfalls of alliancing, including, inter alia:

a. The creation and consequences of fiduciary obligations, as governments may be bound by duties and obligations that surpass those expressed in the terms and conditions of the alliance contract;

b. The perception that alliances fail to demonstrate value for money (since most alliances avoid price competition in setting project costs); and

c. Reduced accountability since alliance contracts result in the creation of a ‘virtual organisation’ with increased scope for decision-making deadlocks, and decision-making by committee.  

Despite animated discussion in the alliance literature, there has been no thorough analysis to quantify these alliance risks. My research addresses this shortfall in the literature by examining the costs and benefits of alliance contracts when compared to the conventional fixed price contracts more commonly used by governments. This empirically based study will advance knowledge in public sector procurement option selection and provide other stakeholders with a comprehensive account of alliance advantages and disadvantages.

This study also contributes to the broader issues associated with measuring the effectiveness of government. Government procurement is a fundamental component of public administration and my examination of decision-making, accountability regimes and the measurement of value for money are all areas that contribute to the

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101 Thomas, above n 63, 343; Chew, above n 15, 324-5; Hayford, above n 90, 50.
broader debate of ‘how effective is the public sector, how is effectiveness measured and how accountability for outcomes are assigned?’

This study focuses primarily on the costs of using alliance contracts, rather than the benefits. The reason I offer an analysis focussing on the disadvantages of alliances is a response to the extant literature, which I believe provides an unbalanced perspective of alliances with a substantial focus on the positive aspects of these contracts. I therefore offer an alternative to the ‘marketing’ dimension, which dominates the alliance literature.

Alliance Governance Risks

This study explores the governance risks of alliances in the areas of accountability, transparency, stewardship (value for money) and integrity. The following section introduces these risks.

Despite the claimed benefits of alliance contracts and other non-traditional forms of contract, international studies report that 70 percent of alliance contracts fail to deliver their expected results. The causes of alliance failure stem primarily from breakdowns in trust, cultural mismatches, and poor communication. The success of an alliance contract is underpinned by a need to maintain trust between parties - the aphorism that ‘trust is hard to build but easy to destroy’ particularly applies to

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104 Deborah Kiers, above n 17, 1; albeit the definition of alliance used in Kier’s paper is broad and includes strategic alliances.

105 Ibid.
alliances.\textsuperscript{106} This study examines whether this concept of ‘trust’ between the public sector and the private sector is a principle the fits comfortably with public sector governance objectives. Where trust underpins project success, the public sector is steered away from an arms-length contractual relationship into one that is more likely to compromise the governance principles of integrity. This governance risk is discussed in Chapter five.

One of the major criticisms of alliances is the alliance’s inability to demonstrate value for money.\textsuperscript{107} The pure alliance in particular eschews price competition and hence tender evaluations involve assessment almost exclusively on non-price criteria.\textsuperscript{108} A feature of the pure alliance is that all alliance participants develop target costs collaboratively for the project. Nevertheless, my research demonstrates that the non-owner alliance participants manage this activity with little input from the alliance owner. Governments may therefore be at the mercy of industry in ensuring the project target cost is a fair estimate. Examining the value for money dimension in alliances is therefore a major theme of this study. Chapters six and seven are devoted to exploring this issue.

The alliance adopts a unique legal framework that ostensibly provides substantial benefits. For example, the typical alliance ‘no disputes/no liability’ clause prohibits liability between participants and eliminates any recourse to the courts for the resolution of disputes. A typical ‘no liability’ clause is as follows:

\begin{quote}
The Alliance Participants will not be liable for any damage or loss of any description, including loss or damage caused by negligence, due to the performance of (or failure to perform) or discharge of (or failure to discharge) any obligation or duty under or arising out of or in connection with the alliance agreement whether arising at law, including by statute or in equity generally,...\textsuperscript{109}
\end{quote}

\textsuperscript{106} Benjamin Gomes-Casseres, \textit{The Alliance Revolution}, (1996) 34.
\textsuperscript{107} Cowan et al, above n 20; NSW Auditor General, above n 96.
\textsuperscript{108} Several pure alliances conduct tender evaluations based on hourly rates for specific activities but arguably these rates are standard across an industry. Furthermore, the weighting applied to these rates in tender evaluations is minimal.
\textsuperscript{109} Federal government pure alliance agreement.
From an optimistic perspective, parties to the alliance would not be concerned with disputes or claims, as all problems and disputes are jointly dealt with by the alliance partners. Practically though, should a critical issue be unresolved between alliance partners, avenues for recourse open to an aggrieved party may be limited. The enforceability of the no disputes clause is untested in Australian courts and this clause is potentially an unlawful ouster to jurisdiction and may be void. Furthermore, there is an increased risk of deadlocks occurring at the alliance leadership level that could potentially delay a project. The effectiveness of the no disputes clause is discussed at length in Chapter five, which argues that the pure alliance ‘no disputes’ and ‘no liability’ framework expose governments to the opportunistic behaviour of other alliance participants. These clauses also dilute accountability for the public sector and is the subject of discussion at Chapter five which explores how alliances accountability frameworks are substantially less robust than those of conventional contracts.

A governance risk also arises with the potential for the establishment of fiduciary obligations in pure alliance contracts. Chapter five examines this risk and the consequences this may have on governments. The fact that alliances require that public sector participants consider the needs of the alliance equally with the needs of the public service also creates a potential ‘conflict of duty’. Alliances therefore increase the risks of compromising the public sector governance objective of ‘integrity’.

Alliance contracts incorporate greater uncertainty with respect to the rights and obligations of the parties than that of conventional contracts. The creation of a virtual organisation to deliver a project offers potential benefits but at the same time dilutes the governance objectives of the public sector. The reliance on common goals and objectives by the alliance participants may be sufficient when all is going well, though when an alliance party is at significant commercial risk, legal recourse may be the most appropriate avenue for action.

110 Most alliances provide recourse to the courts for acts involving wilful default or insolvency.
111 Chew, above n 15, 329; Thomas, above n 63, 335-8.
There is also a credible risk that governments may abuse the alliance contracting strategy. Alliances offer significant benefits when the scope of a project is unknown or when aggressive schedules are required. The alliance may thus become the last refuge for those with poor specification development skills or those with dubious project management competence. This view appeared in an interview with a senior alliance manager who observed that alliances could be used as a means to avoid doing the ground work for a contract.\(^{112}\) Chapter three explores this issue where I examine the reasons why government use alliances and how there is likely an overuse of alliancing.

These potential alliance governance risks form the basis of this study with an exploration of how alliances deal with value for money, accountability, reduced legal remedies and fiduciary obligations. As discussed previously, there is an extensive literature espousing the benefits of alliances but no comprehensive study on the costs of alliances.

**Research Aims and Research Question**

The aims of this study are to identify the relative costs and benefits of alliance contracts and to explore the suitability of alliance contracts for the delivery of public sector outcomes. My research addresses the concerns raised in the alliance literature that alliances fail to demonstrate value for money, dilute accountability and create fiduciary obligations.\(^{113}\)

My research question is: ‘are alliance contracts compatible with public sector governance objectives?’ I have broken this principal research question down into subordinate research questions. These subordinate research questions address gaps in the alliance literature,\(^{114}\) especially audit report concerns. These subordinate research

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\(^{112}\) Interviewee F.

\(^{113}\) Though there is a plethora of papers dedicated to alliancing in Australia, very few articles are peer reviewed. The only available peer reviewed papers that explore alliance risks are: Chew above n 15; Kiers, above n 104; Thomas, above n 63; Quick, above n 94, 3-35 (this latter publication only provides limited content on alliancing).

\(^{114}\) See especially, Chew, above n 15; Hayford, above n 90; Stephenson, above n 91.
questions also build upon prior research, namely that research which explores the benefits of alliancing. The subordinate research questions I examine are as follows:

- **RQ1a** What do contemporary alliance contracts look like?
- **RQ1b** What risks are associated with alliance contracts?
- **RQ1c** Why do Australian Governments use alliance contracts?
- **RQ1d** What is the procurement governance environment for governments?
- **RQ1e** Do alliances comply with the governance obligations of government?
- **RQ1f** How do governments satisfy value for money criteria?
  - **RQ1f.i.** How are target costs estimated?
  - **RQ1f.ii.** How are target costs validated?

In answering the research question and sub-questions, I review alliance contract terms and conditions; conduct interviews and surveys with government alliance managers; conduct a literature review to qualify the governance framework of governments; review equity, partnership, and strategic alliance case law; conduct case studies; and examine alliance audit reports. The methods by which I answer these subordinate research questions are summarised at Table 1-1. I have selected multiple research methods in answering each subordinate research question to triangulate the findings of my different data sources and to reduce the risks of response biases. I have used multiple methods where a single method cannot comprehensively answer the research sub-questions. For example, where I exploit surveys and interviews to establish the governance framework of the public sector, it is likely that participants may not be fully aware of their governance framework or may interpret that framework incorrectly. I therefore augment the interview and survey responses with a review of government policy documentation, audit report findings, and case studies.

Furthermore, triangulation of responses reduces the risks on interviewer biases. I have over ten years experience as a project manager and design engineer in the

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115 Walker et al, above n 85.
procurement of complex military systems. This includes experience in drafting contract specifications, developing procurement risk studies, tailoring head contract terms and conditions, and the developing of capability operational concept documents. There was therefore a potential bias for leading interviewees and steering discussions to suit my agenda. I mitigate these potential biases with the selection of multiple research methodologies that are complementary to the research question and through triangulating answers. The relevance of each subordinate research question is discussed below.

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Table 1-1 - Research Questions and Selected Methodology

What do contemporary alliance contracts look like?

I address this question so that I can identify the various forms of alliance contract (pure, hybrid, competitive TOC) and compare these to the conventional contracts used in the public sector. The content of the alliance contract reveals the degree of risk sharing or risk transfer between alliance participants, how decision-making is managed and how the alliance relationship is managed. These elements all contribute to answering the question of how well alliances comply with the governance objectives of the public sector. I conduct a comparison of conventional contract features to those of alliances in Chapter two.

What risks are associated with alliance contracts?

An assessment of the suitability of alliancing in the public sector requires an understanding of alliance risks. The alliance literature, government guidance papers and audit reports cite many potential risks with alliancing in the public sector. The main risks include reduced legal remedies, failure to demonstrate value for money, opportunistic behaviours from alliance participants, creation of fiduciary obligations, conflicts of duty, governance incompatibility (reduced transparency, integrity, accountability), and decision-making deadlocks. The likelihood and consequence of these risks need to be qualified so that the costs and benefits of alliances can be compared to alternative procurement options.

Why do governments use alliance contracts?

The alliance literature, especially government procurement guides, cite various motives for the use of alliances in the public sector including cost savings, innovation, reduced disputes, schedule benefits, and improved safety in construction when compared to conventional or contracts. Alliances also offer significant benefits where the scope of the project is difficult to determine and complex stakeholder interactions are expected. To answer the primary research question I explore

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118 I do not attempt to provide an exhaustive list of alliance risks but rather extract the significant risks identified in the alliance literature that are relevant to my research questions. See, eg, Victorian Government, above n 29, 18; Chew, above n 15; Hayford, above, n 90.

119 Walker et al, above n 85, 82-4; Victorian Government, above n 29.

120 Ibid 17; Ross, above n 12.
whether these reasons are valid by examining how procurement managers perceive and measure the benefits of alliancing.

In answering this question, I also explore the current engineering and construction market to see whether the use of alliances is a response to a market of limited supply. Chapter two provides an overview of the engineering market, government industry sector plans and the causes of disputes in the construction and engineering sector to help answer this research question.

What are the governance obligations imposed on governments?

To test the suitability of alliances contracts in the public sector, it is first necessary to determine what the governance objectives of governments are at federal, state and local levels and to establish the rules by which governments operate in the procurement domain. In Chapter four, I explore the differences between public and private sector governance and provide a consolidated framework of the governance objectives at federal, state and local government levels. The definition of a governance framework therefore allows subsequent assessment of whether alliances actually comply with these rules.

How do governments satisfy value for money criteria?

This research question comprises two parts. First, I determine the mechanism by which the alliance develops its target cost, and second, I examine how this target cost is validated. These questions stem from criticisms in several audit reports and the alliance literature, which state that value for money is both difficult to demonstrate

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122 NSW Audit Office, above n 96.
and achieve within alliances. These questions are crucial to answering the primary research question, as value for money is a fundamental tenet of public sector governance. There is much debate about the need for price competition to demonstrate value for money in alliances. A consequence of this debate is the emergence of the competitive TOC alliance. This is discussed as part of my demographic analysis of alliances at Chapter two. Exploring the evolution of alliances and the methods by which value for money is both demonstrated and achieved is necessary to establish whether alliances are suitable for public sector projects. This has implications not only on the format of the alliance contract but also upon the capabilities of governments as, in the absence of price competition, substantial emphasis is placed on governments to contribute to the development of target costs and the validation of such costs.

**Methodology**

My research methods are principally qualitative, comprising explanatory and exploratory research. A qualitative framework is appropriate, since I required a research method that enabled me to explore the issues surrounding alliance contracts through open-ended questions and a desire to capture the points of view of interviewees. My exploratory questions establish the alliance demographics and common alliance contractual frameworks as well as a general overview of the conditions applicable to conventional government contracts.

My explanatory questions focus on the ‘hows’ and ‘whys’ of alliances, exploring how risks are managed and why alliances were selected to begin with in lieu of other procurement options. I selected specific research methods based on their achievability, relevance and compatibility with my primary and subordinate research questions. I discuss these research methods below.

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123 Cowan et al, above n 20, 1-4; Chew, above n 15, 335.  
124 Australian National Audit Office, above n 121.  
The first phase of my research comprised collection of alliance contract terms and conditions from federal, state and local governments, as well as interviewing alliance managers to ascertain whether their contract was ‘consistent’ with a standard form of alliance contract. For each alliance contract I received, I examined the relevant clauses to determine the roles and operation of the alliance leadership team, how target costs are determined, how exclusion clauses operate and how disputes are managed in that alliance.

I also conducted a content analysis on four alliance contracts to explore language that may support the existence of fiduciary obligations. For example, counting occurrences of the terms, ‘collectively’, ‘reliance’, ‘dependence’, ‘on behalf of’ etc.

I reviewed eleven alliance contracts to explore the terms of the different types of alliances, namely pure, hybrid and competitive TOC alliances. In addition to relying on material from alliance managers, I triangulated my analysis of alliance terms and conditions by interviewing three experienced alliance contract drafters to determine the more common alliance contract terms and conditions and to establish what the trends were for future alliance contract clauses.

I undertook an extensive literature review to refine definitions of alliances, identify the risks associated with alliance contracts and analyse the current engineering and construction market. The selection of my alliance literature stemmed primarily from published proceedings at the International Industry Research and International Quality.

127 As alliance contracts terms and conditions are commercially sensitive, I anticipated a poor response rate for full disclosure, hence I asked alliance managers to indicate whether their contract had similar ‘alliance leadership team’ clauses, ‘no disputes’ clauses and ‘fiduciary exclusion’ clauses compared to a ‘boilerplate’ alliance contract I presented during interviews. Where the interviewee’s alliance contract differed, I asked for a broad overview of those differences.

128 I adopted Krippendorf’s procedure for content analysis, albeit my content analysis was limited to a few specific phrases in alliance contracts and conventional contracts. Klaus Krippendorff, Content Analysis: An Introduction to Its Methodology (2nd ed, 2004).
and Productivity Centre alliance contract seminars run six monthly in Australia, prior bibliographic research on alliancing conducted by the University of Melbourne,\textsuperscript{129} and government policy documents related to alliances.\textsuperscript{130} My review of the construction and engineering market comprised literature reviews from the Australian Bureau of Statistics, Construction Forecasting Council and Engineers Australia.

I conducted a comprehensive literature review to determine the governance environment applicable to public bodies. To do this, I reviewed the codes of conduct of several federal and state government organisations (see Chapter four), as well as the Chartered Accountant’s governance guide for local governments. My literature review here also encompasses the extensive body of knowledge related to outsourcing and privatisation including the key research by Domberger, Hodge and Savas. I also drew governance content from guidance papers and policy from the Australian National Audit Office and respective State Government Auditor Generals.

\textit{Case Law Review.}

I conducted a review of relevant case law to explore the court’s interpretation of tendering processes and public sector procurement, the likelihood of fiduciary obligations arising in alliance contracts, and the consequences of good faith obligations in contract. As no specific case law involves alliance arrangements in Australia,\textsuperscript{131} my case law review involved drawing analogies from principles developed in cases examining similar relational contracts such as joint ventures.

\textit{Alliance Manager Interviews.}

My primary research method was through interviews with alliance managers. I used a ‘survey’ style interview template to answer elements of the research questions relating to the motivation for using alliance contracts and governance compatibility, followed

\textsuperscript{129} Clifton et al, above n 77.
\textsuperscript{130} See especially, Victorian Government, above n 29, NSW Government, above n 29; Queensland Government, above n 29.
\textsuperscript{131} Willoughby City Council v Sydney Water Corporation (1999) NSWLEC 131involved a pure alliance contract though this action did not involve discussion of any terms of the alliance contract or any operation of the alliance contract.
by an informal conversational interview. I selected interview participants from the following sources:

a. Federal, state and local government information websites on alliance contracts;

b. Points of contact from the alliancing conference proceedings in Australia; and

c. Referrals from alliance interviewees (Snowballing, i.e. gaining further points of contacts from the recommendations of interviewees).

In my interviews, I asked participants from government (federal, state and local) to volunteer information on their experiences with the use of alliance contracts and, in particular, to outline the risk profile of their project, why they used alliancing, their perceptions of alliance risks, whether they consider their value for money objectives were satisfied, and whether they believed such procurement vehicles are compatible with their organisational and individual governance objectives.

To ensure a representative spread of responses I aimed to conduct information rich ‘intensity sampling’ with a minimum of four interviews each for local, state and federal government alliances, with a minimum of fifteen alliance interviews. As a minimum, I ensured each interview or survey participant was an alliance board member, project manager or commercial manager of the relevant government organisation. I also aimed to ensure that my interviews did not involve participants from the same alliance. My preference for conducting interviews was as a face-to-face arrangement, though due to the geographic diversity of alliances, I conducted several interviews via telephone. Twenty five interviews were conducted.

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134 Patton, above n 116, 171; Elizabeth Kemper, Sam Stringfield, and Charles Teddlie, ‘Mixed Methods Sampling Strategies in Social Science Research’, Abbas Tashakkori et al, above n 133, 278.
Surveys

Where participants were unable to conduct an interview, I requested they complete a survey addressing the issues covered in interviews. This survey captures the same questions I asked during interviews, namely, what was the risk profile of their project, why they used alliancing, what was their perceptions of alliance risks, whether they consider their value for money objectives were satisfied, and whether they believed such procurement vehicles are compatible with their organisational and individual governance objectives? The data gathered from surveys is compatible with that of the interviewees (estimates of alliance risks and benefits), although the survey data is not as rich.

My selection of survey participants was the same as that used in interviews. The survey used in this research is attached at Annex A. A total of five surveys were completed.

Audit Report Review

I further examine the governance arrangements of alliances through the review of alliance contract audit reports. At the time of writing, audit reports are available for four Australian alliance contracts, namely:

a. The National Museum Audit Report.\textsuperscript{135} This report on a federal government pure alliance provides a favourable report of alliance governance arrangements on this project; and

b. The Northside Storage Tunnel Audit Report.\textsuperscript{136} This report on a state government pure alliance criticises the governance arrangements of this alliance and the failure to demonstrate value for money;

\textsuperscript{135} Australian National Audit Office, ‘Construction of the National Museum of Australia and the Australian Institute of Aboriginal and Torres Strait Islander Studies, Audit Report’ (2000).\textsuperscript{135}
\textsuperscript{136} NSW Audit Office, Performance Audit, ‘Sydney Water Corporation: Northside Storage Tunnel Alliance’ (2003).
c. Queensland Annual Audit Report for 2007. This state government annual report encompasses an audit of the Gold Coast Desalination Plant Alliance. The governance arrangements for this pure alliance were rated very poorly; and

d. The Tugun Bypass Audit Report. This report, for a competitive TOC alliance, recognised the successful delivery of value for money and recommends the use of alliancing for future projects.

I also investigated audit reports from overseas alliances involving public sector organisations. These overseas audits also identify some governance issues with alliances.

The audit reports encompass an assessment of alliance project risks, determination of value for money criteria and identification of failures to meet governance objectives. I used the audit reports as a prompt to explore the risks of alliances during my interviews and to explore whether audit reports and auditing in general are a concern for government alliance managers.

Case Studies

I conducted two case studies, focusing on a local government competitive TOC alliance and a state government pure alliance. The selection of case study participants was opportunistic since there were few alliances where work was still in progress and progress was of sufficient maturity to be of research value. The primary aim of my case studies was to gain insight into industry participant’s views on alliancing, gain greater access to alliance documentation, and observe the dynamics of the respective alliance culture in operation. Data collected during the case studies included trade studies, employee codes of conduct, minutes, alliance procedures, progress reports, and probity audit reports. I validated collected data by interviewing the authors of the

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respective data where available. I conducted the case studies by remaining on site with the alliance participants for a one-week period. I managed commercial sensitivities by establishing a one-way confidentiality deed between the alliance participants and Griffith University. To protect commercial sensitivities, I also developed a procedure whereby the alliance board or government executive body had the right to vet any of my case study content. Though this introduced the risk that the alliance board could sanitise relevant content from my case study report, this process increased the likelihood of alliance participation in case studies. The manner in which I conducted the case studies follows that recommended by Yin, the leading author of case study research.\footnote{Robert Yin, \textit{Case Study Research: Design and Methods} (1984), 20.} Annex B includes the process used to conduct case studies in my research.

In addition to my two alliance case studies, I also participated in a review of a state government hybrid alliance program on behalf of a leading law firm. In this role, over a two-week period, I reviewed the terms and conditions of an alliance program contract and advised the non-owner client of the commercial risks and opportunities associated with this contract. This action research\footnote{Patrick Costello, \textit{Action Research} (2003) 3-6; Peter Reason and Hilary Bradbury, \textit{Handbook of Action Research} (2007) 3-7; Patton, above n 116, 221.} provided insight into how different clients perceive the risks of alliance contracts. This activity also brought me into contact with leading commercial lawyers with extensive alliancing experience.

Interviews, surveys, and case studies were conducted in accordance with the Griffith University Human Research Ethics Manual.\footnote{Human Research Ethic Protocol LAW/28/05/HREC <http://www.griffith.edu.au/or/ethics/humans/> at 7 April 2008.}

Table 1-1 provides an overview of my subordinate research questions and the methodology applied to answer each of these questions. It shows that I apply a minimum of three methods to address each subordinate research question, so that, with this depth of triangulation, the influence of response biases and interviewee biases are minimised.
Research Outcomes and Thesis Outline

In this study, I argue that there are two key failures in the use of alliances by Australian governments. First, alliances provide a less robust governance framework than conventional contracts and the alliance literature understates this disadvantage. Second, many of the benefits of alliances are overstated in the literature and procurement officers may simply expect the form of the alliance contract to deliver positive outcomes rather than the substance of the alliance process coupled with the commitment of participants.

While alliances offer some scope for improved risk management when compared to conventional fixed price contracts, the alliance introduces many governance risks including failure to satisfy public sector accountability objectives, failure to demonstrate value for money, a lack of transparency in tender evaluations and an increased risk of a conflict of duty. Government procurement guides fail to recognise many of these governance risks or severely understate them.

In many areas, alliance benefits are overstated. I argue that project outcomes are largely independent of the form of contract used since project success is largely contingent on the processes used to allocate risk. What is more important are the intents of the parties, skills of contractors and the organisational culture available to deliver cost effective and timely outcomes. For these reasons, claims that alliances capture the benefits of relational contracts and reduce disputes are erroneous.

This thesis comprises two parts, corresponding to the themes in my subordinate research questions. First, what is the alliance environment (discussed in Chapters two, three and four); and second, what are the alliance risks, costs and benefits (discussed in Chapters five, six and seven)?

Chapter two is dedicated to defining the procurement environment for governments. This chapter explores the range of procurement options available to governments and how these procurement options deal with risk management. This chapter then explores the construction and engineering market to quantify the supply and demand
of services suitable for alliance delivery and to explore the incidence and causes of contract disputes. Following this, the chapter explores those features of alliances that differ from conventional contracts. This activity encompasses a review of the terms and conditions of eleven Australian alliance contracts. This chapter also provides a demographic analysis of where and when governments use alliance contracts, in order to understand how alliances are used and to place the risks of alliance contracts into context. This chapter therefore summarises what alliances are, when and where they are used, and what alternatives are available to governments.

Chapter three is dedicated to exploring why governments use alliances. It explores the reasons forwarded in government policy and procurement guides for when alliancing is appropriate and compares these express reasons with real world practice such as the views of alliance managers and from observations made during my case studies. This chapter also explores the cited benefits of alliancing as a form of relational contract. I argue that the form of contract is less important than the processes used by the project participants to identify and treat risk. I use examples of the success of partnering strategies on fixed price contracts to demonstrate this.

Chapter four explores the public sector governance environment. To assess the suitability of alliances I first establish the rules by which governments operate in procurement. This chapter explores the general governance dimensions of ‘compliance’ and ‘performance’ and then focuses on how federal, state and local governments define their public sector governance environment. This chapter also includes a discussion on the rules and challenges applicable to government owned corporations, as these organisations are prolific users of alliances. This chapter introduces the fundamental governance principles of integrity, accountability, transparency, efficiency and stewardship (value for money). Defining these governance principles and exploring how they are interpreted by public sector managers provides a framework within which I can subsequently assess the suitability of alliancing and in particular how alliances delivery value for money, whether alliances create conflicts of duty, whether alliances dilute accountability and whether alliances provide adequate transparency to stakeholders.
Chapter five builds upon the defined public sector governance environment with an examination of alliance features that fail to comply with these express rules and objectives. In particular, this chapter explores:

a. *accountability* and how the alliance ‘no disputes’/‘no liability’ provisions and ‘virtual organisation’ management structure diminishes responsibility;

b. *integrity* and how alliances create a conflict of duty for public sector managers and increase the risks of the imposition of fiduciary obligations; and

c. *transparency* and how pure alliances fail to provide openness in some decision-making processes, especially the tender selection process and how visibility of project costs and schedules are only provided after governments select a preferred tenderer.

Chapter six examines the governance objective of value for money. Value for money is a key benchmark for assessing the success or otherwise of governments’ outcomes. I therefore use this benchmark to gauge the suitability of alliancing in the public sector. Chapter six first summarises the various definitions of value for money at federal, state and local government level and concludes that these definitions are both nebulous and unquantifiable. Furthermore, chapter six demonstrates that the risk treatment practices of governments make value for money assessments prone to inappropriate manipulation.

The chapter then explores how governments manage compensation in alliances, how target costs are developed, how target costs are validated, and what hidden costs are present in alliancing. Chapter six demonstrates that the subjective definitions of ‘value’ results in a situation where practically any governments’ decision can be justified as ‘reasonable’. Furthermore, the costs of doing business with alliances are high compared to well managed conventional contracts, hence the almost evangelical fervour attached to alliance use is unjustified.
Chapter seven continues on the governance theme of value for money by exploring the tender evaluation process for government. Previous chapters explore when alliancing is and is not suitable. Should governments elect to use an alliance, their next step is to select and alliance team best able to deliver value for money. Alliances introduce substantial risks in selecting prospective tenderers as alliance tender responses are promissory (rather than binding) and tender selection requires assessment against primarily subjective, non-price evaluation criteria. Chapter seven explores these challenges, drawing from the results of my case studies and interviews. I conclude that the alliance tender evaluation process is largely a ‘beauty parade’ where alliance tenderer’s ‘promise everything but guarantee nothing’. This makes it very difficult to gauge whether governments will receive value and is likely at odds with the Australian/United States free trade agreement.

Chapter eight summarises the major findings of this study, and then provides recommendations for reform in the government alliance guidelines. I identify that, despite the governance risks of alliancing, for many projects, alternative procurement options are unsuitable. Alliances therefore represent the lesser of two or more evils. Hence, even where alliances are deemed by governments to be the most suitable procurement option, this study identifies where improvements need to be made in alliance governance arrangements. These improvements include the consideration of all alliance hidden costs, consistent treatment of risks and ensuring tender evaluations are repeatable and fair.
Chapter Two - Government Procurement, Alliances and Their Use

‘All under the Heavens is chaos - and the situation is excellent’
- Mao Zedong (1893-1976)

Introduction

The first Australian public sector alliance agreement appeared as recently as 1998. Within a decade, the use of alliances grew to over a 120 projects worth over $25 billion. What has sparked such overwhelming interest in this relatively new procurement option? The alliance literature offers several reasons, including a significant change in the construction and engineering market, a perception that there were a growing number of disputes in the construction industry and, as a consequence, a general dissatisfaction that conventional contracts were not up to dealing with this changing environment.

Another key reason advanced for recent alliance use is that there has been a dramatic change in the circumstances for government procurement since the late 1980s. The 21st century dawned with a public sector with reduced numbers, diminished skills and greater workloads. At the same time, the capacity of suppliers in the construction and engineering industry had changed dramatically, resulting in an acute skills shortage in Australian industry. Consequently, there is a lessening of competition and a substantial increase in the bargaining power of suppliers in the construction and engineering market. In this chapter, I describe the changed procurement dynamics of the construction and engineering industry, which forces governments to re-evaluate

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2 See Chapter two, footnote 16.
3 I adopt a broad definition of the term ‘construction and engineering’ to represent project delivery of roads, rail, buildings, water treatment facilities, other infrastructure and major systems.
procurement options for project delivery. Consequently, governments have rejected arms-length, adversarial contracts in favour of relational style, collaborative contracts.

A further claim made in the literature explaining the rapid take up of alliancing is that alliances offered a means for reducing contract disputes. Alliances, it is argued, would provide for a collaborative relationship and a no-blame framework for the parties. Several authors advanced the view that construction projects have been plagued by disputes with attendant cost and schedule overruns. These authors further claimed that only alliances could curtail these failures. This chapter demonstrates that this argument fails on two counts. First, the incidence of disputes is substantially overstated in the literature. Second, where disputes do occur, they originated mainly from documentation errors. Consequently, the form of contract is unlikely to address the cause of the disputes; rather, the form of contract simply adjusts the remedies available to resolve those disputes.

This chapter tests the claims that, when compared to conventional contracts, alliancing is better suited to deal with these radical changes in the procurement environment. The chapter explores what alliances are, how they differ from conventional contracts, and where are they used. Several themes emerge from these investigations. First, an analysis of alliance terms and conditions reveals that there are three classes of alliances in use by the public sector: pure, competitive TOC and hybrid alliances. These classes of alliance deal with procurement risks quite differently when compared with conventional contracts. Nevertheless, procurement managers are amending the terms of conventional contracts to capture some of the benefits of alliances. Second, alliance use is growing at all levels of government, and I argue that this is leading to an overuse of alliancing, especially since I demonstrate in this and later chapters that alliances fail to deliver many of their claimed benefits.

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Though this chapter does not explore why the public sector has embarked on the use of alliances to deliver project outcomes, it does set the foundation for answering this question in Chapter three. This chapter defines what situation governments face when procuring services, what are alliances, and where are they used. In so doing, it addresses my research sub-question ‘what do contemporary alliances look like?’

**Procurement Situation - Past, Present and Future**

The literature claims alliances are better able to cater for high-risk projects, engage industry when supply is limited, and provide a means to reduce disputes when compared to conventional procurement options. To examine whether these claims are true requires answering the following questions:

a. What are conventional contracts, where are they used, why are they deemed unsuitable, and how are they evolving to meet the current and emerging procurement situation;

b. What is the current and emerging market for engineering services and how will procurement option selection be affected by this market; and

c. What is the incidence, and what are the causes, of contract disputes and will they be affected by procurement option selection?

**Conventional Contracts**

Alliancing is but one of many procurement options available to governments for delivering major engineering projects. Why then are governments increasingly using alliances? To answer this question demands an assessment of the range of procurement options available to the public sector and an exploration of the features of these contracts.

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5 Ross, above n 4, 21; Hutchison, above n 4; Victorian Government, above n 4, 17; John Purcell and Jim Ross, ‘Project Alliancing – Not a Universal Panacea’ *Engineers Australia* (9 June 2005), 1.
Governments’ dominant form of procurement is with conventional contracts, which can comprise traditional and non-traditional procurement options. Traditional contracts are **construct only** contracts. These contracts rely on the principal’s delivery of a detailed design to the contractor for subsequent progression of the project works. Non-traditional procurement involves not just the construction phase of a project but also design activities. Typical non-traditional contracts include design and construct; design, construct and maintain; managing contractor; and spiral development contracts. The variations in these non-traditional procurement options relate to how risk is allocated between contractor and principal and are discussed later in this chapter.

In addition to the form of contract used, governments are required to select the payment method for each contract. Remuneration may involve fixed price (lump-sum) or schedule of rates arrangements. The remuneration model used for each contract will fundamentally alter the risk profile for that procurement option. For example, fixed price contracts seek to transfer risks to contractors. By comparison, schedule of rates contracts involve the principal accepting most project risks. The public sector uses fixed price contracts more than any other delivery mechanism.

When using these conventional contracts, governments typically adopt ‘boilerplate’ or ‘standard’ forms to reduce transaction costs (saving time and money in negotiating contract terms), provide consistency of agreed terms, and establish minimum

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9 Governments may also adopt a combination of fixed price and schedule of rates remuneration. An example of this is the use of guaranteed maximum price contracts.

10 Productivity Commission, above n 6, xix.
standards of legal protection. Examples of the standard contract forms used by
Australian governments are the Australian Standard suite of contracts including:

a. AS2124-1992 General Conditions of Contract;
b. AS4000-1997 General Conditions of Contract; and

These Australian Standards are popular at all levels of government. Other examples
of standard forms of contract include the Department of Defence’s ASDEFCON suite of contracting documents for request for tenders and contract terms, and the
NSW government’s GC21 contract. These conventional contracts typically advance
an adversarial rather than a collaborative approach, with reliance on risk transfer to
the party most suited to manage project risk, and the use of liquidated damages
clauses to enforce performance. In sum, most conventional contract adopt a win-lose
approach.

In addition to providing consistent terms and conditions, the process for selecting
tenderers with conventional procurement options is also standardised in most
government organisations. Governments procure most services and projects under
competitive tenders. Competitive tenders use a system to select contractors that ‘must

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13 From my interviews, respondents indicated that many local and state governments utilise the
AS2124-1992, AS4000-1997, and AS4300-1995 contract formats or a contract type tailored to that
department. See also Victorian Government, Ministerial Direction 2, Contractual Requirements for
Public Construction (Mar 1997) which mandates standard forms of contract for major works including
15 The NSW government primarily utilises GC21 General Conditions of Contract (July 2003) in lieu of
the AS2124-1992 or AS4000-1997 contracts. The GC21 contract is similar to AS2124-1992 in that
lump sum/schedule of rates can be selected (s2.1) and options remain for liquidated damages (s55).
16 See, eg, Alan Griffin, ‘C21 Contract Conditions – “Ugly Duckling is really a Swan”’ (1997) 55 Australian Construction Law Newsletter, 12; Brian Farmer, ‘Australian Standard conditions of
Contra, John Pilley, ‘C21 Contract Conditions – 57 Examples of Unfairness’ (1997) 53 Australian Construction Law Newsletter, 6 who argues that the NSW C21 style contracts unfairly burden the
contractor with risks that should be managed by the principal. Note that the more recent GC21
addresses many of the criticisms levied by Pilley on the C21 contract.
17 GC21 General Conditions of Contract, above n 15, cl 55.4; AS4000-1997, cl 37.2.
not only be fair and equitable but must also be perceived as being fair and equitable.\textsuperscript{18} Standard contract terms and conditions contribute to reducing tendering costs and the length of time involved in the tendering process, because tenderers are familiar with the risk allocation process of standard contracts. This facilitates faster tender responses and shorter contract negotiations. I discuss the tendering process for alliances and compare this to tendering within conventional contracts at length in Chapter seven.

Governments have extensive experience in the use of conventional contracts and there is a substantial body of knowledge exploring the costs and benefits of these procurement options.\textsuperscript{19} To explore the suitability of these contracts for public sector procurement requires an understanding of how these contracts address risk.

\textbf{Risk Allocation with Conventional Contracts}

One of the frequently cited benefits of alliancing is the superior sharing of risk between principal and contractor when compared to conventional contracts.\textsuperscript{20} Conventional contracts are therefore perceived as unsuitable for high risk projects. To test the validity of this claim and to compare the relative benefits of alliancing to other contracting options in later chapters, I explore how conventional procurement options deal with risk. In doing so I demonstrate that many conventional forms of contract can and do involve effective risk sharing. It is therefore inaccurate to state that only alliances are able to equitably manage contract risk.

A government has a number of choices available to it regarding the form of contract it might use to deal with risk sharing and risk allocation. Procurement managers recognise that risk allocation is a key issue when deciding upon the appropriate contracting mechanism.\textsuperscript{21} Though there is a temptation for principals to try and shed all project risks, this may not always be desirable, because risk allocation will undoubtedly come at a high price. For example, if a principal requires contractors to accept the project risks of site latent conditions, specification errors and adverse

\begin{itemize}
  \item \textsuperscript{18}NPWC/NBCC Joint Working Party, ‘No dispute : strategies for improvement in the Australian building and construction industry’ (May 1990), 39.
  \item \textsuperscript{19}Ibid; See Chapter two, footnotes 16, 28, 29.
  \item \textsuperscript{20}Ross, above n 4, 21; Victorian Government, above n 4, 17.
\end{itemize}
weather under fixed price arrangements then contractors will undoubtedly load their tender responses with very large *contingency fees*. Principals must pay this fee whether risks eventuate or not. A more suitable strategy for the public sector may therefore involve equitable risk allocation in procurement.

Abrahamson developed an ideal model for equitable risk allocation in contract. Abrahamson’s principles state that a party should bear a contract risk where:

a. It is in [their] control, i.e., if it comes about it will be due to wilful misconduct or lack of reasonable efficiency or care; or

b. [They] can transfer the risk by insurance and allow for the premium in settling his charges to the other party... and it is most economically beneficial and practicable for the risk to be dealt with in that way; or

c. The preponderant economic benefit of running the risk accrues to [them]; or

d. To place the risk on [the contractor] is in the interests of efficiency (which includes planning, incentive, innovation) and the long term health of the construction industry on which that depends; or

e. If the risk eventuates, the loss falls on [the principal] in the first instance, and it is not practicable or there is no reason under the above four principles to cause expense and uncertainty, and possibly make mistakes in trying to transfer the loss to another.\(^{22}\)

Though governments recognise the value of these principles and tacitly adopt them,\(^{23}\) in many situations they are ignored. For example, governments often load contractors with risks that are beyond that contractor’s control.\(^{24}\) The following clauses from a typical government contract illustrate this point:

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\(^{23}\) NPWC/NBCC Joint Working Party, above n 18.

\(^{24}\) Pilley, above n 16, 6.
a. The principal assumes no responsibility for the reliability of the tender documentation,

b. The tenderer must acquaint itself with all information, and

c. Information is provided for the convenience of tenders only and this information is not guaranteed.  

Project success is highly dependent on the integrity of tender documentation. If governments fail to guarantee tender documentation or other information provided to tenderers then this will undoubtedly result in the significant loading of contingency costs into bids. This is also likely to increase the risk of disputes, especially where governments provide misleading information in tender documentation. Ultimately, the quality of tender documentation is a principal’s risk and the principal should therefore own and manage this risk.

The scope for allocation of risk varies between contract types. Fixed price contracts typically involve transferring substantial risk to the contractor, whilst schedule of rates contracts transfer most risk to the principal. The majority of the standard forms of contract allow for the use of fixed price, schedule of rates or a combination of the two mechanisms. For example, a contract may use schedule of rates arrangements for design components and fixed price arrangements for construction elements.

Similarly, conventional contracts can incorporate a risk sharing philosophy with guaranteed maximum prices or even incentive bonuses for contractors. It is therefore inaccurate to state that conventional contracts do not support equitable risk allocation. Governments can, and often do, tailor standard forms of contract to allocate risk

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27 See, eg, AS 4000-1997 General Conditions of Contract, cl 5.
28 This strategy is often used in the two stage design and construct contract. See, eg, Roger Quick ‘Queensland’s ECI Contract’ (2007) 24 (1) International Construction Law Review 3, 15; Queensland Department of Public Works, Capital Works Management Framework - Procurement Selection and Generic Contracts (undated).
equitably and effectively.\textsuperscript{29} It is this evolution of conventional contracts that had led to the development of novel procurement options. These novel procurement options, including alliances, treat risk far differently to fixed price construct only contracts.

**Novel Procurement Options, Partnering and Risk Transfer**

Alliancing involves a sharing of all risks between principal and contractor. The alliance adopts compensation mechanisms geared towards ensuring everyone wins or everyone loses. This is in direct contrast to the fixed price arrangements found in conventional contracts where the contractor typically assumes most project risks or schedule of rates arrangements, where the principal assumes most project risks. These two extremes of risk allocation are often undesirable, as this can result in excessive contingency fees or no incentive on contractors to perform. This has led to the emergence of procurement options where risk treatment varies depending on the life-cycle of the contract. Furthermore, governments are overlaying partnering principles into conventional contracts as a means to foster collaboration and reduce disputes. This section explores how conventional contracts are evolving to adopt more balanced risk allocation in procurement.

One recent contracting initiative that reflects the evolution of conventional contracts to better suit higher risk projects is a strategy that promotes Early Contractor Involvement (ECI).\textsuperscript{30} ECI contracts are relational contracts that foster the involvement of contractors in the preliminary stages of a contract. ECI contracts typically involve two-stage design and construct contracts with schedule of rates arrangements used for design activities and fixed price or guaranteed maximum price arrangements used for construction. This strategy provides flexibility, promotes a better understanding of risk, and reduces duplication of effort.\textsuperscript{31} The ECI contracting philosophy captures

\textsuperscript{29} See, eg, Queensland Department of Public Works ‘Managing Contractor and Two Stage Design and Construct Contract’ in Queensland Government, Department of Public Works, *Procurement Selection and Generic Contracts* (undated).


\textsuperscript{31} Quick, above n 28; Neil Doyle, Queensland Government, Department of Main Roads ‘Models of Public-Private Co-operation in the Current Environment’ (7 Jul 2005).
many of the benefits of alliancing, without the sharing of all project risks after completion of project design activities.\(^{32}\)

Australian governments are also pursuing some ‘partnering’ philosophies for the delivery of service and products. Partnering is a non-binding form of cooperation rather than a legally binding requirement.\(^{33}\) Governments can adopt partnering independent of the contractual model used.\(^{34}\) An example of government’s adoption of partnering principles appears in the Victorian Government’s *Partnership Victoria* Policy, which states that partnerships are suitable for projects with the following features:

a. Outputs are clearly specified, including measurable performance standards;

b. Governments make payments only upon delivery of the specified services, to the required standards;

c. Projects involve a relatively long-term commitment;

d. Risk allocation between the parties is clear and enforceable, with consequential financial outcomes; and

e. Government’s responsibilities are clearly articulated with respect to the monitoring of outcomes.\(^{35}\)

\(^{32}\) The emergence of more balanced risk sharing philosophies in contracts such as the NSW Government’s GC21 and the Australian Standard 4000 suite is also indicative of a shift away from ‘hard dollar’ contracts and the adoption of innovative procurement. See especially, Karen Manley, ‘Being the Best’ (2007) 27 at [http://www.brite.crcci.info/resources/pdfs/beingthebest_locked.pdf](http://www.brite.crcci.info/resources/pdfs/beingthebest_locked.pdf) at 8 April 2008.


Unlike alliances, a partnering arrangement seldom involves risk sharing, though the intent is usually expressed that the parties work collaboratively. I discuss the relative benefits of partnering in the context of relational contract in Chapter three.

There is therefore a plethora of procurement options available to the public sector. Governments may use conventional contracts with fixed price, schedule of rates or a combination of these two remuneration schemes. Alternately, governments may use novel procurement options such as alliances or ECI contracts. Furthermore, governments may adopt partnering principles layered above contractual frameworks.

The question procurement officers must ask is which procurement option is most suitable? The answer to this question is largely contingent on the procurement environment, in particular the construction and engineering market and the cause and incidence of contract disputes.

**Government Procurement – Market and Disputes**

The construction and engineering market has undergone significant change in the past decade. Demand for engineering services has increased substantially and there is a corresponding undersupply of those services. The consequences for the public sector is a lessening of competition and inflated prices for projects.

Most of the alliance literature fails to recognise the construction and engineering market as part of the business case for selecting alliancing and hence this implicitly forwards the view that market conditions should not be a consideration for procurement options selection. The literature also expressly claims claim that alliancing reduces disputes in an industry where disputes are rife.

This section tests these claims by exploring the construction and engineering market and the incidence and causes of contractual disputes. Two themes emerge from the analysis. First, the construction and engineering market has radically changed with a

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36 Purcell et al, above n 4.  
consequent lessening of competition and inflation of prices. Second, the historical incidence of disputes in the construction and engineering industry appear much lower than that cited in the alliance literature. Furthermore, the causes of these disputes are typically unrelated to the form of contract used.

**Supply and Demand in the Australian Engineering and Construction Market**

Different procurement options deal with competition in different ways. For example, fixed price contracts that governments offer for competitive tender are ideally suited where competition is robust and where governments anticipate several responses to requests for tender. Conversely, where competition is constrained, and where industry is unwilling to accept project risks, then schedule of rates contracts or alliances appear to be more suitable because these latter contracts maximise response rates to requests for tender and curtail inflated bids from single tenderers. Supply and demand within the construction and engineering market therefore influences the procurement options available for delivering favourable outcomes to the public sector. An exploration of this market assists with assessing whether alliances are or are not suitable for the delivery of public sector projects.

The current Australian construction and engineering market is heavily skewed towards suppliers; that is, it is ‘a seller’s market’. As one commentator has recently stated, ‘…the construction industry as a whole is at full stretch with both materials and skills in intense demand.’ This situation has arisen from two circumstances: a significant increase in the number and size of engineering projects, and a shortage of skilled labour in the engineering sector. The increases in demand and decreases in supply are inflating construction costs and reducing the number of competitively tendered bids for public sector projects.

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There is an unprecedented increase in the number and value of engineering projects in Australia. This growth in projects is documented in the Constructing Forecasting Council’s (CFC) estimates of engineering projects in Australia. The CFC estimates comprise both historical information and projected estimates for non-residential projects valued above $100 million. Figure 2-1 shows the significant growth of engineering project values across multiple industries including roads, water, electricity, rail, and bridges.

**Figure 2-1  Financial Year versus Engineering Sector spending $AU millions (nominal 07/08 dollars)**

Figure 2-1 shows that most sector project values have doubled over the past ten years. This represents annual growth in excess of seven percent. The increase in engineering and construction projects is placing greater pressure on buyers, especially governments, to achieve timely and cost effective outcomes.

There are several causes for the increase in demand for public sector projects, namely:

a. population growth and population redistribution;\(^{41}\)


\(^{41}\) Population growth has been accelerated by increased immigration and increased fertility. Coupled with this growth is a significant movement of people from rural Australia to urban areas. See, eg,
b. climate change and droughts increasing the need for water projects;\textsuperscript{42}

c. an underinvestment by previous governments driving a sudden increase in infrastructure investment (especially ports, roads and rail);\textsuperscript{43} and

d. Heightened regulation of public services (both tightening of standards and new regulation).\textsuperscript{44}

The forces that are influencing growth in the construction and engineering market will continue to drive demand throughout the coming decade, as the data in Figure 2-1 demonstrates.

Coupled with this increase in demand, a decrease in supply is exacerbating the challenge for governments to achieving timely and cost effective outcomes. Unemployment is at record lows (4.1 percent)\textsuperscript{45} and, more specifically, there is a shortage of skilled engineering personnel.\textsuperscript{46} A survey by Engineers Australia of 33 companies revealed a shortage of engineering labour in excess of 20 percent.\textsuperscript{47} As a

\textsuperscript{42} For example the Queensland government will expend over $9 billion over the next five years to secure water resources and most of this procurement will be via alliancing <http://www.qwc.qld.gov.au/tiki-read_article.php?articleId=190> at 2 May 2008.


\textsuperscript{44} For example, the enforcement of more strict waste water contaminant levels by the Queensland Environmental Protection Agency has resulted in a significant number of Queensland Authorities required to upgrade or replace waste water treatment plants. See, eg, Environmental Protection (Water) Policy 1997 (Qld) ; Other jurisdictions face similar requirements. See, eg, Australian Government, Environment Australia Water Quality Targets – A Handbook <http://www.environment.gov.au> at 25 March 2008.

\textsuperscript{45} This represents the lowest unemployment rate since 1976. Australian Bureau of Statistics, Labour Force Australia 6202.0 (Feb 08) <http://www.abs.gov.au> at 12 March 2008. Contra, William Mitchell and Victor Quirk, ‘Skills Shortage in Australia: Concept and Reality’ (Nov 05) Centre of Full Employment and Equity, University of Newcastle, Working Paper 05-16, 11 who criticise the classification of the employed as including an individual who works but one hour a week. As casual labour has increased, the authors argue that the ‘true’ unemployment rate is closer to 10 percent based on individuals who work less than 15 hours per week.


\textsuperscript{47} 33 organisations were surveyed (public and private) with a total employment pool of 3743 employees. There were 777 reported vacancies (21 percent). Andre Kaspura, ‘Survey Shows Extent of Skills Shortage’ (2006) 78 Engineers Australia 36.
consequence, there is greater competition for labour and upward pressure on wages.\textsuperscript{48} Project costs are rising with governments paying substantially more for the same outputs than they were previously.

The undersupply of and strong demand for construction and engineering services has contributed to several consequences, namely greater profit margins for suppliers,\textsuperscript{49} higher costs for the public sector and a substantial reduction in the responses to requests for tenders. My interviews with alliance managers confirm this latter point. Most interviewees stated that both the number and quality of responses to requests for tender have declined substantially over the past years. One interviewee said:

There is clearly a lessening of competition… We have to be very careful about our tendering processes, otherwise we may end up with no bids to our request for tenders.\textsuperscript{50}

Governments certainly face a challenge in acquiring cost effective and timely services since there is a significant shortage of supply. Increased demands for services over the short to medium term have exacerbated this challenge. Procurement officers must therefore be cognisant of the construction and engineering market when selecting procurement options.

\textit{Competition and Procurement Option Selection}

How do these market conditions influence procurement option selection? This section examines the consequences of a limited supply of services and other constraints governments face when choosing from various procurement options.


\textsuperscript{50} Interviewee S.
The ‘overheated’ construction and engineering environment is a significant concern for the public sector as there is a substantial reduction in the numbers of competitive responses received to requests for tender. The following experience is typical of many government departments:

Bidders on Queensland roads projects six years ago had a one in ten chance of winning that bid. They now have a three in four chance of their bid winning.\(^{51}\)

These statistics for tenderers bidding on Queensland road projects are remarkable. Though the current engineering and construction market in Australia provides some level of competition for receiving bids to requests for tender, this competition is substantially reduced to the level it was for governments several years ago. This is especially so in regional Australia where \textit{no-bid} situations remain a high risk for the public sector. The NSW Government has advised its departments that (emphasis added):

\begin{quote}
In cases where there are two or very few suppliers and the case for applying competitive tendering is strong, agencies will need to carefully plan and monitor the process. \textit{This can be especially relevant in rural areas where the level of competition can be less than that present in the larger cities.} \(^{52}\)
\end{quote}

My interviews and case studies in regional Queensland revealed that there is a widespread shortage of contractors. One member of an alliance leadership team in regional Queensland recognised the problems of both securing competitive tenderers and ensuring those tenderers were of a sufficiently high calibre to deliver project outcomes:

\begin{quote}
The problem we had was to get our request for tender out quickly as we knew that other councils wanted these [regional] contractors to upgrade their own water
\end{quote}

\(^{51}\) Presentation by Queensland Government, Department of Main Roads (Institute of Arbitrators and Mediators Seminar, Brisbane 2 August 2007).

treatment facilities. If we did not get our request for tender out first then we would be left with the B-teams or even the C-teams.\textsuperscript{53}

Reduced competition therefore drives governments to be cautious in adopting a fixed price contracting strategy. As is often the case, governments may face a monopoly or at best an oligopoly in the construction and engineering market in rural Australia. This situation can result in inflated tender prices. In such circumstances, the philosophy of competitive tenders testing the market and delivering best value is no longer valid.

When selecting a procurement option, governments face two competing requirements. First, they must ensure their procurement option promotes multiple responses to requests for tender by ensuring the procurement option is sufficiently attractive to industry. Second, governments must ensure the procurement option they choose delivers value for money.

Though I discuss value for money in significant depth in Chapter six, this issue merits consideration in the context of competition. As previously discussed, achieving value for money using a fixed price contract when faced with a monopoly or oligopoly is unlikely, because there is no benchmark by which the customer can compare value between competing options.\textsuperscript{54}

A strategy for governments to avoid the pitfalls of a monopoly may involve selecting a procurement option using a target profit contract or even a schedule of rates contract. The disadvantages of these latter approaches are that governments wear almost all of the project risk with little or no incentive for innovation imposed on the supplier. In Chapter three I discuss how alliances provide a means to promote innovation and share risks,\textsuperscript{55} whilst at the same time catering for situations with lessened competition.

\textsuperscript{53} Interviewee A.

\textsuperscript{54} Tony Lendrum, \textit{The Strategic Partnering Handbook} (4\textsuperscript{th} ed, 2003) 112-3.

\textsuperscript{55} See, eg, Derek Walker and Keith Hampson (eds), \textit{Procurement Strategies: A Relationship-based Approach}, (2003); Ross, above n 4, 82-4.
In some circumstances, it is not feasible for the public sector to provide a procurement option that meets both competitive tendering procurement objectives and provides an attractive environment for tenderers. In these circumstances, governments use direct sourcing, panel arrangements, pre-selection processes and industry plans to ensure cost effective delivery of government projects. The following section explores situations in which these selection strategies are best used.

The development of niche industry sectors (with high barriers to entry), geographic limitations, and a general shortage of engineering and construction services require governments to consider alternative tender selection processes. This is especially so at the federal level, where specific industries are ‘steered’ into the development of clusters and pseudo-oligopolies with the release and promotion of industry sector plans. Indeed these sector plans identify that governments are a dominant or sole buyer in the domestic market, and therefore they ‘shape the industrial base that supports it’. For example, the Australian Defence Aerospace Sector Strategic Plan explicitly states that consolidation in this industry is necessary to achieve economies of scale, promote skills growth, and support local research and development capabilities.

These principles of industry consolidation also appear at the state government level where interstate agreements both limit and protect the interests of some industries (see Chapter four for more discussion on how governments employs tactics which would be deemed anti-competitive in commercial environments). By way of contrast, for industries that have smaller barriers to entry and where competition is more rigorous, governments are less prescriptive in issuing sector plans.

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58 Department of Defence, The Australian Defence Aerospace Sector Strategic Plan, above, n 57, 6.
59 See Chapter four.
60 At the state government level, industry forecasts are produced but no explicit directions are made to support consolidation within the market place. See, eg, NSW Construction Agency Coordination Committee ‘Strategic Information’, <http://www.construction.nsw.gov.au/strategic-info/> at 2 March 2005.
In addition to industry sector plans, the construction and engineering market is also regulated more subtly by law and policy. An example of this is regulation by trade practices legislation, corporations law and trade policy. Thus while governments may drive consolidation of the construction and engineering industry externally, any attempts by the construction and engineering industry to pursue consolidation themselves may run foul of trade practices legislation. Similarly, trade policy influences how governments engage the construction and engineering industry, especially the Australia – United States Free Trade Agreement. I discuss these themes in Chapter seven, which explores government tendering processes and rules at length. Procurement options therefore need to consider not only the latent market conditions but also broader public policy goals such as consolidating key industries, promoting competition, generating economies of scale, and investment in core skills.

The construction and engineering market has a substantial influence on how governments plan and select procurement options. Strategies such as the promulgation of industry sector plans, which drive consolidation in certain areas, the use of ‘panel’ contracting arrangements and other pre-selection strategies, contribute towards minimising the consequences of a reduced supply of services. Nevertheless, there are limits as to how much governments can shape industry and this requires procurement agencies to consider the market conditions when selecting procurement options.

In addition to the depth of competition in the construction and engineering industry, what other characteristics of this industry are likely to influence procurement option selection? The alliance literature would have us believe that the construction and engineering industry is fraught with adversarial behaviour and disputes. An assessment of the incidences and causes of contract disputes therefore provides insight into whether these claims are valid or not.

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62 See especially, Trade Practices Act 1974 Cth, s45(2), s45B, s46, s50.
63 See especially, Australian Government, Department of Foreign Affairs and Trade, Australia – United States Free Trade Agreement - Government Procurement, Chapter 15.
Disputes in Construction and Engineering projects

One of the major cited benefits of alliancing is the ability to avoid contractual disputes. Whether this is a valid claim depends, partly at least, on how often disputes occur with conventional contracts and what causes these disputes. A quantitative comparison of the incidence of disputes between various procurement options would address this component of my research question; however, such an analysis proved extremely difficult for the following reasons.

First, defining the term ‘dispute’ has proved troublesome. At one extreme, disputes may include on-site disagreements between the principal’s supervisor and contractor staff that go no further. At the other extreme, disputes may involve litigation. Between these two extremes disputes may lead to mediation, arbitration, contract renegotiation, or possible termination of the contract for convenience. This lack of precision in defining disputes or more particularly, determining a method for counting disputes, makes it very difficult to provide a reliable comparison of the nature and frequency of disputes between government departments and contractors.

Second, the transparency or visibility of disputes associated with government contracts is poor. Whilst some governments report the incidences of litigation in contracts, other contractual disputes or issues (for example, enforcement of liquidated damages) appear to be treated with commercial sensitivity, and are therefore not available for external examination.

Consequently, the most reliable way of assessing the number of disputes occurring in government contracts, in qualitative terms, was to ask interviewees of their perceptions of the incidence of disputes.

During my interviews with alliance participants, I prompted interviewees to share information on the history of disputes affecting that government department as well as the likelihood of disputes occurring in the future. I triangulated the data from these

64 The alliance literature typically adopts a broad definition of the term ‘disputes’ to include: litigation, arbitration, and arguments over variations. NSW Government, above n 37, 19; Victorian Government above n 4, 17, 92; Ross, above n 4, 1-2.
responses with some published statistics on the occurrences of disputes in the construction industry and some limited metrics provided by government departments (for example published dispute figures from the NSW Department of Public Works).

Based on my interviews and a review of some of the published statistics on construction disputes, the number of disputes that cannot be resolved at project level appears modest in the public sector. My interviews revealed a common view from all government participants that disputes are undesirable and must be avoided. The following survey response typifies this outlook:

> We need to minimise disputes at all costs….resolving issues in the courts is only for when things go really bad.  

Most respondents stated that litigation was rare though there was inevitable conflict arising over the price of variations. It is notable that interviewees observed that these disputes ‘or arguments’ occurred not just for conventional contracts but also for alliances. This was especially so when negotiating the alliance target cost or when progressing scope changes to the alliance. The following three interviewee responses illustrate this:

> We [government] fought very hard in the TOC negotiating state to drive the target cost down.

> We were always suspicious of the first iteration of the TOC.

> A few scope changes resulted in adjustment of the TOC and we argued that these should not have been part of the gainshare/painshare arrangements.

It is not only governments that wish to minimise disputes. Industry recognises that disputes are an impediment to profit, as the following statement demonstrates.

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65 Survey A.
66 Interviewee Q.
67 Interviewee F
68 Interviewee O.
The economy is booming and while there is no doubt that people are having problems and deals are going bad, nobody is interested in stopping to have a fight because they are making too much money and can just move on to the next deal.\textsuperscript{69}

The interview data suggesting low incidence of disputes is corroborated by some published data on construction and engineering disputes. For example, the NSW Department of Public Works cites a dispute rate of one in every 500 projects for those projects of a value in excess of half a million dollars.\textsuperscript{70} By way of contrast, the incidence of disputes in the private sector appears larger. In Victoria, for example, 3.6 percent of construction projects resulted in disputes or conflict.\textsuperscript{71} Of consideration in the Victorian statistics is that these disputes include situations where both the public and private sector operate as the contract Principal. Where the contract principal is from the public sector, I would expect the Victorian rate of disputes to be far lower than the private sector for the following reasons.

First, governments are a ‘smarter buyer’ with robust procurement policies,\textsuperscript{72} core skills in contracting, and external auditing arrangements. This reduces the need for variations. Second, governments have realistic expectations of the outcome of a project (contracting is a core skill of government, hence outcomes should be known at the onset of a project). This is especially so since government policy demands the development of robust specifications and contract documentation prior to entering into a contract. Finally, there is a greater reluctance by all parties to avoid litigation when involved in government contracts especially since relationships need to be preserved.\textsuperscript{73} Industry would be most wary in initiating disputes with a monopsony buyer.

\textsuperscript{70} Alan Griffin, ‘Claims and Disputes in the New South Wales Building Industry – a Client’s Perspective’ (1996) 51 \textit{Australian Construction Law Newsletter}, 10. This paper adopts a narrow definition that a dispute is synonymous with litigation.
\textsuperscript{72} See, eg, NSW Government, \textit{Procurement Methodology Guidelines for Construction} (2005); Queensland Government, Department of Main Roads \textit{Project Delivery System Volume 1} (2nd ed, 2006).
There is little evidence to suggest that disputes are a typical feature of conventional contracts; rather, there is an opposing view that the overwhelming majority of conventional contracts involve no disputes. Consequently, I argue that the incidence of disputes in the construction and engineering environment is small, and therefore using alliancing as means to reduce disputes is a misplaced reason. Furthermore, even if disputes were endemic in the construction and engineering environment, it is questionable whether alliances would actually reduce the likelihood of disputes. The following discussion examines this issue by assessing what the typical causes of disputes are and whether the selection of procurement options will influence the likelihood of disputes.

There is much evidence that the main causes of disputes and claims in construction and engineering projects are errors, contradictions, ambiguity, and the late delivery of contract documentation. A side effect of this poor contract documentation is a greater likelihood of changes in project scope and contract variations. Sixty to 90 percent of all project variations are attributed to poor design documentation. The other significant sources of variations in construction projects stem from unforeseen changes in project circumstances and poor end user input.

Variations generate the largest number of cost and schedule overruns to projects.

Though there is a belief that contractors make their profit from variations, variations

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74 Andrew Stephenson, ‘Alliance Contracting, Partnering, Co-operative Contracting – Risk Avoidance or Risk Creation’ (paper presented to Clayton Utz Major Projects Seminar, Melbourne, October 2000), [6].
76 Engineers Australia, above n 75, 3.
77 Standish Group, Chaos (2005) 4-5 <http://www.educause.edu/ir/library/pdf/NCP08083B.pdf> at 10 April 2008. This report focuses on information technology project failures where errors other than specification errors contribute significantly to failure. Of consideration in this report is the fact that failures are unrelated to the form of contract.
78 Engineers Australia, above n 75, 7.
can adversely affect both principal and contractor, especially if variations lead to disputes. Most variations occur because of poor specifications, so where government fails to provide a robust project specification, there will be an increased likelihood of contract disputes. Consequently, if a project is difficult to define, any procurement option that does not effectively cater for scope changes and variations will be unsuitable. This is especially so when using fixed price contracts where the owner’s and builder’s interests are in fundamental opposition.\(^\text{80}\)

In some circumstances it is not possible to provide complete certainty in project documentation. Furthermore, it is often the case that government is unsure of exactly what it wants to procure.\(^\text{81}\) For this reason, even where governments attempt best endeavours in the delivery of robust project specifications and contract documentation, contractual flexibility may be required and a suitable procurement option selected to support this goal. I explore this theme further in Chapter three.

In addition to poor specifications, the process of drafting contract terms and conditions can also exacerbate uncertainty in contractual documentation as Abrahamson notes:

\[\text{When a standard form or special term for a contract has to be drafted, much time and money is spent employing lawyers to translate it into legal language, and then employing other lawyers to translate it back again when the users want to know what it means. The serious risk, often realised is that much is lost, distorted or overlooked in the process of translation and re-translation.}^{\text{82}}\]

Governments reduce this risk with plain English contracts and by adopting balanced risk sharing.\(^\text{83}\) Examples include initiatives such as the New Engineering Contract (NEC) which aims, inter alia, to reduce occurrences of indeterminate terms such as ‘fair’ and ‘reasonable’\(^\text{84}\) and to format contracts in simple, easy to understand terms.

\(^{80}\) Hayford, above n 4, 45.


\(^{83}\) Farmer, above n 16, 19.

This is a noble goal, but difficult to achieve where subjective evaluation criteria are used to evaluate project performance. This is especially so when project specifications use the commonly used but poorly defined terms *project quality* and *workmanship*.85

Most government contracts are performed without disputes. Where disputes occur, they typically originate from defective specifications or poor documentation. These failures are largely independent of the form of contractual vehicle used. As I argue in Chapter three, any form of contract can reduce disputes if greater effort and skill is applied in defining project requirements and contract documentation. In any case, the incidence of disputes in Australian government contracts is low to begin with; and consequently, the argument that alliances are useful tools to reduce disputes is a tenuous one. Certainly, alliances do foster greater collaboration and innovation, but to say that governments should select alliances solely on the basis of eliminating disputes is flawed reasoning. Rather, investment in more robust contract documentation and project specifications would yield higher returns to procurement agencies. To ignore the problems of defective project specifications may lead to the charge that ‘the alliance contract may become the last refuge of the incompetent specification developer or contract draftsperson’.

So far in this chapter I have defined the procurement environment for the public sector including a summary of procurement options available to governments and an examination of the construction and engineering market. I have introduced the concept of novel procurement options and discussed how these novel procurement options aim to deal with the shortcomings of conventional contracts. In Chapter one, I summarised the key features of alliances, but what are the precise terms and conditions of these procurement options?

**Alliance Contracts – Terms and Conditions**

Having outlined the present procurement environment in Australia for contracting major engineering works, and observed that governments are deserting conventional

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contracts in favour of alliances, we need now to gain a better sense of precisely what are alliances? There is a substantial literature explaining the form and types of alliances in use by Australian governments. These definitions are broad, and offer little insight as to how governments use alliances in practice. What the alliance literature fails to offer is a comprehensive breakdown of the specific features of alliance contracts and how these features function in practice. What the following section demonstrates is that all alliances adopt express good faith provisions, gainshare/painshare arrangements, unanimous decision-making protocols and open book reporting. Differences emerge with deadlock breaking arrangements, the introduction of price competition into selection processes and with retention of liability between alliance participants.

During my interviews, surveys and case studies, I requested access to all relevant alliance contracts. As many of these agreements contain commercially sensitive material, I requested access only to specific alliance terms and conditions relevant to my research, in anticipation alliance managers would be reluctant to provide complete alliance agreements.

In total, I received eleven complete alliance agreements comprising one federal government alliance contract, six state government alliance contracts, three local government alliance contracts, and one ‘boilerplate’ alliance template. In addition, during my interviews I asked alliance managers how their alliance operated with respect to deadlock breaking mechanisms, price competition, liability and decision-making. Responses to these questions corroborate my conclusions from the review of complete alliance terms and conditions, which are as follows.

The following features were common to all alliances:

a. Decision-Making. Each of the alliance agreements contained a clause demanding that decisions be made unanimously between the alliance participants on a ‘best for project’ basis;

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86 Ross, above n 4, 1; Chew, above n 4, 320; Hayford, above n 4, 50; Victorian Government, above n 4, 15; Cowan et al, above n 4; Hutchison et al, above n 4.

87 Alan Cullen, LexisNexis ‘Building Contracts Australia – Project Alliance Main Agreement’ (1997), [66,000].
b. Dispute Resolution. Each of the alliance agreements prohibits recourse to the courts for dispute resolution (no disputes clause). Nevertheless, all alliance agreements include exception clauses permitting litigation for events involving wilful default\(^88\) or insolvency;

c. Good Faith. All of the alliance agreements contain a clause demanding participants conduct alliance activities in good faith. Good faith is typically defined as follows:

   i. being fair, reasonable and honest to the other participants;
   ii. doing all things reasonably expected of it by another participant;
   iii. not impeding or restricting another participant’s performance; and
   iv. giving as much weight to the interests of the work under the alliance as to one’s own self interest.\(^89\)

d. Variations. All the alliance agreements provide for the alliance leadership team to direct project variations. A typical variation clause is as follows:

   The alliance leadership team may by notice in writing direct change in the scope, timing, or nature of the work under the Alliance (including the deletion of work). The Alliance participants will comply with any such direction.\(^90\)

   In some instances, variations may result in adjustment of the alliance target cost and key performance indices (for example the project schedule). None of the alliance agreements require progression of formal contract change proposals to progress variations;

\(^88\) Wilful default is typically defined as, ‘an intentional, or reckless act or omission by an alliance participant’ (State Owned Corporation alliance agreement, clause 57). Failure to abide by alliance principles and operate in good faith also constitutes wilful default in some of the alliance agreements.

\(^89\) State government alliance agreement, clause 6.

\(^90\) Federal government pure alliance.
e. Open-book Reporting. All of the alliance contracts I reviewed demand open-book financial reporting. A typical clause providing accessibility to records is as follows:

Non-owners shall provide the owner with access to their premises, and access to any of their records in connection with performance of work under the alliance.\(^{91}\)

In some instances, these open-book reporting provisions apply to sub-contractors engaged in the alliance;

f. Compensation. Each alliance agreement establishes for a gainshare/painshare compensation model. In each, the alliance owner reimburses alliance participants for all direct costs. Alliance non-owner profit, on the other hand, is contingent on the alliance delivering the project to the agreed target outturn cost (TOC) and other project key performance indices;\(^{92}\)

g. Deadlock breaking mechanisms. Each alliance agreement provides a means to break deadlocks by either escalating issues above the alliance leadership team (for example to organisation CEOs), providing for expert determinations, or the alliance owner reserving powers of a casting vote. In addition, all alliance agreements provide for the alliance owner to terminate the alliance agreement for convenience at any time, subject to a duty of good faith.

Alliances that incorporate all of the common alliance features at paragraphs (a) through (f), do not incorporate price competition into tender selections, and maintain a regime of no liability are termed pure alliances.

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\(^{91}\) State government alliance agreement, clause 6.

\(^{92}\) Though all the alliance agreements ensure that non-owner alliance participants recoup direct costs, there are substantial differences in how the TOC is developed and how costs and savings are shared. For example, three of the state government alliances I reviewed did not adopt a 50/50 sharing of project savings between alliance owners and non-owners; rather, in these alliances the alliance owner is allocated 75 percent of cost savings. See Chapter six, Figure 5-2 for further discussion on alliance remuneration.
Though all the alliances shared the features listed above, there were some differences between the alliances. For example, not all alliances incorporate a ‘no-blame’ clause. In my examination of alliance contracts, I found that three alliance agreements retained liability between alliance participants. Exploring this further revealed that these agreements were hybrid alliances tailored specifically for the provision of project insurance.

Different types of alliances are also distinguished by the way in which target costs are developed. For three alliances I examined, alliance non-owners (industry participants) developed the target cost on a competitive basis. That is, governments used price competition as a means to select tenderers. The remaining eight alliances relied on the development of the alliance target cost after tender selection.

Though there are some differences between alliance agreements, the themes of unanimity in decision-making, good faith, no disputes, open book reporting, and sharing risks (gainshare/painshare compensation) are common to all. Substantial differences, however, emerge between alliances in the following terms:

a. Price competition. Where the alliance introduces price competition into the alliance, tender selections are based primarily on quantitative responses and governments are provided with target costs and schedules before selecting tenderers. When this feature is incorporated into the alliance, the alliance is classed as a competitive TOC alliance or multiple TOC alliance.

b. Retention of liability. When the alliance retains liability between alliance owners and non-owners a no blame framework no longer governs the alliance. This feature arguably supports the acquisition of project insurance. 93

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93 Cowan et al, above n 86.
c. Capping the total project costs for government. That is, limiting the alliance owners liability for payment (for example, using a guaranteed maximum price).

d. Allocating specific project risks to one party rather than sharing all project risks.

Where alliances retain liability, incorporate deadlock breaking mechanisms, allocate rather than share risks and cap alliance owner remuneration, these alliances are termed *impure or hybrid alliances*.  

This suggests that there are three classes of alliances: pure, competitive TOC and hybrid. It is quite simple to differentiate between pure and competitive TOC alliances since the latter alliance model demands that two or more tenderers develop competitive target costs. What is more difficult to resolve is the difference between pure and hybrid alliances. My review of alliance contracts found that many alliances labelled as *pure alliances* incorporate features that the alliance literature associates with *hybrid alliances*. For example, the alliance literature states that pure alliances do not incorporate deadlock breaking mechanisms. Contrary to this claim, seven of the pure alliances I reviewed contained explicit deadlock breaking mechanisms.

Alliances therefore contain the common features of unanimity, good faith, no disputes, open book reporting, and risk sharing. The main differences between alliances emerge when governments invoke price competition and where liability is retained between alliance participants (the competitive TOC alliance and hybrid TOC alliance respectively). Having answered the question of what are alliances, I now examine the issues of where these contracts are used.

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[^95]: See especially, Ross, above n 4, 13; Victorian Government, above n 4, 57.
Chapter Two – Government Procurement, Alliances and Their Use

When Do Australian Governments use Alliances?

Australian governments have used over 120 alliances in the past decade - but precisely when have these alliances been used? In this chapter, I explore alliance use by level of government, location, project value, type of alliance, and project start date. In compiling my demographic analysis of alliances, I included all Australian government alliance contracts regardless of whether they were completed, in-progress or in the planning stage. I also included those alliances deemed as failures by government.96 I compiled my list of alliance contracts from the following sources:

a. Published alliance case studies and Australian text books related to alliance contracts;

b. Client lists from alliance facilitators (for example, Project Control International, Southern Pacific Alliance Network, Alchimie);

c. Government departmental websites;

d. Alliance contract conference proceedings

e. ;

f. Referrals to other alliance practitioners during my interviews with alliance managers (snowballing).97

g. Interviews with alliance contract drafters (I interviewed or requested information from alliance contract developers from three leading law firms);

h. Lists of alliance contracts provided by the Alliancing Association of Australasia;98 and

96 The reasons for my inclusion of failed alliances are to avoid a response bias (that is, a skewed indication of alliance successes) and to explore the potential causes of failures within alliances. I identified three alliances that failed markedly. The alliance owner cancelled the project outright for one whilst the other two alliances changed to a more conventional contract delivery mechanism. 97 Paul Brewerton and Lynne Millward, Organizational Research Methods (2001) 118. 98 The author contributed to the development of this list, see <http://www.alliancingassociation.org>
i. Reported examples of alliance contracts in government guidance papers.  

This diverse approach for identifying alliance contracts provides high confidence that I have captured most of the Australian public sector alliance contracts in my demographic analysis.

I analysed my collected data using a spreadsheet to explore alliance demographics as a function of alliance location, level of government, alliance contract type, alliance start date, and alliance value.

**Alliance Numbers, Locations and Level of Government**

For location, I group alliances by state. For some state government alliances (especially road projects), the federal government provides substantial funding. In these cases, the selection of procurement option is a state government responsibility, and accordingly, I have classified these alliances as state owned.

I did not allocate federal government alliances to any state as many of these federal alliances span multiple states. For example, the Australian Rail Track Corporation uses alliances for rail projects that cross state borders, the Defence Material Organisation is implementing alliances across states, as is the Civil Aviation Safety Authority. I have, therefore, included a unique geographical category dubbed federal to represent all federal government alliances.

Analysis of my data establishes that Queensland is the most prolific user of alliances with 57 Queensland alliances identified out of a total pool of 122 Australian alliances. This represents 33 percent by value (over $8 billion) of all public sector alliances in Australia. In the Queensland region, alliances have delivered primarily construction projects including dams, roads, and waste water treatment facilities. There is no clear reason as to why Queensland has high alliance usage, though I speculate that a number of factors contribute to this:

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99 See especially, Victorian Government, above n 4, Appendix 1.
100 During my case studies and interviews, it became apparent that where federal government funding is involved in state government alliances, the federal government takes a very much ‘hands off’ approach to project delivery.
First, Queensland is a state characterised by greater decentralisation than other states. Queensland’s has a greater proportion of people living outside the capital city than any other mainland state. The need for procuring services in regional areas may be a driver for the use of alliances. I discuss this at length in Chapter three.

Second, Queensland was an early adopter of alliances and enjoyed significant successes in the use of this procurement option (especially the Department of Main Roads). This initial Queensland alliance experience may have been a catalyst for Queensland local government and other Queensland departments to use alliances.

Third, Queensland hosts several alliance facilitators and advisers to government; for example the Project Control International and Southern Pacific Alliance Network. The proximity of skilled alliance facilitators and potential ‘lobbying’ of these organisations may have promoted the use of alliances in Queensland.

Finally, alternate procurement options such as Public Private Partnerships (PPP’s) have not been adopted by Queensland until very recently and there is a general trend of avoiding PPP’s in Queensland. Compared to NSW and Victoria, it would appear that Queensland’s choices for procurement options (in the absence of PPPs) are more limited and hence there is greater likelihood for the selection of alliances.

Other than the above, I discovered no obvious ‘drivers’ for Queensland to use alliances. In particular, factors such as higher risk in projects or greater construction budgets compared to other states are not significant.

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103 See, eg, Los et al, above n 30; Ross above n 4, Appendix 3.
Growth in the use of alliances in other states is less dramatic than it is in Queensland with New South Wales having adopted alliances for 22 projects, Victoria for 10 projects, South Australia for two projects, Tasmania for two projects, and Western Australia for 17 projects. My breakdown of alliance use by state and territory appears at Figure 2-2 below.

![Figure 2-2 Number of Alliances by State (sample size 122)](image)

Figure 2-2 demonstrates that at the federal level, alliances have been used sparingly despite the fact that the Australian Department of Industry, Science and Resources National Museum Alliance was the first construction alliance in the world, let alone Australia. The Department of Defence has adopted four alliances for the delivery of complex, often software intensive, systems engineering projects. The selection of alliances for these defence projects is a reflection on the difficulty scoping projects of this nature and the historically poor performance of these projects using conventional contracting methods. Australian Rail Track Corporation has used three alliances and the Civil Aviation Safety Authority has used alliancing for one project.

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**Alliance Project Costs**

My demographic analysis included an assessment of the total cost for each alliance contract. For each project, I established the project cost from publicly gazetted project figures, from interviews with the respective alliance managers and from published alliance contract lists.107

For completed alliances, the total reported project costs are accurate for work conducted under the alliance,108 but may not represent all costs associated with delivery of the project. For example, there will likely be government costs associated with project delivery that are separate from the alliance. Examples of these costs include funding participation on the alliance leadership team, consultants’ fees, and the provision of government furnished equipment. Similarly, some projects comprise components that use alliance contracts for some project aspects and fixed price contracts for others. In these cases I have attempted to constrain project costs to those components delivered under alliancing arrangements. To illustrate, the Defence Material Organisation Air Warfare Destroyer (AWD) project budget is $8 billion, of which $1.2 billion comprises a fixed price foreign military sale contract (prime equipment) with the remaining $6.8 billion allocated to the AWD alliance.

Alliance project savings or cost overruns greater than ten percent of the target outturn cost are rare.109 This suggests that alliance Target Outturn Costs are representative of actual alliance contract value.110 Consequently, my use of the alliance TOC for project values is appropriate.

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107 The Victorian Government provides a synopsis of alliance project values for many Australian Alliances. Victorian Government, above n 4, Appendix 1.
109 One study indicates that the best case for delivering below the TOC has been 13 percent with the worst case being 5 percent, see Ross above n 4, 17.
110 Note that typical alliances will deliver within plus or minus ten percent of the TOC. Though government will save or pay for half of the net profits, government is liable for all project direct costs (see Chapter six).
To assist in validation of my cost estimates, I published my preliminary findings in the *Australian Construction Law Newsletter*,111 and provided this data to my interview respondents, alliance contract facilitators, the Alliancing Association of Australasia and legal practitioners involved in alliancing. I received substantial feedback on my list of alliance demographics, which I used to refine the data below.

My research establishes that Australian governments have expended over $25 billion on alliances. Despite the relatively low number of federal government alliances, the value of federal government alliances is large compared to state and local government alliances. Figure 2-2 shows this with federal government alliances representing 36 percent of the value of all alliances combined even though the federal government only has eight percent of alliances by number.

![Figure 2-3](image-url)  
*Figure 2-3 Number and Values of Alliances by Level of Government (sample size 122)*

The mean federal government alliance contract value is approximately $1 billion. This figure includes the Department of Defence $6.8 billion Air Warfare Destroyer Alliance program. Ignoring this ‘outlier’ results in a mean federal government alliance value of $234 million. Federal government alliance spending compares to an average alliance value of $170 million, and $96 million for state and local governments respectively. This is unsurprising as many of the federal government alliances are for extremely high value projects.

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My demographic analysis confirms that most alliances are used for high value projects, with 90 percent of alliances above $30 million in value. This is consistent with the alliance literature, which cites alliances as unsuitable for low value projects.\textsuperscript{112}

Local government alliance values are predictably smaller, since most local governments do not possess large budgets, nor do they embark on projects of the same scale as federal or state governments. Nevertheless, some local governments have collaborated to conduct more ambitious projects. For example, the $800 million Southern Regional Water Pipeline alliance comprises Ipswich, Brisbane, Logan and Gold Coast City Councils, and the Beaudesert Shire Council.\textsuperscript{113} Some state governments have also injected funding into local government projects to create very large value alliance projects. The $1.1 billion Gold Coast Desalination Alliance is an example of this, with the Queensland government providing most of the funding for the project.\textsuperscript{114} These projects are atypical of most local government alliances where the state government does not normally provide funding.

**Alliance Chronology**

My demographic analysis includes an assessment of the start date for each alliance contract. This start date is typically defined at the point in time when the alliance participants sign the alliance agreement. I selected the start date rather than the completion date for each alliance as many alliances are still in progress. Furthermore, the alliance start date is an indication of the point in time when all contractual terms are agreed and alliance participants have allocated project risks.


\textsuperscript{114}The $1.1 billion Gold Coast Desalination project is jointly managed by state and local government with the Queensland Department of Infrastructure appointed as a major Shareholder, Queensland Auditor General, *Report to Parliament No. 5* (2007) 20.
I derived the start dates from alliance case studies, government departmental websites, from my interviews and published lists of alliance start dates. Figure 2-4 shows the chronology of government alliance contracts in Australia by start date.

![Australian Government Alliance Chronology](image)

**Figure 2-4 Alliance Chronology by Starting Year (sample size 122)**

Figure 2-4 demonstrates significant growth in the use of alliance contracts by government, with over 20 alliances each commencing in 2006 and 2007. The tail of this graph in 2008 is representative of the fact that I finalised data collection in March 2008. Findings from my interviews indicate that most government departments intend to pursue alliancing in the future. Consequently, I expect there to be substantially more alliances announced for commencement in 2008 and for future years.

**Alliance Classification**

There is no fixed format for alliance contracts. What has occurred is an evolution of ‘classes’ of alliance to cater for the unique needs of projects and the specific risk management strategies of governments. As discussed above, the different classes are
the pure alliance, competitive TOC alliance and hybrid alliance. This alliance classification is consistent with my interview feedback from alliance managers, published alliance case studies, and review of eleven alliance contracts. In several instances though, governments claimed that they used a pure alliance when in fact their alliance incorporated a deadlock breaking mechanism. In these instances, I classified these alliances as pure, contrary to the views expressed in the alliance literature.

I was able to classify 64 alliances as either pure, hybrid or competitive TOC. A summary of the use of each alliance type by Australian Governments is shown in figure 2-5.

![Percentage of Alliances by Type – Sample 64](image.png)

**Figure 2-5 Alliance classification (sample size 64)**

Though pure alliances have dominated the alliance landscape, the use of competitive TOC alliances has grown considerably. From 2004, governments used an equal

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116 Even though these pure alliances used deadlock breaking mechanisms, all other features are the same as that of the pure alliance defined in the literature namely: the sharing of all risks, a regime of no blame/no liability, no price competition, and equitable gainshare/painshare arrangements.
number of pure and competitive alliances. This reflects a growing popularity in the use of competitive TOC alliances.

**Conclusion**

The most common procurement option for government projects is the conventional fixed price contract. There is an increasing trend by governments to avoid these contracts since they do not cater for current and emerging market conditions and they fail to effectively deal with contract disputes. This chapter demonstrates that responding to market conditions is a valid reason for using alliances, but the use of alliancing to deal with contractor disputes is not.

Due to a significant backlog of projects and a significant shortage of service providers, the construction and engineering market in Australia currently favours suppliers. Governments therefore face a reduced number of bidders on tender evaluations, inflated bids and the spectre of monopolies or oligopolies. This has the subsequent effect of lessening of competition and the need for governments to consider market conditions as part of the procurement option selection process. Novel procurement options are both attractive to industry and offer a means for governments to curtail abnormal profits. This suggests that alliances are more suitable than conventional contracts in meeting the demands of current and future market conditions.

This chapter explores the incidence of disputes in the construction and engineering industry and concludes that the number of these disputes appears to be overstated in the literature. This is especially so in the public sector where both industry and governments actively avoid disputes. Furthermore, the cause of most contract disputes is largely unrelated to the form of contract used. Rather disputes stem from the variations created by specification errors and from poor contract documentation. I therefore reject the hypothesis that alliances provide an effective means to reduce disputes. On the contrary, there is a credible risk that governments use alliances as a

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means to mitigate the risks of poor specification and contract documentation development.

This chapter explores the features of alliance contracts, finding that all alliances incorporate features of unanimous decision-making, good faith, no blame/no disputes, open book reporting, sharing of all project risks, and a gainshare/painshare compensation framework. Differences emerge between alliance models when alliances introduce price competition into target cost (the competitive TOC alliance) and when the alliance retains liability between participants (the hybrid alliance). Contrary to the alliance literature, many pure alliances adopt deadlock breaking mechanisms.

Alliance contracts are used in the public sector over a diverse range of projects including roads, rail, water, defence and information technology projects. There is a continued growth in the use of alliance contracts, nevertheless governments adopt and will continue to adopt, conventional contracts for the majority of procurement. Alliance contracts involve high value and high risk projects, with most alliances exceeding $30 million in value. While Queensland has employed the greatest number of alliances (the cause of which is speculative), the use of alliances in other states is increasing.

Having described the procurement situation, what alliances are, and where they are used, I can now proceed with my investigations on why alliances are used and whether the reasons advanced for using alliancing in the literature are valid.
Chapter Three – Why do Governments use Alliances?

‘Rules are not necessarily sacred, principles are’
- Franklin D. Roosevelt (1882–1945)

Introduction

Chapter two explores the procurement options available to governments and examines the circumstances in which alliances are used. This chapter examines why governments use alliances rather than other procurement options. This exploration will provide insight into what governments expect of alliances and the situations they consider are best suited for these procurement options. The question of whether alliances actually deliver the expectations of governments is explored in later chapters.

This chapter answers the question why governments use alliances by combining a top down and bottom up perspective. First, the chapter reviews government alliance policies and procurement guidelines from a top down perspective to identify the claimed benefits and costs of alliances. This encompasses exploring governments’ approach to when alliancing should or should not be used, as well as the broader claim of alliances capturing the benefits of relational contracts. Second, a bottom up analysis is undertaken to see how procurement officers apply these alliance policy and procurement guidelines in practice. This is done using surveys and interviews, which asked procurement managers the following questions: what is the risk profile of your alliance, why was alliancing selected for your alliance, and what are your perceptions of alliance contract risks?

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1 Address to Young Democrats Clubs 24 August 1935 in Henry Steele Commager (ed), FDR Speaks (1960).
An examination of the alliance guides and literature reveals that alliances are claimed to be best suited for large value projects, where project risks are high, and project scope is difficult to define. Contrary to the claim that alliances are relational contracts which foster greater collaboration and reduce disputes, this chapter argues that any contract can provide these benefits. The success of partnering principles and early contractor involvement contracts demonstrate that the form of the contract is not important for the creation of positive contractual relationships.

Exploring the practical reasons for using alliances reveals two central claims from procurement managers. First, they argue that alliances enable the effective management of risk and uncertainty. Second, they claim alliances offer a means to capture industry participation in a market of limited supply. Government policy and guidance does not recognise this later rationale as a reason for using alliances, which suggests that there is a mismatch between procurement policy and procurement practice. This is indicative of a policy gap in the alliance literature, which I claim in later chapters is an area for reform.

**Why Do Governments Use Alliencing?**

Procurement officers in the public sector require a robust means to compare the benefits and costs of alliances with other procurement options so that they can select the most appropriate delivery strategy for any given circumstance. This requires that procurement officers have; a consistent understanding of alliance features, including alliance benefits, costs, and risks; and a robust framework to compare these alliance characteristics to those of other procurement options. The following section explores how governments identify the costs and benefits of alliances and how governments guide procurement officers in selecting the most appropriate procurement option.

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3 The management of risk not only stems from managing project risk but also relationship risk. For example, governments face the conundrum of wishing to simultaneously ensure the commitment of contractors and retain flexibility to cater for contingencies (termination for convenience, reducing or increasing the scope of the project, replacing poor performing contractors etc.) See, eg, Robert Scott and Paul Stephan, *The limits of the Leviathan: Contract Theory and the Enforcement of International Law* (2006) 65.
Alliance Benefits and Costs – Literature and Procurement Guides

The express reasons for governments’ use of alliancing appears in several government procurement guides, and in papers drafted by alliance practitioners and researchers. These sources claim that the advantages of alliancing include reduced disputes, faster tender evaluations, greater innovation, a focus on non-price outcomes, and lower cost of delivery when compared with conventional contracts. These claimed benefits can be summed up in the mantra of ‘faster, better, cheaper’ project delivery. The Victorian Government’s Project Alliance Practitioner’s Guide provides a useful summary of the benefits of alliancing:

a. Creation of a commercial framework which aligns the interests of all parties;

b. Improved risk management especially with uncertain project requirements and environments;

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6 See especially, Michael Keniger and Derek Walker, ‘Developing a Quality Culture – project alliancing versus Business as Usual’ in Walker et al., above n 2, 232; Ross, above n 2, 1.

c. Earlier involvement in preliminary design activities providing greater visibility of project costs and improved decision-making outcomes;

d. Reductions in resources needed to administer contracts, especially contract change proposals;

e. Improved project performance and innovation; and

f. Greater transparency in project prices.  

Other expected benefits of alliancing include providing improved working conditions for staff, and an improved likelihood of delivering value for money. These claimed benefits focus on the perceived shortcomings of conventional contracts and highlight the strengths of alliances with shared risks, collaboration, avoidance of disputes and early contractor involvement in design activities.

Despite the comprehensive alliance procurement guides developed by the NSW, Queensland, and Victorian governments, none of these recognise alliancing as a means to capture industry participation where supply is limited. As demonstrated later in this chapter, procurement officers state that this consideration significantly influenced their selection of alliancing.

While the government guidelines and alliance literature claim that alliances offer substantial benefits when compared to conventional contracts, they also identify disadvantages of alliances, including:

a. An absence of legal recourse should the project go awry.
Chapter Three – Why do Governments Use Alliances?

b. Acceptance of risks that may be broader than the risks normally associated with a particular participant,

c. The absence of price competition in tender evaluations (for pure alliances),

d. The need for greater involvement of management resources in the alliance,

e. No cap on the project schedule or cost,

f. An increased risk of opportunistic behaviour from other parties to the alliance,

g. Prohibition on unilateral decision-making, and

h. Relatively high tendering costs.\(^{12}\)

Other claimed disadvantages of alliancing include perceived problems of gaining cost effective insurance,\(^{13}\) additional costs associated with auditors and independent estimators,\(^{14}\) and challenges associated with conducting tender evaluations against mainly qualitative criteria.\(^{15}\)

These apparent alliance disadvantages stem from the manner in which alliances are perceived to deviate from conventional contracts. That is, alliance shortcomings result from non-price selection processes, the need for the principal to maintain close relationships with contractors, and from the principal forfeiting recourse to the courts for dispute resolution. None of these characteristics appear in arms-length, conventional contracts.

In conclusion, the government procurement guides adequately describe the advantages and disadvantages of alliancing, with the exception of the consideration of

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\(^{12}\) Adapted with modification from Victorian Government, above n 4, 18. Note that the disadvantage cited in sub-paragraph (f) applies to governments’ tendering costs and not industry tendering costs. These latter costs are much lower in an alliance when compared to conventional contracts.


\(^{14}\) Cowan et al, above n 3, 4; Davies, above n 11, 44-6.

\(^{15}\) See Chapter Seven.
market forces in procurement option selection. How then have governments translated these perceived alliance advantages and disadvantages into procurement selection policies and guides?

**Guides on Procurement Option Selection**

The growth in the use of alliancing in government projects has spawned the development of several procurement option selection guides. They include flowcharts, checklists, business-case development rules and score sheets, which offer guidance about when governments should or should not use alliances. They tend, on the whole, to offer considerable amounts of description, without much in the way of prescriptive or proscriptive content, and, in particular, no rules that mandate or exclude the use of alliancing.

For example, the NSW Government, Department of Commerce, *Procurement Method Selection Guide - Contracts Used for Construction Projects* provides the most comprehensive content on alliance selection processes. This guide states that alliancing is used appropriately when there is:

a. unclear or uncertain project scope, unknown factors, unpredictable risks or changeable project criteria;

b. threats and opportunities that are best managed collectively by the participants, rather than allocating them to a single party;

c. a requirement for early input from a range of stakeholders, including end users;

d. exceptionally challenging issues requiring special stakeholder and community involvement;

e. particularly difficult and complex stakeholder, consultant and contractor interfaces and relationships requiring a special management approach;

f. a need for early advice from construction industry experts to help define the project scope and resolve issues;

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16 NSW Government, above n 4; Queensland Government, above n 4; Victorian Government, above n 4; and more recently, the author has developed a procurement guide incorporating many of the areas for reform identified in this study, Queensland Government, above n 11.
Chapter Three – Why do Governments Use Alliances?

This advice recites the advantages of alliancing along much the same lines as the academic and practitioner’s literature. It claims that alliances are appropriate for dealing with high project risks, uncertainty, complex stakeholder interfaces, and advises when early contractor involvement is required. The only reason for adopting alliances advanced by the NSW guide that does not agree with other sources is that it suggests using alliances for projects with fixed or limited budgets. Other sources state that uncapped costs are a disadvantage of alliances. The NSW guide appears to be referring to situations where project budgets are fixed and governments must use a ‘build to price’ strategy. In these circumstances, alliances are able to achieve a greater likelihood of meeting agreed budgets (at the sacrifice of project performance) when compared with conventional contracts. If governments do not require a build to price strategy, then a lump sum contract or guaranteed maximum price contract would best deliver outcomes with a fixed budget.

The NSW guide also recognises the costs associated with alliance tendering and in developing and maintaining the alliance relationship. For this reason, the NSW guide recommends the use of alliancing for procurement where project values exceed $50 million, because alliance costs can be amortised over the value of the project. The Queensland and Victorian Government procurement selection guides express similar requirements, recommending alliancing be used only on high value projects.

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17 NSW Government, above n 4, 14-15.
18 Victorian Government above n 4, 18; Stephenson above n 13, [5.3.3]; Chew, above n 13, 320; Owen Hayford ‘Ensuring your Alliance Contract is Legally Sound’, (2004) 99Australian Construction Law Newsletter 45, 45-6.
The government guides highlight that alliancing is best suited to relatively large projects where either project requirements are undefined or where risks are difficult to allocate to any one party. These guides recognise that alliances provide benefits with the creation of close relationships and sharing of risks. In particular, the alliance guides and literature claim that alliances are a form of relational contract and provide all the benefits associated with these contracts. The remainder of this chapter explores this veracity of this claim as well as investigating the practical reasons for why governments use alliances.

**Alliancing and the Benefits of Relational Contracts**

Alliancing is a procurement model aiming to establish and maintain positive relationships between parties to the alliance. Several commentators and procurement guides claim that alliance contracts are uniquely beneficial to the parties because they are *relational contracts.*

This section reviews relational contract theory to examine whether this claim is true or not.

There are several relational contract theories, with some common themes. The following section explores the origins and evolution of relational contract theory, examines how the contemporary use of the term *relational contract* in the Australian construction and engineering environment diverges from this relational contract theory, and whether the form of contract or procurement model influences contractual relationships.

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**Relational Contract Theory**

The term ‘relational contract’ has its origins in the 1960’s work of Macaulay who explored non-contractual sanctions and the philosophy of contract as a ‘social relationship’. MacNeil pointed out in the 1970’s that parties to a contract are often interested in the establishment of a relationship that goes beyond the particular exchange in a given transaction. McInnis provides a useful summary of the competing relational contract theories and advances the hypothesis that strict definitions of relational contract are unnecessary; rather, relational contract theory is ‘a framework for analysis and argument.’ What then are the features of this relational contract framework?

Relational contract theory often describes behaviours where parties leave the contract in the top drawer and rely on informal mechanisms to drive performance. That is, ‘the myth that legal sanctions, or fear of them, constitute the social glue [of contracts]’ is incorrect. It is therefore argued that contract law has little importance to long-term business relationships, because businesses often want to honour commitments and maintain their reputation, which makes legal sanctions arguably redundant. The theory suggests that relational contracts are characterised by long-term commitments with an emphasis on social relationships, cooperation, and imprecise performance measurement. The theory also supports the premise that relational contracts are

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28 MacNeil, above n 27, 509.

29 McInnis, above n 26, 6.

30 MacCauley, above n 23, 13-5.

31 That is, relational contracts are the opposite to conventional contracts where performance measurement is essential. McInnis, above n 26, 4-5.
often incomplete, where ‘parties are unable to identify and foresee uncertain future conditions’ and hence cannot develop contracts that deal with all possible end states.

At first glance, the alliance contract appears closely aligned to these tenets of relational contract theory since alliances eschew legal sanctions, prohibit liability between alliance participants, and incorporate no liquidated damages clauses. Ironically, though, the alliance contract attempts to formalise the features of relational contracts as express terms in the alliance agreement. This is especially so with the establishment of an alliance leadership team with unanimous decision-making protocols. Similarly, all alliances contain express clauses for alliance participants to operate in good faith on a ‘best for project’ basis. Failure to comply with these provisions is typically considered a wilful default and provides one of the few instances where the ‘no disputes/no litigation’ provisions of the alliance may be voided.

The alliance contract therefore attempts to bind relational contract outcomes and behaviours onto participants through express contractual terms. This leads to the paradoxical situation where alliance participants are forced into relational contract behaviours for fear of litigation. Why then, does the literature regularly describe alliances as relational contracts? The answer to this lies in a shift in the definition of relational contract.

**Relational Contracting in the Australian Construction and Engineering Industry**

Despite the extensive literature on relational contract theory, a competing description of relational contract has emerged. It appears extensively in Australian contract literature to describe contracts that rely on collaboration and non-adversarial behaviour. These descriptions include the concepts of ‘joint maximisation of benefit’.

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Chapter Three – Why do Governments Use Alliances?

long-term arrangements, parties working in good faith, no disputes, prudent risk taking, inventiveness, fairness, and commonsense.\(^{33}\)

The courts have also attempted to explain the operation of relational contracts by applying this definition to franchises, employment contracts and joint ventures as discussed by Hammond J in *New Zealand Licensed Rest Homes Associated Inc v Midland Regional Health Authority.*

These [relational contracts] are vehicles which set up a relationship between the parties. But many of the incidents of the contract are not ‘closed end’, as in the classical form of contract. Examples of the genre include various forms of distributorships, franchises, some kinds of joint ventures, and employment contracts.\(^{34}\)

Unlike relational contract theory, the Australian literature places emphasis on the form of contract rather than the intentions of the parties to describe a *relational contract*. Nevertheless, both definitions recognise the significant benefits that relational contracts can offer.

The stated benefits of relational contracts include reduced transaction costs, shared risks, flexibility and improved performance in delivering contractual outcomes.\(^{35}\) Relational contracts are less adversarial with more risks shared and outcomes negotiated without formal contract change proposals. This offers the principal reductions in project contingency costs, offers the contractor greater certainty in estimating profit, and facilitates improved project delivery.\(^{36}\) As Chapter two demonstrates, there is clearly a current and emerging need for procurement options to better deal with complex projects and a dwindling supply of contractors. The benefits of relational contract support these objectives by allowing parties to negotiate scope

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\(^{34}\) HCNZ, Hamilton, CP 34/97, (15 June 1999) 137. See also, *Rawley Pty Ltd (ACN 009 027 454) as trustee for the Tiltform Unit Trust and Others v Bell and Others (No 2)* 61 ACSR 648, 711; *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2008) 128 FCR 1, 63.

\(^{35}\) Derek Walker and Martin Loosemore ‘Managing Risk and Crises Resolution’ in Walker et al, above n 2, 120-1.

changes quickly and share risks. Nevertheless, there are disadvantages of these types of relationship when compared to arms-length commercial dealings.

Hakansson and Snehota identify several risks of relational contracts including: the greater demand on resources necessary to support relationships, a loss of control when engaging in collaborative ventures, and preclusion from other opportunities (that is, participants are locked into an exclusive relationship). 37 Other potential shortcomings include fear of dependency, lack of perceived value (reduced competition and no regular testing of the market), lack of credibility of partners, 38 and the risk of opportunistic breach (for example exploiting weaknesses of the other party). 39

The alliance literature recognises many of the benefits of relational contracts but affords little discussion on their disadvantages. This study addresses these gaps in the literature by exploring the disadvantages of alliances and relational contracts in general in Chapters five, six and seven. To anticipate these chapters, relational contract processes are less likely than conventional contract processes to be able to demonstrate value for money, provide a robust accountability regime, and separate public interest from the commercial interests of government’s ‘alliance partners’.

Another fundamental tension associated with a relational contract is governments’ obligation to pursue competitive tendering in major projects. 40 Such obligations arguably detract from the relational contracting principle of developing long-term commercial relationships, because the pursuit of price competition involves selecting the cheapest price with a focus on economic factors. Consequently, there are constraints upon how governments can embrace a relational contract philosophy. This

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37 Hikan Hakansson and Ivan Snehota, ‘The burden of relationships or who’s next?’, (11th IMP Conference Proceedings, Manchester, 7-9 September 1995), 522-36. See also, Prof John Farrar, ‘In pursuit of an appropriate theoretical perspective and methodology for comparative corporate governance’, 13 Australian Journal of Corporate Law 1, who examines the risks of a loss of control in relational contracts.


40 The Commonwealth Procurement Guideline 8, Mandatory Procurement Procedures cite the need for open competition with direct sourcing only permitted in exceptional circumstances, Commonwealth Procurement Guideline 8.65; See also, The Commonwealth Procurement Guideline 4, Enhancing value for money through competition.
conflict of duty conundrum appears in the comment that parties must adopt ‘an arms length embrace’ in commercial dealings.\textsuperscript{41}

The literature describes alliances as relational contracts, but what does this mean practically? Rather than consider a relational contract as a class of contract, a more useful way of exploring relational contracts is as a process. The Australian Constructors Association attempts such an analysis as follows (emphasis added):

…[relational contracting is] a process to establish and manage the relationships between the parties that aims to remove barriers, encourage maximum contribution and allow all parties to achieve success.\textsuperscript{42}

Describing relational contracts in this way is helpful since process does not prescribe nor proscribe the form of contract necessary to adopt relational contract behaviours. Herein, however, lies a problem. Examples of collaboration, good faith, fostering long-term relationships and the like are common in conventional contracts. How then is it appropriate to label an alliance contract a relational contract when effectively all contracts can exploit the above processes? A response to this issue is to claim that alliances are more likely to support relational contract behaviours when compared to the alternatives. But is this true?

Certainly express clauses that eschew litigation and demand unanimous decision-making may improve the likelihood of collaboration.\textsuperscript{43} Similarly, a contract that imposes sanctions and penalties for non-performance (for example, liquidated damages) may decrease the likelihood for cooperation and the effective management of uncertainty. It would be a mistake, though, to suggest that a fixed price conventional contract would not drive positive relational behaviours. The success of partnering\textsuperscript{44} principles on fixed price contracts provides evidence in support of this.

\textsuperscript{42} Australian Constructors Association, above n 33, 4.
\textsuperscript{43} The absence of sanctions could arguably reduce collaboration as a party could exploit this feature to behave opportunistically.
Partnering is defined as ‘…the development of successful, long term, strategic relationships between customers and suppliers, based on achieving best practice and sustainable competitive advantage.’\(^{45}\)

International experience with partnering suggests that partnering has been highly successful with reduced project costs.\(^{46}\) Nothing precludes the use of partnering principles in fixed price arrangements, with precise risk allocation between parties to a contract.\(^{47}\) In fact, one commentator goes so far as to state:

> The basic partnering concept is relatively simple and is not intended to give rise to a change in the legal structures, which regulate the risk of the participants to the project.\(^{48}\)

What is most important for project success is a *culture* of collaboration within an organisation and a willingness to pursue positive relationships.\(^{49}\) I argue that these success factors can occur with any form of contract; hence, it is erroneous to state that alliances are relational contracts whilst conventional contracts are not.

The form of the contract will therefore not guarantee positive relationships and collaboration, though specific contracts may be more conducive to fostering positive relationships. The alliance is one such contract with equitable sharing of risks, open book transactions, unanimous decision-making, and an ‘all win or all lose’ philosophy that appears to embrace relational contract principles. Despite these features, it is the intentions of the parties and organisational cultures that are more important.

Accordingly, alliancing should not be adopted as a panacea for avoiding disputes and eschewing adversarial behaviour. Alliancing is simply a tool to formalise the goals of parties that already wish to embark on a project with a sharing of risks and rewards. To what extent, though, do alliance practitioners consider the benefits of alliancing?

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\(^{45}\) Lendrum, above n 5, 7.

\(^{46}\) Chan, et al, above n 44, 190.


\(^{48}\) Stephenson above n 13, 8.

\(^{49}\) Chan et al, above n 44, 196.
Why are Alliances Used in Practice - Research Findings

This chapter has defined the guides and policy used by procurement officers to select appropriate procurement options, and has strongly criticised the claims that alliances capture the benefits of relational contracts. The procurement guides provide direction on when governments should or should not use alliancing. How, then, are these guides applied in practice, and are there any motives, other than for those mentioned in government guides, for procurement officers to use alliances? The following section answers these questions by exploring alliance managers’ perceptions of project risk, why they selected alliancing for their projects, and what risks they identified with alliancing.

Risk and Procurement Option Selection

There is nothing new in the principle that the form of contract should be selected based on the risk associated with the project to be delivered by that contract. How then does alliancing deal with the risks associated with specific projects? This section explores how alliance managers rated the risks of their project and whether this is consistent with the literature, which states that alliancing is a preferred procurement option for high-risk projects.

Risk is defined as ‘the chance of something happening that will have an impact on objectives.’ Risk encompasses elements of consequence (the harm or damage that may occur) in conjunction with a likelihood of that event occurring. Risks on construction and engineering projects are typically categorised into the following areas:

a. Cost. Will the project be delivered over budget and if so, by how much;

b. Schedule. Will the project be delivered over time and if so by how long; and

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51 Ibid, Note 2.
c. Performance. Will the project meet the minimum system performance requirements?\textsuperscript{52}

Other categories of risk may include environmental risks, safety, and legal risks. Arguably, all these latter risks are capable of translation to cost. For example, environmental risks can be associated with clean up costs and performance risk can be assigned to the cost for corrective works.

The government guides state that alliancing is an effective means to manage projects with high cost, schedule or performance risks. How does this translate to alliance practice? To answer this question, I asked alliance managers what their assessment of risk was for their alliance project using the definition of risk provided by Australian/New Zealand Standard 4360:2004 Risk Management to assess their responses. The responses to this question are shown in Figure 3-1.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{3-1.png}
\caption{Project Risk Profile (sample 27)}
\end{figure}

\textsuperscript{52} Jack Meredith and Samuel Mantel, \textit{Project Management} (4\textsuperscript{th} ed, 2000) 12; Project Management Institute, \textit{Project Management Body of Knowledge} (3\textsuperscript{rd} ed, 2004) 111, 238 (this guide uses the term ‘quality’ in lieu of ‘performance’).
The responses show that, on average most alliance managers rate their project risks as medium. The spread of risks on the other hand are significantly different. Figure 3-1 shows a tighter distribution of cost risk when compared to schedule and performance risk. Further analysis of the data shows that for each response, most projects had at least one risk rated high or very high (15 out of 27 responses).

During interviews, case studies and examination of interviewee’s comments I gained further insight into how project risk influenced procurement managers and their subsequent selection of alliancing. The risk profiles of projects examined in this study were diverse. I conducted interviews with managers involved in mature technology projects such as highway construction through to extremely risky endeavours such as the development and construction of an $8 billion air warfare destroyer. The following observations from interviews provide insight into the risks associated with alliance projects:

a. All projects that had software intensive components were considered to be high or extreme risk (schedule and performance);

b. Projects with potential environmental impacts were considered to have high or extreme risks (schedule, cost and performance);

c. Some projects had extremely aggressive schedule imperatives. For example, several projects required completion before the 2000 Sydney Olympics, or to meet Environmental Protection Agency deadlines. Schedule risks for these projects were considered high;

d. On several projects, latent conditions and weather risks were high. This was especially true for projects in tropical conditions or where substantial earthworks were required;

e. Performance risk was deemed high for untested technology (relevant to several waste water treatment facilities); and

53 Average cost risk is exactly ‘medium’, average schedule risk is slightly above ‘medium’ and average performance risk is slightly below ‘medium’
f. Performance risk was high for when ‘live’ operations were involved (for example when carrying out maintenance or reconstruction of railway lines that were operational).

These observations relate to risks that are difficult to quantify and hence are difficult to allocate to either the principal or contractor. For risks of this nature, interviewees recognised that conventional contracts would be unsuitable, because a fixed price contract would involve substantial contingency costs, and value for money would not be delivered. Risk certainly featured as one of the main reasons why governments use alliances, as the following three interview responses demonstrate:

Performance is a major risk. The rails must never be shut down. We would rather pay a contractor to do nothing than have them shut down the railway lines.\(^54\)

Our major motivation for using alliances is from the risk that we do not know what’s out there. For example, we have no idea of site access, geography, or whether our systems are contaminated.\(^55\)

We have no idea when the wet season will start or finish. It is impossible to build for almost five months of the year. There was no way we could sign a fixed price contract in these conditions.\(^56\)

My case study of the Split Rock Inca Alliance also demonstrates the importance of risk treatment and procurement option selection.\(^57\) The project comprised three high risks namely, construction in a tropical environment, construction in an area of cultural significance and construction in a remote location with constraints on labour and supplies. The alliance owner recognised that transfer of these project risks to a contractor would involve massive contingency fees.\(^58\)

\(^{54}\) Interviewee H.
\(^{55}\) Interviewee C.
\(^{56}\) Interviewee V.
\(^{58}\) Ibid, 6-7.
My case study of the Wetalla Wastewater Treatment Plant also provides insight into risk treatment and alliancing. The project was subject to aggressive schedule constraints levied upon the alliance owner, Toowoomba City Council (TCC), by the Queensland Environmental Protection Agency. Council therefore considered schedule risks to be high. This prompted the use of alliancing for two reasons. First, TCC needed a procurement method able to deliver the project to the tight schedule; and second, TCC needed to secure scarce resources for the project since TCC rated the risk of contractor unavailability as high.

Other than alliancing, are there any other delivery options available to cater for unquantifiable risks? Several alternatives are available though they may not necessarily result in delivering value for money. For example, a ‘schedule of rates’ contract may better cater for high risk projects though there is little incentive to deliver superior outcomes. Another option is a hybrid contract with the assignment of high-risk project components to schedule of rates arrangements and low risk project components to delivery under fixed price arrangements. As revealed in my interviews, one major water utility has adopted such a strategy with alliancing only applied to the high-risk elements of a project, and the remainder delivered with a fixed price contract. The Early Contractor Involvement contract is also an example of this approach.

Both the literature and my interview data show that effective management of project risk was a significant reason for the selection of alliancing by governments. As shown in Figure 3-2, risk reduction was the single most important reason for selecting alliances. The nature of the risks varied substantially between projects with neither of schedule, cost or performance risk dominating the mode of risk in my sample. What interviewees generally agreed upon was that in fixed price contracts, where the contractor assumes most of the project risk, there would be large contingency fees and less likelihood of delivering value for money. Does this then mean that governments use alliancing on high-risk projects but not for low-risk projects?

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60 Ibid, 4.
61 Interviewee C.
62 Roger Quick, ‘Queensland ECI Contract’ (2007) 24 (1) International Construction Law Review 3; this procurement option is also introduced in chapter two.
Alliance Benefits Unrelated to Project Risk

Though risk reduction and risk management feature as the main reasons for using alliances, several other factors warrant consideration. As previously discussed in this chapter, the other stated benefits of alliances include:

a. Flexibility. The alliance offers fast progression of variations through the alliance leadership team;63

b. Managing uncertainty. Continuing upon the theme of flexibility, the alliance offers the opportunity to define project outcomes in broad terms with the final project design developed collaboratively between alliance participants.64 This is especially useful where the scope of a project is difficult to quantify;

c. Robust termination for convenience provisions. Alliance contracts enable the alliance owner to terminate the alliance contract at any time (provided such termination is invoked in good faith).65 The open book reporting arrangements of an alliance ensures such termination for convenience results in equitable compensation for work performed by the contractor and for fair demobilisation costs; and66

d. Reduced legal remedies. The alliance eschews litigation other than for wilful default.67 These provisions drive collaboration and eliminate the risk of costly and time-consuming litigation.68

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63 Victorian Government, above n 4, 57; Ross, above n 2, 18.
64 Victorian Government, above n 4, 17; Chew, above n 13, 320.
65 Victorian Government, above n 4, 60; Chew, above n 13, 331.
66 Victorian Government, above n 4, 60.
67 Insolvency also typically allows for recourse to the courts. Ross above n 2, 2; Chew above n 13, 321.
68 Only to the extent that the ‘no-dispute’ provisions of the alliance are not considered contrary to public policy and an ouster of jurisdiction of the courts, see especially, Trevor Thomas ‘Alliance Contracts: Utility and Enforceability’ (2007) 23 Building and Construction Law 329, 335-7.
In addition to these alliance benefits, I also examined whether managers used alliancing in response to executive level direction, either for strategic or ideological reasons.

Furthermore, from a holistic perspective, I asked whether the delivery of ‘value for money’ was a significant factor in selecting alliancing. At first instance, this appears to be a loaded question since the whole purpose of selecting a procurement option is to deliver value for money when compared to the alternatives. Nevertheless, I asked the question to gauge how alliance managers interpret the term ‘value for money’ and to prompt interview participants to describe, ex-post, whether their alliances actually delivered value for money.

I asked interviewees and survey participants whether each of the above considerations influenced their selection of alliancing. The findings are represented at Figure 3-2. Responses are rated from numbers zero to four with zero representing strongly disagree and four representing strongly agree.
Figure 3-2 Reasons for Using Alliances (Average response, sample of 25)

Figure 3-2 shows that respondents gave a relatively high rating to value for money with an average response of ‘agree’. Considering the delivery of value for money is a fundamental objective of government, I expected this response to be closer to ‘strongly agree’. The reason this was not rated higher became apparent in my analysis of interview responses. One interviewee strongly disagreed that value for money was important as their project had a schedule imperative that subordinated the need for cost effectiveness. Further analysis of the data shows that for those respondents that strongly disagreed, disagreed or were neutral about value for money being a consideration for using alliances, their schedule risk was rated much higher than the

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69 Interviewee C.
average response (approximately 30 percent higher schedule risk). Consequently, there is a perception that where ‘schedule is king’, cost is less important.

These instances demonstrate that different respondents define value for money differently. This is a key insight, which I discuss at length in Chapter six. In these cases, respondents did not include ‘timeliness of delivery’ as a dimension of value for money.

As previously discussed, risk management features as the main reason for using alliances, but there are two related alliance features associated with project risks. They are flexibility and the inability to scope or define a project. These features are related but different. For example, flexibility refers to the ability to change project requirements whilst the project is underway or to cater for changes in project circumstances. Uncertain scope on the other hand refers to situations where it is difficult to define the project at the start or the customer is not exactly sure what they want.

Respondents to my survey and interview questions generally agreed that the need to maintain flexibility and the difficulties in fully defining project scope led to the selection of alliancing. One respondent stated ‘the rapid change in technology associated with our project made it impossible to clearly define project objectives and go for a fixed price contract.’

These views are also consistent with the literature from alliance facilitators and government guidance on alliancing, which highlight the benefits alliances offer with undefined project requirements with uncertain scope. Interview responses also clarified why flexibility and scope issues were important. For example, several information technology alliances involved the procurement of systems where end-user requirements were difficult to define and there was no robust project specification. Similarly, some alliances anticipated a change in project requirements mid-way through the project. The Southern Regional Water Pipeline alliance was one such project that underwent radical design changes after contract signature. In these

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70 Interviewee J.
71 Victorian Government, above n 4, 57; Ross, above n 2, 18; NSW Government, above n 4, 14-5.
situations, procurement managers reject the use of conventional contracts and embrace alliances for their projects.

Central to the alliance agreement is the inclusion of a no disputes clause. A no disputes clause excludes litigation as a means to resolve disputes (except for wilful default), and arguably fosters collaboration and discourages adversarial behaviour. Surprisingly, respondents treated these benefits as neutral when deciding whether to use alliancing. Several respondents stated that from their experience very few disputes escalate to arbitration or litigation and therefore the ‘no disputes’ clause was not that important. One respondent went so far to state that ‘no matter what happens and what goes wrong we try desperately to keep out of the courts.’

Nevertheless, some respondents strongly agreed with the proposition that the ‘no disputes’ clause was considered important when selecting alliancing. They stated that a ‘no disputes’ framework was fundamental to driving collaborative behaviour and supporting best for project principles. These latter responses suggest that the respondents felt that the format of the contract was important in fostering positive alliance behaviours. These particular responses contradict the position advanced earlier in this chapter, which demonstrates that the form of contract is not so important in promoting collaborative behaviours.

Another alliance contract feature cited as beneficial in the literature is the robust termination for convenience provisions in an open-book reporting environment. This offers the alliance owner a means to terminate the contract if project performance goes awry or circumstances alter the business case of that project. Respondents deemed this to be of little importance when selecting alliancing. This is most likely a result of the fact that governments seldom invoke termination for convenience and many conventional contracts contain termination for convenience.

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72 Ross, above n 2, 2; Chew, above n 13, 321.
73 Interviewee M.
74 Chew, above n 13, 331-2; Ross, above n 2, 12.
75 Victorian Government, above n 4, 60.
76 See, eg, Steve Gumley, ‘Know Your Customer’ (Keynote Address to the 4th Annual ADM Congress, Canberra, 22 Feb 2007) 7.
provisions (albeit without the open book reporting framework).\textsuperscript{77} Alternately, governments may rely upon the principle of executive necessity to terminate a contract.\textsuperscript{78} Alliance managers therefore deem the open book termination for convenience provisions of an alliance to be of little benefit.

A final area I explored is whether procurement managers select alliancing for political reasons rather than for the delivery of value for money. Though the literature does not address the use of alliancing as means to pursue ideological or political imperatives, I was curious to explore whether public sector managers were coerced or forced into adopting alliances (as is the perception with Public Private Partnerships).\textsuperscript{79} Most respondents claimed that political or executive directions did not influence their decisions. Only one respondent ‘agreed’ that government direction was a driver for selecting alliances. This response was unusual as this particular project was subject to a federal government strategic review and this review recommended the use of alliancing to sustain Australian industry and deliver value for money.\textsuperscript{80}

Exploring the issue of government direction during interviews revealed that alliance managers adopt alliancing typically from the bottom up, where procurement officers themselves considered alliancing to be the most appropriate delivery mechanism compared to the alternatives. In several cases, interviewees stated that executive management and government were actually suspicious of alliancing, rather than ‘champions’ for using this procurement option. One respondent stated ‘we had a hard


\textsuperscript{79} Public Private Partnerships are most attractive to politicians as they offer a means to deliver outcomes to the electorate without having to expend public funds. See, eg, Ken Coghill and Dennis Woodward, ‘Political issues of public-private partnerships’ in Graeme Hodge and Carsten Greve (eds), \textit{The Challenge of Public-Private Partnerships} (2005), 82; Andrew Chew, ‘An Overview of Delivery Structures Used in major and Complex Infrastructure, Process Plant, Mining and Public Private Partnership (PPP) Projects’ (2004) 96 \textit{Australian Construction Law Newsletter} 12.

time convincing the executive directors and treasury of the benefits of alliancing. Everyone at the top was very suspicious of alliances.\(^{81}\)

Chapter six explores why executive management and treasury are suspicious of alliances. Consequently, the selection of alliancing is typically a bottom up activity rather than top down.

**Tacit Reasons for Using Alliances**

I based questions exploring why alliance managers use alliances on the alliance literature, especially government procurement guides. Nonetheless, my questions were exploratory and open ended and my interviews revealed an equally important reason why procurement officers use alliances. One area of particular concern to governments is the under supply of construction and engineering services and a need to proffer procurement options that are attractive to industry. Many respondents in my interviews raised the concern that the ‘tight’ nature of the engineering market has resulted in the situation where either responses to requests for tender contain inflated prices or no such responses are made at all. In several cases, particularly in rural Australia, interviewees stated that the release of fixed priced requests for tender resulted in ‘no bid’ situations.

Many respondents acknowledge that alliancing is an attractive procurement option to industry for the following reasons. First, alliance tendering costs and durations are significantly reduced for industry when compared to conventional contracts. Since industry is not required to submit detailed bids for alliance request for tenders, tendering efforts are substantially reduced.\(^{82}\) Second, there is no risk of industry losing money in an alliance based on the reimbursement of all project direct costs. The only component of remuneration at risk is the project profit margins and key performance index bonuses (see Chapter six). Third, industry is afforded opportunities to develop strategic alliancing skills and a subsequent competitive advantage. This provides industry with the opportunity to pursue further alliances with greater

\(^{81}\) Interviewee Q.  
\(^{82}\) NSW Government, above n 4, 14.
likelihood of winning work. Finally, there is greater certainty in industry achieving profit based on the principles of collaboration, equitable risk sharing and contractor developed target cost estimates.\textsuperscript{83}

It was therefore unsurprising to hear from interviewees that alliances are more likely to attract interest from industry. In fact, several interviewees stated that they would not use a fixed price contract in their circumstances, simply because they did not expect any tender responses to be submitted.\textsuperscript{84} That is, the only perceived procurement options available to these managers were alliances or a schedule of rates contract.

Despite the allure of alliances, industry does not consider all alliance models equally attractive. Several interviewees stated that the pure alliance is the most appealing to industry since this model adopts the fastest and cheapest tender process. By way of contrast, industry considers the competitive TOC alliance to be less attractive. In a competitive TOC alliance, governments pay tenderers to develop their bids whereas in a pure alliance, tenders are not reimbursed for the cost of developing bids. Why then should industry fail to be enticed into bidding on a competitive TOC alliance? The answer to this question became apparent in interviews with industry participants in my case studies. For the competitive TOC alliance, the design teams of a company are locked into a single project for a substantial duration with no guarantee of future work. Project design teams are a scarce resource, typically spread over a multitude of projects. There is, therefore, great reluctance to tie up these scarce resources in a venture that has no assurance of winning future work. By comparison, the pure alliance involves very little input from design teams and industry considers that they have little to lose when bidding on such alliances.

For most alliances, the main reasons for using this procurement option includes risk reduction, providing project flexibility and catering for undefined project scope. This is consistent with government procurement guides. However, these guides fail to identify market conditions as a reason for selecting alliances. Many interviewees stated that the consideration of the construction and engineering market was foremost

\textsuperscript{83} Victorian Government, above n 4, 28-37.
\textsuperscript{84} Interviewee G, Interviewee K, and Interviewee V.
in their decision-making process for selecting alliances. These interviewees also confirmed that competitive TOC alliances are less likely to attract bids when compared to pure alliances. This is an important finding since despite the introduction of price competition into the alliance and all the benefits this provides, competitive TOC alliances are perceived to be less popular than pure alliances.

Despite the claimed benefits of alliances, this procurement option incorporates many risks that are absent in conventional fixed price contracts. Selection of procurement options must therefore consider not just the benefits of alliances but also the disadvantages.

Alliance Disadvantages – Interviewee and Survey Findings

Most of the criticisms of alliancing stem from a legal perspective\(^85\) and comprise the following risks:

a. potential for the alliance relationship to invoke fiduciary obligations and create duties and obligations broader than those agreed to in the alliance contract;\(^86\)
b. the potential for deadlocks resulting from the requirement for unanimous decision-making;\(^87\)
c. reduced legal remedies, in that there is no recourse to the courts for resolving disputes (other than for wilful default);\(^88\)
d. conflicts of interest and conflicts of duty, in that government participants in the alliance must report to two masters: the alliance leadership team and their individual department;\(^89\)
e. governance incompatibility. The alliance creates a virtual organisation with diminished accountability and transparency;\(^90\)

\(^85\) See especially, Chew, above n 13; Hayford above n 13; Stevenson, above n 13.
\(^86\) Chew, above n 13, 323-6.
\(^87\) Hayford, above n 13, 50-1.
\(^88\) This feature is cited as both an alliance advantage and disadvantage. Chew, above n 13, 323-4.
\(^89\) Ibid, 335.
f. lack of applicable case law creating uncertainty about the enforceability of the alliance terms and conditions.

Other than these legal risks, other criticisms of alliances include the risk of opportunistic behaviour, and a lack of integrity in target cost development. These criticisms of alliances originate from the literature - but how do they translate to the views of procurement officers?

To explore alliance risks, I conducted surveys and interviews asking respondents to rate each of these alliance risks. Risks are rated numerically with one representing lowest risk and ten representing highest risk. Figure 3-3 provides the findings of these surveys and interviews:

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92 Cowan et al, above n 5.
The interview and survey data reveals that collectively, most alliance managers’ consider alliance risks to be low. All risks other than the integrity of target costs were rated below four on a scale of one to ten. Most risks were rated around a score of three.

At first instance, the rating of these risks appears very low. However, interviewees qualified many of their responses by stating that alliance risks are addressed by governments’ use of risk minimisation techniques. For example, the risk of target cost integrity is minimised with the use of independent auditors, a conflict of duty is minimised with the use of probity advisers, and deadlocks risks are minimised with contractual deadlock breaking mechanisms (see Chapter two). The inherent characteristics of alliancing with ‘gainshare/painshare’ arrangements also comprise a means to mitigate risk, especially from opportunistic behaviours. Many respondents
also stated that litigation is often a last resort for government and is rarely pursued. Consequently, procurement officers consider the legal risks of alliancing as low.

Alliance managers therefore consider the risks of doing business with alliances as low. This is contrary to several observations in the alliance literature. Why then is there differences between the risks identified in the literature and what managers actual consider as alliance risks?

The vast majority of alliance projects are claimed to be successful with no significant disputes reported, no occurrences of litigation, and no significant schedule or cost overruns. The majority of my interviews and survey responses involved alliance projects that were complete or nearly complete. Consequently, for these projects there is little or no residual risk. This would explain why alliance managers consider the risks of alliances as low. By way of contrast, legal commentators explore what adverse contractual outcomes can occur and what is the a priori likelihood of these occurrences. This goes some way to explain the differences in perceptions of risk between procurement officers and the legal profession.

The consensus amongst alliance managers is that alliances themselves do not introduce substantial risks in the procurement process. There is therefore nothing to discourage alliance managers from using this procurement option in terms of risk. Certainly, the risks of opportunistic behaviour, fiduciary obligations and conflicts of interest are higher in alliancing when compared to conventional contracts. Nevertheless, alliance managers deem these risks low because these risks are capable of being managed successfully. I discuss the cost of alliance risk management in Chapter six. What is necessary to state here is that there is no single alliance risk that any alliance manager identified that would deter them from using alliancing.

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93 See especially, Chew, above n 13; Stephenson, above n 13; Hayford, above n 13.
94 The author is aware of three alliance failures out of a sample of 122. One of these, the Department of Defence Project Djimindi Alliance has reported substantial schedule overruns due to alliance vendor quality control issues. This may not be systemic of the alliance relationship but rather a symptom of involving a vendor as part of the alliance team. Australian Government, *Defence Annual Report 2005/2006*, Volume 2, 34 <http://www.defence.gov.au/budget/05-06/dar/downloads/2005-2006_Defence_DAR_20_v2full.pdf> at 15 July 2008; see also, Ian McPhedran, ‘PM Kevin Rudd warns defence giants of dud projects’ *Herald Sun* 08 January 2008, ‘$600m lightweight torpedo [djimindi alliance], running four to eight years late.’
Though my interviews, surveys and case studies did not identify any significant alliance risks, I did identify several issues that could discourage government from using alliances. These include the greater involvement of government resources in projects, an absence of cost effective insurance and the problems associated with demonstrating value for money. No alliance participant recognised these issues alone as a reason to eschew the use of alliancing, though many respondents stated that they changed the form of their alliance contract to avoid these risks. For example, many respondents adopted hybrid alliances to procure cost effective insurance and other respondents adopted competitive TOC alliances to demonstrate value for money. How then do procurement managers select the most appropriate form of alliance?

**Selecting the Form of Alliance Contract**

Once government has decided that alliancing is the preferred procurement option for a particular project, the next step is to select the form of alliance. Here the question is, what circumstances lend themselves to the use of pure, competitive TOC or hybrid alliance arrangements? During interviews and case studies, I asked alliance managers what form of alliance they used and why.

In Chapter two, I introduced the three classes of alliance, namely the pure alliance, the competitive TOC alliance, and the hybrid alliance. From my analysis of eleven alliance contract terms and conditions, I established that it is not a simple exercise to label an individual alliance into a specific class as several alliances straddle characteristics of both the competitive TOC and hybrid alliance. Similarly, some alliances purport to be pure but embrace some of the hybrid characteristics such as deadlock breaking mechanisms. For these reasons, I focused the examination of the form of alliance used in the context of the following questions: why was price competition used, why was a pure alliance used, and (for hybrid alliances) why was strict liability between alliance participants pursued? The reason for focussing on these questions is that these three characteristics are the main areas of difference between the various forms of alliance contracts.
The Pure Alliance

As discussed in Chapter two, the pure alliance is claimed to maximise the likelihood of delivering innovation, provide the greatest degree of risk sharing and eliminate the likelihood of disputes. Interviews with alliance managers did not reveal any single reason as to why they used pure alliances. Some interviewees recognised the costs and time delays that may have been associated with a competitive TOC alliance, as being a significant factor in favour of choosing a pure alliance. Three respondents stated that a pure alliance was more likely to attract more bidders compared to other forms of alliance. For local governments in regional Australia, this was a substantial concern. Two respondents stated that only a pure alliance could drive the collaborative behaviour needed to deliver their project outcomes. One of these respondents in particular was quite critical of the competitive TOC alliance, stating that this delivery mechanism attempts to capture the benefits of innovation and collaboration while still maintaining competitive tensions and risk transfer. As demonstrated in Chapter two, the pure alliance is more popular than other forms of alliance, though this is largely a reflection of the late introduction of hybrid and competitive TOC alliances. Other than a few respondents who were strongly against the use of anything but a pure alliance, most other respondents were ambivalent to the form of alliance used, with several stating that alliance facilitators and external advisors drove the type of alliance used. Nevertheless, the majority of users of pure alliances were happy with their outcomes with only one user out of 12 who used pure alliances stating that they would not use this form of alliance for similar projects.

The Competitive TOC alliance.

As noted earlier, the competitive TOC alliances comprise all the same elements as a pure alliance, though selection of alliance participants is primarily by price competition. There is little or no collaboration in the development of the TOC with Government and this arguably decreases the scope for innovation. There are also increased sunk costs associated the competitive TOC alliance and increased tender

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95 Interviewee G.
Despite the claimed disadvantages of the competitive TOC alliance, respondents who used Competitive TOC alliances were largely comfortable with this procurement option. Only one respondent out of 11 who used competitive TOC alliances stated that they would not use this form of alliance for similar projects. All respondents shared the view that competitive TOC alliances demonstrate value for money and fairness in the tender selection process. One respondent also stated that the use of a competitive TOC alliance provided substantial benefits as they could get to see the alliance partners ‘operate in action’ prior to selecting the preferred tenderer.

Other respondents cited the need to gain confidence in the TOC, reducing the need for external auditors and estimators as well as satisfying community expectations of fairness as the main motivations for using the competitive TOC alliance. Though not relevant to the alliances subject to my interviews, some projects have demanded the pursuit of price competition to satisfy statutory approvals.

Despite the criticisms of competitive TOC alliance sunk costs in the alliance literature, competitive TOC alliance interviewees recognised these costs as an investment cost (See Chapter six which discusses the benefits of using a losing tenderer’s design in a competitive TOC alliance). Furthermore, no user of competitive TOC alliances stated that the use of such a model introduced tensions with respect to collaboration and the delivery of innovative solutions; rather, my case studies and interviews revealed that innovation was rife in competitive TOC alliances.

Hybrid Alliances.

Hybrid alliances take many forms but the most common form of hybrid alliance incorporates either deadlock breaking mechanisms or provisions for retaining strict liability between alliance participants. Deadlock breaking provisions by themselves do not amount to a significant departure from the pure alliance, and as discussed in Chapter two, the inclusion of a termination for convenience clause effectively

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96 Alchimie, above n 5, 9-11.
97 Interviewee A.
98 See, eg, Bega Valley Sewerage Alliance in Cowan et al, above n 5, 6.
99 Chapter six.
provides a deadlock breaking mechanism for all alliance models. What is a more radical departure from the pure alliance though are hybrid alliances, which maintain liability for performance between alliance participants. Hybrid alliances of this type eschew the use of no disputes/no blame clauses. Such a model ostensibly provides for the provision of project insurance as well as reducing the need for the alliance owner to deploy substantial resources into the alliance team. 101 The current alliance literature supports the premise that cost effective insurance is either unavailable or difficult to procure for pure alliances. 102 Despite the rhetoric and perceptions within some sectors of the alliance community, the current insurance market has and is capable of delivering cost effective ‘first party’ insurance policies for pure and competitive TOC alliances. My interviews with three insurance brokers and the review of a typical first party alliance insurance policy 103 reveals that such policies are robust and provide comparable (and in some instances more comprehensive) 104 cover to traditional, fixed price insurance policies. It is therefore erroneous to suggest that hybrid alliances, which impose strict liability on participants, should be maintained for the sole reason of obtaining insurance. Only one of my interviews involved a hybrid alliance of this type, and this was for a low value local government project. The reason why government adopted a hybrid alliance in this instance was not so much for facilitating insurance, but rather a response to the limited resources of government to participate in an alliance team.

In contrast to the near fanatical promotion of some forms of alliance contract and discouragement of others in the alliance literature (primarily from alliance contract facilitators), the views of alliance managers are more moderate. Few respondents in my interviews were ‘die-hard’ proponents of any particular form of alliance contract.

101 Cowan et al, above n 5, 3.
102 See Chapter three, footnote 13.
103 My investigations revealed that 16 insurance policies have been provided for project alliances on a first party claims basis; John Davies ‘Insurance Under an Alliance’ (presentation to the Alliancing Association of Australasia, Brisbane, 11 February 2008) <http://www.griffith.edu.au/centre/slr/pfd/alliances-insurance-v4.pdf> at 9 July 2008.
104 For example, an alliance insurance policy provides cover for losses resulting from delayed delivery of a project. This effectively provides comparable protection to that offered by liquidated damages provisions in traditional contracts. In fact, the protection offered by alliance insurance for losses is likely to be more robust as liquidated damages claims often suffer from the challenge of the principal proving that they did not contribute to such delay to be successful in claiming for such damages. 

There is no single specific reason as to why alliance managers adopted pure alliances. Pure alliance use stemmed from a number of reasons including the concerns of speed of delivery, tendering costs, attraction to bidders, and maintenance of collaborative behaviour. The users of competitive TOC alliances on the other hand were more concerned with demonstrating value for money, complying with tender policies and minimising auditing costs. My analysis of hybrid alliances is less conclusive as my sample size was very small. Nevertheless, my investigations and interviews related to first party insurance policies tailored for alliances suggests that the reasons for using hybrid alliances are weak, as the insurance market has matured to cater for alliance arrangements.

Conclusion

This chapter has identified the express rationales stated by governments as to why they use alliances as well as how procurement officers interpret these reasons. A consistent theme emerging from both the government procurement policies and the interviewees is that governments select alliancing when they perceived conventional contracts to be unable to deliver value for money. More specifically, governments use alliances where project risks are high, flexibility is required, and project scope is difficult to define. Governments therefore perceive alliances as the most suitable procurement option for delivering value in these circumstances. Nevertheless, the government policies and literature differ from practitioner’s views in some areas. First, procurement managers did not consider alliancing as a practical means for reducing contract disputes. Second, alliance practitioners consider the legal and governance risks of alliancing as low. This later point suggests that either the legal commentators have overstated the risks of alliancing or alliance practitioners are oblivious to these governance risks.

The alliance literature recognises that alliances are a form of relational contract and hence are best able to deliver value by reducing disputes and fostering a culture of collaboration. Nevertheless, alliances are not the only form of relational contract and the success of partnering on fixed price contracts and Early Contractor Involvement (ECI) arrangements suggests that the form of contract is less important than the
culture and commitment of the parties to the contract. Selecting alliancing for reaping the benefits of relational contracts is therefore a flawed reason.

What this chapter also identifies is the absence in the alliance literature and government policies of consideration of market conditions in procurement option selection. That is, should governments use alliances as a tool to better capture industry participation? Several interview respondents stated that when compared to conventional contracts, alliance requests for tenders are more likely to attract bids as tender costs are lower to industry and the bid process can be conducted quicker. This is a valid reason for using alliances and in some instances governments use alliances to curtail the abnormal profits of a monopoly supplier (especially in regional Australia). Nevertheless, there is no explicit content provided in the government guides addressing market conditions for procurement options selection. This gap in government policy is addressed in Chapters seven and eight.

A recurrent theme in the alliance literature and from my interviews and cases studies is that governments perceive alliances as a means to deliver value for money. But what precisely is value for money and how is it measured? Value for money is a key public sector governance objective and the following chapter describes how these governance objectives influence public sector procurement.

105 For example, one state government department received a single bid to a conventional contract request for tender. To address the reduced competition and better demonstrate value for money, this government department converted this conventional contract to an alliance. Interviewee F.
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Chapter Four - The Public Sector Governance Environment

‘Few men have virtue to withstand the highest bidder.’
- George Washington (1732-1799)

Introduction

So far this study has explored what alliances are, where they are used, and why they are used. The remainder of this study explores whether alliances are suitable for use in the public sector. This is by no means a simple question since the term suitability may be framed in an almost limitless manner. To avoid the pitfalls of selecting measures of effectiveness for all government stakeholders, this thesis simply frames the question of suitability from governments’ own perspective. That is, this study takes the rules by which governments set themselves as the basis for assessing the suitability of alliances for major government works. Consequently, it is necessary to define what the rules are that governments set for the expenditure of public monies in the procurement of these projects. These rules manifest themselves as governance objectives.

This chapter therefore addresses the subordinate research question, ‘what are the governance objectives applicable to governments?’ The importance of this question becomes apparent when exploring the costs and benefits of alliances in later chapters. Unlike conventional arms-length contracts, alliances rely on collaboration and the sharing of risks between industry and government. This may introduce conflicts between fostering and preserving positive alliance relations whilst simultaneously delivering outcomes in the public interest. There are, therefore, tensions between satisfying the needs of alliance participants and attaining the best interests of the public. The Auditor General of Australia’s comments reflects this challenge:

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1 John Frederick Schroeder, *Maxims of Washington* (1855).
As such [alliancing] offers potential benefits over conventional contracting but also raises new and different risks that have to be managed – in particular, determining the appropriate balance between maintaining real cooperation and achieving the results required and protecting the Commonwealth’s financial interests. Some see this conundrum as a real threat to accountability, sometimes put rather colourfully as public servants ‘doing deals’.  

To explore whether alliances are a credible threat to accountability and other governance objectives requires a thorough understanding of the self-imposed governance rules applicable to federal, state, and local governments. This includes an exploration of the decision-making processes, accountabilities and other constraints placed upon the public sector.

In the late 1990’s, the Australian public sector embarked on a process of improving and formalising its governance arrangements. This initiative was prompted by higher community expectations and the desire to improve performance of the bureaucracy. This chapter demonstrates that this national initiative has resulted in significant consistency between the governance frameworks at federal, state and local government levels. As later chapters demonstrate, alliances do not fit comfortably within this governance framework. This mismatch between alliance arrangements and public sector governance objectives is a substantial source of criticism in the alliance literature. For example, several sources identify alliance conflicts with the governance principles of value for money, accountability, and integrity (increased risks of a conflict of duty). This chapter therefore defines the governance framework

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of the public sector so that these criticisms may be tested in Chapters five, six and seven.

This chapter first describes the origins of corporate governance theory since this has shaped the behaviours and expectations of the public sector. Following this is a discussion of how the public sector comprises not just government departments but also entities designed to compete on a commercial basis. These Government Owned Corporations (GOCs) are prolific users of alliances, but what governance framework applies to these entities? This chapter reveals that GOCs share more in common with the governance framework of the public sector than their commercial counterparts. This chapter subsequently describes the governance policies of federal, state and local governments and explores the common governance objectives of accountability, integrity, stewardship, efficiency, leadership, and transparency. This provides a baseline with which to explore the governance arrangements of alliances in later chapters.

**Corporate Governance Defined**

Before exploring the governance rules of the public sector, it is useful to explore the concept of ‘corporate governance’ and how this has shaped the environment of both the private and public sectors. The following section explores the origins, definitions, and application of the principles of corporate governance.

Though corporate governance spans centuries, concerns with the financial control and risk management of business (especially publicly listed companies) led to the popularisation of corporate governance in the mid 1990s. Since then, corporate governance theory has emerged from numerous empirical studies and a robust literature on this topic.

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6 International Corporate Governance Network, *Statement on Global Corporate Governance Principles* (1999). The spectacular collapses of industry giants such as Enron, Worldcom, HIH and OneTel has also provided a catalyst for improvements in corporate governance.

Though there are competing theories and definitions of corporate governance, many of the definitions refer to corporate governance as a set of principles. For example, one source defines corporate governance as ‘the set of principles concerning the governing of companies and how these principles are disclosed or communicated externally.’

Many other similar definitions exist but all definitions attempt to explain how corporate governance defines the principle of ‘direction’ or ‘stewardship’ of an organisation. The principles raised in these definitions are exceptionally broad. This is unsurprising since corporate governance addresses:

… the entire scope of responsibilities that a company has to each of its stakeholders: those who have a vested interest in the decisions and actions of a company, like clients, employees, shareholders, suppliers and the community.

It is therefore not useful to limit the term ‘corporate governance’ to a strict definition but rather to treat it as a concept. Tricker claims that:

it [corporate governance] lacks any form of empirical, methodological or theoretical coherence, meaning that only piecemeal attempts have been made to try to understand and explain how the modern corporation is run.

Tricker provides a useful governance model by reducing aspects of corporate governance into four distinct categories. This conceptual framework proves useful in the analysis of alliance contracts as these elements conveniently correspond to federal and state government governance guidelines, as discussed later in this chapter. Tricker’s categories comprise:

a. Direction – formulating the strategic direction for the future of the enterprise in the long term;

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10 Parum, above n8, 703.
b. Executive Action – ensuring involvement in crucial executive decisions;

c. Supervision – monitoring and oversight of management performance;

and

d. Accountability – recognising responsibilities to those making a legitimate demand for accountability.\(^{12}\)

These four categories fall into two distinct functions, namely compliance\(^{13}\) and performance.\(^{14}\) Compliance consists of supervision and accountability to ensure the corporation is compliant with relevant statutes, for example the *Trades Practices Act 1974* (Cth), *Workplace Relations Act 1996* (Cth), and the *Corporations Act 2001* (Cth). Performance, on the other hand, focuses upon direction and executive action. For example, organisations measure corporate performance through comparisons of benchmarks such as return on shareholder’s equity, achievement of corporate goals and revenue growth.

The application of corporate governance principles will vary considerably between organisations. Heavily regulated industries might place substantially more emphasis on the compliance aspects of corporate governance. Lightly regulated industries tend to adopt innovation and high growth strategies that focus more on the performance aspects of governance.

The growth of corporate governance in the private sector has been a recent catalyst for change in the public sector. Governments’ goals of adopting ‘commercial best practice’\(^{15}\) and the desire for government owned corporations to operate on an equal footing with industry has resulted in many of the elements of corporate governance appearing in government policy. Nevertheless, there are significant differences

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\(^{13}\) The Australian National Audit Office use the term ‘conformance’ in lieu of compliance. Australian National Audit Office above n 11, 6.

\(^{14}\) Ibid, 12.

between private and public sector accountabilities, stakeholder interests, reporting arrangements, and organisational goals. The following section explores these differences and explains how the public sector has responded with a distinct governance framework to meet the objectives of governments.

**Public versus Private Governance**

The public and private sectors have different objectives. The rules by which the public sector operates also vary considerably from those of the private sector. While there are some similarities, there are significant differences in both the governance realms of *compliance* and *performance*. The following section highlights these differences, by first exploring the differences between public and private stakeholders, accountability mechanisms, applicable legislation, and performance measurement objectives.

Governments’ charters are to provide services and infrastructure for the ‘good of the nation’, utilising taxpayer’s dollars for best value for money through ‘the proper management of public money and public property’.\(^\text{16}\) A relevant question to ask, though, is who owns government? Unlike publicly listed companies, governments do not have shareholders.\(^\text{17}\) Nevertheless, the public is the major stakeholder of government spending and this lends itself to the argument that the public is the default shareholder of government departments.\(^\text{18}\) This analysis proves useful for describing accountabilities and reporting arrangements; but there are significant flaws in this model. For example, the public does not have adequate recourse for poor

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\(^{16}\) *Financial Management and Accountability Act 1997* (Cth), iii.

\(^{17}\) For statutory Government Owned Corporations and the like, limited shares are owned by the respective ministers. For example, two shareholders are required under Queensland law for Statutory GOCs and five for company GOCs: *Government Owned Corporations Act 1993* (Qld) Division 1 Section 71, 77. In NSW, Statutory SOCs must have two shareholders (being the treasurer and another minister) *State Owned Corporations Act 1989* (NSW) Part 1 Section 20H.

management of their shareholdings as they cannot sell their shares or call for the immediate removal of the directors.  

This shareholder model of the public sector also fails since there is generally significant scope for ministerial intervention, as the responsible minister, in the affairs of government departments or government owned corporations. The broad and largely unfettered powers afforded to responsible ministers provides substantial scope for inappropriate political interference in the running of both government owned corporations and government departments. By way of contrast, shareholders in publicly listed companies rarely have such powers. Grantham notes this difference between private shareholders and ministerial shareholders (emphasis added):

\[\ldots \text{ while the Minister is the sole shareholder, it cannot be said that the Minister acts in the same way as a private sector owner\ldots the Minister is also an agent – of the Crown in the discharge of his or her ministerial function, of the public in general, and of his or her political party.}^{21}\]

The privately listed company has only one goal and that is to satisfy the interests of shareholders above all others. Government departments, on the other hand, have no such goals and GOCs straddle the two extremes with the requirement to meet both commercial objectives and satisfy community obligations. Government departments and GOCs are therefore not equivalent to privately listed companies from a shareholder or accountability perspective. A review of both the compliance and performance aspects of the public and private sector further highlights the differences in the governance arrangements of the public and private sector.

\[\text{\footnotesize 19 Nicholas Seddon,} \textit{Government Contracts: Federal, State and Local (3rd ed, 2005), 17; The public can not readily 'sell' their shares or call for the immediate removal of directors though they have scope for voting ministers out of office (albeit on a three or four year cycle).}^{20}\]

\[\text{\footnotesize 20 See, eg, in NSW, the portfolio minister provides control and direction to the State Owned Corporation; \textit{State Owned Corporations Act 1989} (NSW) pt 1, ss 20D.}^{21}\]

\[\text{\footnotesize 21 Grantham, above n 4, 190; see also Darryl D. McDonough 'Corporate Governance and Government Owned Corporations in Queensland’ (1998) 10 (20) \textit{Bond Law Review} 310.}^{22}\]

\[\text{\footnotesize ‘What this means is that under the corporate governance structure for a GOC, it is the shareholder minister/the government that is the centrepiece of the structure and not the board of directors.’}^{23}\]


\[\text{\footnotesize 23 \textit{Commonwealth Authorities and Corporation Act 1997} (Cth) S17; \textit{State Owned Corporations Act 1989} (NSW) Section 8; \textit{Government Owned Corporations Act 1993} (Qld) s 9.}^{25}\]
There are significant differences in the compliance aspects of the public sector compared to the private sector. In some areas the public sector is subject to greater levels of compliance whilst in others, compliance requirements are less stringent. Examples of greater regulation in the public sector include the requirement to comply with the *Financial Management and Accountability Act 1997* (Cth), respective freedom of information legislation, as well as other government policy documents and ministerial directions.

Additional oversight is also levied on government organisations with potential scrutiny by senate reference and legislative committees, Auditor General reviews, ombudsman reviews, and Administrative Appeals under the *Administrative Decisions (Judicial Review) Act 1977* (Cth).

By way of contrast, the public sector enjoys less regulation than the private sector in some other areas. For example, the Australian Securities Investment Corporation does not generally regulate governments, nor do government departments fall under the ambit of the Corporations Act. There are, however, a significant number of Government Business Enterprises (at the federal level) and Government Owned Corporations or State Owned Corporations (at the state level) that do fall under the influence of the *Corporations Act*.

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28 Contra *Statutory Government/State Owned Corporations* which are not registered under the respective corporations legislation; *Government Owned Corporations Act 1993* (Qld) s 7; *State Owned Corporations Act 1989* (NSW) pt 1, ss 3A.
Compliance differences also appear in what government can and cannot do from a philosophical perspective. Governments distribute public funds and must spend these funds responsibly and equitably. Private industry has no such constraints. As a sizable buyer, government has considerable power as a monopsony buyer that can significantly affect the operation of Australian industry. It is important to governments that the distribution of government contracts is fair and open to eliminate or discourage anti-competitive practices. Industry, on the other hand, will pursue strategies that promote their own profitability above any equitable notions and will actively engage in activities that may encroach on anti-competitive behaviour, provided such behaviour does not run afoul of trade practices legislation. This philosophical demand on the public sector manifests itself in tender selection policies and procurement guidelines. This becomes of substantial importance when exploring alliances and tender evaluations in Chapter seven.

Compliance differences between the public and private sector also exist from a behavioural perspective. For example, case law states that government has high standards of behaviour levied upon it in commercial dealings as a ‘moral exemplar’. In Hughes Aircraft Systems International v Airservices Australia, Finn J goes further to state that fair dealing is a prescriptive duty implied on government:

> fair dealing is, in effect, a proper presupposition of a competitive tender process contract (especially one involving the disposition of public funds), and given that a public body is the contracting party whose performance of the contract is being relied upon, a necessary incident of such a contract with a public body is, I am prepared to conclude, that it will deal fairly with the tenderers in the performance of its tender process contracts with them.

Thus, government must act fairly in commercial dealings. This exceeds the obligations associated with a duty of cooperation and implied duties of good faith imposed on private companies (see Chapter five).

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29 Seddon, above n 13, 16.  
30 Hughes Aircraft Systems International v Airservices Australia, (1997) 146 ALR 1, 41.  
31 Ibid, 42.  
32 Mackay v Dick (1881) 6 App Cas 251, 263.
Another behavioural compliance characteristic unique to governments is the direction to behave as a ‘model litigant’. This includes, inter alia, the duties to prevent delays in litigation, to avoid litigation where possible, and not to rely on technicalities to escape liability. These obligations are substantially more onerous than the requirements levied upon the private sector.

The model litigant and moral exemplar tenets are repugnant to the private sector where companies exploit tactics to thwart equitable outcomes in litigation and frustrate opponents when it is to their own advantage. Though there are some less onerous constraints on the public sector from a compliance perspective, for the majority of situations, the public sector will have its hands tied far more than the private sector. For example, the public sector faces greater disclosure requirements, higher standards of fairness, and greater financial accountability when it comes to procurement. Other than for these compliance differences, how does the public sector fair from a performance perspective?

In addition to the substantial differences in the compliance domain between the private and public sector, there are significant differences in the performance domain. More specifically, from a performance perspective, government has a far more difficult task than does industry. Performance outcomes appear in the governance objectives of stewardship and efficiency. The challenge for governments is how to measure the commonly used terms such as ‘best use of resources’ or ‘use every opportunity to enhance the value of public assets’.

In the private sector, this objective is easier to measure and manage. For example, the majority of private companies can exploit industry benchmarks to gauge their

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performance in comparison to their peers, or simply monitor metrics such as return on shareholders equity or market size. By way of contrast, governments have goals that are far more nebulous with a far greater number of stakeholders to whom they are accountable. Governments must also achieve social, environmental and political goals as well as undertaking commercial activities. Simple metrics such as return on equity and fiscal growth therefore have limited relevance to governments. To this end, governments must rely on internally generated benchmarks with a focus on continual improvement from previous years and comparisons to other states or departments to gauge performance.

This challenge of public sector benchmarking is exacerbated since governments are typically a monopoly supplier or monopsony customer. Consequently, there may be no effective competitors or benchmarks with which to gauge performance. Measuring government’s performance is therefore more difficult in comparison with the private sector’s. Governments therefore tend to focus governance efforts on compliance and strategies that pursue ‘anti-corruption’. This is not to say that performance elements such as value for money are ignored by the public sector, but rather that there is a bias towards the compliance elements of public sector governance.

The public sector shares some of the governance constraints and features of private industry, though there are striking differences in both the compliance and performance domains as discussed above. Where government and industry form an alliance, governance challenges will occur as suggested by the Commonwealth Auditor-General’s comments on government industry partnerships:

34 For example, financial ratios require mandatory reporting for publicly listed companies; Corporations Act 2001 (Cth) s 1(5), (10).
39 For example, the Commonwealth Authorities and Companies Act 1997 (Cth) in particular is heavily focused on conformance rather than performance. Bryan Horrigan, ‘Key Legal and Governance Issues for Companies and Boards Across the Public And Private Sectors’ in University of Canberra, National Centre for Corporate Law and Policy Research, above n 35, 13.
Public and private sector agencies have very different legal and accountability requirements … agreeing governance structures and demonstrating accountability are particular challenges.\(^{41}\)

While the recent public sector governance principles originated from the corporate governance crusade in the mid 1990’s, there are substantial differences in the focus of public and private sector governance. There is one area, however, where the line between public and private sector governance becomes especially blurred. This occurs where governments create statutory bodies that operate in a commercial environment.

**Government Owned Corporations**

Government Owned Corporations (GOCs)\(^{42}\) are government owned entities created to compete equally with the private sector.\(^{43}\) These organisations do not include statutory authorities such as local governments or Commonwealth Authorities (such as the Civil Aviation and Safety Authority) but does include Government Business Enterprises such as Australian Rail Track Corporation.\(^{44}\) GOC’s therefore straddle the domain between the public and private sector.

A relevant question to ask is: what governance framework applies to these entities? This is an important question since my demographic analysis of alliances (discussed

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\(^{43}\) Government Owned Corporations Act 1993 (Qld) s13,14; See also Statutory SOC, State Owned Corporations Act 1989 (NSW) s20E.

in Chapter two) identified 45 alliances with GOCs as participants. An understanding is therefore required of how these organisations are controlled and what governance frameworks apply. The following section demonstrates that GOCs share a governance framework more aligned to that of the public sector than the private sector. This is especially so since I demonstrate that GOC ministers are effectively shadow directors of these entities and therefore have wide-ranging powers and discretions to influence GOC outcomes. This is rarely the case with shareholders in a publicly listed company.

The objectives of a GOC are to allow a government entity to operate in a competitive market and provide a net gain to the government owner. Other aims include the ability for government to deal with the entity at arms-length. In addition to commercial imperatives, a GOC has social responsibilities. These responsibilities place pressure on that entity’s ability to compete equally with business. This tension is highlighted in the NSW Auditor General’s performance audit report on corporate governance:

[for a GOC] there is a tension between commercial and social objectives, especially where a board wants to give priority to one objective over another.

As the shareholders of a GOC typically comprise two ministers and these ministers may impose constraints or obligations upon a GOC that are at odds with directors’ wishes, it is inappropriate to consider a GOC as a private entity from a governance

45 For example, some of the GOCs that use alliances include: Australian Rail Track Corporation, Port of Brisbane Corporation, ACT Electricity and Water, Enertrade (Qld), Queensland Rail, Sydney Water Corporation, Hydro Tasmania, and the WA Water Corporation.
46 See, eg, *State Owned Corporations Act 1989* (NSW) s 8, ‘Company and Statutory SOCs must operate at least as efficiently as a comparable business, must maximise net worth to the state, exhibit a sense of social responsibility and exhibit a sense of responsibility towards regional development.’; *Government Owned Corporations Act 1993* (Qld) s 17, ‘The aim of corporatising is to improve Queensland's overall economic performance, and the ability of the Government to achieve social objectives, by improving efficiency, effectiveness and accountability of GOC’
48 NSW Audit Office, Performance Audit Report – Corporate Governance (July 1997) 78.
perspective. GOCs also differ from the private sector from a compliance perspective. For example, some Commonwealth bodies created under the *Commonwealth Authorities and Companies Act*\(^{50}\) are also subject to provisions of the *Financial Management and Accountability Act* (1997),\(^{51}\) with the attendant requirements for providing efficiency, integrity and transparency, and value for money.\(^{52}\) Employees of GOCs may also be subject to relevant Public Services Acts.\(^{53}\) These acts impose governance objectives on GOCs and their employees that are far more onerous than those associated with the private sector.\(^{54}\)

Despite more onerous compliance requirements, some GOCs share similar immunities to the private sector from judicial review. For example, Government Business Enterprises’ activities may not be subject to judicial review under the *Administrative Decisions (Judicial Review) Act* 1977 (Cth) even if that entity is established under an enactment.\(^{55}\) Similarly, freedom of information legislation does not apply to many GOCs.\(^{56}\) To summarise, with the exception of some judicial review and freedom of information provisions, most GOCs must operate by the rules of the public sector. This is especially so since GOCs are under ministerial control.

Independent of the commercial imperatives of GOCs, these entities operate under ministerial ownership with attendant social obligations. Furthermore, many GOC employees are regulated by public service legislation and treasury oversight,\(^{57}\) and

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50 Commonwealth Authorities and Companies Act 1997 (Cth).
51 Australian National Audit Office, above n 11, 12.
54 See, eg, Owen J, ‘The Failure of HIH Insurance’ (2003), Volume 1. The observation is made that the role of the private sector employee is of shirking responsibility and adopting the role of a ‘functionary’.
57 Many GOCs have two shareholder ministers with a portfolio minister and treasurer fulfilling these roles. Should the GOC wish to enter into a significant contract, borrow money, or divest assets, an appropriate business case would be expected by the shareholder ministers. Value for money also becomes important when adopting the ‘public trust’ model for government companies. See especially, Stephen Bottomley, ‘Corporatisation and Accountability: the Case of Commonwealth Government Companies’ (1997) 7 Australian Journal of Corporate Law 156.
government policy is quite often applicable to GOCs. This suggests that the governance arrangements of many GOCs are more closely aligned to those of government departments rather than those of industry. This is especially so when considering the chain of accountability between the board of directors of the GOC and the shareholder ministers.

The potential for ministerial intervention in the affairs of a GOC exacerbates the governance challenges of GOCs. Though the shareholding ministers of a GOC are not members of the board of directors, such ministers maintain discretions and directional control over the GOC akin to those duties associated with directors. For example, the Government Owned Corporations Act 1993 (Qld) provides for a minister to notify the board of public sector policies, give directions to the board for the public interest, give directions about charter implementation, and issue guidelines about the form and content of corporate plans.

Section 9 of the Corporations Act 2001 (Cth) extends the concept of director to include a person acting in the position of director although not validly appointed to that position (de facto director) and also a person in accordance with whose instructions or wishes the directors of the company or body are accustomed to act (shadow director). In Deputy Commissioner of Taxation v Austin, the extension of directorship was held to include positions that exercise top-level management functions as observed by Madgwick J:

> It is not necessary in all cases, in my opinion, to show that the supposed director has done acts which only a director can do.... The test in the statute

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58 Commonwealth Authorities and Companies Act 1997 (Cth) s 28, s 43.
60 Darryl McDonough ‘Corporate Governance and Government Owned Corporations in Queensland’ (1998) 10(2) Bond Law Review 272; See Uhrig, above n 59, 6, where it is recognised that most statutory organisations do not have the power to appoint and remove CEOs.
61 Government Owned Corporations Act 1993 (Qld), ch 3 pt 10 [123].
62 Ibid, ch 3 pt 10 [124].
63 Ibid, ch 2 pt 4 [49].
64 Ibid, ch 3 pt 7, div 1 [105].
Act] is not whether a person has done acts which only a director can lawfully do, but whether he or she has occupied or acted in the position of a director.\footnote{66}

In \textit{ASC v AS Nominees Ltd}, Finn J held that, where directors normally obey directions of a person, that person is a shadow director, ‘...he [the shadow director] was a person in accordance with whose directions or instructions the directors of both companies were accustomed to act.’\footnote{67}

What Finn J held to be most import is where the locus of effective decision-making lies for determining who is acting as a director.\footnote{68}

In light of the construction of the \textit{Corporations Act 1993 (Cth)} and associated case law, it appears that a shareholder minister may be deemed to be a shadow director, though such a determination would be contingent on the extent to which the minister evokes their responsibilities in issuing directions and policy to the board of the GOC. Additionally, the extent to which the GOC board accepts ministerial directions would be a consideration as to whether the minister is a shadow director. Being a majority shareholder is insufficient to be deemed a shadow director;\footnote{69} rather, the scope for ministerial intervention may attract the application of shadow directorship.\footnote{70}

The drafters of the Queensland GOC legislation appear to have considered this contingency by attempting to limit the ministers’ liability through stating that the minister is not to be treated as a director despite the Corporations Act.\footnote{71} Likewise, the \textit{Commonwealth Authorities and Companies Act 1997 (Cth)} attempts to limit a minister’s liability by constraining ministerial involvement to ‘strategic control’ or ‘general policies of the GBE.’\footnote{72} The success of this ‘ouster’ in the Queensland legislation is questionable,\footnote{73} as are general attempts to limit the minister’s

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\footnote{66}{(1998) 28 ACSR 565, 572; See also \textit{Natcomp Technology Australia Pty Ltd v Graiche} (2001) NSWCA 120.}

\footnote{67}{(1995) 18 ACSR 459, 459.}

\footnote{68}{Ibid, 510.}

\footnote{69}{\textit{Chartered Bank of Australia v Antico} (1995) 13 ACLC 1381, 1439.}

\footnote{70}{Bottomley, above n 57, 165.}

\footnote{71}{\textit{Government Owned Corporations Act 1993 (Qld)}, ch 3 pt 3 div 3 [85].}

\footnote{72}{Bottomley, above n 57. Arguably, providing strategic control and policy is the role of the directors of a company (see Tricker, above n 12).}

\footnote{73}{Inconsistency between the State and Commonwealth legislative spheres are not easy to reconcile despite operation of s109 of the Australian Constitution. See, eg, Geza Francis Kim Santow,
responsibilities using vague terms as attempted in the *Commonwealth Authorities and Companies* legislation;\(^74\) rather, defences to the fact that a minister is not a shadow director would necessarily include demonstrating that the minister actually has no control over the financial affairs and management of a GOC (either through lack of statutory power or from the fact that the board typically ignores directions given by that minister)\(^75\) or the minister lacks a willingness to exercise that control.\(^76\) Despite such defences, if a responsible minister is deemed a shadow director, then government will likely indemnify that minister.\(^77\)

Thus from a directional perspective, a GOC is likely to share more with the public sector than with the private sector. Ministers retain substantial discretion in delivering directions to the board of directors to the GOC.\(^78\) Unlike private shareholders, responsible ministers are less likely to be motivated by economic performance, such as return on equity and dividend yield; rather, a minister is more likely swayed by public interest considerations and outcomes more likely to result in re-election.

Government Owned Corporations therefore share much with the governance arrangements of public sector departments.\(^79\) This is especially so considering GOCs are owned by the public with the board of directors answerable to a shareholder minister. As Mantziaris observes ‘...the statutory corporation is the direct creature of Parliament's will’\(^80\) and as the following section demonstrates, the federal government has issued governance guidelines that apply to all public sector entities *including GOCs*.

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\(^{75}\) Bottomley, above n 57.


\(^{77}\) Bottomley, above n 57.

\(^{78}\) McDonough, above n 60, 274-5.


**Public Sector Governance Principles**

The public sector is characterised by greater compliance constraints than the private sector and substantial difficulty in performance measurement. How then has the public sector attempted to define a governance framework in light of these characteristics? A useful summary of public sector governance principles appears in the Australian National Audit Office better practice guide titled, *Public Sector Governance and the Individual Officer.*

This document lists the following principles of public sector governance (adapted with minor modification):

a. accountability – being answerable for decisions and having meaningful mechanisms to ensure adherence to all applicable standards;

b. transparency – clear roles and responsibilities and clear procedures for decision-making and the exercise of power;

c. integrity – acting impartially, ethically and in the interests of the organisation, and not misusing information acquired through a position of trust;

d. stewardship – using every opportunity to enhance the value of the public assets and institutions that have been entrusted to care;

e. efficiency – the best use of resources to further the aims of the organisation with a commitment to evidence-based strategies for improvement; and

f. leadership – leadership from the top is critical to achieving an organisation-wide commitment to good governance.\(^{82}\)

The public sector governance objectives at the state government level are similar. For example, the Queensland Government’s strategic governance principles include, inter alia, compliance with fiscal and regulatory frameworks, accountability, ethics and

\(^{81}\) Australian National Audit Office, above n 11. 
\(^{82}\) Ibid.
Other state and local government governance principles follow these themes. The Chartered Practicing Accountants’, *Excellence in Governance for Local Government* states the principles of accountability, integrity, transparency and effective decision-making as necessary to achieve excellence. Stewardship and efficiency objectives appear in all state and local government policy with the recognition of the delivery of value for money as a fundamental objective of governments.

Though subtle differences exist between the governance guides at federal, state and local government levels, most of the governance principles capture the requirements for transparency, accountability and value for money. This study adopts the governance framework of the Australian National Audit Office (ANAO) for the following reasons. First, the ANAO better practice guide states that it exists to assist entities outside of the Commonwealth (it is recommended as a guide for state and local governments). Second, the ANAO better practice guide reflects a mature framework developed by an external auditing agency for both government departments and Government Business Enterprises (including GOCs). Third, the ANAO better practice guide is more exhaustive than state government governance frameworks in that it recognises leadership and integrity as part of government’s governance obligations. Finally, several state and local governments have adopted the ANAO governance framework.

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85 Chartered Practicing Accountants Australia, ‘Excellence in Governance for Local Government’ (2005), 4-5.
86 Australian National Audit Office, above n 11, 1.
87 Ibid, 1-2.
The ANAO framework therefore forms the basis of this study for exploring whether alliances are compliant with the rules governments set themselves. To conduct this assessment at later chapters requires an understanding of each of the ANAO governance principles listed above and what these mean to procurement officers in practice. This is the focus of the following section.

**Accountability**

Accountability is a governance theme applicable to all Australian governments.  
Accountability raises the question of ‘who is accountable to whom, for what and when?’ Answering these questions is important since the alliance is a contractual framework that places little accountability for outcomes onto a single entity; rather, responsibilities are shared, and blame (or credit) cannot be assigned to any one person or organisation. Furthermore, the propensity for public servants to adopt risk averse contracting strategies such as alliances may indicate a broader trend to attempt to escape accountability for risk taking behaviour. The following section defines accountability and explores how accountability mechanisms operate in the public sector so that later chapters can explore whether alliances actually meet the express accountability objectives of governments.

At the highest level, ministers are responsible for the management of their departments and are therefore accountable to parliament for the exercise of these responsibilities. Nevertheless, ministers may not be responsible for all acts or omissions committed by their departments. At a subordinate level, departmental secretaries are accountable to their respective ministers and further accountabilities

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exist down the chain of command to procurement managers. This raises the question of what precisely do we mean by the term ‘accountability’?

Defining accountability poses a challenge, as observed by Bottomley:

The term “accountability” has no agreed definition in the public law/public administration literature. It is used variously as a synonym for answerability, responsibility, efficient management, and adherence to the rule of law. 95

Some government guides define accountability as ‘being answerable for decisions and having meaningful mechanisms to ensure adherence to all applicable standards’. 96 Accountability thus includes tenets of being responsible for actions and maintaining clearly defined roles. 97 This does not suggest that responsibility and accountability are synonymous. Uhr observes that, ‘accountability is about minimising misgovernment, responsibility is about maximising good government’. 98 Furthermore, responsibility can be delegated but accountability cannot. 99 The two concepts are therefore related but not equivalent.

In the context of procurement, governments recognise that accountability is fundamental to supporting the ‘public defensibility’ test by ensuring actions and decisions can withstand scrutiny by external agencies. 100 Therefore, accountability supports both the internal goals of providing efficient and effective government and the external goals of demonstrating equity and fairness to stakeholders (including the public).

These definitions of accountability provide insight into this governance concept. How is accountability achieved in practice and are there limitations in its implementation? The following section explores the internal and external mechanisms in the public

95 Bottomley, above n 57, 157.
98 Uhr above n 90, 5; see also, Dawn Oliver and Gavin Drewry Public Service Reforms: Issues of Accountability and Public Law (1996) 3, 6-8.
sector that promote accountability. Not only does this encompass consideration of government policy governing accountability but also an examination of ‘enabling’ influences such as freedom of information legislation, ombudsman review, administrative review, senate committees, and the effects of mass media.\textsuperscript{101}

As previously discussed, one dimension of accountability is responsibility.\textsuperscript{102} Responsibilities may manifest themselves in duty statements or more generally, through organisational structures (for example, chains of command dictate who is responsible to whom). Is it then appropriate to state that a public servant should be held accountable for all their responsibilities? The answer is yes, but only if that public servant holds substantial discretion in the manner in which they could conduct their duties\textsuperscript{103} by being empowered to make effective decisions without any fetters.

Recent reforms attempt to delegate more authority to those public sector officers best placed to make decisions. This has been achieved with the decentralisation of governments\textsuperscript{104} and the promotion of ‘flatter’ organisational structures.\textsuperscript{105} Nevertheless, the responsibilities of public sector employees are framed in broad terms as per the following federal government directions:

\textit{… an APS [Australian Public Service] employee must, taking into account the employee’s duties and responsibilities in the Agency, take all reasonable steps to ensure that he or she:}

\begin{itemize}
  \item[a.] understands the accountability framework within which he or she operates;
  \item[b.] meets individual and Agency statutory and reporting obligations; and
  \item[c.] is able, within the accountability framework, to demonstrate clearly and appropriately to Ministers, to the Parliament and to other stakeholders that he
\end{itemize}

\textsuperscript{101} Ian Thynne and John Goldring, \textit{Accountability and Control: Government officials and their Exercise of Power} (1987), 1.
\textsuperscript{103} Ibid.
\textsuperscript{104} Australian Government, above n 94, 14.
\textsuperscript{105} Thynne et al, above n101, 204.
or she has efficiently, effectively and ethically used the resources allocated to
him or her. 106

These principles demand that all public servants are accountable for demonstrating
that they have delivered effective outcomes. What will prove a challenge, though, is
demonstrating that their actions were effective compared to alternatives that never
eventuated. This implies that public servants face a reverse onus of proof to justify
their decisions. 107 As the following section argues, there are limits to what decisions
procurement managers can make.

My interviews and case studies identified some of the main tasks performed by public
sector employees involved in procurement. These include: selection of a procurement
option or acquisition strategy; development and approval of project specifications,
statements of work and head contracts; initiation and approval of variations;
enforcement of contractual obligations; and conducting acceptance and
commissioning of delivered works.

Whilst it may appear that an individual public officer is accountable for the delivery
of all these activities, there are some activities that demand intellectual and financial
independence. For example, for large value acquisitions, approvals from two financial
delegates may be required. 108 Some departments also prohibit a single person from
approving the expenditure of government funds. 109 Consequently, accountability for
some activities may be difficult to assign to any one individual; rather, they may be
assigned to two or more persons. Even if procurement managers are provided with the
discretions necessary to deliver project outcomes, how then do governments and other
stakeholders hold these procurement decision makers to account?

McMillan, Control of Government Action: Text, Cases and Commentary (2005), 17-8
107 Uhr, above n 90, 6.
108 See, eg, Defence Portfolio Budget Statement 2004–05, p. 81, which requires approvals from both
the minister of defence and minister for Finance and Administration for purchases above $8 million.
109 See, eg, Australian, Government, Department of Defence, Defence Policy Procurement Manual
v6.0 (2006) 1.4.2 which prohibits proposal approval and contract approval being signed by the same
person for contracts exceeding $5000.
Accountability measurement and enforcement is vital since this allows parliament to assess the performance of government agencies,\(^{110}\) provide the public with information with which they can scrutinise the actions of the executive,\(^{111}\) establish rewards and sanctions for the actions of public servants\(^ {112}\) and promote fairness and effectiveness in public administration.\(^ {113}\) Procurement activities must therefore be consistent with these objectives. Governments must implement accountability regimes so that project performance can be monitored; responsibilities for activities can be assigned; and departmental secretaries can state with confidence what will be delivered, when it will be delivered, and for how much. As discussed later, alliance contracts exacerbate the challenge of achieving these objectives as alliances place emphasis on governments\(\text{sharing responsibilities}\) for project delivery with industry and with project goals stated in vague terms.

There are several mechanisms available for enforcing accountability in the public sector. These mechanisms include both procedural and legal aspects (internal and external perspectives respectively). Examples of accountability mechanisms include electoral processes, provision of information,\(^ {114}\) unrestricted media reporting,\(^ {115}\) effective record keeping,\(^ {116}\) ability to challenge official decisions, independent review of decisions, processes governing official action, and policing of safeguards against misuse of power.\(^ {117}\) These varied accountability mechanisms do not have equal weight and no single mechanism should be considered effective by itself.

A useful model for exploring these accountability mechanisms is the three avenues of accountability recognised by Finn. These are:

\(^{111}\) above n 94, 4.
\(^{114}\) John Uhr, above n 90, 10.
\(^{115}\) See especially, Mason CJ, ‘Indispensable to that accountability and that responsibility is freedom of communication, at least in relation to public affairs and political discussion’ Australian Capital Television and oths v Commonwealth of Australia (1992) 108 ALR 577, 594.
a. accountability to members of the public directly, either as individuals (as through administrative law mechanisms) or as a community (as through elections);

b. accountability to agencies such as the Auditor-General, the ombudsman and to parliament; and

c. accountability to official superiors and peers.118

The first avenue is an external mechanism recognising administrative law as a system of review to make administrators accountable for their official actions.119 This is reflected in Guadron J’s observations:

In this context [administrative law], “accountability” can be taken to refer to the need for the executive government and administrative bodies to comply with the law and, in particular, to observe relevant limitations on the exercise of their powers.120

The increase in frequency and scope of administrative law as a tool for ensuring accountability is also reflected in Kirby J’s observations in Hot Holdings Pty Ltd v Creasy and Oths:

It is not coincidental that this growth in administrative law remedies has occurred at a time when the theory of ministerial responsibility, as an effective means of ensuring public service accountability, has been widely perceived as having serious weaknesses and limitations.121

The effectiveness of administrative law remedies is questionable in the context of alliancing, where the delineation of public and private law is blurred. Nevertheless, as discussed in Chapter seven, administrative law may offer relief during the alliance tender evaluation. Similarly, accountability to the public through torts such as

118 ibid, 53-4 (adapted with minor modification).
121 (2002) 70 ALD 314, 335.
misfeasance in public office and other criminal law such as corruption\textsuperscript{122} may also be diluted with the use of alliances as discussed in Chapter five.

The second avenue of accountability is also external with the use of audits and ombudsman review of decisions. Parliament may also provide reviews through Senate Estimate Committees and the like. These organisations ostensibly provide independent reviews of the efficiency, effectiveness and appropriateness of administrative action.\textsuperscript{123} The fact that one alliance contract\textsuperscript{124} has been subject to external audits at the federal level, and three at the state level, suggests that there is no tangible accountability barriers to alliances in this area. The high expenditure of probity audit consultancy tasks on alliancing also supports this premise.\textsuperscript{125}

The last avenue of accountability is addressed by duty statements, control structures,\textsuperscript{126} and similar organisational management tools. These internal structures\textsuperscript{127} make ‘officials accountable to their superiors for the proper exercise of tasks devolved to them.’\textsuperscript{128} Though effective and accountable command and control structures support accountability objectives, internal mechanisms are considered less favourably than the previous two modes of accountability. The Western Australian Royal Commission into Commercial Activities of Government reinforces this premise stating that ‘internal accountability measures are to be treated with scepticism and should be made subordinate to external accountability measures.’\textsuperscript{129}

\begin{itemize}
\item \textsuperscript{122} Western Australian Government, \textit{WA Inc Report} (1992), ch 4,10-15.
\item \textsuperscript{123} John Uhr, above n 90, 10.
\item \textsuperscript{125} Probity Audit consultation contracts are reported in Hansard. The author identified a total of $800,280 expended on probity audits for the Djimindi, ANZAC and Airwarfare Destroyer Alliances (as at 8 May 2008).
\item \textsuperscript{127} Davies, above n2, 75-9.
\item \textsuperscript{128} John Uhr, above n 90, 9.
\item \textsuperscript{129} Royal Commission into Commercial Activities of Government and Other Matters, \textit{Report}, Part II, Western Australia, 1992, [3.12.1].
\end{itemize}
As Chapter five demonstrates, the internal accountability mechanisms used for alliances varies markedly to that associated with conventional contracts. With shared responsibilities and chains of command that include private sector alliance participants, the public servant in an alliance has ambiguous responsibilities.

**Transparency**

Transparency, sometimes referred to as ‘openness’, 130 is a public sector governance principle common to all levels of Australian Government. The ANAO better practice guide for public sector governance states that:

> Transparency is required to ensure that stakeholders can have confidence in the decision-making processes and actions of public sector organisations, in the management of their activities, and in the individuals within them. Being open, through meaningful consultation with stakeholders and communication of full, accurate and clear information, leads to effective and timely action and stands up to necessary scrutiny. 131

The Commonwealth Procurement Guidelines outline transparency obligations in a similar manner but emphasise the need to comply with relevant statutes and policy as follows:

> Transparency provides assurance that procurement processes undertaken by agencies are appropriate and that policy and legislative obligations are being met. Transparency involves agencies taking steps to support appropriate scrutiny of their procurement activity. 132

In practice, transparency demands openness and eschews secrecy. Transparency in government is facilitated by effective performance reporting, explaining the decision-

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130 Australian National Audit Office, above n11, 8.
131 Ibid.
making process and the reasons for decisions made, disclosure of contracts awarded (available in the Commonwealth Purchasing and Disposals Gazette and the availability of access to contracts under the Freedom of Information Act (1982) Cth), and setting performance goals. Financial initiatives such as accrual accounting also promote transparency.

For government owned corporations, transparency is also institutionalised by requirements for boards to vote on all material issues, establishing formal procedures to govern the conduct of its business, and ensuring minutes of meetings are accurately recorded. Transparency is enshrined in most government processes involving full disclosure of information, though there are some caveats. Activities that involve national security and law enforcement may be exempt from specific reporting arrangements. Similarly, trade secrets and other confidential information may be used to thwart the disclosure of information to the public. Threats to transparency also increase during court proceedings as freedom of information legislation does not adequately provide directions on what can or cannot be disclosed.

The need for confidentiality, though, must be weighed against the public interest. Often, governments face a reverse onus of proof to demonstrate that relevant information is confidential prior to their relying on confidentiality defences. Such an approach was endorsed by the Senate Finance and Public Administration References and Legislation Committee’s inquiry into government contract accountability (emphasis added):

134 Senate Finance and Public Administration References and Legislation Committees, Inquiry into the mechanism for providing accountability to the Senate in relation to government contracts (26 June 2000) ch 1, 1.
137 Financial Management and Accountability Act 1997 (Cth), pt 9, s 58.
139 Esso Australia Resources Ltd and Others v Plowman (Minister for Energy and Minerals) and Others (1995) 128 ALR 391, 403.
A pragmatic consideration which the committee has alluded to in previous reports is that, for better or worse, executive claims of commercial confidentiality and/or public interest immunity, however interpreted, are unlikely to be believed because of their suspected use in the past to hide sloppiness, extravagance, incompetence – or worse, in the expenditure of public money.140

Consequently, governments are unlikely to be able to rely on the defence that project information cannot be revealed because such information is confidential.141 Such a tactic is even more unlikely for a completed project where there is very little relevant commercially sensitive information.

The current framework for transparency in Australian Government appears adequate,142 especially at the federal level.143 The influence of the media, political opposition, lobby groups and the electoral process itself also contribute to improving transparency in the public sector.144 As argued in later chapters there are some aspects of alliancing that promotes transparency, such as open book financial reporting, while in other areas transparency is discouraged, especially in tender evaluations for pure alliances.

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140 Senate Finance and Public Administration References and Legislation Committees ‘Inquiry into the mechanism for providing accountability to the Senate in relation to government contracts’- 26 June 2000, Ch 2, 6.
141 Auditor-General, Australian National Audit Office, Special Investigation into Casselden Place Building, Melbourne, Audit Report No. 4, 1994-95, AGPS, Canberra, 1994; Contra, McKinnon v Secretary, Department of Treasury (2006) 88 ALD 12.
142 Reflected in the following comments, ‘[in addition to FOI and commonwealth gazette] a separate disclosure regime may impose costs on agencies which are not warranted by the use that is likely to made of such a regime’; Senate Finance and Public Administration References and Legislation Committees ‘Inquiry into the mechanism for providing accountability to the Senate in relation to government contracts’- 26 June 2000, Ch 1, 2.
143 For a robust discussion on the doctrine of Freedom of Information legislation, see Seddon, above n 19, [8.37]-[8.41]; Transparency is lessened at the state level in several areas. See, eg, Australian Government, Industry Commission Inquiry Report, ‘The Automotive Industry’ (1997) 222, where state governments do not disclose industry assistance packages. Legislation has also been exploited at state level to thwart the disclosure of contractual information. See, eg, Australian Grand Prix Act 1994 (Vic), s 49.
**Integrity**

The governance principle of integrity demands governments act impartially, in the interests of the organisation, and not misuse positions of trust.footnote[145] These obligations are comparable to fiduciary obligations, which incorporate principles of ‘no profit’ and ‘no conflict’.footnote[146] The following section explores how the governments prescribe the governance principle of integrity with prohibitions on a conflict of interest and a conflict of duty.

At the federal level, the tenet of integrity is enshrined in employee codes of conduct and relevant policy documentation. For example, the Australian Public Service (APS) code of conduct requires ‘[e]mployees to disclose, and take reasonable steps to avoid, any conflict of interest (real or apparent) in connection with APS employment.’footnote[147] This applies to not only APS employees but also to agency heads.footnote[148] Similar requirements exist for Commonwealth Authorities and Companies as demonstrated in the Australian Rail Track Corporation’s values:

> We will ensure our staff have the skills and resources needed to perform at the highest level and in return expect their full commitment to the company and its goals. All business activities will be carried out honestly and ethically acknowledging all stakeholder interests.footnote[149]

At state government level, similar codes of conduct mandate the declaration or avoidance of conflicts of interest and for staff to act in the public interest. For example, the code of conduct for the Victorian public sector states that integrity requires:

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footnote[145]{Australian National Audit Office, above n11, 14.}
footnote[146]{This principle is discussed at length in Chapter five.}
footnote[149]{Australian Rail Track Corporation’s, ‘Values’ <http://www.artc.com.au/company/company.htm> at 11 May 06.}
Maintaining public trust by being honest, open and transparent in all dealings and by acting in the public interest. Avoid real or apparent conflicts of interest and report any improper conduct, corruption, fraud and maladministration at work.\(^\text{150}\)

Local government legislation also incorporates the need to declare and avoid conflicts of interest\(^\text{151}\) and recognition of the primacy of operating in the public interest.\(^\text{152}\)

Though the respective government statutes and codes of conduct focus on the prohibition of private gain by public employees, the governance objective of integrity also demands ‘[e]mployees to promote confidence in the integrity of public administration and always act in the public interest...’\(^\text{153}\) The ANAO goes further by acknowledging potential conflicts of duty as an individual may hold one or more official positions that could come into conflict with one another.\(^\text{154}\)

Despite the ANAO’s recognition of a potential conflict of duty, policy and procedures at federal, state or local government level do not specifically address this issue. By comparison, almost all government employee guides address the issue of a conflict of interest. There is therefore little to guide procurement managers upon the risks of a conflict of duty other than for broad statements from auditor generals.\(^\text{155}\) A conflict of duty is precisely the situation procurement officers face when involved in relational contracts such as alliances. Chapter five explores this issues in depth.

**Stewardship and Efficiency**

Stewardship demands effective use of government assets. This includes financial sustainability and the efficient and effective management of resources.\(^\text{156}\) In a similar fashion, efficiency entails providing the best use of resources to further the aims of the


\(^{151}\) *Local Government Act 1993* (NSW) ch 14; *Local Government Act 1993* (Qld) ch 229.

\(^{152}\) *Local Government Act 1993* (Qld), [1273]

\(^{153}\) NSW Government, above n 150, ch 8 [3.3].

\(^{154}\) Australian National Audit Office, above n 11, 18.


\(^{156}\) Australian National Audit Office, above n 11, 8.
organisation.\textsuperscript{157} Both stewardship and efficiency have the objective of the delivery of \textit{value for money}. Arguably, delivering value for money is the most important governance objective, because delivering outcomes for the lowest relative cost and within the bounds of relative administrative policy is the single most important goal of government. Value for money is a fundamental aspect of this study as well as being a considerable point of debate within the alliance literature.\textsuperscript{158} Chapter six is devoted to exploring this element of public sector governance drawing from evidence from my case studies, interviews, surveys and relevant literature.

Value for money definitions appear in numerous guises at federal, state and local government level. A typical definition of value for money is as follows:

\begin{quote}
[Value for money] requires a comparative analysis of all relevant costs and benefits of each proposal throughout the whole procurement cycle.\textsuperscript{159}
\end{quote}

As Chapter six demonstrates, the various definitions of value for money contain subjective and sometimes nebulous terms. For example, many of the definitions use the terms ‘benefits’ and ‘costs’ without actually quantifying these terms. Value for money can therefore be defined to suit the selection of virtually any procurement option by manipulating the underlying components of value and the risk profile of governments. It is important to recognise that Australian governments assign no consistent or repeatable scoring system for defining value for money; rather, government executives prefer the flexibility offered by avoiding a value for money scoring system.\textsuperscript{160}

Pure alliances exacerbate the challenge in demonstrating the delivery of value for money as in these alliances there is no price competition used to develop project costs. Furthermore, the alliance target costs are primarily developed by the industry participants in the alliance with government relying on auditors and independent

\textsuperscript{157} Ibid.
\textsuperscript{159} Australian Government, Department of Administration and Finance, ‘Commonwealth Procurement Guidelines’ (January 2005) 10.
\textsuperscript{160} Steve Gumley, Defence Materiel Organisation ‘Know Your Customer’ (Keynote address to the fourth Annual Australian Defence Magazine Congress, Canberra, 22 February 2007).
estimators to validate these target costs. The following comment from an alliance audit in NSW highlights the concerns with achieving value for money in alliances:

There is a need to ensure that a ‘value for money’ outcome is clearly demonstrated in any future alliances of this type. This is particularly so in the public sector… In our opinion there is insufficient evidence available to judge whether the cost of the tunnel represents ‘value for money’.  

Thus, for a pure alliance there are no competitive tensions demonstrating that the alliance cost is ‘right’.

Demonstrating and achieving value for money is therefore the single greatest governance challenge for a pure alliance. This is not to stay that accountability, transparency and integrity governance challenges are insignificant; rather, achieving and demonstrating value for money raises the greatest concern as demonstrated in Chapter six.

**Leadership**

There is a rich literature attempting to explain the concept of leadership and how leadership differs from management. This study does not attempt to reconcile the various leadership theories or attempt to explore what leadership theory should apply to the public sector; rather, it identifies how the public sector defines leadership itself in the context of public sector governance.

The public sector recognises leadership as a key quality in the achievement of both the compliance and performance aspects of governance. The ANAO identifies

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162 See, eg, Arthur Jago ‘Leadership: Perspectives in Theory and Research’ (1982) 28 (3) Management Science, 315, who claims that thousands of studies have been conducted into leadership; John Antonakis, Anna Cianciolo and Robert Sternberg Leadership Past, Present, and Future (2001) who claim that ‘leadership is social science’s most examined phenomena’; Warren Bennis, ‘Leadership theory and administrative behavior: The problem of authority’ (1959) 4 Administrative Quarterly, 259 who states that ‘Probably more has been written and less known about leadership than any other topic in the behavioural sciences’; Ron Stoghill Manual for the Leader Behavior Description Questionnaire-Form XII, (1963), 8, ‘there are almost as many definitions of leadership as there are persons who have attempted to define the concept’.

leadership as having two goals. First, leadership is necessary to implement and enforce governance frameworks. Second, strong leadership enacts good governance and sets the behaviour and culture of the organisation. The principles of leadership support effective communication, strategic thinking, integrity and the development of effective working relationships. The broad dimensions of leadership make this principle difficult to measure compared to other governance objectives.

Leadership is possibly the most difficult governance principle to measure, albeit some leadership metrics can be achieved with staff feedback and surveys. The themes of leading by example and implementing robust and consistent governance frameworks are demanded upon all public sector leaders. The following comment from the NSW Auditor General supports this premise:

> When leaders are open, transparent and accountable the rest of the organisation is more likely to be so, and to support a good governance culture.

Governments expect their leaders to enforce governance frameworks and set an example from the top. I therefore argue that leadership is therefore not so much a governance principle itself; rather, it is an enabling characteristic used for the achievement of other governance principles. This is especially so since there is little procurement policy or legislation stating what leadership standards are required of public sector managers. By way of contrast, there are minimum requirements articulated for accountability, transparency and integrity governance principles. There is therefore little merit in investigating whether alliances are compatible with the governance principle of leadership.

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164 Australian National Audit Office, above n 11,15.
165 Ibid, 16.
166 Ibid, 17.


**Conclusion**

The governance environment of the public sector captures the rules and principles by which public sector agencies must operate. The governance environment in the public sector shares similar themes with the private sector. This is especially so when considering the *compliance* dimension of governance. Where public sector governance diverges from that of the private sector is in the governance area of *performance*. The public sector has the unenviable task of having to meet the demands of many conflicting stakeholder requirements with attendant success factors that are difficult to quantify. This proves difficult for the public sector to have clearly defined and measurable governance principles. This is especially so when considering the efficiency and stewardship governance objectives where governments must deliver value for money.

The governance framework for the public sector in Australia is consistent between federal, state and local governments. Government Owned Corporations also share many of these governance principles. The principles of accountability, transparency, integrity, stewardship, efficiency and leadership are common features across most government organisations. In practice, these governance principles are enshrined in policy and procedures such as duty statements, financial delegations and control structures. Legislation providing for freedom of information and judicial review also support these governance structures across the public sector. These mechanisms are adequate for conventional arms-length procurement practices, but as we shall see in the following chapters, they breakdown when governments engage in collaborative arrangements such as alliances.
Chapter Five – Fiduciary Obligations, Integrity, Accountability, and Transparency

‘Sunlight is said to be the best of disinfectants.’
Justice Louis D. Brandeis (1856-1941)

Introduction

The previous chapter explored the governance objectives of the public sector. We can now begin to explore whether alliances comply with this governance framework. The nature of the contractual relationship in alliance contracts differ significantly to those in conventional arms-length contracts. As we have seen in Chapter two, pure alliance contracts are characterised by the creation of a virtual organisation, a regime of no blame and no disputes, an emphasis on non-price selection processes, and unanimous decision-making protocols. As a consequence of these features, the governance arrangements of alliances are argued by several commentators to be less robust than those of other procurement options. Are these criticisms valid? This and subsequent chapters explore this question by examining alliance contracts against the governance framework introduced in Chapter four.

I argue in this chapter that contemporary alliances are likely to give rise to fiduciary obligations between the parties to the alliance. Many alliances appear to be constructed on the assumption that such obligations do not arise, and consequently there is no real attempt by the parties during the negotiating and contracting of an alliance to anticipate what would happen if a breach of such obligations were to occur. In addition, the underlying ‘risk’ that a fiduciary relationship exists between the parties to an alliance has significant implications for the governance structures of these procurement options. In particular, there is a strong possibility for obligations to

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1 Louis Brandis, Other People's Money and How the Bankers Use It (1933) 92.
3 See Chapter five, footnotes 88 and 97.
be imposed in the alliance relationship that exceed those agreed to in the express terms of the contract.

Nevertheless, this chapter demonstrates that the consequences of fiduciary obligations are no less onerous than the far-reaching good faith clauses and obligations to performance on a best for project basis clauses that often appear in alliance contracts. This suggests that there are no credible risks to the governance principle of integrity resulting from the imposition of fiduciary obligations in alliances, although the imposition of fiduciary obligations may render the alliance ‘no-litigation’ clause illusory. The risks of fiduciary obligations occurring in alliance contracts are therefore overstated.\(^4\)

With the alliance relationship explained in both common law and equity, this chapter proceeds to examine the governance shortcomings of alliances identified in audit reports. Though some audit reports have concluded that the governance arrangements of alliances have been suitable, two reports found significant failings in this area. This chapter explores why the governance arrangements of alliances are subject to greater criticism when compared to conventional contracts, and in particular, the problems alliances create with the governance principles of integrity, accountability, and transparency.

Though the imposition of fiduciary obligations does not fundamentally alter the operation of alliance contracts, this chapter demonstrates that other features of the alliance relationship create a conflict of duty for the public sector. For example, tensions arise between government’s obligations to the alliance and the broader public sector, because the alliance relationship demands participants operate on a ‘best for project basis’ with all project risks shared. Government participants are therefore unlikely to meet the governance principle of integrity under alliance arrangements unless significant effort is invested in probity audits, employee training, and independent auditing.

\(^4\) See Chapter five, footnote 6.
The alliance no-dispute and no-blame clauses create a situation where accountability for outcomes is diminished. This presents considerable difficulties for governments to meet their public accountability obligations. Furthermore, responsibility for delivering alliance outcomes is assigned to the alliance team, and consequently there is no organisation or individual explicitly accountable for alliance performance. These problems are identified in this chapter via an examination of the roles and responsibilities of the alliance leadership team and the operation of the alliance ‘no blame’ clauses.

Alliances incorporate open-book financial reporting and this arguably meets the governance principle of transparency. This chapter suggests that while alliances operate transparently after contract signature, the processes used to select alliance participants (in pure alliances) and the alliance target cost are far from open.

This chapter confirms that many of the criticisms levied upon alliance governance arrangements are valid, although the risks of fiduciary obligations are often overstated. Alliances create integrity, accountability, and transparency risks that are not associated with conventional contracts. Many of these risks are capable of being mitigated, but as we shall see in Chapter six, the cost of treating these risks is substantial.

**Alliances and Fiduciary Obligations**

So far this thesis has focussed on express contractual terms governing alliance relationships. We turn now to examine whether obligations arise that are not expressly agreed to by the parties; more specifically, whether any obligations might arise from the operation of equity?

Fiduciary obligations can arise between the parties to an alliance. This raises two issues. First, fiduciary obligations operate independently of the form of contract and any express terms of that contract. Equitable remedies may therefore be available despite the presence of the alliance ‘no-disputes’ framework. Second, obligations imposed in equity may substantially exceed the intentions of the parties to the alliance as expressed in the alliance contract. For example, equity may demand alliance
participants give the same weight to the other party’s interests as to their own. For governments, this may be an unwelcome prospect as this could frustrate government’s efforts to deliver outcomes that are in the public interest.

The following section explores how likely it is that fiduciary obligations exist between the parties to an alliance, what the consequences of these obligations will be, and whether the alliance participants can ‘contract out’ of these equitable obligations.

Fiduciary relationships can fundamentally alter the anticipated obligations expressed in a contract. Fiduciary obligations therefore have the potential to adjust the governance framework of a contractual relationship, in particular the governance objective integrity.

Numerous legal commentators identify the possibility of fiduciary obligations arising within alliance contracts. Government departments are also wary of this risk. For example, the Australian Government Solicitor observes:

[T]here is a risk that the close cooperative relationships on the [alliance] board and those teams could be regarded as giving rise to a 'fiduciary relationship'. This would introduce considerable problems for government representatives …. there could be a conflict between their obligations as representatives of the Commonwealth and their personal obligations as members of the [alliance] board or team.

The South Australian Auditor General has also recognised concerns with fiduciary obligations in government contracts:

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5 All alliance contracts include an express term to operate in good faith (see Chapter two).


The application of equitable doctrine and equitable remedies in contract-like situations also requires the expansion of audit analysis to include re-examination of concepts such as the meaning of ‘acting properly’ in the context of government contracting.\(^8\)

The fear of equity intervening in contract results in many contracts attempting to exclude relationships that are likely to give rise to fiduciary obligations. For example, conventional contracts often contain express clauses stating that the contract does not constitute a ‘partnership’ or ‘joint venture’.\(^9\) Alliances extend this by including express terms that attempt to exclude the operation of equity. All eleven alliance contracts reviewed in this study contained such clauses. This suggests that governments are averse to the prospect of obligations being imposed in equity, but is this concern valid?

There are no cases that deal with alliance contracts and fiduciary relationships. Nor is there authority to suggest what the consequences of these obligations will be in an alliance.\(^10\) The following section anticipates how the courts are likely to interpret fiduciary obligations in alliance contracts and explores the impact of this on the governance arrangements of these procurement options. This first requires defining fiduciary obligations and the criteria the courts adopt for establishing whether such obligations should be imposed.

### Defining Fiduciary Obligations

Though there is no universally recognised test for determining what relationships give rise to fiduciary obligations, there are leading cases that provide an indication where fiduciary obligations may arise in a relationship.

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\(^10\) This is unsurprising since it is the courts that determine the presence and consequences of fiduciary relationships and there is no specific case law dealing with alliance contracts. Nevertheless, Thomas provides useful insight into some relevant case law and alliance relationships but does not draw on actual observed alliance behaviours or specific alliance contract terms and conditions; Thomas, above n 6, 343-5.
Fiduciary obligations typically arise where an entity is required to advance or protect the interests of another.\footnote{11} For most arms-length commercial dealings, there is no requirement for parties to consider the other parties’ interests other than those imposed by a general duty of good faith,\footnote{12} a duty to cooperate\footnote{13} and an obligation not to operate for an extraneous purpose.\footnote{14} Conventional contracts are unlikely to give rise to fiduciary obligations because these contracts rely upon risk transfer and an absence of shared responsibilities. Most conventional contracts promote selfish behaviour with a win-lose philosophy.\footnote{15} Nevertheless, a prohibition of selfish behaviour by itself is not a definitive test for establishing the presence of fiduciary obligations.\footnote{16} To explore what circumstances are likely to give rise to a fiduciary relationship requires an understanding of what circumstances the courts look to for the intervention of equity.

Australian case law recognises some features of a relationship that are indicative of a fiduciary relationship such as the ‘concepts of trust and inequality’,\footnote{17} use of the terms ‘for, on behalf of, in the interests of’ appearing in the contract,\footnote{18} and the notion of ‘necessary confidence reposed by the participants in one another’.\footnote{19} These criteria assist in determining the presence of a fiduciary relationship but by themselves, are inconclusive.\footnote{20}

\footnote{11} Paul Finn, *Fiduciary Obligations*, (1977) 9.
\footnote{13} Mackay v Dick (1881) 6 App Cas 251, 263; Secure Income Real Estate (Australia) Ltd v St Martins Investment Pty Ltd (1979) 144 CLR 596 [607].
\footnote{14} Alcatel v Scarcella (1998) 44 NSWLR 349, 368; *Far Horizons v McDonalds* [2000] VSC 310, [120].
\footnote{16} See chapter five, footnotes 33 and 34.
\footnote{18} Hospital Products Inc v US Surgical Corp (1984) 55 ALR 417, 454.
\footnote{19} United Dominions Corp Ltd v Brian Pty Ltd (1985) 60 ALR 741, 750.
\footnote{20} See, eg, John Lehane, ‘Fiduciaries in a Commercial Context’ in Paul Finn (ed), *Essays in Equity* (1985), 101 where the test ‘acting for or on behalf of’ is considered inconclusive.
Contemporary case law generally fails to adopt a consistent framework for determining the presence of fiduciary obligations. This is largely because of the difficulty in defining the principles giving rise to fiduciary obligations. The courts explicitly acknowledge this problem. For example, Dawson J in *Hospital Products Ltd. v United States Surgical Corporation (Hospital Products)* observed that ‘...no single test has emerged which will serve to identify a relationship which is fiduciary.’ Dawson J further commented that a party ‘reposing substantial trust and confidence’ in another does not automatically give rise to fiduciary obligations, but such circumstances are necessary for establishing the presence of fiduciary obligations.

Fiduciary obligations can co-exist in contractual relationships. Nevertheless there is ‘no clear answer given to the question just when a contract which is valid at common law will be rescinded in equity’. In particular, ‘the term fiduciary is not well defined by way of criteria’ and there is ‘no universal, all purpose definition of fiduciary obligations’.

Despite the absence of a universal test for determining the presence of a fiduciary relationship a Canadian Supreme Court decision, influenced by *Hospital Products*, adopted a threefold test in *Frame v Smith*. According to the court, a fiduciary relationship will arise when:

a. The fiduciary has scope for the exercise of some discretion or power;

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23 Ibid.
24 Ibid.
26 *United States Surgical Corp v Hospital Products International* [1983] 2 NSWLR 157, 205. See also, *Hospital Products Inc v US Surgical Corp* (1984) 55ALR 417, 432 (Gibbs CJ) ‘It may be regarded as both arrogant and futile to attempt to arrive at a definition of the circumstances in which a fiduciary relationship will arise, an endeavour which has defeated many before us’.
b. The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests; and

c. The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.  

These criteria are stated slightly differently in *Hospital Products*, nevertheless they are essentially the same, as set down by Gibbs J:  

...there were two matters of importance in deciding when the court will recognize the existence of the relevant fiduciary duty. First, if one person is obliged, or undertakes, to act in relation to a particular matter in the interests of another and is entrusted with the power to affect those interests in a legal or practical sense, the situation is ... analogous to a trust. Secondly, . . . the reason for the principle lies in the special vulnerability of those whose interests are entrusted to the power of another to the abuse of that power.

The three themes of a fiduciary obligation therefore comprise of an obligation to act in the interests of another, the ability to exercise power unilaterally, and the element of vulnerability of at least one of the parties. These criteria offer a useful test for exploring the likelihood of fiduciary obligations arising in alliances. Prior to examining alliances and fiduciary obligations, though, it is useful to explore under what circumstances the courts have found fiduciary relationships in conventional contracts.

**Conventional Contracts and Fiduciary Obligations**

Fiduciary obligations are unlikely to arise in most conventional contracts. They generally only occur where there are certain relationships or behaviours that

30 Ibid, [60]; compare *Hospital Products* (1984) 55 ALR 417, 432 (Gibbs CJ) the characteristics of fiduciaries comprise: special vulnerability, acting on behalf of and entrusted with power.

31 Gibbs J relies upon McLennan J’s test in the previous trial involving these litigants; *Hospital Products Inc v US Surgical Corp* (1984) 55 ALR 417, 432; See also, Mason J at 454, ‘the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.’.

32 *United States Surgical Corporation v Hospital Products International* [1982] 2 NSWLR 766, 810.

33 Finn adopts similar criteria in Paul Finn, *Fiduciary Obligations*, (1977) 9, with the three criteria of a fiduciary comprising: the position existing for the benefit of another party, the source of power is derived outside of agreement and the discretion to unilaterally exercise power.
incorporate trust, confidence, and reliance between participants. These features encroach on alliance arrangements. Consequently, the jurisprudence of conventional contracts and the law of equity provides insight into how the courts may consider alliance relationships.

Fiduciary obligations can arise in contract as long as the imposition of such obligations does not fundamentally change the operation of that contract. Mason J states this principle in Hospital Products v US Surgical Corporation:

> The existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship...[but t]he fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation, which the contract was intended to have according to its true interpretation.\(^{34}\)

Consequently, fiduciary obligations will not displace contractual obligations unless the fiduciary obligations themselves are consistent with the terms of the contract.\(^{35}\)

For most conventional contracts, the duties of the principal and contractor are to advance their own interests. This intent typically appears in the terms and conditions of the contract.\(^{36}\) For this reason, Australian courts are reluctant to subject parties to fiduciary obligations in contracts negotiated at arms-length.\(^{37}\)

Joint venture arrangements often deviate from these conventional arms-length commercial contracts with an emphasis on close relationships and the sharing of profit and risks. By definition, joint ventures require participants to put their trust in others to maintain their interests and this may give rise to fiduciary obligations.\(^{38}\) Consequently, joint ventures offer useful insight into the circumstances where the

\(^{34}\) Hospital Products Inc v US Surgical Corp (1984) 55 ALR 417, 454.

\(^{35}\) Ibid 455.


\(^{37}\) See especially, Hospital Products Inc v US Surgical Corp (1984) HCA 64 [33] ‘the fact that the arrangement between the parties was of a purely commercial kind and that they had dealt at arm’s length and on an equal footing has consistently been regarded by this Court as important, if not decisive, in indicating that no fiduciary duty arose’.

\(^{38}\) See, eg, United Dominions Corp Ltd v Brian Pty Ltd (1985) 60 ALR 741, 744-7.
courts may impose fiduciary obligations. In these circumstances, the substance of the relationship is of utmost importance, rather than the form of the agreement. Gillard J’s observations reflect this principle:

In my opinion, the relationship established by the JVA [Joint Venture Agreement] between the parties inter se is a fiduciary one. The court is not concerned with form or what the parties thought of their relationship. The court is concerned with substance and is bound to consider the relationship between them and in particular, whether the parties have reposed in each other mutual trust and confidence, and an expectation that each will act in good faith towards the other for the common good of the venture.39

The jurisprudence of conventional contracts and joint ventures therefore demonstrates that it is the substance of the relationship between the parties, rather than the form of the contract, that dictates the presence or otherwise of fiduciary obligations. It is in situations similar to alliances where there are shared goals, shared profit, shared risk, and reliance between the parties that the courts will entertain the prospect of fiduciary obligations.

Alliance Contracts and Fiduciary Obligations

By definition, alliances are virtual organisations in which risks and rewards are shared between participants and there is a substantial emphasis placed on relationship management. Alliance features, such as the ‘no-disputes’ framework and a culture of very close collaboration to achieve project goals, are fundamental to the successful operation of alliance contracts. It is these alliance characteristics that drive trust, confidence, and reliance between participants and therefore the likely creation of fiduciary obligations. As previously discussed, the three fiduciary criteria adopted in Hospital Products provide the most useful test for assessing the likelihood or otherwise of fiduciary obligations arising. The following section explores, from first

principles, whether alliances are likely to give rise to fiduciary obligations using these three criteria.

**Does the Fiduciary have scope for the Exercise of Some Discretion or Power?**

The first criterion requires exploring whether the alliance participant can exercise power or discretion. Mason J expresses this test as: ‘the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion.’

The alliance agreement requires alliance participants to act on the behalf of others within the alliance. For example, the following is a typical alliance clause demanding collaboration to achieve mutual objectives:

> The alliance participants will commit to work together to achieve the successful delivery of the supplies.

Most alliance contracts state obligations as collective objectives of both parties with typical alliance clauses adopting words like ‘the alliance partners shall’. A content analysis of four alliance agreements, for example, reveals 116, 68, 100 and 86 instances respectively of the mutual term ‘we’ or ‘the alliance participants’. There are no such clauses in conventional contracts; rather, conventional contracts contain clauses drafted in the singular. For example, AS2124-1992, *General Conditions of Contract* contains 181 instances of a clause of the form ‘the contractor shall...’ Such clauses are rare in alliance contracts. The alliance therefore imposes an undertaking for each alliance participant to act on the behalf of others to meet project

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41 Federal government pure alliance.
42 Ross, above n 6, 12.
43 The four alliances subject to content analysis include: the NSW Rail Corridor Project Alliance Agreement, dated 18 Jan 2006; a state government hybrid alliance (GOC), a state government pure alliance; and a federal government pure alliance. These four contracts were selected on the basis of ease of text searching (availability in PDF or MS Word formats).
44 For example, AS2124-1992 *General Conditions of Contract* and NSW Government GC21 *General Conditions of Contract* contain no instances of the phrase ‘we’ or any other collective terms.
45 AS2124-1992 *General Conditions of Contract*; see also, NSW Government GC21 *General Conditions of Contract* which contains 161 instances of the clause ‘the contractor shall...’
46 In some alliance agreements there are specific obligations imposed on non-owner participants to meet insurance and statutory obligations. For example, in the NSW Rail Corridor Project Alliance Agreement dated 18 Jan 2006, there are three instances of the term, ‘united [the contractor] will...’ these singular obligations are for the provision of insurance, a guarantee for long lead time items and for appointment as the ‘project contractor’ for occupational health and safety purposes.
objectives. To what extent, though, do alliance participants have scope to exercise power and discretions?

The data from my interviews and case studies demonstrate that key managerial positions in the alliance could be held by personnel either from government or industry since individuals were assigned to positions on the basis of being best for project. The powers and discretions available to such position holders were vast and directly affected the performance of the alliance itself. There were virtually no fetters assigned to these position holders other than for some financial expenditure limitations.47

Alliance contracts therefore eschew conventional contractual boundaries with the creation of a virtual organisation. No longer is there a contractor and principal each pursuing separate agendas; rather, each alliance participant has a broad role and responsibilities to advance the outcome of the alliance project. Associated with these roles and responsibilities are substantial powers and discretions afforded to the alliance participants. Alliances therefore most likely satisfy the first test for determining the presence of a fiduciary relationship. What now warrants consideration is whether these powers and discretions can be exercised unilaterally?

**Does the Fiduciary have scope for the unilateral Exercise of Power?**

The second test for the creation of a fiduciary obligation is a test of independence.48 While alliance members operate collaboratively, each alliance member has the discretion to choose how they satisfy the alliance’s objectives. For example, each non-owner participant selects their nominated personnel for the alliance, the mix of assets they will use, and the manner in which project requirements will be satisfied. The alliance leadership team or ‘alliance board’ prohibits unilateral decision-making, but, as we saw in Chapter two, most alliances incorporate a deadlock breaking mechanism which typically allows government to use a casting vote to make unilateral decisions. In these circumstances there is most certainly scope for

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47 For example, one alliance project manager was assigned a $1 million limit for variations or scope changes.
48 Finn, above n 11, 13.
governments to exercise power unilaterally, but how much power does the alliance leadership team wield?

The alliance leadership team only provides broad guidance and generally does not offer ‘day to day’ instructions to the alliance participants.\textsuperscript{49} The hands-off approach of the alliance leadership team was revealed as a common theme in my interviews with alliance managers. A typical response was that:

\begin{quote}
    We never had to raise any issues to the board [the alliance leadership team]. They were there to simply rubberstamp our target cost, plans, and schedule.\textsuperscript{50}
\end{quote}

There is general reluctance to involve the alliance leadership team in dispute or issue resolution. For example, my interviews involving over 40 alliances revealed that only five disputes or issues were raised with an alliance leadership team for resolution, and these disputes were of a minor nature. My review of alliance leadership team minutes from a local government alliance and observation of a state government alliance leadership team monthly meeting also revealed that the day to day running of the alliance is not ‘managed’ by the alliance leadership team. What discretions, then, do the alliance participants possess in the absence of alliance leadership team control?

Alliances are typically used for large and complex projects where many activities will not attract close oversight of the alliance leadership team. Furthermore, alliances do not comprise equal representation of government and industry participants. The majority of the alliances examined in this study involved very few government participants in the alliance itself. There is also a trend for government to reduce the number of their employees in alliance teams, as an increase in the number of public sector projects ‘stretches’ the capabilities of government. The following comment from a government interviewee highlights this:

\begin{quote}
    The biggest problem we face with alliances is not from industry participation but the fact that government will not step up to the mark and place enough people in the alliance.\textsuperscript{51}
\end{quote}

\textsuperscript{49} Federal government pure alliance cl 4.1.
\textsuperscript{50} Interviewee B.
\textsuperscript{51} Interviewee F.
The majority of, if not all, alliance design and construction activities are conducted by industry participants. In some alliances, the involvement of government employees was limited solely to the alliance leadership team and auditing functions. This provides the alliance non-owner participants with substantial latitude as to how they meet the obligations of the alliance. For example, the non-owner participants may instigate variations, trade off key performance indices against each other and select risk treatment measures. Provided the alliance non-owner participants follow ‘best for project principles’ and operate with good faith, then their discretions are largely unfettered. Consequently, alliance decisions made below the alliance leadership team were primarily made by non-owner participants, and in most cases these decisions were made unilaterally.

Several interviewees referred to alliance arrangements as a ‘leap of faith’, as they put considerable trust in their alliance counterparts. This leads to a situation where non-owner alliance participants have both the power to affect the interests of other alliance participants, and can exercise that power unilaterally at a level below the alliance leadership team. On the other hand, most alliances provide for government to break deadlocks at the alliance leadership team level with casting votes. This feature therefore provides the public sector with substantial scope for the unilateral exercise of power at the highest level of the alliance. Alliances consequently will probably satisfy the second test of a fiduciary office holder with both the alliance owner and non-owners able to exercise unilateral decision-making. I now turn to the third factor; whether there is an element of vulnerability between alliance participants.

Is the beneficiary vulnerable or at the mercy of the fiduciary?

The final criterion for determining whether a fiduciary relationship exists is establishing that the beneficiary is particularly vulnerable to abuse by the putative ‘fiduciary’. Alliances are commercial relationships that involve the sharing of risks and rewards, a culture of no blame and with no recourse to the courts for dispute resolution. No other contractual relationship places as much emphasis on sharing or trust as the alliance. Alliances therefore represent the pinnacle of commercial

52 55 ALR 417, 454.
relationships founded upon trust. A consequence of this is that alliance participants are significantly vulnerable to the acts or omissions of other alliance participants.

Unlike conventional arms-length contracts, alliances incorporate the following features that place pure alliance participants (particularly governments) at the mercy of others:

a. The target cost and schedule is generated by alliance participants and not through price competition. There is consequently significant scope for abuse in the cost development process compared to competitively tendered prices (see Chapter six);

b. The target cost and schedule is provided after tenderers are selected. Consequently, governments are ‘locked into a relationship’ before they have visibility of how much money they are liable to expend nor how long the relationship will last;

c. The majority, if not all, of the skills available for developing and validating target costs are possessed by the non-owner alliance participants. Governments are therefore reliant on industry for achieving a fair target cost;

d. The *no disputes* clause of the alliance prohibits recourse to the courts for the resolution of issues. Hence, if the project goes awry, resolution of issues is not dealt with by a third party; and

e. There is no recourse for recovery of poor performance by an alliance participant (by virtue of the alliance *no blame* clause prohibiting recourse for negligent acts or omissions).

These factors make alliance participants especially vulnerable to the acts or omissions of the other participants. Certainly governments can reduce their exposure to these

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vulnerabilities with the use of open book reporting, independent auditors, and the need for unanimity in decision-making, but as I demonstrate in Chapter six, these mitigation strategies are ineffective. The competitive TOC alliance effectively eliminates three of these listed vulnerabilities (sub-paragraphs a, b and c above). Nonetheless, no alliance with a no-disputes, no-blame, and unanimous decision-making clauses can eliminate all vulnerabilities.

The vulnerability of governments in alliances is recognised as a weakness of these contractual relationships where there is a greater risk of opportunistic behaviour. One of my industry interviewees recognised this and observed that ‘alliances offer the greatest scope for rorting the system.’

Alliances demand high levels of trust, especially with the absence of legal remedies should one alliance participant fail to perform adequately. Consequently, alliances, in all probability, satisfy the final criteria of the test for a fiduciary office, with the beneficiary being vulnerable or at the mercy of the fiduciary office holder.

Having satisfied all of the three criteria for a fiduciary office holder, it is most likely that an alliance will create fiduciary relationships. Alliance participants hold substantial scope for exercising power, and may exercise that power unilaterally with other participants at the mercy of others in the alliance. In addition to satisfying this test, a review of how the courts consider contracts that adopt alliance features provides further evidence that alliances will invoke fiduciary obligations.

Alliance contracts do not involve arms-length negotiation and operation, and consequently there is little to suggest that traditional defences for excluding the presence of fiduciary obligations will be effective. It is important to recognise that the courts have not specifically dealt with an alliance dispute. Nevertheless, the courts have explored fiduciary obligations in relational style contracts, similar to alliances.

54 Interviewee K
In *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd (Thiess Contractors)*, participants entered into a contract to develop a mine using a risk sharing, collaborative agreement. Though this contract did not involve a pure alliance structure, several alliance characteristics appeared in this *partnering* contract, including: ‘the parties were required to cooperate in the establishment of rates based as far as reasonably possible on actual costs (with open book reporting)’, the contract eliminated the ability of the contractor to make ‘windfall’ profits, the principal shared risks with the contractor, and the principal and contractor agreed to work in good faith on all matters.

Templeman J discussed the issue of whether fiduciary obligations applied to the contract. In this instance, the judge found that fiduciary obligations did arise as:

> By requiring Thiess to formulate plant rates from historical data in its possession, the contract put it in a position in which it was required to act in Placer’s interest as well as its own. Thiess thus fell within the definition of a fiduciary set out in the Hospital Products case to which I have referred above.

The nature of the relationship in this case is very similar to that of alliances. This provides compelling grounds for the likelihood of fiduciary obligations being present in alliances. More specifically, the alliance features of open book reporting, sharing of risks, and acting on behalf of the interests of others are all characteristics that support the premise that fiduciary obligations will exist in relationships of this type. Alliances are therefore likely to involve fiduciary obligations between participants. It is now necessary to explore the consequences of these obligations and how this affects the governance arrangements of alliances.

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55 *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (1999) WASC 1046.
56 *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (2001) WASCA 166 [33].
57 Ibid [40]
58 *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (1999) WASC 1046, 112-3; The findings in this case were upheld on appeal (except for the calculation of damages); *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (2001) WASCA 166. A further appeal to the High Court of Australia upheld the original trial judge’s calculation of damages with no change to the findings of a fiduciary obligation; *Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd* (2003) 196 ALR 257 [68].
Consequences of Fiduciary Duties

Fiduciary obligations may supplement or even override the express terms of the contract. Consequently, parties to an alliance are likely to be subject to additional constraints and duties that extend beyond that originally agreed to. It is therefore important to understand what these additional constraints and duties comprise.

Finn summarises the fiduciary office bearer duties as follows:

a. a duty not to act for his own benefit or the benefit of a third party,

b. a duty to treat beneficiaries equally where they have similar rights,

c. a duty to treat beneficiaries fairly when they have dissimilar rights, and

d. a duty not to act capriciously or totally unreasonably.  

These duties comprise both positive and negative obligations; nevertheless, Australian law does not recognise any prescriptive duties of a fiduciary. Some fiduciary obligations are framed in the negative with parties obliged not to act in their own interests, not to act capriciously, and not to treat beneficiaries unfairly or unequally.

Fiduciary obligations may be usefully summarised by the principles of no conflict, no profit, undivided loyalty, and confidentiality. Compared to the obligations expressly imposed in the alliance contract, the fiduciary obligations stated above may significantly constrain alliance participants’ behaviours. In particular, alliance participants may owe a duty of care to other alliance members under the equitable principles of fraud. Nocton v Lord Ashburton discusses this principle.

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59 Finn, above n 11, 16.
62 Medforth v Blake and Others (1999) 3 All ER 97, 112.
63 (1914) AC 932.
In Chancery the term “fraud” thus came to be used to describe what fell short of deceit, but imported a breach of a duty to which equity had attached its sanction.\(^\text{64}\)

Of significance in *Nocton v Lord Ashburton* is the finding that fraud can encompass acts that are not morally fraudulent.\(^\text{65}\) That is, fraud does not necessarily require *deliberate* misstatements or actions. Equity may therefore impose protection against acts that would normally be dealt with under the tort of negligence. This is contrary to the intent of the alliance where the alliance agreement effectively indemnifies alliance participants from acts of negligence through the *no disputes* clause.

A further complication with alliances is that all parties to the alliance are likely to be both fiduciary office holders and beneficiaries. A beneficiary-fiduciary is not prohibited\(^\text{66}\) and, ‘a breach of the self dealing rule is not merely a technical gateway to establishing a cause of action…’\(^\text{67}\) Nevertheless, where a commercial participant is both a fiduciary and beneficiary there is increased scope for a conflict of interest and therefore increased likelihood of a breach of fiduciary duty.

Alliance participants must therefore consider the interests of other alliance participants, but only so far as matters relevant to that alliance. The courts will not extend the obligations of alliance participants to outcomes and obligations beyond that of the alliance itself. Bryson J summarises this principle in *Noranda Australia Ltd v Lachlan Resources NL and Others*:

> It is in no way difficult but is ordinarily to be expected that a person under a fiduciary obligation to another should be under that obligation in relation to a defined area of conduct, and exempt from the obligations in all other respects.\(^\text{68}\)

For alliance participants, the consequences of fiduciary obligations are the imposition of rights and responsibilities that exceed those associated with conventional contracts, but as demonstrated later in this chapter, these fiduciary obligations are really no more

\(^{64}\) *Nocton v Lord Ashburton* (1914) AC 932, 953.

\(^{65}\) Ibid 954.

\(^{66}\) Finn, above n 11, 42.

\(^{67}\) *John Reader and Oths v Tab Fried and Oths* (2001) VSC 495, (Unreported, Pagone J, 19 December 2001) [25].

\(^{68}\) (1988) NSWLR 1, 15.
onerous than the alliance good faith clauses and obligation to perform on a best for project basis. One of the most significant consequences, though, of fiduciary obligations is the fact that the alliance ‘no-disputes’ provisions are rendered inoperative should remedies be sought in equity.

As noted above, all eleven alliance agreements reviewed in this study contain clauses that attempt to exclude the operation of equity in the alliance. As the following section argues, these clauses are largely ineffective.

**Contractual Exclusion of Fiduciary Obligations**

The following section explores under what circumstances the operation of equity may be excluded by contractual terms and whether contemporary alliance contract exclusion clauses are effective.

An express term in a contract that seeks to pre-empt the nature of a relationship is not normally enforceable. Nevertheless, parties can exclude themselves from the protection of equity in certain circumstances.

In *Armitage v Nurse*, the exclusion of equitable fraud was effective, though exclusion of wilful dishonesty was not, as observed by Millet J (emphasis added):

> The position which I have reached so far, therefore, is that the respondents are absolved by cl 15 [the exclusion clause] of the settlement from liability for all loss or damage to the trust estate except loss or damage caused by their own dishonesty…

Millet J further stated that the exclusion clause would be ineffective for acts of fraud of the type discussed in *Nocton v Lord Ashburton* but remain effective against mere...

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70 *Noranda Australia Ltd v Lachlan Resources NL and Others* (1988) NSWLR 1, 18; But it is not permissible to exclude remedies against acts of actual fraud in contract nor may trustees escape the operation of statutory instruments related to a duty of care.

71 *Armitage v Nurse* (1997) 2 All ER 705, 716; leave for appeal against this decision was rejected *Armitage v Nurse* (1998) 1 WLR 270.

72 Ibid 712.
and gross negligence. Criticism of this finding is that such a clause is repugnant to the trust as they exempt breaches of fiduciary obligations. No pleading was made to the repugnancy of the exemption clause in this case and Millet J refers to the findings in Wilkins v Hogg where a 'no indemnity' clause protecting a trustee from his ordinary duty 'had ever been held so repugnant as to be rejected.'

Millet J observed that it is the responsibility of Parliament to resolve the public policy issues associated with trustees excluding themselves from fraud of this type. A subsequent UK Law Commission report has expressed a general preference for a prohibition on remunerated trustees from exclusion clauses of this type, though no statutory instrument currently enforces this. Whether the courts will strike down such a clause in the future will be contingent on the pleadings made and the construction of the trust or relationship.

Australian jurisdictions have applied the principle in Armitage v Nurse. In Green v Wilden Pty Ltd an exclusion clause afforded protection to a trustee acting reasonably and honestly but not for acts of bad faith. Australian courts are therefore likely to allow exclusion of remedies for negligent acts in equity despite this being contrary to public policy. The established precedents in Australia and overseas suggest that an exclusion clause that incorporates indemnification for all events other than for dishonesty, wilful neglect, or actual fraud will be effective for excluding equitable remedies for negligence.

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73 Ibid 713.
75 (1861) 31 LJ Ch 41, 42.
76 Armitage v Nurse (1997) 2 All ER 705 at 713.
77 (1997) 2 All ER 705, 715.
80 (2005) SCWA 83 (unreported, Hasluck J, 10 May 2005) [493, 858]; See also Australia & New Zealand Baking Group Ltd v Intiagro Projects Pty Ltd (2004) NSWSC 1054, [28] (White J) Indemnity only applies where the trustee acts in good faith.
Fiduciaries are therefore likely to be able to exempt themselves against acts of negligence. What now requires investigation is how contemporary alliance contracts deal with these indemnifications and whether they are likely to be successful.

**Alliance Exclusion Clauses**

Of the eleven alliance agreements reviewed in this study, none of these fiduciary exclusion clauses were drafted in the same way as in *Armitage v Nurse*. The following were typical alliance clauses that attempted to exclude the creation and consequences of fiduciary obligations:

This PAA [project alliance agreement] is not intended to create nor will it be construed as creating any legal partnership, joint venture or fiduciary relationship between us and it will not give rise to any obligations between us apart from those obligations expressly stated in this PAA or imposed by law.\(^2\)

The alliance contractor’s liability to the alliance owner under this agreement for any default will, notwithstanding any other rights or remedies which the alliance owner may have at law or in equity, will only be that described in clause 25 [limitation of liability].\(^3\)

The first clause is unlikely to be effective. The clause purports to state that no fiduciary obligations exist. As argued above, the nature of the relationship cannot be pre-empted in contractual terms; rather, the courts will determine the nature of the relationship if so asked. This is especially so since in alliances, the express terms of the contract encroach upon fiduciary obligations. Alliance clauses of this type are unlikely to offer alliance participants a means to escape the operation of equity.

The second clause attempts to exclude all liability except for that liability expressly outlined in the alliance contract. In most alliances there is no liability retained between alliance participants other than for ‘wilful default’. This alliance contract

\(^2\) Newcastle Rail Corridor Project Alliance Agreement, (18 January 2006) cl 34.4.1.

\(^3\) Federal government pure alliance.
clause therefore incorporates the exclusion of liability for negligence in equity and other events that do not come within the ambit of wilful default.

Typical alliance exclusion clauses therefore deviate substantially from those adopted in *Armitage v Nurse*. These alliance clauses attempt to provide an all encompassing exclusion from equitable remedies and so their success is doubtful since the courts will most likely strike down the whole exclusion clause. Contemporary alliances are consequently unlikely to be able to rely on indemnification for negligence in equity. This therefore renders the alliance no disputes framework illusory. An obvious solution to this problem is to draft the alliance exclusion clause in the same manner as that used in *Armitage v Nurse*. By carving out exclusion for actual fraud and fraud of the type discussed in *Nocton v Lord Ashburton*, alliance participants will be able to escape liability for negligence in equity. This will resolve the issue of the interference of equity in the operation of the alliance *no disputes* clause.

Fiduciary obligations also impose the requirement for selfless behaviour but this obligation is already a feature of the alliance contract through the good faith obligations and the gainshare/painshare remuneration arrangements of the alliance. Express good faith clauses in alliance contracts typically incorporate the requirement of ‘giving as much weight to the interests of the work under the alliance as to one’s own self interest.’

Similarly, the alliance remuneration mechanisms enforce selfless behaviours by rewarding collaboration and punishing selfish behaviour. Consequently, the alliance participants impose a fiduciary standard upon themselves by express terms in the alliance agreement itself. Claims in the alliance literature that fiduciary obligations introduce substantial uncertainty into alliance agreements are therefore overstated.

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84 State government alliance agreement.
85 Hayford, above n 6, 53; Chew, above n 6, 324-6; Ross, above n 6, 14; McInnis, above n 6, 52-56; Australian Government Solicitor ‘Relationship and Alliance Contracting By Government’ (2001) Commercial Notes 4, <http://www.ags.gov.au/publications/agspubs/legalpubs/commercialnotes> at 21 July 2008; Thomas, above n 6, 346; Ross is the only commentator that recognises the fact that the alliance expressly imposes a standard that is comparable to a fiduciary standard, Ross above n 6, 14.
The only tangible consequence of a fiduciary relationship is the ability to escape the alliance ‘no disputes’ clause and thus pursue recourse for negligent acts or omissions by other alliance participants through the courts. To minimise uncertainty, future alliance contracts should draft indemnification clauses to explicitly exclude negligence in a similar fashion to the clause used in *Armitage v Nurse*. This will ensure the operation of equity is consistent with the alliance no dispute provisions.

This investigation into alliance relationships from the perspective of equity provides insight into what exactly the alliance relationship entails and how this affects the governance structures of these arrangements. The key observation made here is that the alliance participants expressly impose upon themselves obligations equivalent to a fiduciary standard. The remainder of this chapter explores the concerns auditors raise with the governance structure of alliances and whether their concerns are valid.

**Alliance Audit Reports**

Audit reports typically assess the governance arrangements for public sector activities. An exploration of alliance audit reports therefore proves useful for exploring how alliances deal with the governance principles of accountability, integrity and transparency. Only four audit reports have been conducted by Australian governments for alliance projects. Two of these audits identified significant issues with the governance arrangements of alliances. In particular, the NSW Auditor General observed of the Northside Storage Tunnel alliance:

> Our view is that Sydney Water’s governance of the project [the alliance] was not as robust as it should have been.\(^{86}\)

The NSW Auditor General goes further in this report, observing that Sydney Water failed to manage the risk of the parties getting too close in the alliance relationship\(^{87}\)


\(^{87}\) Ibid 60.
and recommending that Sydney Water adopt lessons learnt for alliance governance arrangements.\textsuperscript{88}

The Auditor General of Queensland also raised considerable criticism with respect to the governance arrangements on the Gold Coast Water Desalination alliance. In this alliance, the Auditor General gave governance, transparency, and accountability and probity the lowest scores possible.\textsuperscript{89} This audit report criticised the alliance for poor request for tender documentation, for adopting a less than ideal governance structure, for using independent estimators inappropriately and for failing to establish risk and audit committees.\textsuperscript{90} In this project, many of these criticisms originated from the fact that the alliance was a fast track project with major scope changes.\textsuperscript{91} Consequently, several of these shortcomings may have been present independent of the contractual vehicle adopted.

Not all audit reports raise issues with the governance structures of alliances. The Acton Peninsula National Museum alliance audit report conducted by the Australian National Audit Office stated that governance on this alliance was adequate.\textsuperscript{92} Similarly, the Auditor-General of Queensland assessed the governance arrangements on the Tugun Bypass alliance favourably.\textsuperscript{93} This later alliance, though, was a competitive TOC alliance with price competition used to select the alliance participants.

There are also credible concerns of alliance governance arrangements raised in the alliance literature\textsuperscript{94} but are these claims and those made in the respective audit reports valid? The following section answers this question by exploring how alliances impact upon the governance principles of integrity, accountability and transparency.

\textsuperscript{88} Ibid 6.
\textsuperscript{90} Ibid 20.
\textsuperscript{91} Ibid.
\textsuperscript{94} Chew above, n 6, 335; Hayford above, n 6, 50-54; Andrew Stephenson, ‘Alliance Contracting, Partnering, Co-operative Contracting – Risk Avoidance or Risk Creation’ (paper presented to Clayton Utz Major Projects Seminar, Melbourne, October 2000) [5.1]; Thomas, above n 6, 338-344.
**Alliances and Integrity**

The governance principle of integrity requires that governments avoid a conflict of interest and a conflict of duty. The following discussion demonstrates that while a conflict of interest is not a particular concern, alliances do impose a conflict of duty on public sector participants at both the individual and organisational level. This introduces significant hurdles for governments.

**Conflict of Interest and Conflict of Duty**

Alliances involve a relationship in which government and industry form a virtual organisation with common goals. This places governments in the situation where they must simultaneously meet the broader needs of the public sector and alliance obligations. This creates tangible risks on the governance structures of alliances. No such risks are associated with conventional fixed price contracts. The following section shows how alliances adequately deal with a conflict of interests but are silent on a conflict of duty.

My review of alliance contract terms and conditions reveals that all alliance contracts contain express terms that demand the disclosure of a conflict of interest in the following terms:

> A representative of an Alliance Participant must fully disclose to both the other Alliance Participants any conflict of interest that exists or is likely to arise before participating in a discussion on any relevant issue.\(^{95}\)

This duty of disclosure requires that participants reveal any current or future relationships with third parties that may influence performance of the alliance. This duty of disclosure is no more onerous for an alliance contract than it would be for other public sector contracts because a conflict of interest refers to a private interest at the individual level.\(^{96}\) Even where public sector employees are embedded into an

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\(^{95}\) Federal government pure alliance.

\(^{96}\) Australian Government, Australian National Audit Office, Better Practice Guide, *Public Sector Governance and the Individual Officer* (July 2003), Volume 1, 18; *Local Government ACT 1993* (Qld) ss 246A (2); *Local Government ACT 1993* (NSW) s441; Western Australian Government, The
alliance team, such conflicts of interest are relatively easy to identify and manage. Problems occur, however, when we explore a conflict of duty.

My review of contemporary alliances reveals that alliances do not recognise the tensions resulting from a conflict of duty. Of the alliances subject to this study, only one alliance out of eleven mention the term a ‘conflict of duty’ and for this alliance, no guidance was provided on how such a conflict of duty should be managed. Arguably all contracts are capable of creating a conflict of duty as noted by the Australian National Audit Office: ‘it is often not possible to avoid all potential conflicts absolutely’. Why then should governments consider alliances differently from conventional contracts in this area?

The alliance contract provides some critical differences from conventional contracts when it comes to the responsibilities and obligations of the alliance participants. These differences stem from the fact that alliances are virtual organisations with all alliance participants collectively responsible for delivering project outcomes. Consequently, the performance, or lack thereof, of governments within alliances will directly affect the profit of other alliance members. In addition, the collaborative nature of alliances fosters a culture in which all alliance participants share the same values and goals with enhanced friendship, cooperation, and teamwork. This introduces the risk of government alliance participants foregoing the goals of the public sector in lieu of alliance goals. As the Australian National Audit Office has observed: ‘the obvious risk to address and manage in alliance relationships is that the parties get too close’. This risk is less likely in a conventional arms-length...
contractual relationship, so what then are the consequences of alliance parties ‘getting too close’?

From an ‘integrity’ perspective, governments are required to meet alliance obligations and actions that support the public good. By design, these objectives should be the same, though there is a risk that they diverge.\(^{103}\) The foremost obligation for government is to select courses of action that collectively deliver best outcomes for the public. This principle appears in the Australian National Audit Office, *Better Practice Guide on Public Sector Governance*: ‘[T]he organisation uses its governance arrangements to contribute to its overall performance and the delivery of its goods, services or programs.’\(^{104}\) But as argued earlier, the alliance imposes express obligations equivalent to that of a fiduciary standard; therefore problems may occur when legitimate alliance obligations impose or constrain actions that fail to meet the needs of the collective ‘public good’. This may occur when project requirements fundamentally change, unforeseen circumstances arise or other events place the profit of industry participants to the alliance in jeopardy. As we shall see in Chapter six, the risk of a conflict of duty is afforded great importance as all alliances are assigned extensive probity audits to manage this risk, despite the fact that such risks are not specifically addressed in the alliance agreement itself.

The potential for a conflict of duty to attract adverse publicity or even unfavourable project outcomes is therefore significantly greater with an alliance when compared to a conventional arms-length contract. Governments may mitigate against such potential conflicts but this requires greater management oversight, improved training of employees, and greater visibility of the alliance by auditors and probity advisers. It is questionable whether governments consider these hidden costs associated with alliances during selection of a procurement option for a project. Certainly, most alliance contracts fail to recognise the potential for a conflict of duty and no alliance

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\(^{103}\) For example the Department of Defence Djimindi Alliance has failed to deliver outcomes since this alliance involved a vendor product where the alliance owner and non-owner goals were in fundamental opposition. Australian Government, Joint Standing Committee on Foreign Affairs, Defence and Trade Defence Sub-Committee, *Submission number 2: Review of Defence Annual Report 2004-2005* (5 May 2006), 3; see also, Ian McPhedran, ‘PM Kevin Rudd warns defence giants of dud projects’ *Herald Sun* 08 January 2008.

\(^{104}\) Australian National Audit Office, above n 96, 6.
contract states how such conflicts should be resolved. The alliance relationship therefore places the governance principle of integrity at risk.

**Accountability and Alliances**

The governance principle of accountability requires public sector managers to have clearly articulated roles and responsibilities.\(^{105}\) Alliances create risks in meeting this governance principle since the alliance resembles an entity separate from either the principal’s or contractor’s organisation. Furthermore, the alliance contract requires participants to operate on a *best for project* basis, rather than in each participant’s own interests.\(^ {106}\) The Victorian Government’s *Project Alliancing Practitioner’s Guide* demonstrates how alliances require the creation of a new organisation comprising public and private sector entities:

> Project alliances operate as “virtual organisations” performing all of the functions required to deliver a project. In these alliances, the commercial interests of each alliance participant are best served by meeting or exceeding the agreed alliance objectives.\(^ {107}\)

Drawing upon alliance contract terms and conditions and interview and case study observations, this section demonstrates that alliances fail to provide clearly defined roles and responsibilities, and disenfranchise government from effective decision-making.

**Alliance Management Structures**

Significant differences in the management structure between conventional contracts and alliances emerge at the alliance management and leadership level. Whereas conventional arms-length contracts use separate government and industry teams to

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\(^{105}\) Ibid 8.


\(^{107}\) Victorian Government, above n 2, 12.
manage projects, the alliance incorporates a leadership team charged with delivering the whole project and this team comprises government and private sector employees.

This executive level team is commonly called the Alliance Leadership Team (ALT), with membership typically including executive managers drawn from the alliance owner and non-owner participants. A review of eleven alliance contracts reveals that the responsibilities of this ALT typically include providing overall governance and leadership to the alliance, approving the appointment of staff to the alliance, defining the alliance scope of work, directing the alliance management team, resolving alliance disputes, confirming priorities of the alliance, approving amendments and variations to the target costs, and monitoring the performance of the alliance. All alliances I reviewed required the ALT to make decisions unanimously on a best for project basis.

Though the ALT provides high level direction to the alliance, this team only meets occasionally. Four of the alliance contracts I reviewed call for mandatory meetings every month. Four of the alliance contracts I reviewed also contain provisions for the ALT to meet on an as required basis to deal with contingencies or disputes. The infrequent meetings of the ALT requires the establishment of a working level team to implement ALT directions and deliver alliance outcomes. This subordinate team, responsible for project management, is typically referred to as the Alliance Management Team (AMT). The AMT is responsible for carrying out directions and objectives set by the ALT, implementing alliance principles, approving alliance management plans and policy, continuously improving business practices, and issuing weekly reports.

Unlike the ALT, which operates upon the need for unanimity in decision-making, the AMT is headed by a project manager reporting directly to the ALT. Consequently, there will usually be one individual accountable to the ALT for delivering the project.

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109 In most instances, the ALT includes Chief Executive Officers from non-owner alliance participants and executive managers from Government Departments. Ibid 14.
110 These are common attributes of the management team taken from the local, state and federal government alliances.
111 See, eg, local government competitive TOC alliance clause 5.1, state government pure alliance clause 5.2, and federal government pure alliance clause 5.2.
It is important to recognise that the alliance project manager is appointed on a ‘best for project basis’ and this may result in a project manager being selected from either the alliance owner or non-owner’s organisation. Consequently, a public servant may be responsible to the ALT for delivery of the project works in their capacity as alliance project manager. This has been the case with several alliances.

Several important themes emerge from the typical alliance management structures. First, the high level alliance leadership team comprises a virtual organisation of public and private sector representatives. There is therefore no individual person or organisation responsible for project delivery. Second, the ALT is required to make decisions unanimously. This introduces the risk that governments are unable to progress with courses of action that are in the public interest. The following section explores how these alliance management structures dilute accountability in project delivery.

**Accountability in Alliances**

The foremost question concerning accountability in alliances is who is ultimately responsible for project delivery. At the highest level, ‘the buck stops’ with the ALT. This virtual organisation comprises owner and non-owner participants, all with an equal voice. A criticism of this structure is that decision-making is by committee and accountability is therefore diluted. Coupled with the alliance no-blame and no-liability clauses, there are significant risks of the roles and responsibilities of the public sector being distorted.

Fundamental to all alliance projects is the need to adopt ‘best for project principles’. By design, the goals of the alliance must be congruent with the goals of each alliance participant. Consequently, while it is the responsibility of each member of the ALT to be responsible or accountable for delivering alliance outcomes, that same ALT

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112 Victorian Government, above n 2, 14.
113 See, eg, Paradise Dam Alliance, where the alliance owner ‘Burnett Water Corporation’ appointed their representative as the AMT project manager.
114 Chew, above n 6, 321; Victorian Government, above n 2, 13; Ross, above n 6, 2.
115 Ross, above n 6, 41; note, Ross states that this issue can be managed (but does not quantify the cost of doing so) and claims that decision-making is actually faster than with conventional contracts.
participant also has responsibilities to their direct employer. The nature of this 'conflict of duty' was discussed earlier in this chapter. To summarise, the responsibilities of the alliance leadership team must take into account best for project objectives as well as other stakeholder needs not explicitly identified in the alliance contract. For example, non-owner alliance participants have prescribed duties to shareholders. The alliance owner, on the other hand, has obligations to the public to ensure government funds are used to deliver best value for money. This is reflected in Finn’s principles of public accountability:

Where the public’s power is entrusted to institutions and officials for the purposes of government, they hold that power of the people to be exercised for the people. They are the public’s trustees.\[116\]

The responsibilities of government and industry alliance participants should not be in conflict. Nevertheless, the potential exists for goals of the alliance and those of individual alliance participants to diverge. In this instance, the ability for alliance participants to deliver best for project outcomes is compromised. Consequently, alliance partners may have their hands tied and it would be inappropriate to hold that alliance participant accountable for alliance performance.\[117\]

In addition to the overarching best for project principles, the alliance embarks on a regime of ‘no disputes’ and ‘no liability’ between alliance participants (except for wilful default).\[118\] A consequence of this arrangement is that no alliance participant is liable for negligence, correction of defects, or rework in the contract. The gainshare/painshare arrangements of the alliance discourage negligent behaviour but this involves all alliance participants suffering from the actions or inactions of another. This is in conflict with the general accountability principles of assigning responsibility for the delivery of outcomes to a specific officeholder. As liability is recognised as a form of accountability,\[119\] the alliance no liability regime effectively absolves each alliance participants from being responsible for the delivery of a


\[117\] Stephenson, above n 94 [5]; Victorian Government, above n 2, 18.

\[118\] Chew above n 6, 328; Ross, above n 6, 13.

project. This has proven a considerable concern to governments, especially for the provision of project insurance. Consequently, the pursuit of hybrid alliances is used to preserve liability between parties so that ‘the alliance contractor owes the normal responsibilities of delivering the works’ and cost effective indemnity insurance can be sought. As demonstrated in Chapter six, government’s rationale for using hybrid alliances to procure cost effective insurance is flawed. Nevertheless, there is recognition within governments that shared responsibilities within alliances create accountability issues. The use of the hybrid alliance is a response to this problem.

Other than for the accountability risks arising from the alliance best for project and no-liability frameworks, accountability problems also arise from the imprecise contract documentation associated with alliance projects. Governments recognise that contracting with a clearly defined set of performance requirements is a way of increasing accountability. In a conventional contract, government develops and approves a robust specification for the project it wants delivered. Ideally, this specification contains measurable performance criteria so that there is no question as to what will be delivered by contractors, because any change to project requirements must undergo a robust contract change proposal.

The alliance, on the other hand, typically incorporates a very broad statement of project objectives, rather than a detailed specification. As discussed at Chapter three, this is the raison d'être for using an alliance, in projects where the scope is difficult to quantify, or complex stakeholder interactions can substantially alter this scope of work. In this situation, governments are only accountable for specifying outcomes in broad terms, with no, or very little, allocation of risk since, in an alliance, all risks are shared. How then can we say that government is accountable for project documentation in an alliance when that documentation is drafted in the broadest terms possible?

120 Cowan et al, above n 106, 3.
123 Ibid.
The alliance contract also introduces substantial problems in the realm of financial accountability. In a typical conventional contract, a business case is developed and funding approved to deliver defined outcomes. Contingency funding is typically included in the budget proposal to cater for contract variations and potential increases in project scope. Contingency is also allocated to cater for project risks that are managed by government. In consideration of contingency, a funding proposal for a project should include statements as to what will be delivered, how much it will cost and how long it will take to deliver. By definition, a fixed price contract such as this involves an agreement about what is to be purchased for a particular price. This supports financial accountability as expenditure, and more specifically, the spending of contractors, is subject to scrutiny.\textsuperscript{125}

The alliance, on the other hand, involves development of a target outturn cost which is a \textit{best guess} at what the project will cost.\textsuperscript{126} Similarly, alliance schedule outcomes are unquantified in fixed terms. An important feature of the alliance is that target costs and schedules are developed collectively between government and industry. It is also the alliance, not government, which is responsible for deciding how funds are expended. This raises the question of what rules should govern the expenditure of public funds. The alliance’s primary goal is to deliver outcomes that are ‘best for project’. This may involve funding activities that are ostensibly outside of the original project scope. Normally such activities could not be pursued if these activities were managed by government.\textsuperscript{127} This creates a fundamental accountability tension for government participants in the alliance as my case study on the Split Rock Inca Alliance demonstrates.\textsuperscript{128} In this alliance, the alliance team expended funds to resurface a hospital car park, provide fencing for a tourist attraction and pave a tennis court for the local community. These activities were well outside the funded scope for the project yet the alliance was able to commit resources to these activities under the auspices of ‘greasing the wheels’ of the local community.

\textsuperscript{125} Oliver et al, above n 121, 11; \textit{Auditor-General Act 1997} (Cth), ss11-14.
\textsuperscript{126} Victorian Government, above n 2, 44-5.
\textsuperscript{127} Any activities outside of the project scope (and hence the original project business case) cannot have funds expended against them. Government must seek a variation to the original financial submission to progress such activities.
The pure alliance embarks on a no-disputes framework with all decisions requiring unanimity. The consequences of this are that a deadlock may occur where parties to the alliance cannot agree on the resolution of an issue and the project is stalled. How, then, can parties be made accountable for outcomes in such circumstances? Practically, few alliance agreements contain provisions that allow deadlocks to occur at the alliance leadership level. Even alliances that purport to be ‘pure’ alliances contain a mechanism to resolve deadlocks. The inclusion of deadlock breaking mechanisms suggests that governments would prefer not to enter into a situation where a deadlock may occur.\textsuperscript{129}

Despite the inclusion of deadlock breaking mechanisms, alliance managers perceive that the risks of deadlocks occurring are low. Four alliance managers responded in interviews that the ‘best for project’ principles coupled with close collaboration all but eliminate the risk of disputes. Why then do deadlock breaking mechanisms appear so frequently in alliance contracts when deadlocks are considered a threat to effective alliance behaviours?\textsuperscript{130} Governments are most likely worried by the threat of being excluded from effective decision-making and from taking responsibility for outcomes. My interviews and case studies revealed no evidence to suggest that deadlock breaking mechanisms diluted the collaboration and best for project philosophy of the alliance. Most alliances therefore do not pose any accountability challenges for governments in terms of the alliance deadlocks resulting from the ‘no disputes’ philosophy.

The unique features of an alliance introduce accountability challenges that are absent in conventional arms-length contracts. The establishment of a virtual organisation with shared responsibilities and an emphasis on collaboration are all features that drive positive alliance behaviours and foster breakthrough results.\textsuperscript{131} It is these same features that exacerbate government’s challenge to maintain a robust accountability framework, since, in an alliance, there is no one person or organisation that is accountable for project outcomes. Coupled with the alliance best for project and no-

\textsuperscript{129} See chapter two.
\textsuperscript{130} Ross, above n 6, 13, Andrew Hutchison and John Gallagher, ‘Project Alliances an Overview’, (presentation to the Centre of Advanced Engineering Seminar, Christchurch, NZ, 2003) 17.
\textsuperscript{131} Walker et al, above n 15, 68-9, 74-7.
blame/no-liability frameworks, broadly articulated project documentation and questionable financial accountability, the alliance is exposed to decreasing levels of accountability when compared to conventional contracts. These accountability hurdles are by no means unsurmountable and the perceptions of alliance managers is that accountability risks are low to begin with. What requires consideration is that alliances require greater management oversight and involvement of probity advisors and auditors to demonstrate a robust accountability regime to stakeholders when compared to other procurement options. These costs are discussed in Chapter six.

**Alliances and Transparency**

Transparency requires the public sector to be open with full, accurate, and clear communication to stakeholders. In an alliance, the principle of transparency is facilitated with open book reporting of all contractor activities. Nevertheless, there are other areas in alliance contracts that impede transparency. This is especially so in the process used to select tenderers and develop target costs. The following section encroaches upon the analysis on value for money and alliance tender selections in Chapters six and seven, but these themes warrant consideration in terms of the governance principle of transparency and I provide a short summary here.

In a fixed price contract, tenderers are selected primarily on price competition. As I demonstrate later in Chapter seven, this process supports the principle of repeatable and reproducible tender selection against quantitative criteria. The pure alliance, on the other hand, embraces a process where tenderers are selected primarily on non-price selection criteria. This introduces significant subjectivity into the tender selection process and hence a failure to demonstrate transparency in how tenders were fairly treated and selected. This is especially so since the Australian National Audit Office recognises that transparency includes the need for government information to be understandable and comparable.

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132 Australian National Audit Office, above n 96, 8.
133 Ross, above n 6, 3; Victorian Government, above n 2, 8.
In addition to the process used for selecting alliance participants, transparency risks emerge in the process used to develop the alliance target cost. Unlike conventional arms-length contracts, pure alliances use a process of developing the project cost after tender selection as a collaborative activity between government and industry. How then can this process by which target costs are derived in an alliance be open and subject to scrutiny? It is through the use of external auditors and probity advisers that governments attempt to validate target costs. Validation of alliance costs in this manner obviously comes at a price and, as Chapter six demonstrates, these audits may not be effective. No such problems occur in conventional fixed price contracts where tendered prices are effectively validated by the market.

Alliances generate several transparency tensions that are not associated with conventional contracts. These tensions stem primarily from the manner in which value for money is demonstrated and the process by which tenderers are selected. Governments may manage both of these issues so that there is little difference between the openness of conventional contracts and alliances. For example, the pursuit of competitive TOC alliances alleviates the transparency issues of both openness in target costs and tender selection. If governments wish to improve transparency in alliances then competitive TOC alliances are certainly a step in the right direction. Similarly, an increase in external auditing will improve transparency in an alliance, but, as discussed Chapter six, these auditor and probity advisor costs can be significant.

Alliance Managers’ Perspectives of Governance Risks

My interviews and surveys with alliance managers specifically explored the governance environment applicable to alliances. I asked each alliance manager whether they were conversant with their governance objectives and if their alliance was compatible with these objectives. From a sample of 24, only one manager stated...

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135 See, eg. Victorian Government, above n 2, ch 4-5.
136 Although tendered values only represent a fair price where competition is robust (see Chapter two).
that they were not fully conversant with their governance principles. Six managers stated that their alliance was not compatible with their governance objectives.

For those managers that stated that their alliance governance structure was compatible with their governance codes, the majority stated that the alliance principles were specifically tailored to this effect. One interviewee went as far as to state that at the commencement of the alliance, ‘governance principles were workshopped to death’. 137 Respondents made similar comments reflecting a conscientious effort to tailor the alliance principles, values and codes of conduct to ensure such principles were consistent with the public sector’s governance objectives. One alliance went so far as to specifically set up a governance board to provide independent oversight to that alliance.

Addressing individual governance principles, several respondents cited the value of open book reporting as fostering transparency. One respondent recognised the issue of a conflict of duty but stated that ‘all staff face conflicts of duty hence alliances are nothing new’. 138 One interviewee recognised that federal government statutory requirements have the potential to thwart alliance success, especially the Financial Management and Accountability Act, though this risk did not occur on their alliance. 139 Most interviewees recognised the use of probity auditors and clearly defined roles and accountabilities as a means to promote good governance.

For those respondents that did identify governance incompatibilities with their alliance, such incompatibilities were mostly a result from a value for money perspective. One alliance manager stated that ‘end users saw the alliance as an endless bucket of money’. 140 Similarly, one interviewee stated that governance tensions arose from ‘the desire to bring the project in for the lowest initial cost versus bringing it in at the lowest whole of life cost’. Interviewees also recognised the culture and roles of the non-owner participants as a source of governance problems. The comment from an alliance manager that ‘the real issue is that commercial parties to the alliance are not bound by these [public sector] codes of conduct’, illustrates this point.

137 Interviewee D.
138 Interviewee G.
139 Interviewee L.
140 Interviewee Q.
The majority of respondents stated that there were no significant governance issues with their alliances, although many of these respondents alluded to the use of mitigation strategies such as probity auditors, reliance on competitive TOC alliances, retention of liability with hybrid alliances and workshops addressing codes of conduct. Where respondents identified governance tensions, the leading cause was from the problem of demonstrating value for money in a pure alliance.

**Conclusions**

Compared to a conventional arms-length contract, alliances introduce significant risks to the public sector governance objectives of integrity, accountability, and transparency. These risks stem from the express terms of the alliance. In particular, the creation of a virtual organisation responsible for project delivery, the presence of no-blame/no-liability clauses, and the obligation to behave on a best for project basis all conspire to make the governance arrangements of alliances tenuous.

Alliance contracts are likely to give rise to fiduciary obligations, although these obligations are no more onerous than the express requirements in the alliance contract itself. The presence of fiduciary obligations, though, renders the alliance no disputes clause illusory, especially since alliance fiduciary obligation exclusion clauses are ineffective.

The governance challenges identified in this chapter are by no means insurmountable and the fact that alliances enjoy considerable use and claimed success in Australia suggests that there is a level of comfort within governments on the use of such contractual vehicles. What this study identifies, though, are tensions that are not typically present with government’s use of conventional contract. Such tensions need additional management oversight to preserve the integrity in government’s governance framework. For example, most alliances exploit probity auditors, independent auditors, values workshops and the like to mitigate many of the governance risks identified in this chapter. These strategies certainly reduce the
likelihood of governance risks occurring but come at a considerable cost to governments as discussed in the following chapter.
Chapter Six - Alliances and Value for Money

‘...value is determined by value and this tautology means that, in fact, we know nothing about value.’

Karl Marx, Value Price and Profit (1898), 52

Introduction

This chapter continues upon the theme of exploring the governance arrangements of alliances. As demonstrated in Chapter five, alliances weaken accountability structures and create tensions with the governance principles of integrity and transparency. Though these governance issues are significant, a greater problem arises for alliances in complying with government’s need to demonstrate and achieve value for money in procurement.

Australian governments have expended over $25 billion on alliances. A question that must be answered is whether this expenditure has delivered value for money. Answering this first requires an understanding of how governments define value for money. This chapter recognises substantial consistency in the definitions of value for money at federal, state, and local government levels, but these definitions are inherently nebulous and do not provide a reliable framework for assessing the value for money of competing procurement options. This problem is compounded by the fact that governments rarely adopt consistent decision-making rules when selecting procurement options. This enables governments to justify any procurement option by manipulating the definition of value for money and government’s risk profile.

This chapter demonstrates that the nebulous definitions of value for money provide a framework that makes it impractical to confirm or reject the proposition that alliances offer better value for money than conventional contracts. It also explores other

1 Transcripts of a speech by Marx to the First International Working Men’s Association, June 1865.
elements of value that are poorly considered in the alliance literature and government alliance policy. More specifically, some of the hidden costs of alliance contracts are examined, along with how government decision makers often fail to consider these hidden costs. These hidden costs include: the loss of price competition (no market forces driving costs down), the cost of insurance, auditor costs, independent estimator costs, and additional contract management oversight. Even if a robust and repeatable definition of value for money is developed, this chapter shows how alliance costs and benefits are difficult to quantify when compared to those of conventional contracts.

Alliances have evolved, with the competitive TOC alliance, to better demonstrate value for money. In fact, two polarised views have developed in the alliance community. One view proposes that only pure alliances offer value for money as this model reduces sunk costs, promotes more collaborative behaviours, and maximises the likelihood of industry participation in tender evaluations. The opposing view is that only price competition can demonstrate and achieve value for money. I argue that both views may be valid depending on which definition of value for money is adopted. Consequently, value for money can be demonstrated for any procurement option depending on how an individual weighs selection criteria and treats project risk, because value for money cannot be reliably measured and governments treat risk inconsistently. Thus, claims that alliances offer better value than conventional contracts, or vice versa, cannot be substantiated.

**Defining Value For Money**

Chapter four described the governance objectives of the public sector and, in particular, the governance objectives of stewardship and efficiency. These governance principles require the delivery of value for money, but how is this term defined? Federal, state, and local governments all provide directions for managers to achieve value for money, but are silent on how value for money should be measured. Consequently, establishing whether value for money results from any government decision remains extremely difficult, if not impossible. A review of the definitions of value for money establishes this to be the case.
Australian governments adopt a broad definition of value for money so as to include quantitative criteria, such as life cycle costs, as well as qualitative and less tangible criteria such as risk, innovation, safety, and flexibility. Definitions of value for money include the following from the federal government, Queensland government, NSW government and local government respectively.

Value for money is the core principle underpinning Australian Government procurement. Officials buying goods and services need to be satisfied that the best possible outcome has been achieved taking into account all relevant costs and benefits over the whole of the procurement cycle.²

Value for Money is defined as the benefits compared to the whole-of-life costs.³

Ensuring value for money is one of the three objectives of the State Purchasing Policy. Government purchasing must achieve the best return and performance for the money being spent. Price is not the sole indicator of value.⁴

Value for the money spent on systems, services and projects… is, the audit committee [asking] if the council is doing what it said it would do and for the cost which was anticipated.⁵

A common theme in the majority of these definitions is that value for money incorporates all project life cycle costs and the achievement of the best outcome compared to the alternatives. The latter criterion, though, implies that value for money can only be measured in qualitative terms, as the alternative options can never be

costed with complete certainty, since project costs can only be quantified ex post, after project risks have either been retired or have eventuated.

The above definitions also contain imprecise terms, such as ‘benefits’, ‘best possible outcome’ and ‘anticipated cost’. As shown later in this chapter, it is difficult to define the benefits and costs of competing procurement options because different procurement managers define benefits and costs differently. None of the value for money definitions above state how benefits and costs are measured.

The nebulous definitions of value for money have provided governments with the opportunity to expand the concept of value for money tacitly to encompass less tangible aspects of project delivery. Whilst the traditional aspects of measuring project value comprise cost, schedule, and performance, governments often consider broader aspects. For example, the political dimensions of government decision-making have encroached on value for money assessments with the inclusion of social objectives such as Indigenous employment targets, Australian industry involvement and rural development in procurement decisions. These political considerations exacerbate the difficulty of defining value for money, as problems arise with defining social values with certainty. Without a quantitative basis for assigning and measuring political and social costs and benefits, there is no repeatable framework to assist decision makers to develop tender selection criteria or for auditors to scrutinise these decisions.

Measuring value for money is made even more difficult when considering the risk profile of governments. Even if the term value for money could be quantified, estimation of future costs is precisely that, an estimation. Costs are therefore not discrete values; rather they are probability distributions. This introduces the concepts of risk treatment in decision-making and the collective treatment of risks.

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The decision-making process of governments influences how value for money is considered by procurement managers. For example, governments may select ‘minimax’, ‘expected value’, ‘maximax’ or ‘least regret’ decision-making options, each of which will provide different perceptions upon the value for money for competing procurement options. Figure 6-1 highlights the influence of risk management practices on decision-making.

Figure 6-1 – Cost Probability Curves for Various Procurement Options

Though figure 6-1 is a fabricated example (developed by the author) of the cost probability curves for various procurement options, it shows how the risk management practices of an organisation can influence decisions. This figure demonstrates that the outturn cost for a project is never a discrete value at the outset, but is rather a probability distribution taking into account project risks and uncertainty. The probability distributions will differ for each procurement option (as illustrated in Figure 6-1) with the three distinct cost probability curves.

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8 The aforementioned selection strategies are adopted as a function of the level of risk aversion of the decision maker; John Wiley, *Decision and Control* (1966), 222.
The following table (Table 6-1) summarises the cost outcomes at the 10 percent, 50 percent, and 90 percent probability levels ($P_{10}$, $P_{50}$, $P_{90}$ respectively). These confidence levels are commonly used in the construction industry to represent the best, most likely and worst case scenarios for a project.

<table>
<thead>
<tr>
<th>Probability</th>
<th>$P_{10}$</th>
<th>$P_{50}$</th>
<th>$P_{90}$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alliance</td>
<td>118</td>
<td>128</td>
<td>144</td>
</tr>
<tr>
<td>Fixed Price</td>
<td>124</td>
<td>132</td>
<td>138</td>
</tr>
<tr>
<td>Schedule of rates</td>
<td>106</td>
<td>156</td>
<td>170</td>
</tr>
</tbody>
</table>

Table 6-1 Outturn Costs for the Procurement Options at Figure 6-1

As Figure 6-1 and Table 6-1 demonstrate, the attractiveness of each procurement option varies depending on the probability outcomes assigned to each option.

The economist’s view typically requires selection of the procurement option that has the lowest expected value. This involves selecting the procurement option with the lowest average cost (or the $P_{50}$ value). In this instance, alliancing offers the lowest expected cost of $128 million. This is dubbed ‘expected value decision-making’ and represents a risk neutral stance in decision-making.

The outcome will change if the decision-making rules are altered. Decision-makers may wish to minimise the maximum loss, to avoid the worst possible outcome. This is termed ‘minimax’ decision-making. With minimax decision-making, the procurement option that avoids the largest loss will be selected. Minimax decision-making is synonymous with risk averse behaviour. If minimax decision-making is applied, then the decision maker selects the lowest value at the $P_{90}$ confidence level. In this instance, we assume that everything that can go wrong will go wrong. For the example at Figure 6-1, a fixed price contract is the preferred procurement option as this option results in the lowest worst case outturn cost of $138 million.

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9 Ibid.
10 Ibid.
A less likely option for governments would be a risk taking strategy. A risk taking strategy involves selection of the option most likely to yield the greatest savings. In these arrangements, decision makers are optimistic and assume nothing goes wrong. This is termed ‘maximax’ decision-making because this requires that decision makers maximise the maximum gain. For the example at Figure 6-1, a schedule of rates procurement option is the preferred maximax option as this offers a $\text{P}_{10}$ that has the lowest value of $106$ million.

At first, expected value decision-making appears the most logical decision-making rule for governments, because losses and gains can be amortised between multiple projects. Despite this logic, not all government departments have the luxury of adopting expected value decision criteria. Where a government department has infrequent projects or capped budgets then any cost overruns are unpalatable. Local governments typically face such circumstances and are more likely to adopt minimax decision-making rules with procurement options that minimise the maximum loss.

During this study, I attempted to quantify the decision-making rules used by governments. My review of government policy at federal and state level revealed no explicit guidance on the use of expected value, minimax, or maximax decision-making rules when selecting procurement options. During interviews, I asked alliance managers whether risk based decision-making was adopted for the selection of their procurement options. In all instances, alliance managers stated that their selection of alliancing did not consider expected value, minimax or other decision-making rules. One local government did recognise that large cost overruns were unacceptable and this influenced their choice of procurement option, even though no formal analysis of cost probability curves was conducted by this organisation. This suggests that there is substantial scope for manipulating decisions as there is no formal recognition of risk treatment in procurement option selection.

Whilst there are numerous definitions of value for money, these definitions are less than useful, as there is no robust framework with which value can be measured.

11 The Queensland Government, Treasury, Cost-Benefit Analysis Guidelines (Jun 2006) 18, mandates the use of expected values for all costs and benefits but these guidelines do not extend to the comparison of actual procurement options.
Coupled with the political aspects of decision-making and the consideration of ‘social values’, value for money remains an elusive concept for Australian governments. For these reasons, many commentators avoid defining value for money in any measurable fashion.¹²

As the previous discussion suggests, the integrity of value for money assessments are dependent on the ‘risk profile’ of decision makers. Where risk profiles of decision makers are not clearly articulated or applied consistently, there remains substantial scope for procurement options to be selected on the whim of individual managers rather than on uniform procurement practices. Flyvbjerg et al dub the manipulation of value for money assessments ‘strategic misrepresentation’.¹³ Indeed, the susceptibility of the ‘definitions of value’ is a well recognised concern:

> It is well established in the project appraisal literature that estimating benefits and costs is difficult and vulnerable to manipulation.¹⁴

Paradoxically, the prospect of a loose definition of value for money is arguably attractive to Australian governments as suggested by the CEO of Australia’s Defence Material Organisation:¹⁵

> Defining Value for money is a key element of the Commonwealth Procurement Guidelines... Australia does not use a rating system like other countries. It’s a more subjective judgement and another example of the flexibility we have. I support that.

Value for money is therefore unmeasurable by Australian governments in any meaningful sense. The term value for money is interpreted by local decision makers where reproducibility and repeatability is usually not contemplated or attempted. Consequently there is little merit in comparing the proposed value of various

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procurement options. That is not to say that value for money principles, such as open and fair competition, consideration of life cycle costs and identification and allocation of risk, cannot be identified; rather, statements that alliancing offers better value for money than fixed price contracts or vice versa cannot be verified.

All construction and engineering projects involve risks and uncertainty. At best, a decision maker can state that with given selection criteria weightings, one procurement option is more attractive than another. Unfortunately, the lack of consistency in weighting the elements of ‘value’ dilutes the meaningfulness of even this claim. This becomes even more apparent when exploring the hidden costs and benefits of alliances.

**Measuring the Value of Alliances**

As the previous section has demonstrated, Australian governments do not reliably define value for any procurement option. Furthermore, the inconsistent application of risk management practices exacerbate poor value for money assessments. Even if Australian governments develop a quantitative and robust value measurement regime with consistent, and therefore repeatable, risk management processes, alliances would negate the benefits of such initiatives because alliance costs and benefits are more difficult to quantify than those of conventional contracts.

The following section explores several of the alliance costs and benefits including those which fail to be acknowledged explicitly in the alliance literature and government guidance papers.\(^{16}\) This is a difficult task as the terms ‘costs’ and ‘benefits’ are in themselves replete with subjective judgement. To ensure a holistic approach in this assessment, this research includes the types of alliance costs and benefits identified in interviews with government alliance managers, drafters of alliance contracts, and alliance insurance brokers. Also considered are the alliance costs and benefits cited in the alliance literature developed by legal commentators.\(^{17}\)

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\(^{16}\) For example, the Victorian Government, *Project Alliencing Practitioner’s Guide* fails to acknowledge many of the costs and benefits of alliancing identified in papers by the legal fraternity (see footnote 17 below).

\(^{17}\) See especially, Owen Hayford, ‘Ensuring your Alliance Contract is legally Sound’ (2004) 99, *Australian Construction Law Newsletter* 45, 48-9; Andrew Chew, ‘Alliancing in Delivery of major...
The alliance compensation framework is significantly different from that of conventional procurement methods. An understanding of this framework is required to assess the rewards and penalty framework for both pure and competitive target outturn cost alliances and to examine the processes used to develop and validate target costs.

**The Alliance Compensation Framework**

For pure and competitive TOC alliances, the process for developing target costs is consistent and well documented. The alliance compensation model comprises three elements:

a. Limb 1. The first limb of compensation includes all project direct costs (labour and material) as well as project specific overheads. The alliance owner (government) pays for all limb 1 costs. Payment of limb 1 costs is independent of the performance of the alliance participants;

b. Limb 2. Limb 2 costs comprise ‘normal’ profit and corporate overheads associated with the project. All limb 2 costs are at risk to the contractor with payment of these costs contingent on project performance; and

c. Limb 3. Limb 3 costs are effectively an equitable share in the project gains or losses depending upon whether the project is delivered within or outside the project budget. Limb 3 costs are adjusted by the achievement, or otherwise, of key result areas such as project schedule, safety and quality.

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19 Adapted with minor modification from Victorian Government, above n 18, 27.
Figure 6-2 demonstrates how the alliance compensation process guarantees payment of direct costs to non-owner participants with profit, overhead and limb 3 costs at risk to the contractor.

![Figure 6-2 Alliance Compensation Framework](image)

The worst possible project outcome for non-owner alliance participants is loss of profit and corporate overhead. By comparison, the best outcome would be the full recovery of profit and overhead (limb 2) elements of compensation and of an equitable share of the maximum limb 3 pool.

For governments, as the alliance owner, this pure alliance compensation framework results in a situation where project costs are uncapped,\(^\text{21}\) because the alliance owner must reimburse all limb 1 fees associated with the project. This situation is in contrast to fixed price (or a schedule of rates contract with a not to exceed price)

\(^{20}\) Adapted from Victorian Government, above n 18, Figure 4.1.

\(^{21}\) Costs are uncapped to the point where government elects to invoke termination for convenience.
arrangements, in which there is a set figure that limits government’s liability for cost reimbursement. Government may attempt to cap costs under a pure alliance framework by relying on termination for convenience once a budget threshold has been reached, though such a measure would result in a huge sunk cost and introduce additional demobilisation costs.

The manner in which the alliance allocates the proportion of limb 2 and limb 3 fees to alliance participants is a function of two elements. First, limb 2 reimbursement is adjusted against project performance relative to the pre-determined Target Outturn Cost (TOC). Second, limb 3 reimbursement is adjusted against project performance adjusted by agreed key result areas. Examples for how alliances allocate compensation for a variety of scenarios are provided in the Victorian Government’s *Project Alliancing Practitioner’s Guide* and Ross’s ‘Introduction to Project Alliancing’.  

In most instances, adjusting compensation against non-cost targets prevents the pursuit of cost savings at the expense of other criteria such as quality. For example, if cost criteria alone are applied to the alliance compensation model then alliance participants may be tempted to sacrifice quality, schedule, or safety to deliver under the target cost. This situation is discouraged in practice by adjusting the limb 3 fees against these non-economic key result areas of the project.

This study does not explore the manner in which limb 3 costs are calculated and shared amongst alliance participants, nor how the alliance exploits non-economic performance elements to adjust the limb 3 fees; rather, what is relevant to this study is an examination into how the target outturn cost itself is developed at the onset of the project. It is the TOC which ultimately shapes the cost of the project and is the indicator of whether the project is a success or otherwise.

To summarise, the key characteristics of the alliance compensation framework involve a situation where: costs are uncapped for the alliance owner, non-owners in

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22 Victorian Government, above n 18, ch 4; Ross, above n 18, App 1.
23 This process is thoroughly documented in other sources and is highly variable amongst alliance contracts. See, eg, Ross above n 18.
the alliance are guaranteed reimbursement of all direct costs and direct overheads, profit and company overhead is at risk for non-owners, and non-economic performance is used to adjust the limb 3 reimbursement (thus encouraging superior performance in areas such a schedule, quality, and safety).

A feature of the alliance compensation framework is the ability to implement project variations in an open book fashion, faster than variation management of conventional fixed price contracts. This is often cited as one of the key benefits of alliances.  

**Variations in Alliances**

This section explores what actual benefits alliances offer in the management of variations compared to other procurement options. It is worth noting again that risks associated with an alliance project are managed collectively by the alliance participants. Consequently, situations leading to variations under a conventional contract may not result in variations under an alliance framework because the alliance target outturn cost inherently allows for some project contingencies provided there is no substantial change in the scope of the project. In addition, the claimed collaborative nature of alliances discourages the opportunistic use of variations (see Chapter two).

Variations may occur when there is a need either to increase or decrease the scope of the project, or where there are fundamental changes to the project ‘deliverables’. In alliances, the progression of such variations requires unanimous agreement from the alliance leadership team and possible amendment to the target outturn cost. This has the subsequent effect of adjusting each of the limb 1, limb 2, and limb 3 elements of alliance compensation. Though this adjustment is somewhat complex, by comparison to the progression of contract change proposals in conventional fixed price contracts,

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24 Ross, above n 18, 9; Victorian Government, above n 18, 37.
25 Victorian Government, above n18, 37.
26 Ibid.
27 Some alliances allow for the alliance project manager to progress variations up to a monetary threshold.
variations are likely to be quicker under an alliance framework. Furthermore, variations under the alliance operate in the same open book, collaborative manner for which the alliance target outturn cost is developed. This provides some inherent level of *value* in the management of variations within an alliance.

By way of contrast, variations costed under conventional contracts are not subject to price competition, and consequently governments are at the mercy of the contractor to obtain value for money in these variations. In addition, the claimed adversarial nature of conventional contracts, with fewer shared risks, may lead to a greater number of variations and hence a demand for more contract change proposals.

Alliances offer substantial benefits in the management of variations with lower administrative costs, faster implementation and transparency in the costing of variations. It is important to note that these alliance benefits only manifest themselves in projects where variations are expected. Consequently, this is one of the reasons why governments use alliances in high risk projects with uncertain scope.

The alliance compensation framework and variation management process potentially offer significant benefits compared to conventional fixed price contracts, but this is only true if the target outturn costs represent a fair price for delivering the project works. As the following section demonstrates, proving that the target outturn cost is a fair estimate is a significant challenge for the pure alliance.

**Developing the Alliance Target Cost**

Unlike conventional, competitively bid contracts, pure alliances do not rely on price competition to develop the target cost of a project. The alliance target cost is developed collaboratively between alliance participants *after* tender selection. This

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28 Though calculating compensation is more complex, an alliance has substantially less contract administrative overheads such as developing contract change proposals and negotiating the cost of such proposals.

unique price development process introduces substantial auditing costs to alliancing (discussed later in this chapter) and raises questions on the integrity of these internally developed target costs.

The key benchmark of any alliance is the Target Outturn Cost (TOC). The TOC comprises the estimates for all limb 1 costs and non-owner limb 2 costs. This TOC represents a ‘business as usual’ estimate for delivering the project, incorporating all costs associated with delivering the project, including contingencies for identified and unidentified risks.

A requirement in the development of the TOC is for open book reporting and collaboration in developing this estimate. Transparency of this type provides some degree of confidence in the veracity of the TOC, but this may not be sufficient to demonstrate that the target costs are fair. Often, governments may not have the requisite skills or resources to contribute significantly to the development of the TOC. Consequently, some procurement guides recommend the following strategies to facilitate improved confidence in alliance target cost development.

The first strategy is to have the alliance owner conduct robust cost modelling before selecting alliance participants. This may include the use of Monte-Carlo simulations to develop a realistic range for the TOC. Alliance tenderers may also be asked to critique the owner’s estimate.

The second strategy is to appoint an independent estimator, akin to a quantity surveyor, to audit the TOC development process and/or audit the TOC itself, including contingency fees.

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30 The use of the term ‘business as usual’ is an imprecise term. For example, some alliance practitioners refer to the target cost being an estimate of a business as usual quotation employing a high performance team.
32 Ross, above n 18, 6.
33 Monte-Carlo simulations are numerical methods using random numbers to explore possible outcomes for an event. Monte-Carlo simulations are used to generate probability distribution curves for schedules and cost estimates (similar to those presented in Figure 5-1).
34 Victorian Government, above n 18, 40.
35 Hutchison et al, above n 31, 24.
The third strategy is to appoint a financial auditor to review the limb 1 and limb 2 fees (the reimbursement model) as well as general financial and cost accounts.\textsuperscript{36}

The fourth strategy relies on the use of previous project costs to demonstrate actual rates for specific tasks. This provides a proven baseline with which to benchmark the TOC.\textsuperscript{37}

Despite all these strategies being required by the Victorian Government’s, \textit{Project Alliancing Practitioner’s Guide} (the leading alliance guide in Australia), in practice most pure alliances do not adopt them all. Although all pure alliances use independent estimators and financial auditors, very few of the alliances examined in this study involved robust cost modelling, to develop a realistic range for the TOC, nor was effective benchmarking conducted.\textsuperscript{38}

Even if governments use all four strategies recommended by the Victorian Government’s, \textit{Project Alliancing Practitioner’s Guide} to validate target costs, the value of these strategies is questionable. The following section explores some of these validation challenges, including: how to make comparisons to fixed price values,\textsuperscript{39} the problems associated with the allocation of reimbursement against soft dollar criteria, and the problems governments face by being dependent on the non-alliance owner’s integrity in cost development.\textsuperscript{40} Furthermore, these validation processes impose costs and potential delays, and governments must consider the implementation of validating the TOC as a \textit{cost of doing business} with pure alliances.

\textbf{Auditing - Compliance and Performance}

The pure alliance relies on target costs being developed after tender selection with no competitive process to ensure that the price is fair. If governments are to remain committed to their accountability principles, they need to acknowledge the problems a pure alliance creates in demonstrating value for money. The inherent slipperiness in

\textsuperscript{36} See, eg, Victorian Government, above n 18, 41.
\textsuperscript{37} Ibid. This selection process requires contenders to submit cost/performance data on two relevant projects that they bid competitively.
\textsuperscript{38} Interviewee A, Interviewee H.
\textsuperscript{39} Hayford, above n 17, 53.
\textsuperscript{40} Victorian Government, above n 18, 40-1.
any calculation of value makes this difficult, though auditing the target cost from the perspectives listed above (namely modelling costs prior to issuing requests for tender, utilising independent cost estimators, and using financial auditing and benchmarking) improves confidence in target costs. But how effective is this auditing and what is the cost?

Independent auditing of projects is conducted at all levels of Australian government to assess compliance with government policy and obligations in applicable legislation. A substantial challenge for the auditor, though, is to determine whether value for money has been or will be achieved in a project. Before embarking upon how value is audited in an alliance, it is necessary to explore briefly how value is audited with fixed price and other contracting methods.

Independent of the procurement option selected, a process is usually adopted to determine whether the pursuit of a project will deliver value for money. This typically manifests itself in the form of a business case that will be reviewed regularly throughout the life of a project to confirm that the project delivers value. These reviews may take the form of a probity audit (usually on a voluntary basis), or an external audit from an auditor general’s department (usually on an involuntary basis).

Probity Audits aim to monitor pre-contractual and contractual phases of projects to:

a. ensure that the tender evaluation process is fair and equitable,

b. provide guidance to the client as to how unforeseen issues could be resolved,

c. monitor communication during the period between submission of tenders and signing the project alliance agreement, and

d. ensure that transparency and accountability are maintained during the course of the contract.

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41 Alan Cullen, ‘Project Alliance Main Agreement’ in Building Contracts Australia (1997), LexisNexis [64,090].
43 Cullen, above n 41, [64,090].
Some commentators suggest that probity audits also contribute to demonstrating value for money.⁴⁴

Audits conducted under the auspices of respective audit legislation encompass financial audits as well as examinations as to whether activities are conducted ‘efficiently and economically’.⁴⁵ Whilst financial auditing is relatively easy to conduct, the more recent emphasis on the auditing of the ‘effectiveness’⁴⁶ of an organisation and the requirement for justification of value for money has raised considerable concern for auditors as the following comment demonstrates.

Unquestionably, what frightens auditors as they move from certification into value for money assessments, and within the latter from economy through efficiency to effectiveness, is the difficulty in satisfying normal professional standards of evidence and the increasing risk associated with the greater use of judgement as opposed to supportable facts.⁴⁷

Further, value for money determinations often include a ‘political dimension’ with the consideration of social objectives (see Chapter seven) as well as an analysis of how resources could have been put to better use with alternative procurement options.⁴⁸ This may prove to be a significant challenge for the auditor who is compelled to rely upon subjective assessment criteria. An auditor in these circumstances can more confidently state that a project has not delivered value for money, than to certify that a project has delivered value for money.⁴⁹ Or to phrase this more colourfully ‘the only thing auditors fix is the blame’.⁵⁰

There are, therefore, substantial challenges in auditing how value for money has been delivered on any form of contract. As the following section demonstrates, this

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⁴⁵ See, eg, Public Finance and Audit Act 1983 (NSW), s38B.
⁴⁸ Glynn, above n 46, 115-6.
challenge is exacerbated with pure alliances as this contractual model avoids price competition and a greater emphasis is placed on the skills of auditors than is the case with conventional contracts.

**Auditing in an Alliance – Effectiveness and Costs**

Auditing is used in alliances to provide confidence that the target outturn cost is a fair estimate for delivering the project. What governments must ask, though, is how effective is auditing in an alliance, and what is the cost of providing this auditing? Auditing is likely to prove to be a significant challenge for the auditor in a pure alliance as great reliance is placed on subjective assessment criteria such as non-economic compensation, and target costs are developed collaboratively between alliance participants. The following comment suggests that effective auditing is crucial to demonstrate value for money in pure alliances:

> There are examples of alliancing which have occurred in this country where contractors have been able to declare very significant profits as a consequence of the project while the project suffers overruns in cost by hundreds of millions of dollars.  

Acknowledging that auditing is mandatory in a pure alliance,\(^5^{2}\) how effective will that auditing be? The following discussion demonstrates that pure alliance auditing and validation strategies are largely symbolic.

One of the common features of an alliance contract is open book reporting for all associated alliance costs. While governments may have full disclosure of hourly rates and the hourly estimates for work packages, the ability to validate these estimates may be limited.\(^5^{3}\) Even if robust labour rates and bills of material are available, great uncertainty may lie in the actual estimates of the number of hours to complete tasks and the quantity of materials needed to complete the project. Typically, governments do not possess the core competencies relevant to the project at hand and the resources

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\(^{51}\) Stephenson, above n 17, [5.2].

\(^{52}\) Victorian Government, above n 18, 30-1.

to contribute to or validate project work breakdown structures. Consequently, mere open book reporting may be insufficient to prove that the TOC is a robust ‘business as usual’ estimate of the work at hand.

Owner developed project estimates are used as a means to validate target costs. Developing a budget estimate for the project before selecting alliance participants provides some level of confidence in the range in which target costs should lie. The use of Monte-Carlo analyses and comparison to similar projects will help the owner establish an approximation or best guess for the target outturn cost, but only if the owner has the competencies and resources to undertake such an activity. Robust project cost estimation is often not performed by governments, especially by local governments where preliminary design activities are required to produce cost estimates. Such an endeavour may be invaluable for budgeting purposes and for developing project business cases, but will not normally enable robust validation of target costs developed by the alliance participants. Furthermore, my interviewees reveal that governments are a very poor estimator of project costs, as government’s estimates for project costs are significantly below tendered values. This is indicative of government’s poor skills in project cost estimation.

Independent estimates are used extensively on pure alliances. Where governments do not possess the core skills or resources to validate or assist in the development of the TOC then a ‘quantity surveyor’ or estimator may validate the TOC. An estimator used for this purpose must be both intellectually and financially independent of the non-owner alliance participants to ensure that this second opinion is at arms-length; but how effective is this estimation?

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54 A common theme in my interviews and surveys was that government’s involvement in pure alliance TOC development was either non-existent or very limited.
55 See, eg, Victorian Government, above n 18, 40.
56 Cowan et al, above n 53, 3.
57 For example, the Port of Brisbane motorway alliance TOC was double the owner’s estimate, Ibid 5.
58 For example, one interviewee stated that their organisation typically underestimate project costs by 30 percent (interviewee F).
The independent estimator is able to provide a broad assessment of the veracity of the TOC, but this will most likely be a close approximation. The development of the TOC may involve many thousands of person-hours using many subject matter experts. Consequently, it is unlikely that the independent estimator will have the skills or resources to validate all aspects of the TOC, even if a team of independent estimators is used. At best, the independent estimator will offer a rough estimate for the project and identify any glaring errors in the TOC. Furthermore, if independent estimates provide effective cost estimation capabilities then why do governments fail to use these estimators in the development of project cost estimates prior to issuing requests for tender? As mentioned above, project budgets on government projects are notoriously unreliable. This suggests that independent estimators are only effective for validating existing project schedules and work breakdown structures rather than developing their own project budgets from the bottom up.

Governments may rely upon previous projects to benchmark the TOC. This strategy relies on a comparison of the proposed alliance project with similar projects delivered under competitive arrangements. Where relevant project data exist for comparison, these offer a substantial means not only to validate hourly rates and bills of material but also the work breakdown structure of the project. The challenge in using this method is in finding projects that are similar to the alliance project at hand. The comparison of project costs may need to consider geographic similarities (for example, remote versus urban projects); the effects of variations on project costs; the application of novel techniques or technology; changes in labour costs; and expected profits as a function of time, market conditions and inflation.

Consequently, benchmarking the TOC with similar projects will only offer substantial confidence in the integrity of the TOC if an equivalent comparison can be made between the projects. This technique may be ideally suited to the more common

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60 Cowan et al, above n 53; the authors argue that independent assessors are either ineffective or used improperly. Contra, Alchimie 'TOC Process: Demonstrating and Ensuring Value for Money (2004), 10 <http://www.alchimie.com.au/links.html> at 12 June 2006; where the authors states from their experience that independent estimators arrive at an estimate very close to the TOC (within 2% and 4%). The later authors do not qualify whether the estimators had visibility of the TOC prior to developing their estimate nor the risk profile of the projects. The fact that estimators are not used to develop government project proposals prior to the issue of requests for tender (or if they are, then they are incredibly poor at doing so) suggests that auditors reach the value of the TOC simply because they have visibility of the TOC a priori.
construction and engineering tasks such as development of roads, waste water treatment plants and the like, but not so valuable for one-off projects such as the design and construction of an Air Warfare Destroyer or the development of a custom built human resource information system. Furthermore, if a proposed alliance is so similar to a previous project with known risks and technological challenges, then the argument for using an alliance in the first place is weakened simply because the risk profile of that project would be better dealt with a fixed price contract which enables the parties to adopt the philosophy of transferring risk to the party best able to manage that risk.

The auditing methods discussed above attempt to ensure value for money by validating the TOC. These processes are substantially more complex for a pure alliance than for fixed price tendering arrangements. Furthermore, there is substantially greater emphasis on the competencies of governments to support this validation process. It is highly unlikely that auditing alone of pure alliances is capable of demonstrating value for money to any reasonably reliable standard for many reasons. First, audits are typically ‘process-centric’, in that they focus upon whether correct procedures were followed or not. Little emphasis is placed upon effectiveness. Second, whilst audits can validate the hourly rates applied to a contract (via comparison to commercial best practice), audits are unlikely to explore whether better value could have been achieved with another procurement option. Third, auditors will most likely adopt the selection criteria and associated weightings developed by the government contract team rather than revisit these elements. The government contract team arguably includes subject matter experts and an audit team would be exceedingly brave to suggest that the ‘technical’ selection criteria were erroneous. Finally, with a pure alliance, primarily the non-owner participants determine the work breakdown structure for the project. In the absence of price competition, there will be greater emphasis on auditors to validate the scope of work. The auditors will likely have neither the resources nor competence to validate fully the project work breakdown structures used to develop the target outturn cost.

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61 Glynn et al, above n 47, 67.
Should governments elect to address the above issues by improving the number of audits and breadth of skills of auditors, then substantial costs will result. My interview and survey data neither confirmed nor rejected the proposition that the auditors offer confidence in assessing value for money in alliances. Even where governments used external auditors, many respondents acknowledged that the integrity of target costs were a risk when using pure alliances. My interviews with pure alliance managers also revealed that governments rarely accepted the initial estimate of the TOC presented by the alliance management team; rather, the alliance was constantly required to drive the TOC down. As one interviewee stated, ‘we never took that first estimate of the TOC … we sent the alliance back to push this estimate down as low as we could’. This suggests that government, as the alliance owner, is usually suspicious of the first iteration of the TOC.

I therefore conclude that auditing alone is not an effective means to validate alliance target costs. Confidence in the TOC may be increased with auditing but this improvement in confidence will result in a substantial increase in auditing costs. No alliance literature or government policy attempts to quantify this auditing cost. The reason this is so is because auditing may not appear as a project cost but is rather a cost amortised over the whole of government. In other words, the funding of auditing comes from a ‘different bucket of money’ and does not appear as an alliance cost. Other than auditing, what other tacit costs are associated with alliances?

**Value for Money and Hidden Costs**

Developing an accurate TOC and demonstrating that this TOC is a fair estimate of the cost for completing project works is crucial to meeting government’s goal of achieving value for money. In addition to developing fair target costs, alliances also raise other value for money challenges. When determining value for money, government relies on the concept of ‘life cycle costs’ which capture all costs of the project and not just tendered values.

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62 Interviewee Q.
All costs and benefits must be clearly identified so that government is provided with a realistic estimate of what the project will cost and how long it will take to deliver. The following aspects in particular require careful consideration when assessing the value of alliances: loss of price competition, cost of administration, sharing the costs of mistakes, cost effective insurance, loss of incentives, and termination for convenience.

The above list encompasses the costs or disadvantages of alliancing. Other sources thoroughly document the benefits of alliancing, such as innovation, collaboration, and reduced disputes, and there is no need to revisit these. What this study therefore examines is the costs of alliancing with the particular aim of examining whether these costs are actually any worse than the costs associated with conventional contracts.

**Loss of Price Competition**

Substantial debate surrounds the concept of value for money in pure alliances from the perspective of price competition. Most commentators are polarised on the issue, either arguing that pure alliances offer the best value for money for appropriate projects or that only price competition can provide value for money. How, then, do governments reconcile the perceived need for price competition and procurement options such as pure alliances? Several government policy documents and guidance papers recognise the need for competition in achieving value for money. For example, the NSW Independent Commission Against Corruption observes:

> Best value is best achieved through a fair and open process. Regular market testing can allow new options and technology to be considered, encourage existing contractors to maintain or improve the service and price, and give new contractors an opportunity to bid. In the absence of a competitive process, it is very difficult to gauge best value for money.

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64 See, eg, Derek Walker and Keith Hampson, *Procurement Strategies: A Relationship-based Approach*, (2003), 68-9; Ross above, n 18, Alchimie above n 60.  
65 See, eg, Ross above n 18; 19-20 Alchimie, above n 60, 9-10.  
66 Cowan et al, above n 53.  
67 NSW Independent Commission Against Corruption, ‘Direct negotiations in procurement and disposals: dealing directly with proponents’ (1 June 1997)
The Commonwealth Procurement Guidelines also capture the need for competition. They define value for money as ‘encouraging competition by ensuring non-discrimination in procurement and using competitive procurement processes’.\textsuperscript{68}

Pure alliances do not eschew competition; rather this procurement option requires governments select tenderers on the basis of non-price evaluation criteria. The absence of price competition in pure alliances thus appears contrary to some of the government guidance listed above. This concern is reflected in a recent pure alliance audit report which raised concerns with the demonstration of value for money in a pure alliance.\textsuperscript{69}

In a pure alliance there are no competitive forces dictating the value of the target outturn costs. Arguably, governments select a team on a competitive basis that is perceived as best capable of delivering value for money with the lowest target outturn cost. This is an invitation for criticism, as one alliance manager summarised:

\begin{quote}
We cannot win. If we deliver the project above the TOC then we are seen as a failure. If we deliver under the TOC we are deemed as being soft in setting realistic targets.\textsuperscript{70}
\end{quote}

No such criticism can be levied on a bid developed under price competition as the process for developing final costs are generally hidden from scrutiny from governments in an arms-length environment. In such circumstances, \textit{the market sets the right price}.

What then is the ‘cost’ of doing business with a pure alliance where there is no price competition? As previously discussed, the pure alliance places substantial emphasis on independent auditing to validate target costs. The cost of this auditing is a direct


\textsuperscript{70} Interviewee 1.
cost to the project and will be unique to the pure alliance, since conventional fixed price contracts do not require substantial validation of tendered costs.

In addition to the costs associated with auditing, a less tangible disadvantage of the absence of price competition is the lack of confidence in pure alliance target costs. Many respondents to my interviews expressed some discomfort with the pure alliance target outturn cost. That is not to say the respondents considered the target costs to be an unfair estimate, but rather they had difficulty in justifying the integrity of these target costs. Pure alliance managers are therefore left with a ‘nagging feeling’ associated with their cost estimates. One respondent to my interviews stated that they particularly feared an audit of their project as the target costs could not be properly justified.

The absence of price competition in the pure alliance therefore introduces additional auditing costs when compared to conventional contracts. A less tangible, but relevant, issue associated with the absence of price competition is the lack of confidence alliance owners have in their target costs.

**Cost of Administration**

There is general acknowledgement by governments that the management of alliance contracts involves substantially more effort than that associated with conventional contracts. With an *ideal* conventional contract, governments develop a specification, select a tenderer (primarily against price criteria), provide some limited supervision during construction and finally accept the end product. This arm-length process theoretically involves little input from governments, as the prime contractor is

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71 Interviewee Q.
72 Interviewee M.
73 My case studies, interviews and literature review reveals that auditing cost are substantial for all pure alliances. Over $800,000 has been expended on probity audits for three defence alliances (ANZAC, Djimindi, SEA4000 alliances) as at Jan 2006: Australian Government, Hansard, Senate No 2, 2006 (27 Feb 06)
solely responsible for delivery of the project works to a defined schedule and at an agreed price.

By way of contrast, the alliance requires substantially more involvement from governments, including maintaining government employees in the alliance team, providing government support to the alliance leadership and management teams, facilitating alliance relationships and aligning organisational cultures,⁷⁵ providing employees with additional training,⁷⁶ and the extra resources needed to develop and validate the TOC.⁷⁷

Using teams that are already conversant with alliancing principles can reduce these costs of alliancing,⁷⁸ though for ‘greenfield’ alliance projects governments will be required to fund initial alliance training and fund alliance setup costs.

Consequently, alliances are not recommended for low value projects where the cost of administration cannot be appropriately amortised over the value of the project.⁷⁹ The true cost of administering alliance contracts thus appears to be substantially larger than for a conventional contract which is devoid of variations, disputes and the need for management intervention. Such a conventional contract is argued to be rare.⁸⁰

The cost of monitoring contractor performance, administering variations and other costs associated with the claimed adversarial behaviour in conventional fixed price contracts may be substantial to the extent that these costs rival or even exceed the administrative costs of alliances. Nevertheless, the administrative costs associated with conventional contracts largely stem from poor specifications and poor contract documentation,⁸¹ both of which are capable of being managed. Furthermore, as demonstrated in Chapter two, the incidence of disputes in conventional contracts is overstated by alliance protagonists.

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⁷⁵ Ross, above n 18, 21; NSW Government, above n 53, [3.1.4].
⁷⁶ Building Contracts Australia above n 41, [64.185].
⁷⁷ See especially, Victorian Government, above n 18, Ch 5.
⁷⁸ Ross, above n 18, 21.
⁷⁹ Victorian Government, above n 18, 19. See also, Chapter three.
⁸⁰ Ross, above n 18, 1.
The alliance therefore places greater demands on government resources and has greater associated administrative costs than is the case with well managed conventional contracts. This concern is acknowledged in the rapid growth of ‘early contractor involvement’ contracts, which capture many of the benefits of alliancing but without the attendant need for alliance owner resources.\(^{82}\) It will only be for large projects that have significantly undefined or variable project requirements that alliance administrative costs may become comparable to those of conventional contracts.

**Sharing the Cost of Mistakes**

A further criticism of alliances in the context of value for money is that in alliances governments pay for a substantial component of contractor mistakes.\(^{83}\) Where project rework results from an alliance participant’s negligence, governments pay for a portion of the rectification costs of these mistakes and any attendant delays. Though the ‘gainshare and painshare’ arrangements of the alliance discourage poor performance and the likelihood of rework, the presence of the alliance no-disputes clause prevents governments from recovery of substantial loses suffered from gross negligence or inefficient work practices.\(^{84}\) These costs, or *loss of value*, are offset somewhat as government is afforded the same protection from its own negligence and poor performance, such as the delivery of poor specifications or providing inappropriate site access.

Given that the majority of the design and construction responsibilities of an alliance project will be assigned to non-owner participants, governments will most likely be exposed to the ‘costs’ of the no-disputes framework, rather than the ‘benefits’ in the context of value for money. The no-disputes clause does have benefits associated with positive alignment of the alliance culture and reduced costs of litigation, though

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\(^{82}\) These ECI contracts evolved within the Queensland Department of Main Roads who were concerned with the management effort associated with alliances see Roger Quick, ‘Queensland’s ECI Contract’ (2007) *International Construction Law Review*, 3.

\(^{83}\) Hayford, above n 17, 49.

\(^{84}\) Ibid 50.
establishing whether this value exceeds the cost of paying for other’s mistakes remains unanswered. The emphasis on the need for a no-disputes clause in most alliance arrangements suggests that the benefits outweigh the costs, though no evidence is available to support this premise. Conversely, there is no evidence to suggest that preservation of some form of liability between alliance participants will substantially undermine the collaborative nature of alliancing.

The currently overheated construction market (discussed in Chapter two) has increased the likelihood that alliances will involve more ‘B-teams’, rather than the high performing ‘A-teams’ from industry. There is therefore more likelihood that things will go wrong in future alliances and that the no disputes/no liability regime of the alliance may no longer be appropriate. Alliance managers must therefore consider what costs and benefits are expected with the no disputes regime of alliances when selecting procurement options. Currently, no government alliance policy or guidance addresses this cost.

**Alliances and Insurance**

Associated with the cost of ‘paying’ for contractor mistakes and a framework of ‘no liability’ is the concern that professional indemnity insurance is very difficult to obtain or may not be available for work conducted under a pure alliance. The presence of a no-disputes clause in a pure alliance results in alliance partners not being liable for any losses (except for wilful default). Consequently, conventional liability-based insurance will be ineffective as no liability arises. Standard insurance policies will therefore offer the alliance owner little comfort and either the alliance must obtain special insurance or parties must deviate from the pure alliance, ‘no liability’ regime.

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85 Public liability insurance also presents unique challenges with alliances, though this is manageable and far less a concern than the issue of professional indemnity insurance. See especially: Victorian Government, above n 18, 63; See also Chew, above n 17, 329-3, who describes the benefits of a project specific public liability insurance policy


87 Ross, above n 18, 13-4.
There is a perception amongst several alliance managers and legal commentators that obtaining project specific professional indemnity insurance within a no-liability framework is extremely difficult in Australia. Should such policies be available, it is also perceived that they are prohibitively expensive. A response to this perception has been the use of self-insurance or deviation from the pure alliance model to preserve liability between alliance participants.

Self-insurance may be desirable where design risks are manageable. Furthermore, the reimbursement model of the alliance inherently caters for self insurance with the designer’s limb 3 compensation being at risk from design errors (see the alliance compensation model above, figure 6-2). The challenge for governments with self-insurance is with respect to insurance cover after final completion of the project after the award of all limb 1, 2 and 3 fees. If latent defects in the design or construction elements of the project are discovered after final completion then governments’ options for cost recovery are limited, as no liability exists between alliance participants. This may prove highly undesirable where the integrity of the delivered project is unable to be fully verified at final completion.

Where self insurance is deemed unsatisfactory, governments can use a hybrid alliance with liability preserved between participants. Alliances of this type deviate from the pure alliance model by maintaining strict liability between government and the alliance contractor. This alliance model provides access to standard insurance post-alliance where latent defects may be discovered in the project works. It should be recognised that where liability is maintained between alliance participants, there is increased risk that the collaborative nature of the alliance may be diluted, as well as reduced pressure on the drive toward innovation. The acceptance of these costs need to be considered in the context of project risk (the likelihood and consequence of latent defects occurring) as well as government’s obligations to support the delivered works after final completion.

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88 Stephenson above n 17, [5.3].
89 Victorian Government, above n 18, 62; Ross, above n 18, 14; Chew, above n 17, 329.
90 Cowan et al, above n 53, 3.
91 Ibid 4.
92 Ross, above n 18, App 2.
93 Hayford, above n 17, 50.
Despite the continued use of hybrid alliances and the pursuit of self insurance, there are commonly available insurance products for pure alliances that allow for first party claims. During this study, I interviewed leading insurance brokers and reviewed several alliance insurance policies. The results of this investigation reveal that the alliance first party insurance product is as robust as a conventional design and construct insurance product with respect to the scope of insurance cover, triggering events, insurance run off cover, and protection for delays. In several areas, the alliance insurance policy provides more comprehensive protection than conventional insurance products as the alliance policy provides cover equivalent to liquidated damages protection.\footnote{John Davies, ‘Alliance Contracts and Insurance’ paper presented to the Alliancing Association of Australasia, Brisbane, 20 February 2008,6, <http://www.griffith.edu.au/centre/slrc/pdf/alliances-insurance-v4.pdf> at 6 June 2008.}

My review of these alliance insurance products suggests that these policies have a premium and excess comparable with conventional insurance products and that over 15 alliance insurance policies have been issued to date. There is no compelling reason to adopt a hybrid alliance model for the purposes of obtaining alliance insurance. Consequently, the cost of procuring and managing alliance insurance is no worse than that associated with a conventional fixed price contract despite the continued use of hybrid alliances\footnote{The author is aware of one local government, as recently as April 2007, adopting a project alliance for the express purpose of obtaining insurance.} and the perceptions documented in the alliance literature.\footnote{Box, above n 86, 29; Hayford, above n 17, 51; Stephenson, above n 17, [5.3]; Victorian Government, above n 18, 63.}

Also worthy of consideration is the issue of government insuring against the risk of alliance participants becoming insolvent. The author is aware of two alliance projects where an alliance participant became insolvent. It is inconceivable that an administrator of an insolvent alliance participant will adopt ‘best for project’ principles. In such circumstances, governments may wish to protect themselves against such an outcome. Contemporary insurance products for conventional contracts and alliances do not provide protection for this event.\footnote{Davies, above n 94, 8.}
Loss of Incentives

Another cost of doing business with alliances is the risk that non-owner participants will abandon the alliance once all potential incentive payments are lost. The alliance gainshare/painshare arrangements result in a situation where, potentially, a non-owner participant may only recover direct costs and project specific overheads. Should the outcomes of an alliance project drop to such low levels of performance then the non-owner alliance participants have little incentive to achieve project outcomes other than to preserve their reputation (which by this stage would probably be quite tarnished)!

Once a non-owner participant is limited to limb 1 reimbursement (or a value close to it), there is little motivation to achieve key performance areas or deliver future cost savings. As one commentator states:

One of the critical issues uncovered is that contract alliances work well when progress is good. However, when a contract falls behind and any bonuses (or penalties) have been used up, the incentive for a contractor to perform at optimum pace is lost.  

The claimed success of most alliance contracts in Australia suggests that losing incentives is not a great risk to project success. Nevertheless it is foreseeable that should an alliance fail markedly then any anticipated value for money may not result as the non-owner alliance participants are unlikely to pursue ‘breakthrough results’, nor deliver excellence in outcomes. Rather, the non-owner alliance participants will want to complete the project as quickly as possible (at the expense of all non-economic key result areas), so that their resources can be employed on more profitable endeavours.

98 Chew, above n 17, 335.
99 Claims of alliance successes rely on the fact that alliances typically deliver outcomes 5% below the TOC. ‘Success’ is therefore contingent on the difficult task of proving the TOC was a fair estimate to begin with.
Termination for Convenience

Termination for convenience is usually considered a strength of the alliance contract with the alliance owner able to end the contract at any stage (subject to express obligations of good faith). Furthermore, typical alliance contract termination for convenience clauses allow the owner to continue work on the project with other contractors.

Despite the benefits to the owner of such a broad clause, there is a substantial cost associated with invoking termination for convenience. Should the alliance owner elect to terminate the contract then they are typically liable to reimburse the other alliance participants. The following typical alliance provision illustrates the far reaching costs associated with invoking termination for convenience. The costs include:

a. Direct Costs and Gross Margin payable in accordance with the Agreement for the work carried out prior to the date of termination;
b. Reasonable costs of Constructional Plant and Materials justifiably ordered by the Other Participants for the work under the Agreement, which the Other Participants are legally liable to accept, but only if the Materials become the property of the Principal upon payment;
c. Costs reasonably incurred by the Other Participants in the expectation of completing the whole of the work under the Agreement and not included in any payment by the Principal;
d. An amount of 2% of the unpaid portion of the Target Cost;
e. Reasonable and direct costs of demobilisation from the Site, subject to a strict duty on the Other Participants to mitigate costs;
f. Reasonable costs of complying with any directions given by the Principal upon, or subsequent to, termination; and

100 Victorian Government, above n 18, 60; Federal government pure alliance, cl 23; State government pure alliance, cl 21; Cullen above n 41, Section B ‘Conditions of Contract’ cl 22.
101 Ibid.
The reimbursement of all costs incurred up to termination is easy to both quantify and to justify for payment, since alliances use open book reporting. The more subjective aspects, such as ‘reasonable demobilisation’ and other costs ‘reasonably incurred’, will be more difficult to quantify and introduce risks to governments.

Most alliance contracts provide for the alliance board to determine the costs to be awarded post termination. This demands that termination payouts are agreed unanimously between all alliance participants. At this stage, the incentives to maintain positive relationships and operate for the collective good are most likely absent. In this situation, non-owner alliance participants will wish to maximise the termination payout whilst the alliance owner will seek to minimise such payments. While parties would normally be bound by an express provision to negotiate the termination payout in good faith, once the termination notice is served, parties may be absolved from such obligations as the contract is no longer afoot.

Furthermore, the obligation for non-owner participants to continue to provide open book reporting may cease. Government, as the alliance owner participant, requires books to remain open during the termination proceedings, and even afterwards, so that termination sums may be validated. This opportunity could be lost if a termination for convenience notice is served. There is therefore a credible risk that opportunistic behaviour of non-alliance participants might result in inflated termination costs which are difficult for the alliance owner to quantify. As it is the alliance board that determines the termination payout, the risk of deadlocks occurring also increases. Consequently, the unanimity provisions of the alliance agreement may provide a leveraging tool for one of the alliance participants to achieve a commercial objective by thwarting the fair calculation of demobilisation costs.

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102 Cullen above n 41, Section B, ‘Conditions of Contract’ cl 22. See also, Federal government pure alliance, cl 23; State government pure alliance, cl 21.

103 Most alliance contracts incorporate an express provision for parties to operate in good faith, see Chapter two.

104 Chew, above n 17, 328.

105 Stephenson, above n 17,[5.2].
Some conventional contract termination clauses adopt similar wording, such as NSW Government’s GC21 General Conditions of Contract, which allows for payment of the cost of work incurred, the cost of removing temporary works and the costs of materials purchased.\(^\text{106}\) GC21 also includes an imprecise element for reimbursement during termination for convenience as follows:

\[
\text{costs reasonably incurred by the Contractor in the expectation of completing the Works and not included in any other payment by the Principal.}^{107}
\]

Other conventional contracts adopt the calculation of termination sums based on those sums, which would be liable to be paid in the event of contract frustration.\(^\text{108}\) In fixed price arrangements, it is far easier to establish what costs would have been incurred at the point of termination as there is a fixed sum for completing the works with associated schedule payment milestones.\(^\text{109}\) The alliance, on the other hand, only has a target cost for the calculation of termination payouts and this target cost is adjusted by non-economic factors which may be difficult to quantify.

Though alliance open book reporting will facilitate the establishment of costs incurred to the point of termination, estimating demobilisation costs may be more complex in alliances because alliance participants may have sunk considerable cost into developing alliance cultures, with significant training and substantial management involvement. These costs must be considered as part of the cost of demobilisation. No doubt how the cost of training and cultural alignment is amortised over a project will become a subject of debate between alliance participants if termination for convenience is invoked.

\(^{106}\) NSW government, GC21 General Conditions of Contract (July 2003), provides a comprehensive termination for convenience clause, though AS2124, AS4000, AS4300 are silent on termination for convenience. Nevertheless, a termination for convenience clause may be included in the Australian Standard suite of contract formats. Termination for convenience clauses are usually present in federal government contracts. See, eg, Nicholas Seddon, Government Contracts – Federal, State and Local (3rd ed, 2004) 197. Termination for convenience may also be implied in law for government contracts. See, eg, L'Huillier v State of Victoria (1996) 2 VR 465, 465 as per Charles and Callaway JJA ‘…the contract contained a term, implied by law, reserving to the Government the right not to perform the contract if performance would be contrary to the proper exercise of the discretion…’.

\(^{107}\) NSW government, GC21 General Conditions of Contract (July 2003), cl 78.

\(^{108}\) Cullen above n 41, ‘Special Conditions of Contract ’ [13,175]. The payment of sums on contract frustration mirrors that for the GC21 payment for termination on convenience.

\(^{109}\) See, eg, NSW government, GC21 General Conditions of Contract (July 2003), cl 62.
In practice, the alliance owner is only likely to terminate the alliance should one alliance participant become insolvent, or if agreement cannot be reached on the TOC. Termination for convenience may also be used as a deadlock breaking mechanism in extreme cases. If agreement cannot be made on the TOC then termination for convenience will be invoked very early in the project, in which case termination sums would be easy to reconcile as no party has incurred substantial mobilisation costs. In the case of insolvency, termination sums are limited to the remaining non-owner alliance participants.

Termination for convenience offers the alliance owner participant some significant benefits. Conventional contracts provide similar advantages, albeit without an express duty to operate in good faith in the terms of the contract itself.

There is a potential for non-owner alliance participants to behave opportunistically in the process of termination for convenience as it is the alliance board that determines the termination sum. This may manifest itself as a hidden cost to government, which may influence the value for money proposal of alliances. The same criticism may be made of conventional contracts, as a contractor may load their fixed price with a ‘contingency fee’ should termination for convenience occur, though termination for convenience in conventional contracts generally excludes future profits. Consequently, there may be little to differentiate the advantages and disadvantages of alliances and conventional contracts.

As demonstrated above, the hidden costs associated with alliance insurance and termination for convenience are no greater than those costs associated with

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110 Alternately, insolvency may be handled within the default provisions of the alliance, where insolvency is defined as an act of ‘wilful default’. Victorian government, above n 18, 60.
111 Ibid.
112 NSW government, above n 106, cl 78. Termination for convenience may be invoked without the need for the principal to give any reasons.
113 Apple Communications Ltd v Optus Mobile Pty Ltd (2001) NSWSC 635, (BC200104524) Windeyer J held that there is no implied duty of good faith to notify parties of the reasons for invoking termination for convenience [19] nor an obligation to consider that party’s performance when invoking the termination clause [17]. In GEC Marconi Systems Pty Ltd (t/as EASAMS Australia) v BHP Information Technology Pty Ltd, (2003) FCA 50, BC200300200, [753], [920-2], however, Finn J held that termination for convenience must be not be invoked in ‘bad faith’; This is not a settled area of the law. See eg, Kellogg Brown Root Pty Limited v Australian Aerospace Limited (2007) VSC 200 [61,73], where Hansen J states that the issue of an implied term of good faith in the invocation of termination for convenience is an issue that requires further consideration.
114 Seddon, above n 106, 197.
conventional fixed price contracts. By way of contrast, the loss of price competition, loss of incentives, costs of administration, and paying for others mistakes are substantial costs of doing business with alliances when compared to other procurement options.

These costs detract from the claimed superior value of pure alliances. In recognition of this, several alliance practitioners have attempted to eliminate or reduce these costs by deviating from the pure alliance model. The following section explores how modifications have been made to the pure alliance model to address some of the value for money concerns listed above.

**Overcoming Pure Alliance Value for Money Concerns**

The pure alliance is characterised by a contractual model with no liability between alliance participants, selection of alliance participants on primarily non-price criteria, and the use of unanimity for all project decisions.\(^{115}\) Though these features are claimed to deliver superior value, the arguments presented above demonstrate that the costs of these features are high. Consequently, governments have pursued alternate forms of alliance contracts to eliminate many of these disadvantages.

Despite the growth in the use of other alliance models, pure alliances remain the most popular and are adopted at all levels of Australian government.\(^{116}\) In particular, the Victorian Government’s *Project Alliance Practitioners Guide* recommends the use of pure alliances over competitive alliances.\(^{117}\) Even though pure alliances remain popular, significant debate exists on whether these alliances deliver value for money compared to other alliance models. The following section explores some of the arguments for and against the use of pure alliances when compared to these other alliance models.

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\(^{115}\) See chapter 2.

\(^{116}\) See chapter 2.

\(^{117}\) Victorian Government, above n 18, 31.
Alliances and Price Competition

There is no substantial price competition in the selection of alliance participants in a pure alliance. The pure alliance target cost is developed after tender evaluation on a collaborative basis between alliance participants. This introduces the dilemma of how governments can prove that the target outturn cost represents best value for money in the absence of price competition. The lack of price competition is the greatest criticism of the pure alliance model.

Proponents of pure alliances argue that value for money in alliances is demonstrated by the historical achievement of target outturn costs. They assert that alliances have typically delivered outcomes very close to the predetermined target cost. The criticism of this claim is that government is at the mercy of its alliance partners in the development of these cost estimates and such targets become a self fulfilling prophesy. To paraphrase Lord Caldecote ‘[T]he trouble is that they [the participants] mark their own examination papers’.

Australian government procurement philosophies strongly support the concept of using the market to demonstrate and achieve value for money via price competition. ‘…[i]t is noted as a general rule, it is highly difficult to determine if one has achieved “value for money” in the absence of competitive tendering.’ The pure alliance deviates from this principle and many government procurement managers are uncomfortable with the prospect of losing price competition. This concern has led to a deviation from pure alliance principles to an alliance model that introduces price competition.

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118 Some pure alliances consider hourly rates as part of the tender selection process, but the weightings applied to these rates are minimal (see chapter seven).
Delivering Value for Money with Competitive TOC Alliances

A reaction to the challenge of demonstrating value for money in pure alliances has been the evolution of the competitive TOC alliance (or multiple TOC alliance). \(^{122}\) The competitive TOC alliance shares most of the characteristics of the pure alliance; but there is one critical difference. In a competitive TOC alliance, governments select alliance participants primarily on a tendered target cost for the alliance project. This eliminates the subjective assessment process of the pure alliance. Ultimately, the competitive TOC alliance introduces price competition into the alliance.

The competitive TOC process typically involves two short listed alliance participants who independently develop a TOC for the delivery of the project. \(^{123}\) This activity is normally funded by the alliance owner. \(^{124}\) The alliance owner is thus able to select a preferred tenderer based on price competition as well as some of the qualitative selection criteria used for selecting pure alliance partners (for example, past performance, organisational culture, and tender interview responses). The presence of price competition consequently reduces the importance of independent auditors, robust owner estimates, and comparisons with similar projects. Despite these benefits, the competitive TOC alliance will result in sunk costs as government has paid for the TOC development effort of the losing tenderer. The costs of such an endeavour have been claimed to be up to three percent of the total project budget; \(^{125}\) however, typical competitive TOC alliance bid costs are below 1.5 percent. \(^{126}\)

Critics of the competitive alliance model state that such sunk costs actually misrepresent the true cost to governments because, based on the alliance 50:50 gainshare arrangements, the alliance must deliver a saving of six percent below the TOC to recover this maximum three percent sunk cost. \(^{127}\) This is a mischievous criticism of the competitive TOC process, on two levels. First, it ignores the

\(^{122}\) Cowan et al, above n 53, 5; Victorian Government, above n 18, 15.  
\(^{123}\) Cowan et al, above n 53, 5.  
\(^{124}\) Alchimie, above n 60, 10.  
\(^{125}\) Ibid.  
\(^{126}\) For example the Tugun Bypass alliance bid costs were approximately one percent; QLD Government Public Works Committee, ‘The Tugun Bypass Project’ Report 97, (2007), 32. The author’s case study of a competitive TOC alliance also confirms that the tendering costs are between one and 1.5 percent of the project cost for each tenderer.  
\(^{127}\) Alchimie, above n 60, 10.
The pure alliance incurs additional costs in the auditing and validation of the TOC when compared to competitive TOC alliances. None of the competitive alliance critics suggest that pure alliance administrative cost should be doubled in the same manner as competitive TOC sunk costs. It is therefore more appropriate to treat a sunk cost as its true value rather than trying to convert such costs to ‘opportunity costs’, as some commentators attempt to do, and explicitly recognise that pure alliances incur greater administrative costs after tender selection when compared to competitive TOC alliances.

Though the sunk costs of competitive TOC alliances are significant, these costs may be recouped. As governments pay for the development of the TOC, all foreground intellectual property of the losing tenderer’s design may be exploited to refine and amend the winning alliance tenderer’s design. During my case study of a competitive TOC alliance, the government tender evaluation team stated that there were substantial savings realised from the exploitation of the losing tenderer’s design efforts. A recent audit of a competitive TOC alliance also demonstrates that the losing tenderer’s design led to savings that exceeded the tenderer’s development costs (sunk cost paid by government) by $3 million. In several areas, the alliance literature has therefore substantially overestimated the sunk costs of competitive TOC alliances and under reported their benefits.

In addition to pricing issues, there are substantial differences in the qualitative benefits and costs of competitive TOC alliances. The competitive TOC alliance model is subject to great criticism as such a model may diminish the alliance culture of collaboration, reduce innovation during construction and increase the project cost.

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128 Conversely, government must increase resources to manage the two bidding teams during the competitive process.
131 Ross, above n 18, 19; Alchimie, above n 60, 9-10.
duration (since the competitive TOC alliance increases the time taken to complete tender evaluations) when compared to pure alliances.¹³³

Despite these disadvantages there are several qualitative benefits of competitive TOC alliances. The competitive TOC model allows the owner to see each tenderer operate ‘in action’ so that a more robust assessment can be made of the capabilities of each tenderer before selection. One respondent to my interviews recognised the importance of viewing the alliance tenderers in the tender evaluation phase as follows:

With a competitive alliance we spent most of our time with the engineers and managers rather that with the marketing personnel of the company as we would have done in a pure alliance.¹³⁴

The competitive TOC alliance also satisfies the political imperative of setting the project cost in an arms-length environment, thus absolving governments from the challenge of demonstrating that the TOC is a fair estimate of the project value. The competitive TOC alliance model may also reduce the risk of a challenge from losing tenderers to the alliance selection process (see Chapter seven). With greater reliance upon quantitative selection criteria, governments will be better able to demonstrate fairness in the tender selection process when compared to the mainly qualitative pure alliance selection process. This will also facilitate alignment to the Australia/US Free Trade Agreement principles. In particular, competitive TOC alliances place substantial emphasis on past performance and this emphasis is more complaint to Article 15.7 of the Australia/US Free Trade Agreement, which states that parties may not:

impose the condition that, in order for a supplier to participate in a procurement, the supplier has previously been awarded one or more contracts by a procuring entity

Government, above n18, App 3 which states that competitive TOC alliances are more likely to promote innovative solutions earlier so that the TOC may be driven as competitively low as possible.¹³³ See, eg, Ross, above n 18, 19; Alchimie, above n 60, 9-10; Contra, Mike Montefiore ‘The Burnett Dam Alliance’ (paper presented at the International Quality and Productivity Center Conference, Sydney, 2005), who argues that pure alliances may introduce conflict in the TOC negotiation phase as price tension is between owner and non-owners, whereas in a competitive alliance, price tension is between industry participants.

¹³³ Interviewee A.
of that Party or that the supplier has prior work experience in the territory of that Party.\textsuperscript{135}

Similarly, Competitive TOC alliances are more amenable to Australia/US Free Trade Agreement Article 15.9, treatment of tenders and awarding of contracts, which demands ‘procedures that guarantee the fairness and impartiality of the procurement process.’\textsuperscript{136}

The introduction of price competition clearly overcomes many of the pure alliance disadvantages. How, then, do procurement managers perceive the benefits and cost of pure and competitive TOC alliance?

\textit{Comparison of Competitive Alliances and Pure Alliances}

Both pure and competitive TOC alliances are used extensively by Australian governments. Which alliance, then, offers the best value? The answer to this question is difficult to resolve since value is a subjective term and governments apply inconsistent weightings to procurement option selection. The following section explores how various stakeholders perceive value and attempt to justify their procurement options.

Pure alliances were employed by the public sector in Australia two years prior to the use of the first government competitive TOC alliance. Unsurprisingly, the number of pure alliances used by Australian government is larger than the use of competitive TOC alliances. My demographic analysis of alliances reveals a total of 34 pure alliances used by governments compared to 14 competitive TOC alliances.\textsuperscript{137} My interviews confirmed that most alliance respondents were content with their form of alliance contract, be it pure or competitive TOC.\textsuperscript{138} There is no evidence to suggest

\textsuperscript{135} Australia/US Free Trade Agreement 15.7.2(b).
\textsuperscript{136} Ibid, 15.9.1.
\textsuperscript{137} John Davies, ‘Alliance Demographics’ (2007)
\textsuperscript{138} Only two respondents stated that they would use an alternative alliance model. One respondent stated that they would reject a pure alliance in lieu of a competitive TOC alliance, whilst the second
that there is a likely to prefer either pure or competitive alliances. What my interviews and surveys did reveal is that for pure alliances, participants were far more concerned with the challenge of demonstrating value for money compared with competitive TOC alliances.

Though pure alliances introduce challenges in demonstrating value for money, it is claimed that the pure alliance framework offers benefits that are absent in competitive TOC arrangements. The literature claims that pure alliances provide the best means of developing positive alliance behaviours, avoiding adversarial behaviour in the bidding process, offering shared ownership of the TOC with the alliance owner, and reducing tendering costs. All interviewees recognised the value provided from at least one of these benefits.

During my interviews and case studies, a further reason emerged for using pure alliances instead of competitive TOC alliances. Industry is more likely to bid on a pure alliance than a competitive TOC alliance. The pure alliance is therefore more likely to be used as a tool to capture industry participation rather than for the benefits of this procurement option claimed by the literature. A leading facilitator of alliance contracts, Project Control International (PCI), recognises the danger of this approach:

A recent trend observed by PCI is increased interest in alliancing as a means of attracting industry participation at a time when resources are in very high demand. Whilst there may be some merit in logic to this approach, PCI believes that this alone is not sufficient reason to use an alliance and may even increase the risk of using an alliance!

Pure alliances thus offer the claimed benefits of improved innovation, collaboration, reduced tender costs and increased likelihood of capturing industry participation. How, then, do alliance managers consider the benefits and costs of competitive TOC alliances?

respondent stated the opposite, ie. they would prefer a pure alliance in lieu of a competitive TOC alliance.

Victorian Government, above n 18 , App 3; Ross, above n 18 , 19.


My interviews explored some of the costs of competitive alliances and in particular the sunk costs associated with funding multiple bids. No competitive alliance participants identified funding bids as a problem. Rather, alliance managers acknowledged these sunk costs as an investment cost, as the losing bidder’s design effort was typically reused to some extent by the winning tenderer. Alliance managers involved in competitive TOC alliances also rejected the claims that competitive TOC alliances risk the loss of collaboration and innovation. The major criticism made of competitive TOC alliances was the excessive effort required of governments to conduct tender evaluations. This was because governments had to provide staff within two design teams rather than just the one associated with a pure alliance.

Interviewee findings therefore neither confirm nor reject the proposition that pure alliances are superior to competitive TOC alliances, or vice versa. What interviews did confirm is that pure alliances are more attractive to industry, but that these alliances are less likely to demonstrate value for money. This latter shortcoming of the pure alliance has led to the development of a program of alliances.

**Programs of alliances**

Competitive TOC alliances offer the advantage of demonstrating value for money far better than a pure alliance. Recent initiatives have been introduced by governments to improve the demonstration of value for money in a pure alliance. This has resulted in the development of a program of alliances.

A program of alliances involves breaking down a major project into separate parts. Each part is treated as a separate project. In a program of alliances, alliance participants are selected via the pure alliance selection process. Hence, for the first stage of the alliance, there are no market forces demonstrating that the price is right.

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142 Of the 12 pure alliance interviewees, only one stated that they would prefer to use a competitive TOC alliance in the future. Of the 11 competitive TOC alliance interviewees, only one stated that they would prefer to use a pure alliance in the future.
The novel concept of the program of alliances is that the second stage of the project uses the *actual outturn cost* of the first stage of the project as the target costs for the second stage and so on. This effectively ‘bootstrap’ the alliance target cost between project stages. In this arrangement the first alliance project may not adequately demonstrate value for money; rather, it is the subsequent alliance projects in the program that provide greater certainty that the target cost is set fairly. My case study on the Barklay Highway program alliance demonstrates the effectiveness of this approach.143 This alliance program involved three separate projects and the actual outturn costs for specific activities (earthworks, subgrade preparation, and gravel production) were used as the target costs for subsequent phases.

Based on alliance interview responses and case studies, I am unable to state whether the pure or competitive alliances offer best value for money simply because value cannot be consistently defined. Competitive TOC alliances certainly provide a better way of offering a benchmark for establishing value for money – by using the ‘market price’ for establishing value, consistent with government’s goal of pursuing price competition,144 but whether this translates to actually delivering value for money remains a separate question. There is no objective test to establish whether a pure alliance or conventional fixed price contract could have delivered the same outcomes faster and cheaper.

As I previously demonstrate, value for money is a nebulous concept. It can be manipulated to support the selection of any procurement option. For example, a government organisation can successfully argue that value for money is primarily delivered by facilitating a rapid tender selection process, reducing disputes, aligning goals, catering for complex stakeholder issues, sharing risks, and providing open book costing information. In this case, the pure alliance is the obvious choice for progressing a project. That same government organisation, though, could also argue that value for money is defined as pursuing open and fair competition, and the elimination of the need for complex external auditing and validation. The adoption of this approach would most likely result in the selection of a competitive TOC alliance.

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144 See, eg, Commonwealth Procurement Guidelines above n 2, 4.2.
or even a fixed price contract. Both arguments are defensible from criticism, as there appears to be little science, in the author’s opinion, in government decision-making. I therefore conclude that it is a fool’s errand to argue that the pure alliance delivers better value for money than a competitive TOC alliance or vice versa.

**Conventional Contracts and Value For Money**

Whether alliances deliver value for money or otherwise is also contingent on whether other contracting methods are more capable of delivering value for money. To summarise, alliances are expected to deliver better value when collaboration is needed between government and industry, complex stakeholder interactions are envisaged, where there is a need to foster innovation, where risk sharing is required, and where a culture of ‘no disputes’ is warranted. Unfortunately, projects are unlikely to lie on either end of the spectrum for either needing an alliance or a conventional fixed price contract; rather, projects will comprise some elements that are suited to alliance arrangements with others more appropriately managed with conventional contracts. The NSW Government’s *Procurement Methodology Guidelines for Construction* attempts to facilitate the selection of the best procurement method (and hence value for money) by providing a checklist of project characteristics that can be scored each for alliancing, design and construct, managing contract formats etc. It is left to the discretion of individuals to weight each criterion and this adds substantial subjectivity to the procurement option selection process.

Consequently, the selection of alliancing or conventional contracting options is subject to manipulation of weightings in which any outcome can be determined *a priori* and be ‘proven’ to deliver best value for money. Similar to my arguments about the relative merits of pure and competitive TOC alliances, the intangible definitions of value for money provide a difficult environment to support the selection or otherwise of alliancing since other contracting methods (for example, schedule of rates contracts) could provide equal value.

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Furthermore, the hidden costs of alliances exacerbate the difficulty in making value for money assessments. Uncertainty in value measurement is also introduced when government’s political and social objectives influence decision makers. Given any set of circumstances, it is difficult to argue that an alliance provides better value for money over a fixed price contract, or vice versa. Just because an alliance delivers claimed superior outcomes does not imply that those claimed outcomes could not have been achieved with a well managed fixed price contract.

It is not possible to conduct a controlled experiment in which the same project is performed with both an alliance and fixed price contract so that the value of each can be compared; rather, the best governments can achieve is the identification of risk and known project circumstances and the selection of a procurement option that best fits that government’s risk profile. This process will be subjective and only be capable of facilitating the demonstration of value for money at the time of procurement option selection. It may transpire at the completion of the project, after new risks have eventuated, that whilst the contracting method selected was originally most likely to deliver value for money it did not actually do so at project completion.

**Perceived success as evidence of Value for Money?**

A final consideration of the value for money conundrum associated with alliances is the fact that alliances are claimed to be very successful. Alliance protagonists state that alliances deliver outcomes very close to target costs, deliver projects on time, and to superior quality. The argument here is that it is the alliance that delivers these benefits, and these benefits cannot be achieved with conventional fixed price contracts. There is a causation fallacy associated with this argument.

Alliance proponents cite overwhelming evidence suggesting that alliances deliver superior outcomes. These claims cannot be substantiated because ‘superiority’ is defined by the alliance itself, through the TOC. Furthermore, the success factors of

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alliance projects are unlikely to be related to the form of contract at all. For example, the claimed success of alliancing may be a result of the quality of the team placed on that project coupled with the extensive management oversight attendant with alliances and the high profile projects associated with these contracts. Thus a project may be a ‘success’ not because it was an alliance, but because it had good people undertaking the project. The skills of personnel applied to a project will clearly influence outcomes, since ‘the most skilfully drafted contract and the most sophisticated pain/gain framework will not lift an ordinary team to outstanding results’.

Alliances typically rely on the use of ‘A-teams’ where the best and brightest are applied to a project. Success in an alliance is therefore highly likely. Stephenson acknowledges this by identifying examples where extreme risks of a negative type have been allocated to contractors with resounding success whilst, by way of contrast, there are numerous examples of equitable risk sharing ‘alliance’ contracts that have been failures. Stephenson further argues that the ‘defining element’ of project success is most likely the management skills employed rather than the legal structure of the contract. The following response from my interviews reinforces this point:

alliances will succeed with good people but same is true of any contract
…Government tend to put whoever is available onto the alliance and this is a big risk to alliance performance.

Consequently, the success of pure alliances is likely a result of the high calibre candidates employed in such arrangements.

A further fallacy associated with the claimed success of alliances is in ignoring the reasons why conventional fixed prices contracts fail. As demonstrated in Chapter two, conventional contracts tend to fail because of poor contract documentation and inappropriate risk allocation. The success of alliances is not so much a result of the

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147 My interviews revealed that the governments recognised the non-owner alliance teams to be the ‘A-teams’ of industry, which is the best available team.
149 Stephenson, above n 17, [5.1].
150 Ibid.
151 Interviewee F.
form of the contract but rather the process used to identify risk and develop project costs. In conventional fixed price contracts, tenderers are provided with little, if any, resources to develop bids and are often afforded little time to develop these bids. By way of contrast, in a pure alliance, the successful tenderer gets to develop the TOC and project schedule in as much time as they wish and this activity is funded by the principal. It should be no surprise, then, that this process results in an achievable target cost for the project compared to procurement options that provide insufficient time and money for contractors to develop their bids.

**Conclusion**

Value for money is a key component of public sector governance common to all levels of government. Nevertheless, the nebulous definitions of ‘value’ and the inconsistent methods by which value is measured makes any value comparison between procurement options difficult. Thus, whilst the debate between the relative merits of competitive TOC alliances, pure alliances, and conventional contracts rages on, the wily procurement manager can simply adopt selection criteria that justify any decision they make. Furthermore, independent of the selection criteria used, the same decision maker can adopt expected value, least regret, or minimax decision-making rules to justify whatever outcome they wish. Consequently, value for money decisions are very easily manipulated and any final decision can be justified without criticism.

Even if value can be clearly defined and measured, the proponent of pure alliances has a more difficult task in demonstrating that value is being delivered as there are no competitive tensions proving that the ‘price is right’. Competitive TOC alliances address this shortcoming but these same competitive tensions may dilute the value of alliance collaboration and such strategies may be unsuited to regional projects with limited competition. The use of programs of alliances mitigates these concerns, albeit not all projects may be suitable for delivery under an alliance program structure.
Whilst the NSW government has adopted selection guides for various procurement options,\textsuperscript{152} other state governments, the federal government, and local governments do not appear to apply consistent principles for procurement option selection. There is no guidance provided by any Australian government on how to treat the hidden costs and benefits of alliances discussed in this chapter, nor on what risk profiles should be selected in procurement option selection. To improve the integrity of government decision-making in procurement option selection, a robust and repeatable process is required to ensure; risk is treated consistently and transparently and all project costs and benefits are considered.\textsuperscript{153}

Demonstration of value for money with a repeatable and reproducible framework also supports fairness in the tender selection process. As we shall see in the next chapter, the pure alliance is less likely to support this objective in tender evaluations.

\textsuperscript{152} NSW Government, above n 29.
Chapter Seven - Alliances and the Tender Selection Process

‘Politics is not the art of the possible. It consists in choosing between the disastrous and the unpalatable.’
- John Kenneth Galbraith

Introduction

So far this study has explored the governance arrangements for alliances and how alliances are less likely to meet the objectives of accountability, integrity, transparency, and value for money. This chapter continues upon this theme by exploring the process governments use to select alliance participants during tender evaluations.

While governments may overcome the significant hurdles in demonstrating that the alliance is the most appropriate procurement option for a given set of circumstances, a subsequent challenge is to demonstrate that government’s preferred alliance tenderer is the right team for the job, and can deliver better value for money than the losing tenderers. This is a formidable problem with a pure alliance, because in this alliance model there are no tendered schedules or project costs used to select tenderers. How, then, do governments satisfy themselves that they have picked the right alliance team in the absence of price competition?

To address this question, this chapter first defines the objectives of the tender selection process and the tender evaluation rules applicable to federal, state, and local governments. This includes the relevant procurement legislation and policy as well as court developed principles relevant to tendering.

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Chapter Seven - Alliances and the Tender Selection Process

With the tendering environment defined, this chapter examines the tender processes used for pure and competitive alliances, based on the alliance literature, and the findings from my case studies and interviews. A comparison can then be made between the tender selection features of conventional fixed price contracts and alliances. This comparison reveals that alliances create tender selection problems in several areas. First, pure alliances place significant emphasis upon subjective assessment criteria in tender selections. This compromises governments’ objectives of providing repeatability and reproducibility in tender selections. Second, alliances (both pure and competitive) require significant resources from governments in the tender selection process. Third, pure alliance tender selections, by virtue of their emphasis on non-price selection criteria, increase the risk of challenges from losing tenderers. Fourth, pure alliance tender representations provide no information whatsoever as to what the project will cost or how long it will take to deliver.

This chapter concludes that governments will face difficulty when adopting pure alliance tender selection processes, because it is exceptionally difficult to demonstrate fairness in such arrangements and there is substantial reliance on the integrity of tenderers to achieve value for money. To phrase this less charitably, the tendering process of pure alliances significantly increases the likelihood and consequences of tenderers lying.

**The Aims of Tendering**

The aims of a government tender selection process are twofold. First, governments aim to solicit goods or services that represent and deliver best value for money. Second, governments must promote fairness and access to contractors in a free market. The former objective of delivering value for money not only requires

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4 Pure alliances also place greater reliance on the integrity of government officials. Alliance thus may increase the likelihood of corruption. A response to this is the significant emphasis placed on probity audits in alliances (see chapter six).  
5 Nicholas Seddon, *Government Contracts – Federal, State and Local* (3rd ed, 2004) 256. This second objective of tendering also has implications for delivering value for money. Only by promoting open and fair competition can government expect to receive competitive quotations. If the tendering process
governments to obtain detailed quotations, but also to ensure the tender process itself uses minimal resources and is completed as quickly as practical. This immediately generates conflicting requirements. Detailed quotations require governments to obtain as much information about tenderers as possible. This minimises uncertainty and consequently maximises the likelihood of delivering superior value. Obtaining detailed information about tenderers, though, comes with a schedule and cost penalty to the project. Delivering value therefore creates tensions between maximising tenderer information and minimising tender costs and schedules. The following examples illustrate these tensions by analysing the two objectives.

To maximise the receipt of detailed information from tenderers, governments may issue an unrestricted expression of interest to gauge market capabilities for the delivery of a project. Following this, governments may short-list two or three tenderers and provide funding for each tenderer to produce a concept design for the proposed project. Tenderers subsequently deliver their concept designs with a fixed price and delivery schedule which governments use to discriminate between tenderers. This process provides government with considerable information of tenderer capabilities and certainty on the outcomes of the project. Despite these benefits, there is the substantial cost of increased tender evaluation duration and the associated administrative cost of tendering itself. This tendering process also places substantial demands on industry to prepare detailed tender responses with no guarantee that they will win the tender.

A contrasting tendering philosophy may require governments to avoid detailed information and certainty by adopting a quick and cheap tender evaluation. In this instance, governments may issue a restricted tender and conduct a tender evaluation against non-price criteria such as tenderer capabilities, company culture, and past performance. This is a relatively fast process and involves minimal resources from...
industry. Unfortunately, such a process does not provide substantial information against which governments can base meaningful decisions. In particular, the project delivery price and schedule only becomes apparent after tender selection. Furthermore, this tender process places substantial reliance on tenderer representations and not the guarantees associated with the tender selection process described previously.

The availability and capabilities of industry also need to be considered when selecting tendering options. Minimising the resources used in tendering is a substantial concern in the current Australian construction and engineering market where there is a substantial undersupply of contractors (see Chapter two). The increasing size of government contracts, both in number and value, is also placing pressures on industry. There is consequently a requirement for reducing efforts in tendering so that scarce resources can be applied to actually delivering projects. Tendering costs and the subsequent impacts on industry are therefore a significant consideration when governments select procurement options.

Other than delivering best value for money, the second objective of tendering is to ensure that the tender process itself is fair and eschews anti-competitive behaviour. This is becoming increasingly important with the rising value and number of government contracts. Government tenders must satisfy the supplier community that government’s procurement policies are impartial. Furthermore, governments must demonstrate the effective use of public funds to all government stakeholders, especially tax payers. As demonstrated later in this chapter, pure alliance tenders are less likely to demonstrate fairness in tender selections when compared to conventional

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9 The guarantees of fixed price contracts manifest themselves in the forms of fixed contract values, warranties, and liquidated damages
10 See especially, the Construction Forecasting Council’s projections <http://www.cfc.acif.com.au>; Chapter two.
11 See especially, Norm Augustine, *Augustine’s Laws* (6th ed, 1997) law xxxvi, ‘The thickness of the proposal required to win a multimillion dollar contract is about one millimetre per million dollars’.
fixed price contracts. The following section explores the tendering rules applied to governments and how these rules represent the overarching tendering objectives discussed above.

**The Tender Selection Environment and Rules**

Government tender selection processes are functions influenced by public policy, legislation, and the common law. There are express limits on what governments can and cannot do during tender evaluations. There are also more subtle influences on the process, driven by public policy objectives. This tendering environment and rules apply equally to alliances and conventional contracts. What this study reveals is that there is far greater scope for inappropriate political interference in pure alliance tender evaluations, because alliance contracts rely on more subjective selection criteria than is the case with conventional fixed price contracts.

The following section examines this tendering environment for governments by exploring how public policy objectives manifest themselves in tender selection criteria, what the scope is for inappropriate political interference in tender evaluations, what legislation and regulations apply to tendering, and how the courts have dealt with the government tendering processes. By defining this environment, it is shown that while pure alliances generally comply with many of the express rules governing tender selections, they are less likely to satisfy the tendering goals of demonstrating fairness and value for money.

**Tendering and Public Policy Objectives**

The inclusion of public policy objectives in tender selection criteria exacerbates the challenge of measuring *value* in tender evaluations. Quite often, tender selection criteria encompass objectives that are not directly related to project delivery; rather, they are included to promote broader government objectives such as local industry involvement or improved Indigenous employment. Since there is no consideration of price or schedule in pure alliance tender evaluations, there is likely to be greater reliance of these public policy objectives when compared to conventional fixed price
contracts. What, then, is the scope for abusing public policy selection criteria to influence tender outcomes?

Public policy objectives often appear in government request for tender selection criteria. Typically, selection criteria are included to promote the regulation of industry, prohibit monopolies, and encourage competition.\(^{14}\) For example, governments may adopt rules to prevent one market participant from gaining too many contracts.\(^{15}\) Conversely, governments may encourage industry consolidation or the creation of oligopolies for strategic purposes.\(^{16}\) Government’s commitment to the support of small to medium enterprises is also reflected in tendering policies. For example, some governments require head contractors to award a set amount of project work to smaller sub-contractors.\(^{17}\)

In addition to promoting competition in tendering, government request for tenders often include selection criteria based on social objectives. These typically include improving indigenous employment,\(^{18}\) environmental objectives,\(^{19}\) and community

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\(^{15}\) This is not only for discouraging monopolies but also ensuring one contractor does not over extend itself in the market, thus compromising its ability to deliver value to governments; See also, National Competition Council, ‘Compendium of National Competition Policy Agreements’ (1998) <http://www.ncc.gov.au/pdf/PIAg-001.pdf> at 8 June 2008 which incorporates several principles binding the Commonwealth, States and Territories in matters relating to competitive neutrality and public monopolies.

\(^{16}\) The implementation of Industry Sector Plans is an example of this. See, eg, Australian Government, Department of Defence ‘Naval Ship Building and Repair Sector Plan’ (2002) section xv, which calls for sole source contracting using alliancing; see also Australian Government, Department of Defence, ‘Australian Defence Aerospace Sector Strategic Plan’ (2003) 7, which calls for the consolidation of the aerospace industry into a small number of large prime contractors supported by small to medium enterprises. Nevertheless, strategic sector plans calling for consolidation are rare and are limited to niche industries where governments have a captive market, such as the defence and security industries.


service obligations. These objectives may appear as specific tender selection criteria, as a minimum requirement to be deemed successful (a go/no-go criterion), or may yield a score to compare against competing tenderers.

These public policy selection criteria apply equally to conventional contracts and alliances, but the absence of price competition in pure alliances places greater emphasis on these non-price tender selection criteria. Consequently, there is a greater likelihood that governments will use public policy objectives as a means to discriminate between tenderers in a pure alliance. This increases the scope for inappropriate political interference, but raises the question: what is the likelihood that governments will actually exercise inappropriate interference in tender selections?

**Political Impartiality in Tendering**

Pure alliances place substantial emphasis on more subjective tender selection criteria than is the case with fixed price contracts. As argued above, this increases the scope for political interference in alliance tender selections. How likely is this?

Governments must demonstrate that they are impartial in tendering and treat all tenderers fairly. Finn observes that:

> Government are sensitive to the need to demonstrate the integrity of the process of public administration and the impartiality of officers and agencies of government.\(^\text{21}\)

What then do we mean by fairness and impartiality? Just how far can governments go to pursue their own political agendas (such as election promises) above the delivery of value for money? The following section describes what standards the courts have set with respect to government decision-making and electoral favouritism. This provides useful insight into how far elected officials can meddle in the affairs of tendering.

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The spectre of pork barrelling\(^\text{22}\) has the potential to tarnish the integrity of the tendering process. Pork barrelling in itself is not proscribed, as recognised in Randwick City Council and Another v Minister for the Environment and Another, with Finn J’s observation of a ministerial decision allegedly favouring that minister’s electorate:

> The system of representative democracy practised in this country and the discipline exacted by political parties have given party policy a central place in our elections and in the consequential actions to be expected of elected governments… The use of the “pork barrel” in election promises has been with us since the colonial period.\(^\text{23}\)

The distinction between pork barrelling (which is lawful) and bribery (which is unlawful) is made in The Matter of an Application by Bailey for an Inquiry Relating to Elections for Offices in the Transport Workers Union of Australia, where Gray J observes:

> It is not uncommon for elected officials to make decisions which benefit their constituents, in the hope that by doing so they will become more popular and hence more likely to be re-elected. Indeed, it could be said that such a process is fundamental to most systems of representative democracy. However cynically a disgruntled voter might regard such "pork-barrelling", it must be distinguished from bribery by the absence of any overt appeal for the casting of a vote in a particular way as a quid pro quo for the conferral of the benefit.\(^\text{24}\)

Since pork barrelling is not proscribed, what is the likelihood of pork barrelling interfering in tender evaluations?

The extent of political interference, such as pork-barrelling, tarnishing the outcomes of a tender evaluation is arguably reduced with strong and centralised party systems,

\(^{22}\) ‘Pork barrel politics is a particular type of constituency service through which a legislator’s geographic constituency benefits from the distribution of public works projects.’ Thomas Lancaster, ‘Electoral Structures and Pork Barrel Politics’ (1986) 7 International Political Science Review, 67.


\(^{24}\) (1997) 79 IR 1, 3; see also, Scott v Martin (1988) 14 NSWLR 663, 673.
such as is the case in Australia, because the incumbent government manages the spending of public funds collectively. Furthermore, individual candidates are prohibited from making specific electoral promises. Only portfolio ministers or leadership teams announce policy. This arguably reduces the likelihood of political meddling in tender evaluations.

Nevertheless, whilst some government practices reduce the likelihood of pork barrelling, it has been the subject of one state government audit report and one commentator has constructed a regular column labelled 'pork watch' which provides a vignette of Australian government subsidies and grants claimed by the author to represent examples of ‘politically opportunistic rent creation.’ Several studies also provide compelling evidence that pork barrelling is rife within the federal government. This suggests that governments cannot eliminate the spectre of pork barrelling occurring nor eliminate criticisms that they have engaged in such practices.

For example, the Airwarfare Destroyer alliance tender selection comprised selecting alliance participants on a competitive TOC basis. The two tenderers for the ship building component, worth many billions of dollars, were based in South Australia and Victoria respectively. Both state governments provided considerable support to their tenderers as a means to capture employment benefits for their electorates. The winning tenderer was from South Australia. Unsurprisingly, the Victorian government accused the federal government of pursuing pork barrelling in this tender, in the words of the member for Chelsea (Robert Smith):


26 Orr, above n 25, 238.

27 Ibid.


The feds [sic] were looking after their mates in South Australia who were just desperate for some major industry, given Mitsubishi was all but ready to fold.  

No doubt the converse arguments would have been forwarded if the South Australian tenderer had lost the bid for this high value project.

Though tender evaluations may incorporate political imperatives, there is a limit to the scope of inappropriate interference by individual ministers. The courts, for example, will look unfavourably upon directions provided from ministers to tender evaluation teams. In *Hughes Aircraft Systems International v Airservices Australia*, Finn J was critical of the communications from ministers to the tender evaluation team. These communications were described as ‘palpable and colourable’ and ‘highly imprudent’. Despite these observations, in this case Finn J held that there was insufficient evidence that the ministers’ intervention resulted in a breach of the tender evaluation process. Nevertheless, ministerial directions can result in a breach of a tender process contract, as observed by Finn J:

> Where a ministerial communication could, because of its tenor or context, reasonably be interpreted by those to whom it is made either as being akin to a direction (whether or not it formally disclaims such an intent) or as manifesting an intent to contrive a decision to be taken, it properly can be regarded as offending the purposes (constitutional and statutory) which inform the legislative creation of bodies whose decisions are intended by parliament to be freed from ministerial control …

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33 Ibid 76.

34 Ibid 75.

35 Ibid. 75.
Whilst blatant political interference is eschewed, there is recognition that ‘[t]he tender process is also the area that offers the greatest temptation to meddle’.\textsuperscript{36} This temptation for interfering increases when the tender process relies on more subjective selection criteria with an absence of price competition, as is the case with the pure alliance contract.

Despite the increased likelihood of political interference in pure alliance tender selections, there is little evidence to suggest that such interference occurs. In my interviews with over 25 alliance managers, spanning over 40 alliance contracts, I asked whether the selection of alliancing as a procurement option was driven by government policy or executive direction. Associated with this question were questions whether there were any influences in the tender evaluation by politicians. No alliance participant identified political interference in the tender evaluation process. One respondent stated that ‘the political hierarchy did not care how we delivered the project. The only stumbling block we had was proving to treasury that we were delivering value for money.’\textsuperscript{37} Another interviewee stated that:

The politicians didn’t care how we managed the alliance. The only thing they were concerned about and became actively involved in was the selection of the name for our alliance.\textsuperscript{38}

My case studies also confirmed the position that state and local governments adopt a ‘hands off’ approach to tender evaluations and procurement option selection.

The incorporation of the lessons learnt from the \textit{Hughes Aircraft} decision and other relevant cases into government procurement policies\textsuperscript{39} has likely curtailed political interference in government contracts. Though alliances increase the risk of political interference in tender selection, there is currently no evidence suggesting that the

\textsuperscript{36}\text{Senate Standing Committee on Finance and Public Administration, ‘Contracting Out of Government Service’, 2\textsuperscript{nd} Report (1998) ch 2.}
\textsuperscript{37}\text{Interviewee C.}
\textsuperscript{38}\text{Interviewee I.}
vulnerabilities of the pure alliance tender selection process are being exploited for political ends.\textsuperscript{40} Furthermore, as the following section demonstrates, legislation and policy place constraints on the scope of such interference. Abuse of the tender process is also discouraged with the significant emphasis placed on probity advisers in pure alliances.

\textit{Legislation and Government Policy}

As argued above, there is scope for inappropriate political interference in tender selection processes, and pure alliances increase the likelihood of such interference. Nevertheless, the scope for such interference is limited by legislation, regulations, and policy. Legislation and associated regulations provide prescriptive and proscriptive rules governing the tender evaluation process.\textsuperscript{41} In most instances, these legislative imposts dictate when compulsory competitive tendering must be pursued, how conflicts of interest are to be managed, and who has power to enter into contracts. What, then, are the consequences of these rules on alliance tender evaluations?

The state and federal government legislation provides broad rules governing contracting and tendering powers,\textsuperscript{42} It is only when examining government policy and guidelines that the specific rules of tendering become clear.\textsuperscript{43}

\textsuperscript{40} Claims of political interference have been levied on the Air Warfare destroyer alliance, see eg. Parliament of Victoria, ‘Parliamentary Debates (Hansard), 55\textsuperscript{th} Parliament First session’ (10 August 2005) at 96-101 at http://www.parliament.vic.gov.au/downloadhansard/. These claims are made by a losing state government against the federal government and are therefore tainted by politicisation themselves.


\textsuperscript{42} The opposite is true in the European Union. In this jurisdiction, legislation explicitly governs the rules by which contracts are let and tender evaluations are conducted. See, eg. Statutory Instrument 21.0 Public Procurement, \textit{The Public Supply Contracts Regulations 1995} (UK), Pt III Procedures leading to the Award of a Public Supply Contract and Pt IV Selection of Suppliers (this reflects European Parliament and Council Directive 97/52/EC of 13 October 1997); Anne Davies, Accountability: A Public Law Analysis of Government by Contract (2001) 2.

\textsuperscript{43} The converse is true for local governments where ordinances and regulations provide prescriptive tendering rules See eg, \textit{Local Government (General) Regulation 2005} (NSW) Pt 7; City of Brisbane
Australian procurement guidelines and policy documents applicable to the tendering process at federal, state, and local government level are numerous. These government tendering rules are specific and outline the general principles promoting open and fair competition. Ethical behaviour is also required in tendering, reflected in uniform tendering codes such as the Australian Standard Code of Tendering. Not only does this standard provide guidance on how government should conduct itself during tendering, but also who government should deal with in invitations to tender (for example, avoiding tenderers who engage in collusion).

Australian government tendering policy also prescribes how tenders are invited. For example, some policy requires that requests for tenders be issued through newspaper advertising. Only in extreme circumstances can government engage in direct negotiations with a single supplier, for example, where unique intellectual property is owned by one industry participant and where competition is constrained.

The tender selection process is also regulated. Common to all tendering policies in Australia is the requirement to maintain a tender evaluation plan with predefined tender evaluation criteria. The NSW Government, Tendering Guidelines provides the following useful tendering principles:

Ordinances, Ch 2 (enforceable through City of Brisbane Act 1924 (QLD)); Failure to comply with these local government ordinances and regulations can result in a successful legal challenge by losing tenderers See eg Hunter Brothers v Brisbane City Council [1984] 1 Qd R 328.


Tender Support Services ‘Selling to Government’ in Maddock Lonie and Chisholm Lawyers (eds) Solving the Tender Puzzle (1997) 27.


a. Accountability and transparency. The process will be open, clear, and defensible.

b. Fairness. Equal opportunities are provided for all tenderers in the process.

c. Impartiality. The process treats all tenderers the same way and without bias.

d. Objectivity. Subjective judgement and opinion not based on objective evidence is minimised in decisions.

e. Repeatability. Repeated evaluation of the same tender against the same criteria by the same evaluation team will yield the same decisions.

f. Reproducibility. Evaluation of the same tender against the same criteria by a different evaluation team will yield the same decisions.

g. Reasonableness. Decisions are based on the information reasonably known by the evaluation team and are supported by rational and logical argument.

h. Thoroughness. Decisions are based on competent and comprehensive analysis of all relevant information.\(^{48}\)

As well as encompassing several of the more general governance objectives discussed in Chapter four, these rules also incorporate principles of ‘fairness’ and the promotion of natural justice in tender evaluations. Of relevance to pure alliance tender selections is the emphasis made on repeatability and reproducibility. This implies a focus on objective selection criteria, which becomes problematic for pure alliances because pure alliances do not use quantitative values, such as fixed prices, to select tenderers.

Other state and federal level tender evaluation guidance includes the need for impartiality, openness, and fairness,\(^{49}\) but these other documents do not emphasise the importance of objectivity, repeatability or reproducibility as the NSW guide does. Arguably these criteria are ‘derived’ requirements from the ‘fairness’ and ‘impartiality’ objectives, though no other government goes as far as the NSW government to recognise these as unique tender evaluation objectives.\(^{50}\)


\(^{50}\) Several ANAO audit reports acknowledge some of the NSW tender objectives such as thoroughness and repeatability. vide Australian national Audit Office, Audit Report No.32 2005–06 ‘Management of the Tender Process for the Detention Services Contract’, 14.
The tendering guidelines provided by the NSW government are robust, but it is important to recognise that they are not mandatory, as there is no legislation enforcing the use of such guidelines; rather, the NSW guidance provides ‘aspirational goals’ for tendering. The NSW tendering guides are therefore less robust than the Commonwealth Procurement Guidelines.

Rule based tender evaluations promote procedural fairness by ensuring all tenderers are aware of how their bids will be assessed, and ensuring that all bids will be treated equally. The pure alliance tender selection process, on the other hand, is a less formal process and tends, in effect, to be a negotiation style of tender evaluation. This provides the opportunity for contractors to ‘tell their side of the story’ with emphasis on workshops and presentations to convey information.

The pure alliance therefore introduces substantial challenges for governments aiming for objective, repeatable, and reproducible evaluations of tenders. Nevertheless, there is no policy at any level of government that precludes conducting tender evaluations based on purely non-price criteria. Even if such policy existed, there is nothing to suggest that the application of such policy is mandatory. This leads to the question of how the courts interpret the rights and obligations of parties to a tender evaluation.

The Courts’ Interpretations of Tendering Rules

Though legislation and government policy provide some of the internal rules for public sector tenders, the courts have also developed principles outlining how governments must deal with tender evaluations. This includes what standards are required of governments and what acts, or omissions, are prohibited. At the time of writing, there have been no court decisions on alliances. This is unsurprising given the relative immaturity of alliances coupled with the alliance ‘no-disputes’ framework. Tender case law, though, proves useful for examining how the courts

52 Ibid.
53 Ibid. 26-7.
55 Ibid.
may interpret alliance tenders from the perspective of rights, obligations and remedies.\textsuperscript{56}

In \textit{Hughes Aircraft Systems International v Airservices Australia},\textsuperscript{57} Finn J made several observations concerning the conduct of tenders by a Commonwealth statutory corporation. This landmark case is important for several reasons. Firstly, the traditional analysis of tenders was rejected\textsuperscript{58} as the court held that the tender process itself is governed by contract. That is, the request for tender is not just an invitation to treat, but rather:

\begin{quote}
...the circumstances here were ones in which it properly can be said the parties, by agreement, had used contract to protect ``the integrity of the bidding system''.\textsuperscript{59}
\end{quote}

The creation of a ‘process contract’ will not occur in all circumstances; rather, it is the facts relevant to the tender and the intentions of the parties that dictate whether a process contract arises.\textsuperscript{60}

In \textit{Hughes Aircraft} Finn J also identified the requirement for governments to adopt fairness in the tender evaluation:

\begin{quote}
...fair dealing is, in effect, a proper presupposition of a competitive tender process contract (especially one involving the disposition of public funds), and given that a public body is the contracting party whose performance of the contract is being relied upon, a necessary incident of such a contract with a public body is, I am prepared to conclude, that it will deal fairly with the tenderers in the performance of its tender process contracts with them.\textsuperscript{61}
\end{quote}

\textsuperscript{56} The alliance tender evaluation is not governed by the alliance ‘no-disputes’ regime as no contract is afoot. Conventional case law relevant to tendering is therefore applicable.
\textsuperscript{57} (1997) 146 ALR 1.
\textsuperscript{58} Owen Hayford and James Shirbin, ‘Recent Developments in Tender Process Contracts’ 108 Australian Construction Law Newsletter 37; Seddon above n 5, 261-2.
\textsuperscript{59} (1997) 146 ALR 1, 29; This approach is widely accepted, vide: \textit{Cubic Transportation Systems Inc v New South Wales} (2002) NSWSC 656, [44]; See also, \textit{Pratt Contractors v Transit New Zealand} (2002) UKPC 84, 44.
\textsuperscript{60} \textit{Dockpride Pty Ltd v Subiaco Redevelopment Authority} (2005) WASC 211 [109].
\textsuperscript{61} (1997) 146 ALR 1, 42.
Further, any deviation or improper application of the tender selection criteria or tender process constitutes a breach of contract.\textsuperscript{62} Despite this finding, failure to comply with internal policies and procedures will not necessarily be construed to be a breach of a pre-award contract as observed by Adams J in \textit{Cubic Transportation Systems Inc v New South Wales:}

\begin{quote}
The plans for evaluation of Proposals were detailed documents covering every aspect of the evaluation process. However, they were internal documents never notified to either of the Proponents ... I cannot see any basis for concluding, therefore, that their provisions comprised in any sense a term of the contract alleged by the plaintiffs...\textsuperscript{63}
\end{quote}

Le Miere J made a similar observation in \textit{Dockpride Pty Ltd v Subiaco Redevelopment Authority:}

\begin{quote}
I conclude that the Design Guidelines are a guide … against which the Authority will assess tenders. The Design Guidelines are not, and do not contain, a series of mandatory or prescriptive requirements compliance with which is a pre-condition to the tender being considered or accepted by the Authority.\textsuperscript{64}
\end{quote}

Consequently, only when the request for tender documentation specifically incorporates the tender evaluation rules and processes will governments be obliged to follow such rules.\textsuperscript{65} Nevertheless, there is likely to be an implied term in the tender evaluation contract that government deals with tenders fairly.\textsuperscript{66}

A competitive TOC alliance will certainly involve contractual relationships during the tender evaluation phase as the principal engages tenderers, with funding, to deliver a preliminary design and develop a target cost and schedule. A similar situation exists if an Interim Project Alliance Agreement (IPAA) is used to develop target costs and

\textsuperscript{62} Ibid 67.
\textsuperscript{63} \textit{Cubic Transportation Systems Inc v New South Wales} (2002) NSWSC 656, [46]; See also \textit{Pratt Contractors v Transit New Zealand} UKPC 84 (2002) 44, '[t]he detailed procedures prescribed by the other manuals are no doubt intended in part to ensure that Transit does comply with the terms of the CPP and in part for its own administrative convenience, but they are not something upon which an outsider can rely'.
\textsuperscript{64} \textit{Dockpride Pty Ltd v Subiaco Redevelopment Authority} (2005) WASC 211; [139]
\textsuperscript{65} Owen Hayford et al, above n 58, 39.
\textsuperscript{66} (1997) 146 ALR 1, 118.
For a pure alliance, the potential for a process contract to exist is less certain and will be contingent on the manner in which the request for tender documentation is constructed.

For example, the Victorian Government’s *Project Alliance Practitioner’s Guide* specifies a robust and precise tender evaluation process involving the evaluation of written submissions, auditing, interviews, and workshops. If this process is incorporated into the request for tender documentation, then it is likely that this will be construed as a process contract. If such a process contract exists during a pure alliance tender, then there are several consequences.

First, the pure alliance selection process is more susceptible to a losing tenderer challenging the tender outcome than would be the case with a fixed price contract, because greater emphasis is placed on non-price, subjective selection criteria during tender evaluations. In addition, the pure alliance selection process is an interactive activity utilising workshops and presentations with potential bidders in the tendering phase. If a process contract exists, then an alliance bidder may claim that a breach of this process contract occurred. For example, it may be claimed that the manner in which workshops were conducted, or the process for evaluation used, was inconsistent between tenderers. Such claims are considerably less likely in conventional fixed price arrangements, where price is the main tool used to discriminate between tenderers.

Second, if it is held that a process contract exists then that contract will not be governed by the alliance ‘no-disputes clause’, because the alliance contract is not afoot and the dispute resolution mechanisms of the alliance contract do not exist at this stage. Consequently, governments may make claims against the contractor for acts or omissions in the tendering phase and vice versa. This is not within the spirit

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68 Victorian Government, above n 67, 75.
69 Typical alliance agreements only apply a non disputes regime to operate under the project alliance agreement, ‘A failure by any alliance participant to perform any obligation or to discharge any duty under or arising out of this PAA will not give rise to any enforceable obligation at law or equity.’ State Government Alliance Agreement.
of alliance principles, but may be a means for parties to pursue action against another participant if they did not prepare or evaluate their tender in good faith or to a reasonable standard of care. A more successful claim, though, would be for misleading or deceptive conduct (see below).

An additional risk to governments is from the contract departing from what was originally advertised. In many contracts, negotiations are likely to occur with the preferred tenderer prior to entering into a contract. These negotiations should not radically depart from the original scope of work offered, or from the contractual framework advertised. In a pure alliance, though, the scope of work and contractual framework may require substantial variation because in a pure alliance there is no schedule or price tendered and no preliminary designs are submitted as part of the tender process. This is more likely to lead to substantial deviation from the advertised tender.

Several of my case studies and interviews identified that the project scope changed substantially between what was in the tender document and what was finally negotiated with the preferred tenderer. To illustrate, in the Southern Regional Water Pipeline Alliance, the original specification was for the installation of a pipeline to provide water from the Brisbane Region to the Gold Coast. After contract signature, the scope of the project changed radically for the delivery of 125 mega litres of water from the Gold Coast desalination plant to Brisbane. The dynamic nature of alliencing arrangements can result in situations where the delivered products do not resemble the original project goals. This raises considerable scope for a challenge by disgruntled tenderers, since the contracted work is more likely to depart from the request for tender documentation when compared to conventional fixed price contracts.

It is difficult to predict how the courts will deal with alliance tender evaluations. Nevertheless, there is authority to suggest that the alliance tender evaluation process will be interpreted as a process contract, especially where tender evaluation plans are incorporated into the tender documentation. A prudent government would therefore

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ensure that their tender evaluation processes are fair, and perhaps that they offer some means of redress if a tenderer suffers loss because of changes in the tendering process. The subjective nature of the pure alliance selection process is likely to increase the risk of challenges to the tender process. These challenges may not only arise from a potential breach of the tender process contract, but also from administrative review of government decisions.

**Administrative Remedies in Tender Evaluations**

In addition to common law contractual remedies, tender evaluations may be subject to administrative law, which may introduce further constraints on government activity. Where government decisions are of an administrative character, judicial review may be available to tenderers through the *Administrative Decisions (Judicial Review) Act 1977* (Cth) or equivalent state acts.\(^{71}\)

The courts have generally been reluctant to recognise requests for tender by government departments as acts of an administrative nature.\(^{72}\) For statutory bodies, judicial review will most likely be unavailable.\(^{73}\) Furthermore, administrative challenges to tender decisions are typically framed in the context of ‘unreasonableness’ as defined in *Associated Provincial Picture Houses Ltd v Wednesbury Corporation*\(^ {74}\). or by demonstrating a failure to adopt the rules of natural justice. In such instances, a decision can only be found to be unreasonable if no reasonable person could have come to that decision\(^ {75}\). Or if the rules of natural justice were not followed.

Pure alliance tendering relies substantially on subjective selection criteria. On the one hand, a disgruntled tenderer may claim that the tender process was unfair as the tender


\(^{73}\) *General Newspapers Pty Ltd v Telstra Corporation* (1993) 45 FCR 164 [27].

\(^{74}\) [1948] 1 KB 223.

\(^{75}\) Ibid 230.
evaluation is inherently unreliable (see discussion above at page 266). On the other hand, that same tenderer must demonstrate that their bid was more competitive than others when using that same ‘unreliable’ selection process. Since unrestricted access to a competitor’s tender responses is unlikely, challenging a tender decision through administrative review will be problematic on two fronts. First, a tenderer must establish that the decision is subject to judicial review. Second, the tenderer must demonstrate blatant unreasonableness in the tender evaluation process. Pure alliances arguably provide greater protection to governments as their tender decisions are more defensible. That is, it will be very difficult for a challenger to demonstrate bias with the use of subjective selection criteria.

Another possible course of action for tenderers then is to pursue review by an ombudsman. The Ombudsman Act 1976 (Cth), and state and territory equivalents,\(^\text{76}\) provides a means for review of government decisions, including tenders. An ombudsman may make recommendations ranging from the issue of an apology through to the granting of compensation. The intervention of an ombudsman’s review, though, is confined to administrative matters and to circumstances where unfairness is demonstrated.\(^\text{77}\) Matters of commercial judgement are exempt.\(^\text{78}\) Consequently, there is unlikely to be any recourse for a pure alliance tenderer unless there is a substantial departure from the tender selection procedures or that tenderer can demonstrate blatant unfairness. Even where an ombudsman discovers procedural irregularities in a tender (such as inconsistent scoring and poor documentation of decisions), it is unlikely that the subsequently awarded contract will be invalidated.\(^\text{79}\)

Administrative law is therefore unlikely to provide comfort to disgruntled tenderers in a pure alliance tender. Only where there is evidence of flagrant unreasonableness in

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\(^{76}\) Ombudsman Act 1989 (Act); Ombudsman Act 1974 (NSW); Ombudsman (Northern Territory) Act 2004 (NT); Ombudsman Act 2001 (Qld); Ombudsman Act 1972 (SA); Ombudsman Act 1978 (Tas); Ombudsman Act 1973 (Vic); Parliamentary Commissioner Act 1971 (WA).

\(^{77}\) Seddon, above n 5, 371.

\(^{78}\) Ombudsman Act 1976 (Cth) s4H (12); Ibid.

the tender evaluation will remedies be available and these remedies are significantly limited.

**The Public Sector Tender Evaluation Process**

The rules by which alliance tenders are managed in the public sector have been defined above; but how is the tender process managed in practice? The following section explores the specific tender deliverables required to promote fairness and deliver value for money to governments for fixed price conventional contracts, competitive TOC alliances, and pure alliances. Each of these procurement options attempts to achieve these objectives in different ways. This section examines what each procurement option delivers in tender evaluations, and highlights why the pure alliance offers the least tangible information about tenderers.

**Fixed Price Conventional Contract Tender Evaluation Outcomes**

The outcomes of a tender evaluation for projects in a conventional fixed price contract typically incorporate a tendered price and project schedule with the supplier best able to deliver value for money. This provides governments with a reliable indication of the project cost for budgeting purposes as well as the project delivery schedule. Tender evaluations also provide a preliminary indication of project risk based on other data provided by tenderers. For example, tendered information such as financial statements, examples of past performance, insurance premiums and risk management plans are all indicative of project risks. The contract negotiation phase of a fixed price contract may also provide an additional level of risk assessment for the project as government and the contractor negotiate upon liquidated damages values and warranty periods. For example, where a contractor insists upon very large premiums for liquidated damages and upon reduced warranty periods, governments should be alerted to the fact that the risk profile of the project is likely to be high (or alternately, contractors have little faith in their own cost and schedule estimates).

Typically, when a fixed price contract is signed, the contractor accepts all the risks of delivering the project to the tendered price and within the tendered schedule. Should
the project run over budget then the contractor is responsible for funding this additional cost over-run. Similarly, if the project duration exceeds the tendered schedule then the contractor is exposed to the payment of liquidated damages, so long as those damages are not held to be punitive.  

Consequently, in the absence of variations and excusable delays, fixed price contracts provide governments with relative certainty as to the contracted outcomes and with appropriate remedies if the contractor defaults. In practice, this confidence may be illusory, especially where variations are to be encountered in a contract. Furthermore, contractors will most likely be able to invoke several defences for delivering the project late or request additional payments for delivery of the project. Examples of excusable delays included: latent conditions, industrial disputes, weather, and acts or omissions by the principal or their agents. Any one of these may trigger delay or disruption costs allowing the contractor to recoup additional sums and the grant of an extension for delivery of the contract works.

**Competitive TOC Tender Evaluation Outcomes**

The outcomes of a competitive TOC tender evaluation are similar to the outcomes of a fixed price, conventional contract. Differences lie in the fact that with a competitive TOC alliance there are no liquidated damages available to the principal, and project warranties are more restricted or non-existent. A further difference between the two exists in the remuneration model. In a competitive TOC alliance, the tendered price and schedule are not fixed and may change depending on project performance. The actual target costs, though, are delivered under competitive pricing arrangements, hence governments are provided with an indication of the likely cost and schedule for a project prior to tender selection.

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80 *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* (1914) 83 LJKB 923; *State of Tasmania v Leighton Contractors Pty Ltd* [2005] TASSC 133. Contra, Seddon above n 5, 10-11, referring to *Clydebank Engineering and Shipbuilding Co Ltd v Don Jose Ramos Yqueziero Y Castaneda* [1905] AC 6, argues that in some government contracts the genuine pre-estimate requirements of liquidated damages may be waived.


83 Ibid.
**Pure Alliance Tender Evaluation Outcomes**

The pure alliance provides the least amount of information in the tender evaluation process. In a pure alliance, there are no estimates of target costs or project schedules delivered; rather, the preferred tenderer is selected on qualitative criteria which aim to select the candidate most likely to deliver best value for money. Though this is a substantial criticism of the pure alliance, target costs and schedules become apparent very soon after tender selection in either the early states of the alliance contract, or during an interim project alliance agreement.84 In either case, governments may terminate the contract for convenience if the developed target costs and schedule are substantially higher than anticipated.

There is, therefore, substantial variation in what each different procurement option delivers at the conclusion of a tender evaluation particularly in the tender evaluation costs, schedules, and information delivered. What then should a procurement manager look for when deciding upon the most appropriate procurement option? The following section explores the relative merits of the tendering process for pure alliances and competitive TOC alliances and how this may influence procurement option selection.

**Pure Alliance Selection Process**

There are no recognised methods for undertaking pure alliance tenders. My interviews and case studies reveal that there is substantial variation in how tenderers are invited to participate in an alliance project and how a tenderer is selected.85 Nevertheless, the Victorian Government’s *Project Alliencing Practitioner's Guide* outlines typical alliance tendering processes for both pure and competitive alliances. This guide is useful for exploring the usual features of an alliance tender evaluation.

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84 Ross, above n 67, 3.
The Victorian guide recommends a two stage approach for selecting alliance participants. Stage one deals with the request for proposal and stage two addresses the selection of the non-owner alliance team. In some circumstances, governments may seek expressions of interest beforehand. This is useful where the capabilities of industry are unknown or there is a risk that governments will receive too many tender responses.

The request for proposal stage of an alliance tender is similar to that of a conventional tender evaluation. Request for proposal documentation includes specifications, selection criteria, a draft alliance agreement and possibly the owner’s budget or project delivery estimate. Also associated with the request for proposal will be a tender evaluation plan. This plan explains how tenders will be managed and assigns tender evaluation responsibilities to relevant agencies within government. Prospective tenderers therefore use the request for proposal package to develop their bids. The evaluation of these bids is conducted by governments in the second stage of the alliance tendering process.

Pure alliance tender selection relies on scoring tenderers against the defined selection criteria articulated in the request for proposal responses. In addition, governments use interviews and workshops to gain additional information from tenderers. Typically, four or five tenderers will be invited to participate in interviews to clarify their proposals. Based on these initial interviews, governments normally short-list two respondents to participate in a two-day workshop. These workshops allow for governments to examine the proposed alliance culture, strategies, commercial framework, and resourcing options presented by the tenderers. These workshops arguably provide governments with the information necessary to select the team best able to deliver value for money.

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87 Ibid 69.
88 Ibid 73.
89 The number of tender responses will dictate how many will be shortlisted. In some instances, government may only receive one tender response for an alliance, especially in rural Australia.
90 Ibid. 78; Ross, above n 67, 10-11. Andrew Hutchinson and John Gallagher, ‘Project Alli ancing - an Overview’ (Centre of Advanced Engineering Seminar, Christchurch, NZ 2003), 26.
It is important to recognise that during the tender evaluation, there are no obligations to abide by the alliance ‘no disputes framework’ or the alliance express provisions to work in good faith. This introduces substantial scope for alliance tenderers to ‘strategically misrepresent’ their capabilities. This is especially true when considering the unmeasurable selection criteria used in alliance tender evaluations.

The selection criteria used to select alliance participants typically include the following:

a. Demonstrated technical, financial and management capacity to handle the work;
b. Understanding of and commitment to the alliance way of doing business;
c. Track record and demonstrated capacity to deliver outstanding outcomes in safety, quality, environment, community relations etc.;
d. Preliminary ideas on innovation and execution strategies and the potential to deliver outstanding design and construction outcomes;
e. Willingness to commit to project objectives and pursue “breakthrough” results;
f. Track Record/demonstrated ability of proponent companies to work with each other; and
g. The quality of the key personnel and their affinity for working together and with the owner’s personnel as a high performance team. 91

The emphasis on these ‘soft’ selection criteria has resulted in this pure alliance selection process being unfortunately labelled as a ‘beauty parade’. 92 The following comment from an industry interviewee demonstrates the subjective nature of pure alliance tender evaluations; ‘the selection process involved us wheeling out our best and brightest to the tender evaluation team and running through workshops for a few days.’ 93 It is also important to recognise that the above tender selection criteria comprise three components that rely on the past performance of tenderers (sub-paragraphs a, c and f above).

91 Ross, above, n 67, 11.
92 This term appeared frequently in my interviews with industry (non-owner) participants involved in alliances.
93 Interviewee R.
When governments have selected their preferred tenderer against the above selection criteria, that tenderer is invited to enter into the alliance agreement. It is this emphasis on past performance of tenderers coupled with reliance on more subjective selection criteria that introduces problems for demonstrating fairness in pure alliance tenders.

**Pure Alliance Selection Challenges**

The pure alliance selection process relies almost exclusively upon non-price criteria, with emphasis on past performance and the tenderer’s ability to operate in an alliance team. This introduces several challenges for governments from two perspectives. First, government must demonstrate fairness in the tendering process. Second, government must select the team that will offer the best value.

From a fairness perspective, the subjective selection criteria of the pure alliance raise potential conflict between the objectives of *repeatability and reproducibility*. The pure alliance tender selection team will be basing all their decisions upon written responses, workshops, and interviews with prospective tenderers. Repeatability and reproducibility are therefore contingent on how the tender teams interpret these tender responses. There is substantial reliance upon the judgement and objectivity of the tender evaluation team. For example, the evaluation team must be able to ‘test’ the tenderers ‘understanding’ of alliance principles, and those tenderer’s ‘willingness’ to commit to project objectives. This is a far more difficult proposition than simply comparing fixed price tender values. Reliance on non price criteria also proves a challenge for the development of bids, as the following comment from the Queensland Government illustrates.

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95 For example, the Queensland Government recognises traditional lump sum contracts will have a 95 percent weighting on price and non-traditional contracts will have a 70 percent weighting on price; Queensland Government, Department of Public Works, ‘Building Industry Contractor Tender and Selection process’ (2000) 20, http://www.build.qld.gov.au/industry/BiDocs/pqcobic.pdf. See also, the Tasmanian Government who set minimum and maximum values against past performance at five and 20 percent respectively; Tasmanian Department of Finance and Treasury ‘Guidelines on Tender Evaluation using Weighted Criteria for Building Works and Services’ (1999) 4.3.
It is difficult for tenderers to interpret the non-price criteria in order to provide meaningful responses, which, in turn, makes it difficult for evaluators to undertake effective evaluations that produce meaningful results for comparison.\(^{96}\)

The pure alliance selection process avoids quantitative comparisons of fixed prices. Tenderers and other stakeholders are therefore more likely to treat the pure alliance selection process with more suspicion than they are with conventional fixed price contracts.

Perceptions of unfairness in pure alliance selections may also occur if governments base their decisions primarily upon the past performance of tenderers. This is especially so for new entrants to a market. A new entrant certainly introduces a greater element of risk for delivery of a project, but the question needs to be asked, ‘how much weight should be afforded to past performance’? A typical pure alliance tender selection relies on three of seven selection criteria linked to past performance.\(^{97}\) Considering some Australian governments only apply a two percent weighting to past performance in conventional contracts,\(^{98}\) the substantially larger weighting in pure alliances appears unbalanced.

If a proposed tenderer has no prior performance then government must ask itself whether it is fair to preclude that tenderer from competing. The United States Government Accounting Office prohibits \textit{de facto} debarment of tenderers based on past performance.\(^{99}\) Further, the US Department of Defense guide for assessing past performance states:

\begin{quote}

The method and criteria for evaluating offerors with no relevant PPI [Past Performance Indicators] should be constructed for each specific acquisition to ensure
\end{quote}


\(^{97}\) Ross, above, n 67, 11


that such offerors are not evaluated favorably or unfavorably [sic] on past performance.¹⁰⁰

No such guidance or policy is provided by Australian governments. If a tenderer has no past performance, then under pure alliance arrangements they will face a substantial hurdle in proposing a competitive bid. No such barriers exist to this extent in conventional contracts. This raises the scope for criticism that pure alliance selection processes are unfair.

In addition to demonstrating fairness, the pure alliance selection process suffers from the criticism that the selected team may not necessarily deliver the best value. As previously demonstrated, the pure alliance tender selection process eschews the delivery of detailed prices and schedules. Tender selection is based largely on tenderer representations and promises. Unlike the situation with fixed price tender evaluations, nothing is guaranteed in a pure alliance tender response. This lends itself to the cynical charge that pure alliances promote the selection of tenderers who can best misrepresent their capabilities.

A further problem with the value for money dimension of pure alliances is that the target price and schedule do not become apparent until after the selection of the preferred tenderer. This places government in a poor negotiating position.¹⁰¹ This reinforces the conclusions outlined in Chapter six, that it is very difficult to demonstrate value for money in the absence of price competition.

Compared to conventional fixed price tender evaluations, pure alliances create governance tensions related to fairness and value for money. No specific governance rules or principles are broken with pure alliances; rather, pure alliance selections are more likely to be perceived as unfair and less able to demonstrate best value. The emergence of the competitive TOC alliance is a response to these pure alliance short-comings.

¹⁰⁰ Ibid 10.
¹⁰¹ This risk can be mitigated by adopting a two-stage alliance process with an interim project alliance agreement (Ross, above n 67). This two-stage approach allows government to abandon the alliance should the alliance be unable to agree upon a TOC or if it transpires that the project cannot be delivered within the ambit of the original business case (Alchimie, ‘Target Outrun Cost: Demonstrating and Ensuring Value for Money, (2005) 5.)
Chapter Seven - Alliances and the Tender Selection Process

Competitive TOC alliance Selection process

The competitive TOC alliance tender selection process shares many of the same characteristics as those of the pure alliances in the early stages. Both processes require government to short-list potential tenderers into a manageable group, from which a more thorough evaluation can be conducted. The two processes, though, radically diverge in the final selection phase of the tender. Whilst both tender selection processes aim to select a tenderer most likely to deliver value for money, the competitive TOC alliance achieves this aim primarily through price competition.

In a competitive TOC alliance, governments provide funding for a number of short-listed tenderers (usually two) to develop project proposals, including a target cost and schedule for the project. Substantial weight is afforded to this target cost during final tender selection. For example, I conducted a case study of one competitive TOC alliance, which applied an 85 percent weighting to tendered price and a 15 percent weighting to non-price criteria.

In a competitive TOC alliance, the processes for developing final costs may be hidden from scrutiny, hence the argument proposed is that market forces demonstrate value for money and governments are kept at arms-length from cost development.

Subsequently, governments enter into contract negotiations with a robust indication of the target cost and project schedule. Similarly, the emphasis on selecting a tenderer from objective criteria, such as measurable project costs and schedules, relieves governments of the pitfalls of conducting a tender evaluation against subjective selection criteria.

A further benefit of the competitive TOC alliance is that governments get to see each alliance proponent in action. During my interviews, one alliance manager

102 Alchimie, above n 101, 10.
103 Cowan, above n2, 5.
acknowledged this as ‘a try before you buy’ strategy, affording governments a chance to see how the tenderer operates before they take on the final project.

The competitive TOC alliance also satisfies the political imperative of setting the project cost in an arms-length environment, thus absolving governments from the criticism that the TOC is not a fair estimate of the project cost.

The competitive TOC alliance model may also reduce the risk of a challenge from losing tenderers. With greater reliance upon quantitative selection criteria, governments will be better able to demonstrate fairness in the tender selection process when compared to pure alliances. For the federal and state governments, this also facilitates alignment to the Australia/US Free Trade Agreement principles, especially the promotion of fairness and impartiality in the tender selection process. Despite these benefits, the competitive TOC alliance introduces some costs that are not associated with pure alliances.

**Competitive TOC Alliance Selection Challenges**

The competitive TOC alliance selection process is not without criticism. These criticisms include the issues of sunk costs, increased tender evaluation duration, and reduced collaboration.

The competitive TOC alliance will result in sunk costs as governments have paid for the design development effort of a losing tenderer. As discussed in Chapter six, the costs of such design activities are between one and 1.5 percent of the total project budget, but this sunk cost often results in substantial benefits as governments can

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105 Interviewee N.
106 Australia/ United States Free Trade Agreement, 15.9.1.
107 See, eg, Victorian Government, above n67, 100; Ross, above n 67, 19-20; Alchimie above n 101, 9-10.
108 Tugun Bypass Alliance where the competitive TOC tendering costs were less than 1.5 percent of the total project budget: Queensland Government, Public Works Committee 'Tugun Bypass Report’ December 2007, 32<http://www.parliament.qld.gov.au/view/committees/documents/PWC/reports/PWCR97.pdf> at 18 June 2008; See also the Wetalla Waste Water Treatment Plant Case Study where competitive TOC tendering costs were less than 1.5 percent of the total project budget <http://www.griffith.edu.au/centre/slr/pdf/WWTP.pdf> at 31 July 2008.
reap substantial savings from the losing tenderer’s design efforts.\textsuperscript{109} One respondent in my interviews stated that ‘we managed to reuse a lot of the losing tenderer’s design in our project. This saved us a lot of money in the long run.’\textsuperscript{110} As argued in Chapter six, sunk costs are not a significant impost on the competitive TOC alliance.

The duration for a competitive TOC alliance tender selection is also substantially longer than that associated with a pure alliance. The Victorian Government’s *Project Alliancing Practitioner’s Guide* cites a typical pure alliance tender duration of 14 weeks.\textsuperscript{111} By way of contrast, the duration of the competitive TOC alliance selection process can be over six months.\textsuperscript{112} Though there is merit in claiming that the competitive TOC alliance tender process is lengthier than the pure alliance, the competitive TOC alliance tender process delivers substantially more than the pure alliance. For example, the outcomes of a competitive TOC alliance tender selection are a robust TOC (developed through price competition), the project schedule, and a preliminary design for the project. This means that the winning tenderer can commence further design and implementation activities *immediately* after contract signature. By way of contrast, in a pure alliance, the preferred tenderer starts a project from the beginning after contract signature. Consequently, whilst the competitive TOC alliance involves a longer tender evaluation duration than a pure alliance, this does not necessarily result in a longer period for delivery of the project.

Though competitive TOC alliance sunk costs and tender duration issues appear to be overstated in the literature,\textsuperscript{113} a more valid criticism is that competitive TOC alliances dilute collaboration between alliance participants. Several respondents in my interviews referred to the competitive TOC alliance model as ‘a glorified competitive design and construct contract.’\textsuperscript{114} One interviewee in particular considered the competitive TOC alliance ‘as akin to being half pregnant’.\textsuperscript{115} That is, the competitive TOC alliance tries to facilitate trust and collaboration as well as retaining price

\begin{itemize}
\item \textsuperscript{109}Queensland Government, above n 108, 32.
\item \textsuperscript{110}Interviewee A.
\item \textsuperscript{111}Victorian Government above n 67, figure 7.4. This is the duration from issue of the request for proposal to when the project alliance agreement or interim project alliance agreement is ready to sign.
\item \textsuperscript{113}Victorian Government, above n 67, 100; Ross, above n 67, 19-20; Alchimie above n 101, 9-10.
\item \textsuperscript{114}Interviewees G, M and P.
\item \textsuperscript{115}Interviewee G.
\end{itemize}
competition. The following interview response from the CEO of a construction company also highlights the fact that competitive TOC alliances are less likely to promote the same levels of trust as in a pure alliance:

With a competitive alliance there is no right pricing. It is really a competitive design and construction contract. The competitive alliance is not really transparent as companies do not want to reveal all their information, especially where it might be seen by competitors.\(^\text{116}\)

The competitive TOC alliance model is therefore recognised as more likely to diminish the alliance culture of collaboration and trust when compared to pure alliances.\(^\text{117}\) This claim is based on the premise that price competition drives alliance bidders to an adversarial position. In such circumstances, innovation and best for project principles are more likely to be abandoned.\(^\text{118}\) This risk was reflected in my interviews involving two competitive TOC alliances. In these alliances, the alliance owner participants expressed the view that the winning tenderers underestimated the scope of work with the view of increasing the TOC through ‘variations’. These observations must be tempered by the fact that several pure alliances also required substantial adjustment of target costs after initial design activities. Nevertheless, there is a risk that competitive TOC alliance tenderers underbid with the goal of increasing target costs after they are selected. Such a strategy will not compromise the non-owner alliance participants profit. Competitive TOC alliances therefore introduce the risk of greater deviation from collaborative behaviour when compared to pure alliances.

Though not specifically mentioned in the alliance literature, the competitive TOC alliance has other disadvantages related to tender selection. Three areas in particular warrant assessment. First, the short-listing process of a competitive TOC alliance

\(^\text{116}\) Interviewee P.
\(^\text{117}\) See, eg, Ross above n67, 19-20; Alchimie, above n 101, 9-10; Contra Mike Montefiore’ The Burnett Dam Alliance’ (International Quality and Productivity Centre Conference, Sydney, 2005) who argues that pure alliances may introduce conflict in the TOC negotiation phase as price tension is between owner and non-owners, whereas in a competitive alliance, price tension is between industry participants.
\(^\text{118}\) There is a competing argument that competitive alliances are more likely to promote innovative solutions earlier so that the alliance tenderers drive the TOC as competitively low as possible. Victorian Government, above n 67, Appendix 3.
must adopt the same ‘beauty parade’ selection process as used in the pure alliance. Second, the fact that the competitive TOC alliance requires substantial involvement from industry has led to some industry participants refusing to engage in competitive TOC alliance bids. Two industry representatives acknowledged this claim in interviews by citing specific companies which were averse to participating in competitive TOC alliances. One of these interviewees stated

> In a competitive TOC alliance, we need to tie up our design team for a long time with no guarantee that we will win any work. We would much rather bid on a pure alliance for this reason since we do not have to commit scarce resources in tender development.119

Thirdly, the resources demanded of governments are substantial in the competitive TOC alliance.120 In my interviews, one government alliance manager stated that they had to provide two teams in the competitive TOC alliance tendering phase. This was to avoid any conflicts of interest and to preserve the integrity of the bidding process. This involvement was a substantial cost to governments that would otherwise not have been incurred.121

The competitive TOC alliance eliminates many of the problems associated with the pure alliance tender selection process. The competitive TOC alliance promotes greater fairness in tender selections and demonstrates better value with price competition. The promotion of price competition is of significance as this satisfies most stakeholders. One alliance manager, in particular, stated:

> [Our] treasury would be more impressed with a competitive TOC alliance as these alliances adopt the mantra of price competition.122

Despite these advantages, the competitive TOC alliance introduces additional sunk costs and increases the tender evaluation duration. Neither of these disadvantages

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119 Interviewee K.
120 Victorian Government, above n 67, 100.
121 Interviewee A.
122 Interviewee Q.
appears to be significant and the alliance literature\textsuperscript{123} overstates their importance. The main criticism of competitive TOC alliances stems from the fact that industry looks unfavourably on such procurement options and governments are less likely to solicit competitive bids with such tenders. The increasing demand for engineering services coupled with dwindling supply (see Chapter two) suggests that competitive TOC alliances may be a luxury government cannot afford.

The pure and competitive alliance tendering processes demonstrates two extremes. The pure alliance offers faster and cheaper selection, but eschews price competition, and relies mainly on tenderer’s representations rather than guarantees. By way of contrast, the competitive TOC alliance provides substantial information about the proposed design solutions, retains price competition, incurs a penalty of sunk costs, and reduces the likelihood of industry participation. The competitive TOC alliance best demonstrates fairness in tender evaluations when compared to pure alliances. Consequently, tenderers are less likely to mount a challenge if these lose under competitive TOC arrangements. What remedies are available to governments if tenderers do not bid honestly? This is of significant concern in pure alliances since tenderers guarantee nothing in their tender responses.

\section*{Tender Obligations, Remedies and Defences}

The pure alliance tender selection process incorporates many disadvantages not associated with conventional fixed price contracts. As this chapter has demonstrated, these disadvantages appear in the form of perceptions of unfairness in tender evaluations and with poorer demonstration of value for money. What also warrants consideration in pure alliance selection processes are the obligations, remedies, and defences relevant to tenderers and principals. In particular, the risk of misleading or deceptive conduct is far greater in pure alliance tendering because the pure alliance tendering process relies substantially more on tenderer representations when compared to conventional fixed price contract representations.

\textsuperscript{123} See especially, Victorian Government, above n 67, 100; Ross, above n 67, 10-11; Alchimie, above n 101, 9-10.
Though the pure alliance embarks upon a no dispute framework, these obligations only apply when the alliance contract is afoot. All activities conducted during the tender evaluation phase and subsequent contract negotiations are therefore exempt from the alliance ‘no fault, no blame’ regime. Governments, as the alliance owner, therefore retain an avenue to seek external remedies if contractors engage in misleading or deceptive conduct during tender evaluations. These same remedies apply to all government contracts. Nevertheless, the pure alliance increases the dependency of government on contractor representations for several reasons. First, the alliance selection process places substantially more emphasis on the culture and capabilities of contractors, assessment of which can only realistically be based on contractor representations. Second, the alliance contractors provide more information during tender responses and this information may not be subject to robust legal consideration. This is especially true during alliance workshop presentations provided during tender evaluation. Third, there is little or no quantitative representations made by contractors in their tender responses (for example, contract price or contract schedule).

Pure alliance contractors must therefore be extremely cautious in their dealings with governments when providing tender responses. Conversely, government must also be wary as to what an alliance contractor promises versus what that same contractor offers as best endeavours, or indications of future performance. The emphasis on qualitative tenderer representations introduces a greater likelihood of misleading or deceptive conduct occurring. This offers remedies not only to governments as the alliance owner, but also to losing tenderers. To further explore the significance of these risks requires an assessment of legislation and case law relevant to misleading or deceptive conduct.

**Misleading or deceptive Conduct - Legislation**

124 Negligent Representations are also relevant; however, compared to statutory misleading and deceptive conduct, liability for negligent representations is not strict (*Shaddock and Associates Pty Ltd v Parramatta City Council* (No 1) [1981] HCA 59, (1981) 150 CLR 225, 230-231; Seddon, above n 5, 314). To this end a claim is less likely to succeed should government pursue an action for negligent misrepresentation when compared to an action under s52 of the *Trade Practices Act 1974* (Cth).
All pure alliances incorporate ‘no disputes’ clauses. Nevertheless, these clauses cannot exclude the operation of trade practices legislation. The aim of trade practices legislation are to ‘enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection’. In keeping with this aim, the Trade Practices Act 1974 (Cth) prohibits misleading or deceptive conduct, at section 52:

A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

Trade practices legislation at the state level also embraces this principle. Trade practices legislation not only applies to activities performed within a contract, but also any conduct leading up to the formation of a contract. For example, representations about future events and predictions are also captured, as set out in Section 51A of the Trade Practices Act:

For the purposes of this Division, where a corporation makes a representation with respect to any future matter (including the doing of, or the refusing to do, any act) and the corporation does not have reasonable grounds for making the representation, the representation shall be taken to be misleading.

Trade practice legislation therefore provides some relief for governments if they are misled or deceived by tender responses. The operation of an alliance no-disputes clause after contract signature will not provide an alliance contractor with a means to avoid trade practices legislation.

Alliance tender responses are clearly captured by trade practices legislation and, more specifically, the prohibitions on misleading or deceptive conduct. What now needs to

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125 Trade Practices Act 1974 (Cth), s2.
126 Trade Practices Act 1974 (Cth), s52 (1); see also s53 (e) related to false or misleading representations.
128 Ibid s 51A(1).
129 See, eg, Chew, above n 3, 332.
be established is exactly what conduct is likely to be considered misleading or deceptive and how this applies to alliance tender responses?

**Defining Misleading or Deceptive Conduct**

Conventional fixed price contracts rely on a firm fixed price and schedule as the prime indicator of what the contractor will deliver and for how much. By way of contrast, pure alliances place substantial emphasis on representations made in tender responses with no guarantees. This provides substantial opportunity for tenderers to be economical with the truth. It is therefore crucial to define what responses from an alliance contractor are likely to come under the ambit of misleading or deceptive conduct.

Whether a statement is misleading or deceptive may depend on whether the statement is based on facts or future predictions. When an alliance tenderer states that they have the capability and capacity to deliver the outcomes of a project, these predictions would only be deceptive if the tenderer knew the claims were false at the time they were made or the claims were made with reckless indifference regarding their truth or falsity. This principle appears in *Thomson v Mastertouch TV Services*:

> [I]t is necessary for the informant to prove that the defendant did not believe that the forecast or prediction would be satisfied or was recklessly indifferent concerning the forecast or prediction.

This does not imply that just because future events do not eventuate, as anticipated in the tender response, that a contractor will be held to have engaged in deceptive conduct. Lockhart J’s observations in *Bill Acceptance Corporation Ltd v GWA Ltd* clarify this latter point:

> The mere fact that representations as to future conduct or events do not come to pass does not make them misleading or deceptive.

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Though these cases deal with general representations, there is specific authority supporting the premise that misleading or deceptive representations made by tenderers are subject to recourse under trade practices legislation. In *Pourzand v City of Nedlands and Anor*, tender representations provided to a local government were found to be in breach in s10(1) of the *Fair Trading Act 1987* (WA). In this case, a tenderer’s claim that they ran their organisation in a ‘sound and business like manner’ was held to be misleading.

Alliance tender responses place substantial emphasis on similar criteria to that in *Pourzand v City of Nedlands and Anor*. For example, selection criteria used in pure alliances include past performance, alliance culture, and ability to deliver future outcomes. If these representations are demonstrated to be knowingly false or if they are made recklessly then governments have grounds for recourse through trade practices legislation. Such recourse exists for all contracts; nevertheless, alliances increase the scope for claims under misleading or deceptive conduct simply because other contracts have more robust strategies for curtailing misleading or deceptive conduct such as liquidated damages and fixed price contract values.

**Claims from Losing Tenderers**

Governments, as the alliance owners, are not the only beneficiaries of trade practices legislation in tendering. Losing tenderers may also pursue claims against winning tenderers under the guise of misleading or deceptive conduct. This occurred in *Pourzand v City of Nedlands and Anor*, where a losing tenderer was successful in bringing a claim against the winning tenderer. In this instance, the loss of a chance to gain business is quantifiable and damages awarded as explained by Ng M:

...the plaintiffs have pleaded a causal link between the loss or damage and the defendants' conduct in contravention of s10 of the Act [*Fair Trading Act 1987* (WA)]

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in that the second defendant's conduct had induced the first defendant to accept his tender and reject the plaintiffs' tender as well as others thereby costing the plaintiffs the chance to obtain a grant of the lease of the centre.\textsuperscript{136}

Remedies available to losing tenderers are contingent on whether they would have been awarded the contract had no misleading or deceptive conduct occurred. This principle is stated in \textit{Poseidon Ltd \& Sellars v Adelaide Petroleum NL}.\textsuperscript{137}

When adopting pure alliances, it would appear that there is greater potential for challenges from losing tenderers as tender responses will comprise substantially more representations about past and future performance. Nevertheless, such challenges are contingent upon losing tenderers having access to competitor’s responses and demonstrating that such responses are misleading or deceptive. This will prove a difficult task. Consequently, a successful claim for misleading or deceptive conduct made by losing tenderers is unlikely, even with a pure alliance tender.

\textbf{Hurdles to Misleading or Deceptive Conduct Claims}

Governments will most likely be the instigators of actions for misleading or deceptive conduct as they have access to all tender responses and will suffer greatest during the execution of a contract from such misleading or deceptive conduct. Even so, governments face challenges in demonstrating that tenderer representations are misleading or deceptive.

Where promises made during tender responses are unqualified, then it is likely that such promises may come under the ambit of section 52 of the \textit{Trade Practices Act}. Lee J explained this in \textit{Wheeler Grace \& Pierucci Pty Ltd and Others v Wright and Another}:

\begin{quote}
A positive unqualified prediction by a corporation may be misleading conduct in trade or commerce if relevant circumstances show the need for some qualification
\end{quote}

\textsuperscript{136} Ibid 7.
\textsuperscript{137} (1994) 120 ALR 16, 17.
to be attached to that statement or the possibility of its non-fulfilment to be disclosed as a requirement of fair trading.\textsuperscript{138}

Conversely, in \textit{Evans Deakin Pty Ltd v Sebel Furniture Ltd},\textsuperscript{139} Allsop J held that a tender response was not misleading or deceptive where no qualifiers were attached to tenderer responses:

It does not follow that any statement in any commercial context which can be characterised as a promise must be accompanied by any existing legal or factual qualification (whether known or adverted to by the predictor or promissor or not).

Tendering is a precursor to contract negotiations. The operation of section 52 of the \textit{Trade Practices Act} does not preclude one party pursuing a series of representations that aim to maximise their outcomes in a bargain, as observed by Burchett J in \textit{Poseidon Ltd v Adelaide Petroleum NL}:

I do not think it has ever been suggested that s 52 strikes at the traditional secretiveness and obliquity of the bargaining process. Traditional bargaining may be hard, without being in the statutory sense misleading or deceptive. No-one expects all the cards to be on the table. But the bargaining process is not therefore to be seen as a licence to deceive. If, for example, the bargainer has no intention of contracting on the terms discussed — perhaps because his real aim is to tie up the market, or to achieve some other ulterior purpose — may not (at least, in some circumstances) his conduct in seeming to bargain be accurately stigmatised as misleading? It certainly may do enormous harm to a competitor.\textsuperscript{140}

On the other hand, outright lies that aim to increase the likelihood of winning a bid are misleading or deceptive, provided loss occurs to the principal. Thus in \textit{Beckhaus Civil Pty Ltd v Brewarrina Shire Council},\textsuperscript{141} MacReady M held that representations made by a tenderer were ‘misleading’, but since there was no resultant loss suffered from these representations, there was no breach of section 52 of the \textit{Trade Practices Act}. This principle was endorsed on appeal:

\textsuperscript{138} (1989) 16 IPR 189, 201.
\textsuperscript{139} (2003) FCA 171 [627].
\textsuperscript{140} (1991) 105 ALR 25, 26.
\textsuperscript{141} NSWSC (2004) 840, [313].
There must be an adequate causative link between conduct that is, in terms of s 52 of the Trade Practices Act, misleading and deceptive and the damage suffered by the party at whom such conduct is directed. Misleading and deceptive conduct that merely induces a party to enter into a contract is far too remote from damage caused by breaches unrelated to that conduct to give rise to a claim for that damage.\textsuperscript{142}

Consequently, while there is some latitude afforded to contractor’s developing tender responses in alliances, unqualified representations may be held to be misleading or deceptive, especially if those representations lead to tangible losses to the principal.

Pure alliance selection processes have increased emphasis on tender representations. This increases the likelihood of misleading or deceptive conduct occurring. Consequently, while pure alliance tenderers may embellish upon their capabilities; outright lies, or reckless statements will provide governments with avenues for recourse. These avenues for recourse trump the alliance ‘no-disputes’ clause.

Misleading or deceptive conduct claims are substantially less likely in conventional fixed price contract and competitive TOC alliance tender evaluations. In these latter forms of tender, substantial reliance in made on tendered prices and schedules. There is far more promissory content in these tender responses compared to the broad statements related to culture, capabilities, and positive relationships in the pure alliance tender responses.

**Conclusions**

The pure alliance tender selection process is less likely to satisfy the governance objectives of integrity and stewardship when compared to conventional contract tender evaluations, because of the absence of price competition and the subsequent emphasis on subjective selection criteria. This makes it exceedingly difficult to demonstrate that the tender evaluation process is fair and will deliver value for money.

\textsuperscript{142} Brewarrina Shire Council v Beckhaus Civil Pty Ltd (2005) NSWCA 248 [190].
The competitive TOC alliance tender process avoids the pitfalls of the pure alliance. In many respects, the competitive TOC alliance selection process is similar to a conventional, *design and construct* tender process since both adopt price competition as the primary means to differentiate between tender responses and this better demonstrates fairness and impartiality in tendering. Though, the competitive TOC alliance does introduce some sunk costs and a significantly longer tender evaluation duration, these disadvantages are by no means significant. The competitive TOC alliance therefore generates substantial benefits as governments receive quantifiable information with which to select the ‘best’ tenderer. The competitive TOC alliance tender evaluation process is therefore more consistent with the public sector governance objectives of stewardship and integrity. The noteworthy disadvantage of the competitive TOC alliance is the risk that governments will not receive any bids to the request for tender as these procurement options are less attractive to industry.

By way of contrast, the pure alliance tender selection process relies on selecting a preferred tender on non-price criteria. This proves a challenge for governments to demonstrate fairness in the tender selection process with this ‘beauty parade’ selection process. A conundrum also arises from potential challenges to the tendering process. On the one hand, a losing tenderer may claim that the subjective selection process was unfair, but, on the other hand, they must demonstrate that their bid was more likely to deliver better value for money using those same subjective assessment criteria. I therefore argue that a losing pure alliance tenderer is unlikely to seek remedies to tender decisions unless the tender process departed radically to the process specified in the request for tender documentation. Furthermore, through interviews with alliance managers and alliance contract draftspersons, I am aware of no challenges being made by disgruntled alliance tenderers. This may be a reflection of the current buoyant economic conditions in which industry is unlikely to challenge tender decisions, as there is plenty of other work to pursue. ¹⁴³

The focus on subjective assessment criteria in the pure alliance increases the likelihood of inappropriate political interference, though no evidence of such

interference was revealed in my interviews. This is likely the result of the court’s
damning appraisal of such interference and the explicit recognition of the risks of
political interference appearing in government policy.

All alliance models offer governments recourse to claims based on misleading or
deceptive conduct. The pure alliance increases the likelihood of such claims
occurring as governments place substantially more emphasis on the representations
made by tenderers. This does not raise any governance compatibility issues other
than to preserve some recourse to governments should the alliance turn sour. In such
circumstances, the alliance no-disputes framework is illusory.
Chapter Eight – Conclusions and Observations

‘We know why projects fail, we know how to prevent their failure, so why do they still fail?’
- Cobb’s Paradox, Martin Cobb, Treasury Board of Canada Secretariat.

Introduction

This thesis addresses the central research question of whether alliances comply with the governance framework of the public sector and hence, whether these procurement options are suitable for delivering public works. In doing so, this study explores what alliances are, where they are used, why they are used, and what governance rules apply to the public sector. I have shown that alliances fail to comply with both the performance and compliance aspects of public sector governance. In particular, this study reveals that pure alliances, despite their popularity, fail to adequately demonstrate value for money for the public sector and contribute to diminished accountability, integrity, and transparency in procurement.

This study also contributes to the broader issues associated with measuring the effectiveness of governments in public spending. Examination of the governance objectives of the public sector reveals that there are no precise definitions of value for money provided by any level of government in Australia. Similarly, there is no consistent framework used by governments for the treatment of risk in decision-making. Consequently, there is no repeatable means for measuring and reporting upon the success or otherwise of public sector projects. This provides a means to escape accountability for outcomes since it is extremely difficult to state that a project is a failure in any meaningful sense using the current methods of assessing value for money.

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1 Standish Group ‘Unfinished Voyages’ (1996).
2 Chapters five, six and seven.
3 Chapter six, 202-5.
Chapter Eight – Conclusions and Observations

The key findings from this study stem from the failures of alliance governance arrangements. In particular, this study shows that the weaknesses of alliance governance arrangements are capable of exploitation to disguise poor project management, poor configuration management, poor legal drafting, and poor specification development practices. At the end of this chapter I identify several recommendations for reform in the use of alliancing and government procurement in general. These include the need for developing more robust decision-making processes, improving repeatability in tender evaluations, promoting more effective auditing in target costs development, the consideration of *alliance programs*, and capturing all life cycle costs in procurement business cases.

My focus on the disadvantages of alliances may give the impression that such procurement options will never be suitable for the public sector and that conventional procurement options will always be superior. It is important to recognise that the scope of this thesis has precluded a thorough investigation of the governance arrangements of conventional contracts. As demonstrated in Chapters two and six, conventional contracts share some of the same problems as alliances. Consequently, many of the criticisms I levy upon alliances are equally applicable to conventional procurement options. Nevertheless, of all the procurement options available to governments, pure alliances, in their current form, are less likely to satisfy value for money, accountability, integrity, and transparency objectives. My recommendations for reform address many of these alliance governance issues.

**Alliance Contracts – An Overview**

There is no single definition of an alliance contract. Nevertheless, this study, reveals the common features of these contracting vehicles to be; the sharing of all project risks, unanimous decision-making, a regime of no-disputes/no blame, adoption of best for project principles, and a remuneration system that rewards or penalises all participants (all win or all lose).

Only hybrid alliances deviate from the above principles and make provisions for deadlock breaking mechanisms, retention of liability between alliance participants and
adopts risk allocation rather than risk sharing. As Chapter two demonstrates, hybrid alliances are less popular than the pure or competitive TOC alliances, and interest in the hybrid alliance is dwindling with the emergence of first party insurance products tailored specifically for alliances.\(^4\)

The two most common forms of alliance used by governments are the pure alliance and the competitive TOC alliance. Though these alliance models use different methods to select tenderers, it is important to recognise that both operate in an almost identical fashion after the selection of the preferred tenderer.

This study demonstrates that alliances are used at all levels of government (federal, state and local) for the delivery of a diverse spectrum of projects, including roads, rail, bridges, buildings, aerospace, information systems, and ship building. Testimony to the popularity of alliancing as a procurement model is the fact that $25 billion has been expended on alliancing to date in Australia by the public sector. Though there has been a steady increase in the use of alliancing since 1998, my research suggests a slow down in the use of this procurement model by Australian governments. The introduction of Early Contractor Involvement (ECI) contracts\(^5\) in 2005 is certainly one of the reasons alliancing has experienced reduced usage, especially in Queensland. There is no evidence to suggest that governments will cease to use alliances in any particular area, though governments recognise that alliances are unlikely to succeed where vendors are party to an alliance. This caution has recently been included in a Queensland Government, better purchasing guide.\(^6\)

Despite the overwhelming benefits of alliancing cited in the alliance literature, these procurement options incorporate several flaws that make many government stakeholders, especially Treasuries, suspicious. Why, then, is alliancing used? My case studies and interviews revealed that governments use alliancing primarily to cater for high risk projects that are difficult to provide a defined scope for and for projects that demand an aggressive delivery schedule. In particular, governments use alliances

\(^4\) John Davies ‘Insurance Under an Alliance’ (presentation to the Alliancing Association of Australasia, Brisbane, 19 February 2008).

\(^5\) See Chapter two, 51-3.

for high risk projects for three main reasons. First, the use of conventional contracts on high risk projects will result in large contingency fees since contractors will load tendered prices to cover all risks, whether they eventuate or not. Second, where there are high risks, conventional contracts increase the likelihood of disputes and variations, because there is more likely to be changes in the scope of the project. Third, the use of conventional contracts in high risk projects will most likely result in degraded project quality, because contractors trade off project quality with cost and schedule objectives.

In addition to using these reasons as part of the *business case* for using alliancing, my case studies and interviews revealed that governments also use alliances as a tool to capture industry participation. The use of alliancing increases the likelihood of tenderers responding to a request for tender and the avoidance of *no bid* situations. Though governments must consider the *attractiveness* of procurement options to prospective tenderers, this reason alone is insufficient for the appropriate selection of alliancing. There is little in the alliance literature and government procurement policies advising on the use of alliancing as a reaction to an undersupply of construction and engineering contractors. This issue is explored in my recommendations for reform.

My examination of the construction and engineering forecasts for the next decade suggests that there will be further demands on the construction and engineering industry with alliancing remaining a key tool for the delivery of such projects, despite the introduction of competing procurement options such as ECI contracts and increasing use of PPPs. Australian governments have also committed themselves to alliancing with the release of several alliancing guides and policies. Consequently, alliancing is becoming a mainstream procurement option for the public sector. What is lacking in both the alliance literature and government policy is a robust analysis of the governance arrangements of such procurement options.

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Public Sector Governance Arrangements

This study examined the rules by which governments must operate in procurement in order to assess whether alliances actually meet these rules. Chapter four reveals that while governance arrangements do differ subtly between the levels of government and between the states themselves, there are common themes. The common governance objectives of the public sector include value for money (or stewardship), accountability, integrity, and transparency.\(^8\) All of these governance principles introduce obstacles for alliances, but it is the governance principle of value for money that proves most troublesome.

Stewardship

Stewardship demands the delivery of value for money. As demonstrated in Chapter six, there is no consistent definition of value for money used by Australian governments. Furthermore, the decision-making processes of governments are ill defined and prone to inappropriate manipulation. This situation proves a challenge for procurement managers engaged in any procurement activity, but pure alliances exacerbate this challenge since there is no price competition to ensure that project costs are a fair representation for the true cost of delivery. Consequently, even if a consistent and repeatable process is available to measure value for money, such a process would be meaningless in a pure alliance.

This study suggests that the auditing and independent validation processes of pure alliances are unsatisfactory since auditors neither have the resources nor capabilities to validate pure alliance target costs. Only the competitive TOC alliance provides a credible means of demonstrating that the target costs are fair. This criticism (the lack of price competition) may be extended to some conventional fixed price contracts since, in some circumstances, fixed price contracts involve substantial variations that significantly increase contract values. There is no price competition on these variations, but, as demonstrated in Chapter two, the problems of variations largely stem from poor specifications and not the form of contract.

\(^8\) Leadership is also a common governance objective of the public sector, though this is more of an enabling objective to achieve the compliance and performance aspects of governance (see chapter 4).
The alliance literature, from academics and alliance protagonists, universally recognises pure alliances as favourable to industry as the absence of price competition in tender selections makes tendering fast and cheap for contractors. This suggests that the public sector is sacrificing its governance values simply to encourage industry participation in projects.

The competitive TOC alliance adopts price competition for tender selection and this eliminates many of the value for money concerns associated with pure alliances. Despite the criticisms associated with competitive TOC alliances, I demonstrate that these criticisms are largely exaggerated. For example, the competitive TOC alliance sunk costs displace many of the pure alliance independent auditor costs, and reuse of the losing tenderer’s design solution can generate substantial cost savings. The alliance literature also cites the risks of less collaboration and a greater likelihood of diverging goals associated with the competitive TOC alliance when compared to pure alliances. Contrary to this view, my interviews and case studies revealed that competitive TOC alliances do not introduce any changes in the behaviours of the alliance participants after tender selection when compared with pure alliances. This accords with my general observation that positive behaviours and success are driven by the skills and leadership of the teams applied to the project, rather than by the form of the contract used.

Though the discussions on value for money are animated in the alliance community, I argue that these arguments are circular since there is no robust definition of value for

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10 See, eg, Chapter six where I demonstrate that some commentators significantly overstate the sunk costs of Competitive TOC alliances.
money and decision-making process can be manipulated to favour any outcome over another. Nevertheless, an absence of price competition proves a formidable challenge for justifying the selection of a tenderer even if governments define value for money in quantitative terms. The pure alliance therefore fails to satisfy the governance objective of stewardship, despite resources expended on independent auditing, probity advisors, and with the use of open book financial reporting.

**Accountability**

In conventional fixed price contracts, governments act as the principal and engage contractors on an arms-length basis. By comparison, alliances involve the creation of a virtual organisation with shared responsibilities. This study found that all alliance agreements require unanimity in decision-making, contain express terms demanding a ‘no blame’ and ‘no litigation’ environment, incorporate a remuneration system where participants all lose or all win, and require the establishment of the alliance where key roles are held by either industry or public sector personnel on a ‘best for project’ basis. Arguably, these features of alliancing are fundamental to project success by aligning goals, fostering collaboration, and driving innovation. Nevertheless, incorporation into an agreement of express terms that demand collaboration and the sharing of risks may prove to be a Faustian bargain. In particular, these alliance features create accountability tensions.

The spectre of deadlocks occurring with the alliance unanimous decision-making protocols is a real concern for governments. A reaction to this concern is the inclusion of deadlock breaking mechanisms in most alliances. Other accountability problems, though are not so easily eliminated. For example, I demonstrate that governments have no recourse to compensation for failures by the other alliance participants as the

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13 See, eg, Figure 6-1 in Chapter six.
14 Ross, above n 12, 2; Victorian Government, above n 7, 8; See also Chapter two.
15 See especially, Ross, above n 12, 13; Andrew Hutchinson and John Gallagher ‘Project Alliancing – an Overview’ (Centre of Advanced Engineering Seminar, Christchurch, NZ 2003) 17.
16 See Chapter two, 59.
alliance no blame and no litigation clauses\textsuperscript{17} dilute accountability for negligent acts or omissions on a project.

In addition, accountability issues arise from the fact that alliances typically allow for the progression of projects with broadly defined specifications and outcomes.\textsuperscript{18} This provides an avenue for governments to escape accountability for the integrity of project documentation, or as one interviewee phrased this ‘alliances provide an avenue to avoid doing the documentation leg-work’.\textsuperscript{19}

The \textit{teaming} philosophy of alliances, with a focus on relationship management, offers substantial benefits. Nevertheless, such relationships are at odds with the public sector governance objective of accountability. Comments from my interviewees to the effect that ‘we are all in this together’ are quite noble, but do not fit comfortably with the principles of division and assignment of responsibility. No other procurement option, joint ventures included, provides the same scope for a dilution of accountability than alliances.

\textbf{Integrity}

Integrity comprises principles of honesty, fairness, and objectivity.\textsuperscript{20} This creates problems for alliances in two distinct areas. First, alliances place government employees in a situation where they must simultaneously meet the requirements of the alliance, on a \textit{best for project basis}, and the broader goals of the public sector. This is a credible concern for governments if the alliance goals diverge from those of the alliance owner. In addition to this conflict of duty, a second problem arises in pure alliances with the absence of price competition. The governance objective of integrity requires fairness, but how is fairness demonstrated in the pure alliance ‘beauty parade’ tender selection process?

\textsuperscript{17} The no disputes and no blame clauses are common to all pure and competitive TOC alliances, see Chapter two,\textsuperscript{58}.
\textsuperscript{18} NSW Government, above n 7, 10; Victorian Government, above n 7, 17.
\textsuperscript{19} Interviewee F.
A conflict of duty is a credible threat to the success of alliancing. At the start of a project the goals of the alliance and those of the public sector must be congruent. If the alliance subsequently fails to perform then it is likely that the goals of each alliance participant will diverge. This is especially true for industry participants in the alliance whose overriding duty is to shareholders. Further issues emerge when considering the potential for fiduciary obligations arising in an alliance.

Though all of the alliance contracts I reviewed attempted to exclude the operation of the law of equity in the express terms of the agreement itself, the drafting of these exclusions is unlikely to be successful. I propose, in Chapter five, a clause that is more likely to be valid in excluding the intervention of equity in the alliance agreement. Nevertheless, the potential obligations imposed in equity are no more onerous than the express good faith obligations that form part of the alliance terms and conditions. Consequently, the risk of the creation of fiduciary obligations in alliances is overstated in the literature.21

Other than the problems associated with a conflict of duty, challenges also arise with the demonstration of fairness and objectivity in alliances. This is especially so in the pure alliance tender selection process. As Chapter seven demonstrates, the pure alliance relies on tender selection in the absence of price competition. This selection process therefore relies on more subjective assessment criteria and typically places substantial emphasis on a contractor’s past performance. This creates problems with the governance dimension of integrity in two areas. First, the reliance on subjective selection evaluation criteria diminishes the repeatability and reproducibility aspects of tender evaluations. This introduces greater scope for meddling in the outcomes of a tender evaluation. Second, the substantial focus on past performance in tender selection criteria disadvantages new entrants. That is not to say that past performance should be absent from selection criteria, but rather that there should be scope for new entrants to be granted reasonable access to government contracts. My examination of one pure alliance tender evaluation found that three of the seven selection criteria

21 Equitable remedies, however, provide for ‘specific performance’ should an alliance participant seek such relief.
focused on past performance. Such tendering practices are unfair to new entrants and are unlikely to comply with the Australian/US Free trade agreement principles.\textsuperscript{22}

The competitive TOC alliance does not suffer from these criticisms as governments primarily use price to discriminate between tenderers. For example, one competitive TOC alliance I explored in my case studies assigned a weight of 85 percent to the tendered price. This is certainly a fairer and more objective means to conduct tender evaluations.

All alliances increase the risk of a conflict of duty. In addition, the pure alliance is less likely to demonstrate fairness and objectivity in tender evaluations. The governance objective of integrity is therefore unlikely to be satisfied by alliance contracts. Certainly, other procurement options can suffer from the same criticism if they avoid price competition, but no other procurement option places government employees in a situation where they have \textit{two masters} and where tenderer selection is based primarily on qualitative evaluation criteria.

\textbf{Transparency}

Transparency demands openness and promotes confidence in public sector decision-making.\textsuperscript{23} Alliances incorporate open book reporting and this facilitates transparency in some areas. Nevertheless, there is no arms-length process in target cost development for a pure alliance project and there is no price competition demonstrating that this target cost is set fairly. Furthermore, the tender selection process of the pure alliance also compromises the governance objective of transparency since there is no repeatable means to demonstrate that tenderers were fairly selected. This is because the pure alliance tender selection process is based primarily on qualitative criteria.

Pure alliances attempt to mitigate some of the criticisms associated with the integrity of target costs by ‘opening up the process’ with independent auditors and probity

\textsuperscript{22} See Chapter 7, 279.
\textsuperscript{23} Ibid 8.
advisors. This certainly sheds some visibility into target cost development, but as I argue in Chapter six, auditing of this type is unlikely to yield useful information, as independent estimators will not have the resources to validate all aspects of the TOC. Pure alliances are therefore less transparent than conventional fixed price procurement options because, in these later contracts, price competition, and hence quantitative selection processes, sets the price fairly. The competitive TOC alliance, though, does not share these problems.

**Are alliances compatible with public sector governance objectives?**

This study has shown that pure alliances are left wanting in many areas when assessed against public sector governance objectives. It is true that many of the criticisms I levy against the pure alliance are equally applicable to other contractual vehicles, especially where variations are common and when price competition is avoided. Nevertheless, the pure alliance is more likely to compromise public sector governance objectives since there is diluted accountability, no price competition, no liability between participants, and the tender selection process lacks repeatability and reproducibility. All these elements conspire to create an environment for exploiting the alliance in a manner not consistent with the broader public sector objectives of delivering value for money, preserving accountability, promoting integrity and fostering transparency. Consequently, the pure alliance incorporates inherent weaknesses that are prone to abuse. Given the amounts of public money at stake, governments need to recognise and manage these weaknesses. The following section explores these alliance pitfalls in depth.

**The Potential Abuses of Alliances**

The governance arrangements of pure alliances are not as robust as those associated with conventional, fixed price procurement methods. This weakened governance framework introduces the potential for alliances to be misused. Though several of the reasons advanced for using alliances are valid, some of these reasons are susceptible to misuse. For example, the weakened governance environment of alliances enables
procurement managers to mask shortcomings in the public sector in the following areas:

a. Alliances as a mitigation strategy for poor project management skills,

b. Alliances as a tool to overcome poor specification development skills,

c. Alliances as a means to overcome poor configuration management practices, and

d. Alliances as a means to avoid best practice legal drafting.

Despite some of the alliance literature suggesting that alliances offer a means to avoid lawyers or use lawyers inappropriately,\textsuperscript{24} I found no evidence in my case studies and interviews to suggest that governments used alliancing to avoid legal review of the alliance contract. Furthermore, I found no evidence to suggest that governments used alliances as a tool to avoid robust specification development practices. What I did discover in my case studies and interviews was that governments were forced to rely on the use of alliancing where there were self-imposed deadlines that precluded the use of conventional procurement options and where the poor configuration management practices of government agencies made fixed price contracts unworkable.

The alliance therefore offers credible scope for misuse. In particular, governments may select alliancing to mask systemic failures in project management, contract drafting, configuration management, and specification development practices. No government procurement policy or guidance considers these potential abuses.\textsuperscript{25}

\textbf{Alliances as the Last Refuge of the Incompetent Project Manager}

Best practice project management demands an investment in effective resourcing, planning, and scheduling.\textsuperscript{26} This promotes an environment of ‘no surprises’ and adequate time for project planning. Conversely, an absence of sound project

\textsuperscript{24} Stephenson, above n 12, [5.1].


\textsuperscript{26} Project Management Institute, \textit{Project Management Body of Knowledge} (3\textsuperscript{rd} ed, 2004), ch 6.
management results in time pressures and inadequate resources available to deliver projects. Alliances are universally accepted in the alliance literature as being suitable for projects with aggressive schedules, where time pressures prohibit the use of conventional procurement options.²⁷ Alliances therefore provide a means to overcome poor strategic planning and project management practices. There was evidence in my case studies and interviews of circumstances where governments had to use alliances to overcome their own poor planning.

My interview and survey findings demonstrate that time pressures were a key reason for the use of alliancing.²⁸ As shown in Chapter three, governments considered the schedule imperatives of some projects to outweigh costs substantially, that is ‘schedule became king’. Nevertheless, in several of these alliances, schedule constraints were self-imposed.

I found two examples of alliances that faced self-imposed schedule pressures. The first was the upgrade of a waste water treatment plant to meet mandatory pollution targets (set by the Environmental Protection Agencies). The tightening of effluent targets (nitrogen and phosphorous emissions) required the modification of most of waste water treatment plants in Australia. For the one particular waste water treatment plant, the procurement authority considered alliancing the only procurement model able to meet the aggressive schedule constraints and to secure contractor resources that were in high demand.

The second example was the Sydney Northside Storage Tunnel Alliance. This project required completion prior to the Sydney 2000 Olympics. Despite the fact that this project deadline was known for quite some time, construction began quite late on this project. The procurement authority found that it could only achieve the project deadline with an alliance contract.²⁹

²⁷ NSW Government, above n 7, 42; Chapter three, 91.
²⁸ See Chapter three, figure 3-1, which demonstrates that schedule risks were rated higher than cost and performance risks.
In other alliance projects, the time constraints were the result of prolonged drought and an underinvestment in water security. Consequently, some of the schedule pressures resulted from unforeseen circumstances, but, in many cases, schedule constraints were self imposed and arguably, a result of poor planning or complacency. Procurement managers facing these circumstances felt that they could only meet the schedule imperatives with an alliance, since this procurement option best deals with project schedule constraints.

There is a danger that alliancing is used as a tool to overcome poor planning and project management practices since there is little incentive for governments to avoid situations where schedule constraints occur. This is a credible risk for governments as alliancing enters the mainstream of procurement options. Neither the alliance literature or government policy recognises this risk. In my recommendations for reform, I discuss the need for procurement business cases to identify what the causes of project schedule pressures are to assist procurement agencies recognise where alliancing is applied inappropriately.

Alliances as the Last Refuge of the Incompetent Specification Developer

Alliances are ideally suited for high risk projects where project scope is difficult to define, because conventional delivery mechanisms with fixed price contracts typically incorporate very high contingency fees to deal with project uncertainty. Consequently, alliances are attractive for projects with high geotechnical risks, software intensive elements, complex stakeholder needs, and variable project scope.\(^{30}\) This introduces the potential for governments to use alliancing where governments do not possess the skills or resources necessary to develop appropriate project briefs and specifications, simply because alliances do not require such documentation.

Chapter two demonstrates that most cost overruns are a result of poor specifications.\(^{31}\) An inappropriate treatment of this systemic failure is to use alliancing rather than

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\(^{30}\) Victorian Government, above n 7, 17; Ross above, n 12, 1.

\(^{31}\) See especially, Engineers Australia, ‘Getting it right first time: A plan to reverse declining standards in project design documentation within the building and construction and industry’ (2003) 3
develop competencies within government for robust specification development or invest in preliminary design activities to quantify project scope. Procurement managers may be lured into using alliances where they are faced with a lack of skills or resources to conduct a thorough investigation into project scope.

Though I saw little evidence to suggest that procurement managers exploit alliances as a means to avoid sound specification development and risk quantification, some alliance managers stated that they overused alliancing because even though there was high risk components associated with the project, the majority of the project risks were medium or low risk. One alliance manager stated that:

Next time we will break out the high risk components and deliver this under an alliance. The rest of the project will be under a D&C [Design and Construct] contract.

There is a risk of an overuse of alliancing for projects with scope that is difficult to define. This risk is likely to increase with declining skills in engineering competencies within the public sector. Governments must be cognisant of this risk and procurement business cases and trade studies should consider the use of scoping studies, site surveys, and rapid prototyping where possible. Governments should not automatically apply alliancing to projects simply on the basis that there is high risk or unquantifiable risks associated with a project.

**Alliance Contracting as a Cure for Poor Configuration Management Practices**

Alliancing is an attractive procurement option when the configuration of a project is unknown. This is generally not an issue with *greenfield projects*, but is a likely

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32 For example, the Department of Defence recommends ten percent to 15 percent of the project budget be expended on project definition prior to release of a request for tender; Department of the Prime Minister and Cabinet ‘Defence Procurement Review’ (2003) 12


34 Interviewee C.

35 Engineers Australia, above n 31, 28, which recognises the retirement of skilled ‘baby boomers’ and a shortage of engineers causing the problems of poor specifications.

36 Greenfield projects are defined as new systems or infrastructure developed from ‘a blank sheet of paper’. For example, the design and construction of a new bridge or a new sports stadium. By way of contrast, the refurbishment, upgrade, or redevelopment of existing systems is not considered a greenfield project.
problem for upgrades to existing infrastructure or systems. Many alliances involved such upgrades. In Chapter two, for example, I identify the use of alliances for rail upgrades, defence platform upgrades (ships and aircraft), and waste water treatment plant upgrades. In many of these projects the configuration status of existing systems proved to be a high risk, because the alliance owner was uncertain of the exact configuration of their own equipment. This precluded the use of conventional fixed price contracts. Consequently, government’s own poor configuration management practices led to the use of alliancing, as the following examples illustrate.

On one rail upgrade project, an alliance manager stated that the configuration of rail signals and wiring was unknown, because no records were made of the original wiring installed over fifty years ago. This agency considered a conventional fixed price contract to be inappropriate as the rail upgrade project involved substantial signal wiring upgrades and the agency could not advise contractors where existing wiring installations were.

Similarly, in one of my interviews, one alliance contract manager stated that they used alliancing on their rail upgrades because the rail authority in question had no idea what the configuration of their track was from a reliability perspective. For the maintenance of a significant length of track, the rail authority could not adopt fixed price arrangements and they consequently had to use alliancing.

As the above examples illustrate, alliances proved a means to mitigate against unknown configurations of existing systems. This provides an avenue for exploiting alliances in areas where poor configuration management practices are rife. Governments should recognise this risk and ensure they do not use alliances to cater for configuration management failures.

37 Interviewee H.
**Alliance Contracting used as a Tool to Mitigate against Poor Contract Drafting**

Unlike conventional contracts where responsibility for risks, rights, and obligations are clearly stated, the alliance involves risk sharing with few legal rights and responsibilities. Several interviewees expressed the view that ‘alliances keep the lawyers out of the loop’.\(^{38}\) There is also a perception in some of the alliance literature that alliances do not require robust legal review.\(^{39}\) The fact that alliances include a ‘no disputes’ clause and a regime of ‘no liability’ lends weight to the view that lawyers have little bearing on alliance contract development. This introduces the risk that governments become cavalier in the drafting of alliances and this could lead to sacrificing certainty in the agreement.\(^{40}\)

My review of eleven alliance agreements found that some of the alliance clauses are poorly drafted and do not provide sufficient certainty to the participants of the alliance. This is especially so in the drafting of fiduciary obligation exclusion clauses (see Chapter five). This view is corroborated by the following observation from a legal commentator:

> …some alliance contracts are loosely drafted and do not clearly deal with risk allocation between the parties.\(^{41}\)

Governments need not draft alliances as robustly as a fixed price design and construct contracts; nevertheless, alliances must clearly articulate rights, responsibilities, and obligations. Many alliance contracts are uncertain in this area with the role of the lawyer stated in vague terms.\(^{42}\) The poor drafting of some alliance agreements is surprising considering the responses from my interviews with four senior lawyers

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\(^{38}\) Interviewee F, Interviewee G.


\(^{40}\) See especially, Stephenson, above n 12, [5.1]; Hayford, above n 12, 50-1.

\(^{41}\) James Forrest ‘Legal Considerations of Alliance Contracts’ (paper presented at the Institute of International Research Alliance Contracting Conference, Brisbane 7-9 Dec 2005) 4.

\(^{42}\) ‘It is submitted that the idea that alliance contracting can or should be a legal concept confuses the role of a lawyer with that of management.’ Stephenson above n 12, [5.1].
experienced in drafting alliance agreements. Their responses confirmed that governments expend substantial resources in developing alliance agreements. The relative lack of maturity of alliancing may explain some of the poor drafting of these contracts when compared to, say, a mature system of contracts such as the Australian Standard, *General Conditions of Contract* suite (AS4000-1997, AS2124/1992).

Though I found no evidence to suggest alliances are used to avoid robust legal review, there is a potential for procurement agencies to be seduced into using alliancing as a means to avoid the time and expense of involving the legal profession. Certainly, the presence of a no-disputes regime and a relationship of no liability provide a false impression that legal review is unnecessary. Nevertheless, alliances demand the clear articulation of rights and obligations, just like any other contract.43

There are clearly avenues for abusing the alliance contract to overcome systemic problems in the public sector, but do the benefits of these procurement options outweigh the risks?

**Are Alliances Successful?**

This study demonstrates that alliances fail to meet many of the governance objectives of the public sector and that there is substantial scope for misusing alliances. Despite these shortcomings, I must answer the broader question of whether alliances are successful. This is necessary since alliances are one of many potential delivery mechanisms available to the public sector. If other procurement methods are unable to deliver project outcomes faster and cheaper than an alliance, then no matter what governance risks exist with alliances, the alliance is the most suitable procurement model (the alliance is the lesser of two or more evils!)

Assessing the success of alliances is a challenge in itself as the term *success* is not easy to specify. My examination of value for money in Chapter six highlights this problem. The majority of my interviewees judged alliance success to be based on delivering the project both within the target cost and schedule and to the desired performance requirements. Most alliances appear to achieve this goal, with the cost

43 Stephenson, above n 12, [6]; Forrest, above n 41, 5.
of delivery of alliance projects within five percent of the target cost. The problem with these metrics is that it is the alliance itself that sets the target cost and hence target costs become self-fulfilling prophecies. An alternative test for success would be to compare the alliance outcomes with what other procurement options would have delivered. Such a test is elusive.

A broader test I explored was asking interviewees whether they would use alliancing again, given the same circumstances. All replied that they would, though two respondents said that they would change their type of alliance. Alliancing has also entered the mainstream of procurement. This is indicative that the alliance is a successful procurement model, despite observations from critics of pure alliancing who are sceptical of the gains made. Nevertheless, there have been alliance failures and this study demonstrates that achievement of the target cost is not a measure of success. A more relevant measure of success, then, is to identify procurement model features that are more likely to deliver faster, cheaper and better outcomes when compared with alternatives. This study recognises that there are features more likely to result in project success. I derived these success factors from observations in my case studies, interviews, survey responses, and from the alliance literature. In particular, interviewee responses show that fair risk allocation, adequate time for planning, and strong leadership are crucial to project success. Consequently, it is the following features that are likely to lead to alliance success:

a. Adequate resources (time and money) to develop realistic project cost estimates and schedules,
b. Strong and effective leadership,
c. Commitment to project success,

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46 See especially, Stephenson above n 12; Cowan et al above n 12.
47 See Chapter five, footnote 103.
d. A culture of continual improvement,
e. Fair risk allocation,
f. Fair profit margins for industry participants, and
g. Clearly articulated project goals and specifications.

It is important to recognise that these features may appear in both alliances and conventional contract delivery methods. Alliances, though, are more likely to incorporate these features for the following reasons.

First, pure alliance participants can take as long as they wish and spend as much money as they want to develop target costs. This is not the case with a conventional fixed price contract. Second, alliances demand strong leadership from all participants with the formation of alliance leadership and management teams.\(^{49}\) Third, alliances force parties to commit to project success since all alliances use a gainshare/painshare remuneration system (all win or all lose). Fourth, these alliance gainshare and painshare arrangements reward innovation and continual improvement. Fifth, all project risks are shared in an alliance. This therefore avoids the problem of risk being allocated to parties that cannot control that risk. Sixth, fair profit margins for industry participants are agree upon prior to entering the alliance contract. Finally, project goals and specifications are clearly defined in the development of the alliance target cost in a collaborative manner. Risk workshops are also used extensively in the alliance,\(^{50}\) and this greatly reduces the likelihood of disputes.

I do not conclude that alliances succeed simply on the basis that they are ‘alliances’; rather, this study demonstrates that alliances likely succeed because they force participants to define project requirements robustly and to treat risks sensibly (at the expense of the compliance aspects of governance). Furthermore, the alliance develops target costs and schedules after considerable time and money is expended. Competitively developed bids are not provided with these luxuries.

\(^{49}\) Ross, above n 12, 21.

\(^{50}\) My interviews with alliance insurance brokers revealed that insurance underwriters were intimately involved in robust risk workshops at the beginning of alliances, John Davies ‘Insurance Under an Alliance’ (presentation to the Alliancing Association of Australasia, Brisbane, 19 February 2008).
Chapter Eight – Conclusions and Observations

The alliance process certainly increases the likelihood of positive collaboration and the alignment of goals, but there is no reason why such attributes cannot be associated with other contract delivery models. The success of ‘partnering’ and ECI contracts, discussed in Chapter three, is an example of this. This study therefore demonstrates that alliance success is mostly a result of sensible risk management and with adequate resources assigned to project planning.

As a final observation, it is useful to review why conventional contracts have failed to deliver successful outcomes.\(^{51}\) Other than the problem of defective specifications, discussed in Chapter two, another reason for adversarial behaviour and excess contract claims stemmed from the fact that contract margins in the previous decade were razor thin.\(^{52}\) Where contractors were operating on less than five percent profit margins, the only scope for making an equitable profit was through the escalation of contractual claims.\(^{53}\) Furthermore, the likelihood of winning work was very low. This resulted in increasing bid costs to industry and the common practice of underbidding prices to win work and then recover profit from variations.\(^{54}\) It is unsurprising that in these circumstances, fixed price contracts resulted in major cost escalations and disputes.

The current construction and engineering market is less competitive and profit margins are much higher.\(^{55}\) This has substantially reduced the likelihood of claims and disputes for all contracting vehicles. It is erroneous to compare the claimed success of present day alliances to the failures of conventional fixed price contracts a decade ago. Consequently, there is a bias towards the over reporting of alliance success and conventional fixed price contract failure.

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\(^{54}\) Hayford, above n 12, 45; Ross, above n 12, 13.

\(^{55}\) Freehely, above n 44, 4.
Future Directions

Even though alliances are now in the mainstream of government procurement options and many procurement agencies are comfortable with their use, I have identified several shortcomings of the governance arrangements of these contracting vehicles. In this section I suggest reforms that will improve the governance arrangements of alliances. In particular, I recommend consideration of the following.

Value for Money

Governments must adopt a robust definition of value for money to facilitate repeatable and reproducible decision-making. In Chapter six, I demonstrate that governments can manipulate value for money decision-making to justify any outcome. For example, a procurement officer can justify three different outcomes depending upon whether they use expected value, minimax or maximax decision-making rules. Similarly, the encroachment of political and social objectives in tender evaluations increases the scope for inappropriate interference in tender evaluations.

The risk of abuse of government decision-making cannot be eliminated, as all decisions are likely to involve some qualitative elements. Nevertheless, pure alliances place an emphasis on subjective evaluation. Governments must recognise the problems created with measuring value in alliances and adopt consistent measures for conducting tender evaluations and use consistent decision-making criteria. For example, governments should mandate the use of expected value decision-making and capture all project costs and benefits in business cases prior to selecting a procurement option. This will not only improve the legitimacy of pure alliances, but also that of conventional contracts.

I incorporated these recommendation in a Queensland Government, better purchasing guide (emphasis added):
Procurement agencies are to develop cost probability curves for each procurement option. *These cost probability curves must consider all life cycle costs and incorporate risk adjusted expenses and benefits in ‘expected value’ terms.*

These elements [value for money] are of significant relevance to alliance contracts as these procurement options deliver substantial non-cost benefits and incorporate hidden costs and benefits that are typically not considered in conventional contract delivery methods.

Though it is not possible to provide a consistent and measurable definition of value for money to meet all procurement situations, governments must ensure that the encroachment of political and social objectives in tender evaluations is consistent between departments and projects. This is a broader consideration of the problem of applying value judgements in tendering and is not just limited to alliances.

**Price Competition**

The competitive TOC alliance negates many of the pure alliance shortcomings identified in Chapters six and seven. Governments must therefore consider continued use of competitive TOC alliances with the aim of attracting industry into bidding on such contracts. As recognised in Chapter seven, competitive TOC alliances are less attractive to industry when compared to pure alliances, as the competitive TOC alliance requires the commitment of scarce resources, such as design teams, with no guarantee of winning work. In a construction and engineering market that is short of supply, governments may need to increase tenderer remuneration during the competitive phase of this alliance model to attract participants. This will increase sunk costs to the project, but will overcome the risk of ‘no-bid’ situations. Furthermore, these increased sunk costs deliver substantial benefits with the demonstration of value for money and the demonstration of fairness in tender evaluation. In addition, the competitive TOC alliance also provides cost savings since there is little or no need for independent estimators to validate target costs. Recognition of these competitive TOC benefits appeared recently in a Queensland...

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56 Queensland Government, above n 6, 21.
57 Ibid 4.
Government, better purchasing guide,\textsuperscript{58} because no other alliance guide identified the reduced need for independent estimators in competitive TOC alliances.

Alternately, governments can better demonstrate of value for money with the use of an \textit{alliance program}. This contracting strategy provides a means to demonstrate value for money more effectively between stages of a pure alliance although only large-scale projects that can be broken up into phases are suitable for such a strategy. The Queensland Government better purchasing guide for alliances, is the first government procurement guide to recognise the benefits of alliance programs.

\textit{… improved demonstration of value for money resulted by using the actual outturn costs of the first alliance as the target costs for subsequent alliances. This resulted in a continual improvement for subsequent alliances with significant stretch targets incorporated into the Target Outturn Costs. Bundling of projects into a ‘program alliance’, is suited in these circumstances as the subsequent alliances involve the same risks, technologies, and geographic circumstances.}\textsuperscript{59}

\textbf{Alliance Procurement Guidance}

Though alliances are now a mainstream government procurement method and several alliance guides are available at the state government level, there is little to warn procurement officers of the pitfalls of alliancing.\textsuperscript{60} In particular, this study demonstrates that alliances may be used inappropriately to overcome systemic failures in the operation of key government activities including specification development, project management, configuration management, and contract drafting. The alliance literature and alliance guides also fail to recognise many of the hidden costs of alliancing. The pure alliance places significant emphasis on independent auditors, probity advisers, and participation of government employees in the alliance team. Though these activities incur substantial costs for the public sector, they are given scant consideration in the alliance literature. Consequently, governments must provide guidance at the strategic level to warn against the potential abuses of alliances and the

\textsuperscript{58} Ibid 14.
\textsuperscript{59} Ibid 21.
\textsuperscript{60} For example, none of the Victorian Government, NSW Government or Queensland Department of Main Roads procurement guides (Chapter 8, footnote 7) identify the alliance risks in this chapter.
hidden costs of these procurement options. This guidance has been recently included in a Queensland Government, better purchasing guide:

Alliancing should not be used as a means to cater for shortfalls in project documentation/specification development competencies…Procurement agencies should not adopt alliancing simply because they do not have the resources to develop appropriate project documentation.

Alliancing should not be used to mitigate schedule pressures resulting from poor planning… Alliancing should never be considered a project management tool for dealing with self-imposed schedule constraints.  

Exporting Alliance Benefits to Other Procurement Options.

This study demonstrates that the success of alliancing lies largely in the alliance process. In particular, alliances demand investment in risk management and a thorough investigation into project scope (to develop the target costs). These features of alliancing can easily be transferred to conventional procurement options. For example, conventional contracts can benefit by encouraging tenderers to conduct risk workshops, and from governments providing tenderers with ample opportunity to explore the project scope, possibly with government funding.

My investigations into the failures of conventional contracts in Chapter two demonstrate that poor project documentation is the major cause of disputes and cost overruns. Consequently, governments must not only invest adequately in project definition activities, but must also encourage tenderers to enter into a ‘negotiated risk transfer’ process to deliver a realistic project cost and schedule. The emergence of the ECI contract is a step in this direction. Though risk management and thorough project scoping will increase tender duration and cost, the end result is greater certainty for both governments and contractors.

61 Queensland Government, above n 6, 19.
Hybrid Alliances

Many alliances have retained liability in the alliance model on the basis that this is the only means available to procure cost effective insurance. The insurance industry has responded to the proliferation of alliance contracts with the development of cost effective first party insurance products. My examination of these insurance products reveals that alliance insurance offers comparable cover to conventional insurance at a similar price. There are no compelling reasons to use a hybrid alliance for the sole purpose of procuring insurance. Government procurement guides must alert procurement managers to the fact that the current insurance market does cater for first party insurance policies and there is therefore no requirement to maintain liability between alliance participants for the purposes of gaining insurance.

I included such guidance in a Queensland Government, better purchasing guide:

Recent developments in the insurance industry have led to the development of ‘first party’ principal arranged insurance products. These products provide alliances and other ‘no-blame’ contractual relationships with cost effective insurance cover for major projects. The continuation of such insurance products will be contingent on the insurance market.

Conclusions

This study has encompassed an investigation into what alliances are, where they are used, why they are used and in what governance environment. I have demonstrated that alliances are significantly less likely to satisfy the governance objectives of the public sector than conventional contract delivery mechanisms. A solution to this is to either change the governance arrangements of alliances or the governance rules of the public sector.

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63 Cowan et al, above n 12.
64 Queensland Government, above n 6, 15.
The governance rules of the public sector need attention. Improvements are required in how governments define value for money and how governments select decision-making rules. Without a robust and repeatable framework for measuring the value of competing procurement options and tenderers then any attempts to develop project business cases are fraught with the risks of abuse.

Alliances also need to evolve to better demonstrate value for money, retain accountability for outcomes, and achieve fairness in tender evaluations. The competitive TOC alliance is best suited for eliminating many of the pure alliance failures in demonstrating value for money; nevertheless, all alliances create accountability tensions with shared decision-making and the creation of a virtual organisation. Governments may simply need to consider diluted accountability, and a conflict of duty as a ‘cost of doing business’ with alliances. Governments must capture these costs in project business cases and during the selection of procurement options.

In Chapter three I demonstrate that alliances offer substantial benefits in projects with undefined scope and high risks. This provides a means for governments to exploit alliancing to mask broader shortcomings in the public sector. In particular, alliances can potentially hide broader problems such as poor specification development, project management, configuration management, and contract drafting practices. Governments must clearly articulate these issues in policy and procurement selection guides so that procurement officers and approvers are cognisant of the potential over use of alliancing.

Though this study has focussed on many of the negative aspects of alliances, I cannot ignore the positive response these contracting vehicles receive from both governments and industry. I do consider that there is a legitimate niche for using the alliance process in high-risk projects that are subject to variable scope. This is even considering the substantial governance shortcomings, since in these circumstances, conventional fixed price contracts will likely result in very high contingency fees, disputes, and poor project quality. Nevertheless, procurement agencies should be alerted to the risks of these contracts and capture all alliance costs and benefits in business cases.
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Standards Australia  AS 4000-1997, General Conditions of Contract
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September 2008


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Annex A

Alliances and Public Sector Governance Objectives

QUESTIONNAIRE COVERSHEET

Senior Investigator
A/Prof Justin Malbon
Dean, Griffith Law school
Griffith University
Phone 56483
Email j.malbon@griffith.edu.au

Student Researcher
John Davies
MPhil Student
Griffith Law School/Socio-Legal Research Centre
Phone 0407064893
Email davies71@bigpond.net.au

Background
Alliance contracts are used extensively by all levels of Government in Australia. Though there are many benefits associated with the use of Alliance contracts there are several perceived risks. Case studies of select alliances are being conducted to explore alliance participants’ perceptions of risks and benefits of alliance structures.

What Participation in this Questionnaire Involves
Participation in this study asks that you complete a questionnaire or participate in an interview that enquires about your perceptions of alliance contracts. It is estimated that the questionnaire/interview will take you approximately 30 minutes to complete. In which case, your written completion of the questionnaire is not required.

The Expected Benefits of the Research
The outcomes of this research will provide a more thorough understanding of the governance tensions associated with government’s use of alliance contracts. This may enable alliance participants in a government owned alliance to better understand alliance risks and benefits

Risks to you
Participation in this research poses no risks, as the research will not enable any individual respondent to be identified. This research explicitly excludes the assessment of any commercially sensitive information from alliance participants. The principle researcher has completed a deed of confidentiality with your alliance.

Your confidentiality
We assure you that your name and any information that you provide to us will remain completely confidential.
Your participation is voluntary
Your participation is this questionnaire is voluntary. Participants do not need to answer every question unless they wish to do so. Participants are free to withdraw from the study at any time up to the collation phase of respondents data (Sep 2006).

Questions / further information
At any time, requests for information or clarification can be discussed with the Student Researcher, John Davies.

The ethical conduct of this research
Griffith University conducts research in accordance with the National Statement on Ethical Conduct in Research Involving Humans. If, at any time you have concerns about the ethical conduct of this study, you can contact:

Manager, Research Ethics, Office for Research, Bray Centre, Nathan Campus, Griffith University (ph 3875 5585 or research-ethics@griffith.edu.au).

Privacy
The conduct of this research involves the collection, access and / or use of your identified personal information. The information collected is confidential and will not be disclosed to third parties without your consent, except to meet government, legal or other regulatory authority requirements. A de-identified copy of this data may be used for other research purposes. However, your anonymity will at all times be safeguarded. For further information consult the University’s Privacy Plan at www.griffith.edu.au/ua/aa/vc/pp or telephone (07) 3875 5585.

Expressing consent
If a potential participant completes and returns the questionnaire, they will be deemed to have consented to their participation in the research. Please detach this sheet and retain it for your later reference. If you agree to participate in an interview, your consent will be verified and recorded by the researcher.

Griffith University thanks you for your consent and participation in this research.
CONSENT FORM

Alliance Compatibility in the Delivery of Public Infrastructure/Services

Senior Investigator
A/Prof Justin Malbon
Dean, Griffith Law school
Griffith University
Phone 56483
Email j.malbon@griffith.edu.au

Student Researcher
John Davies
MPhil Student
Griffith Law School/Socio-Legal Research Centre
Phone 0407064893
Email davies71@bigpond.net.au

I have read the information form and understand that:

• This research is to investigate perceptions of alliance contracts
• I am being asked to complete a questionnaire/participate in an interview about my perceptions of alliance contracts
• The questionnaire/interview will take me approximately 30 minutes to complete
• My participation is voluntary and that I may discontinue my participation at anytime without penalty or explanation
• Any reports or publications from this study will be reported in general terms and will not involve any identifying features
• The data will be kept confidential at all times with email/written responses destroyed after collating the study’s findings
• A report about the study findings will be made available to me.

I have read the information sheet and the consent form. By completing and returning this questionnaire, I agree to participate in this study and give my consent freely. I understand that the study will be carried out as described in the information statement, a copy of which I have retained. I realise that whether or not I decide to participate is my decision alone. I also realise that I can withdraw from the study at any time and that I do not have to give any reasons for withdrawing. I have had all questions answered to my satisfaction.

………………………………………………        …………

Name and Signature/Date
Questionnaire – Alliance Contracts

1. How do you perceive the risk associated with your Alliance Project (tick one against cost, schedule & performance)? (candidates may use AS 4380:2004 for risk definitions)

<table>
<thead>
<tr>
<th></th>
<th>Low</th>
<th>Medium</th>
<th>High</th>
<th>Extreme</th>
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<tbody>
<tr>
<td>Cost</td>
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<td>Schedule</td>
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<td>Performance</td>
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</table>

Comments:

2. How would you rate the effort involved in setting up your alliance compared to traditional contracting methods? (consider cultural alignment, alliance workshops, training etc.)

(Significantly less, less, no difference, more, significantly more)

3. How was the Alliance Target Cost Estimate (TCE) or Target Outrun Cost (TOC) developed? Eg. was the TCE/TOC developed collaboratively, were benchmarks used, were stochastic models used etc?

4. Compared to traditional contracting methods how confident are you that an alliance represents appropriate risk sharing?

(Very Confident, Confident, Neutral, Unsure, Very Unsure)

5. Are you satisfied that your project TCE/TOC is a genuine pre-estimate of the project?

(Strongly Agree, Agree, Neutral, Disagree, Strongly Disagree)

6. What is the current progress of your alliance contract? eg have you achieved detailed design, is the project complete?
7. State whether you believe the following influenced the selection of Alliancing for project delivery (indicate whether you strongly agree, agree, neither agree nor disagree, disagree or strongly disagree). Tick one for each criterion.

<table>
<thead>
<tr>
<th>Alliance Selection Criteria</th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Neither Agree/Disagree</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value for money</td>
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<td>Risk reduction</td>
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<td>Government/management direction (policy driven)</td>
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<td>Flexibility</td>
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<tr>
<td>Inability to scope project</td>
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<td>Reliance on termination for convenience clauses</td>
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<tr>
<td>Elimination of legal remedies</td>
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</tbody>
</table>

7. How do you perceive the risks associated with Alliance contracts for each of the following criteria using a scale of one to ten (one being lowest risk, ten being highest risk)?

<table>
<thead>
<tr>
<th>ALLIANCE RISK CRITERIA</th>
<th>Perceived Risk (1-10)</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conflicts of interest/duty</td>
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<tr>
<td>Establishment of fiduciary duties</td>
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<td>Governance/Commercial incompatibility</td>
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<td>Integrity of Target Cost Estimates</td>
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<td>Reduced legal remedies</td>
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<td></td>
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<tr>
<td>Lack of applicable case law (reduced certainty)</td>
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<tr>
<td>Alliance board deadlocks</td>
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<tr>
<td>Opportunistic behaviour by alliance participants</td>
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</tbody>
</table>

8. Is your alliance board effective in resolving disputes or issues?

(Strongly Agree, Agree, Neutral, Disagree, Strongly Disagree)
9. Are you familiar with the governance/employee code of conduct provisions of your organisation? (YES/NO)

If YES, state what they are (eg. ANAO guidelines, Australian Public Service code of conduct)

10. Do you consider that your governance principles are consistent with your obligations under an alliance? (consider conflict of interest, accountability, value for money criteria).

11. Have any disputes associated with your Alliance been referred to the Alliance board for resolution? (YES/NO)

If YES, were those disputes resolved to the Satisfaction of Government?

12. Given the circumstances for your project, would you recommend using an alliance for similar projects? (YES/NO)

If NO, briefly explain why not.