FEATURE ARTICLE

Project financing of alliance-based projects

This article seeks to investigate the compatibility of project alliancing and project finance, with a particular focus on how traditional lender concerns during the construction stage of any given project may be equally, if not better, addressed where that construction is delivered on an alliance basis rather than through a more traditional contacting method.

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Introduction

The rise of alliance contracting, whereby the parties contractually agree to work in an open and trusting manner on the basis of aligned commercial interests, has been viewed by many in the worldwide construction industry as a significant step forward in allowing complex projects to be completed on time and within budget. Notwithstanding the general support of industry, major banks and financial institutions have not always shared the same confidence that alliance contracting can deliver those outcomes necessary to support limited recourse financing. Support for alliance contracting within these banking circles is nevertheless critical to ensure not only that individual project alliances receive necessary financing, but also to ensure the ongoing viability of the alliancing model.

This article seeks to investigate the compatibility of project alliancing and project finance, with a particular focus on how traditional lender concerns during the construction stage of any given project may be equally, if not better, addressed where that construction is delivered on an alliance basis rather than through a more traditional contacting method. This article will argue that, while traditional fixed price, fixed time contracting retains a central place in achieving the best outcomes for owners and lenders alike, project alliancing, when used for an appropriate project, offers the opportunity for both superior outcomes and a more cost-effective method of managing project risk.

Project alliances

Project alliancing is generally described as a project delivery structure whereby all participants share in the results of a project, be they positive or negative, against agreed project objectives and assessment criteria. Projects are planned and executed by an integrated owner-contractor team on a 'best for project' basis, with risks to be addressed by means of participant cooperation and without resort to adversarial legal processes. Project alliancing is an inherently flexible form of procurement and, for that reason, the descriptions set out in this article are by their nature general and, in practice, will be adapted to the particular circumstances of the given project.

The identity of the participants in a project alliance will vary to reflect those entities which have the ability to significantly influence the outcome of the project. In any case, a project alliance will in almost all cases include the 'owner' of the project (which may be a concessionaire that will not, in a legal sense, actually own the asset to be constructed) and the construction contractor. Additionally, it is very common for the designer of the project to be made party to the alliance, particularly given the disproportionate effect that the design and engineering of a project may have on a project's delivery. In appropriate projects (and even where it is not the 'owner' of the project), a government authority in its capacity as a concession grantor may also be a member of the alliance. Another potential alliance participant, to which we will return later, is the operations and maintenance contractor, notwithstanding that it will not be directly engaged in the project's construction.

Perhaps the most challenging aspect of project alliancing, from a financing point of view, is the payment structure. A project alliance will generally provide for non-owner participants (primarily the construction contractor and designer) to be reimbursed all of their direct costs incurred in implementing the project (subject to certain exceptions), meaning that costs caused due to the ordinary default or negligence of a participant will be recoverable by the non-owner participants in the same way as all other costs.

Other key features of a project alliance, many of which directly relate to the interests of lenders include an overwhelming focus on creating a 'best for project' environment, with an alliance team drawn from the most capable staff of each of the alliance participants being managed by an alliance board that is empowered to take almost all decisions in relation to the project on a consensus basis only.

Generally the parties will agree to a very limited liability arrangement, with the traditional position being for each party to be liable for its wilful default only. This structure is intended to underpin the best for project approach and foster a creative environment by ensuring that participants do not act to protect their own company's position. In addition to the lack of certainty regarding the cost of the project, an alliance will additionally provide no contractual certainty (nor any contractual recourse) with respect to the owner's other key objectives, including the time for completion and the performance of the constructed asset.

While the non-owner participants will, barring acts of wilful default, always be entitled to recover their direct costs incurred in implementing the project, those participants will only earn profit and recover their non-project specific overheads if the project achieves certain minimum requirements, including staying within the alliance budget, completing within time, maintaining excellent relations with the local communities and causing no disturbance to the environment. Where the project exceeds the owner-participant's requirements, the non-owner participants are typically rewarded at level far greater than that available in a traditional procurement – excellent performance delivers excellent rewards. Importantly, the targets against which the performance of the alliance is measured are only subject to change in truly exceptional circumstances, meaning that ongoing variations to those targets are excluded, on the basis that the very aim of the alliance is to collectively manage such issues to mitigate their effect. This gainshare/painshare arrangement forms the basis for the commercial alignment of the alliance participants and the best for project ethos that underpins the alliance's performance.

One should note, however, that a project alliance is not a 'cost plus' arrangement contract and, while there are superficial similarities, neither is it a 'partnering' arrangement (which enjoys a certain popularity in the UK based on the New Engineering Contract standard form).

Project finance

In simple terms, project finance or limited recourse finance is finance provided solely for the purpose of, and based on the security provided by, the relevant project. In such an arrangement, lenders do not have any recourse beyond the project assets, the most important of which is the revenue stream which the constructed asset is expected to generate and which will, in turn, repay the project finance loans in the agreed period. A classic project finance structure requires the borrower (typically the project owner) to be a special purpose vehicle with the project being its sole asset. The shareholders of the borrower will inject an agreed level of equity into the borrower, however the nature of project financing means that shareholders will seek maximise the leverage of their investment by maximising debt and minimising equity.

In a project finance scheme, lenders are exposed to significant downside – if the project fails there may be no way to repay the debt. Similarly, if the cost of constructing the project is greater than expected, the revenue that the project produces may be insufficient to repay the initial construction price plus the interest that has accrued. A consequence of the parameters of a project financed deal is that lenders will tend to require certainty for all aspects of any project which is to be financed on such a basis: certainty of construction costs; certainty of time to complete the construction phase; certainty that the built asset will perform in the way expected; certainty that the built asset will have only those operation and maintenance costs budgeted for by the lenders; and certainty that the revenue anticipated to be generated by the project will, in fact, be produced.

Perhaps more so than in other branches of finance, in order to be able to lend project finance requires certainty that where the assumed outcomes are not able to be achieved for any reason, there exists a clear allocation of risk pursuant to which entities other than the borrow (whether that be the construction contractor, the project's users, the government or the insurers) will ensure that the project's economic position is kept within the lender's initial assumptions. This approach of project finance lenders is often referred to as a 'bankability' analysis.

Project finance lenders will, therefore, tend to focus on certain features of the construction solution (be it traditional or alliance based) proposed for a project, in particular:

- the certainty of the price of the works. Lenders will generally require a fixed price with limited opportunities for it to be reopened;
- the certainty of the projected time for completion, with liquidated damages (sized at a level that will meet the borrower's debt service obligations) to be payable in the event of a delay; and
- adequate and enforceable financial remedies in the event that the construction contractor fails to meet to owner's (and the lenders') requirements, including, with respect to industrial projects, performance damages where the built asset cannot operate at the level expected.

On the face of it, such requirements appear to rule out a project finance funding solution where a project is to be delivered by a project alliance. However, as we propose to demonstrate in the remainder of this article, this is a somewhat glib analysis that both overestimates the true protection that a traditional construction contract delivers for project finance lenders and underestimates the broader benefits available using a project alliancing approach.

Bankability and the myth of fixed price, fixed time contracts

For an experienced construction practitioner (whether that be in project management, law or engineering) this is stating the obvious, but the reality is that a fixed price, fixed time contract does not necessarily mean that the project will either be built by the time required or for the initially agreed price, and nor does it mean that the owner will be able recover the losses it incurs as a result of a failure of the contractor to deliver within the parameters initially agreed. Variations, owner or third party interference and new regulatory requirements are just some of the circumstances where, under most traditional contracts, the owner's and lenders' expectations on time and cost would be breached. Furthermore, it is generally the case that fixed price and fixed time contracts do not seek to manage future risks or even to identify them at an early stage in order to mitigate their effect; rather such contracts simply allocate responsibility without practical consideration as to how such risks, should they occur, will actually affect the project. When events that are the risk of the owner arise, the contractor will be entitled to make a claim for its additional costs and time based on moving its entire construction programme to address the particular issue, representing a level of additional owner expenditure that would be far lower had the risk been more proactively managed.

An additional concern for lenders and owners alike is that, from the perspective of a contractor, the manner in which to make the greatest profit under a traditional construction contract is to deliver as little as possible while still meeting the contractor's contractual obligations. Where such a delivery may lead to a fundamental issue for the owner, this will inevitably result in a variation being ordered, entitling the contractor to additional time and cost as described above. Without a variation, such an approach from a contractor may lead to the constructed asset having higher ongoing operation and maintenance costs than originally expected, or the asset performing at a level which is below that which could otherwise have been achieved.

The foregoing paragraphs set out a few examples of why traditional contracting is not the silver bullet that some lenders consider it to be. In this respect, a standard bankability analysis by lenders and their advisors often places undue emphasis on the certainty of the initial conditions for construction (that is, the terms that may be obtained under a fixed price, fixed time construction contract) while the need for future flexibility is overlooked. In practice, therefore, an attractive price in the initial construction contract may end up having a significant premium added in the future when, inevitably, an owner-allocated risk arises. In our view, it would be more appropriate for lenders to take into account the whole of the construction requirements and implications for a project when assessing, for project finance purposes, the appropriateness of a project's construction arrangements so as to ensure that the best overall project outcome is achieved.

Project alliancing as an alternative model for managing risk

As argued by this article, the key elements of a successful project alliance should, at least to some extent, assuage lending concerns as to the suitability of project alliances for the delivery of appropriate project financed projects. Further, as discussed in more detail below, the commercial and delivery structure of the alliancing model, the procurement and due diligence methods commonly adopted in the establishment of an alliance project and the content of the alliancing contracts can all combine to overcome many of the obstacles (real or perceived) that have to date been raised by reluctant lenders. Ultimately, more should be done to educate the lending community on the benefits of alliances, particularly in light of the deficiencies of traditional construction contract models.

> *'[t]raditional contracting is not the silver bullet that some lenders consider it to be.'*

Comfort that project objectives will be achieved and financing assumptions maintained

One reasonable question for project finance lenders to raise, with respect to project alliances, is what will the sponsors obtain from a project alliance that cannot be achieved from a standard fixed price, fixed time construction contract? This is, of course, a very relevant consideration and the answer will depend on the particular project and the risks that the project is likely to encounter. In this respect we would also note that project alliances are not the answer to all projects and that in many cases the interests of both the owner and the lenders will be best served by a fixed price, fixed time construction arrangement. This is particularly the case for straight forward construction projects where the risk of variations or other intruding factors is low.

The natural focus of a project alliance is on generating positive outcomes, including through design innovation, flexibility to adjust to changing circumstances and the proactive management of all risk (and not only those risks allocated, sometimes irrationally, to the contractor). This broad focus arguably provides a basis for an overall better outcome for the owner and the project lenders. Similarly, the non-adversarial environment of a project alliance where the potential for win-win situations is paramount provides a structure whereby the issues that normally bedevil traditional contracts (in particular, ongoing and complex claims for additional cost and time) are set aside for pure commercial considerations. In other words, the only way that the non-owner participants can make significant profit is by delivering the owner's (and the lenders') requirements as efficiently as possible. The flexibility of an alliance structure combined with commercial incentivisation provides for project objectives to be achieved and financing assumptions maintained, albeit not in the express terms that would ordinarily appear in a fixed price, fixed time contract.

This flexibility of a project alliance can extend beyond normal construction concerns, providing additional benefits to sponsors and lenders. For example, the inclusion of operations and maintenance companies within a project alliance can help to ensure that whole of life costs are minimised. In this respect, in the Australian State of Victoria, a number of project alliances in the rail sector have been developed which include the private rail franchisee (which, in effect, will be both the operator and maintainer of the project and, to an extent, the project owner for the remainder of its franchise period) as a key alliance participant. This structure has helped to ensure that the constructed asset will be accepted into the privatised network, that the rail franchisee will obtain all safety and other regulatory approvals in a timely manner and that operations and maintenance concerns are factored into the project in the most efficient way possible.

The above paragraphs primarily focus on the upside that project alliances may bring, which is primarily a sponsor point as it is the equity return that will reap the most benefit from cost savings, early completion or improved project performance. Such a positive viewing of project alliances reflects a commercial argument that does not always sit well with the legal community where the focus tends to be on downside scenarios rather than potential gains. Nevertheless, the downside concerns with respect to project alliances can be countered with the same arguments. Put simply, where a project alliance engages the right participants and is based on commercial targets that are both achievable and fair and which, if achieved, will more than meet the requirements of the sponsors and lenders alike, there is no reason why the non-owner participants should act in a manner that is prejudicial to the interests of the owner or the lenders. Again, this is a commercial view which requires a leap from a normal bankability analysis; however, as discussed throughout this article, it is our view that lenders and their advisors should take the broader interests and risks affecting a project into account when assessing whether limited-recourse finance should be provided.

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Contractual provisions

A project alliance is not simply an agreement between the participants to cooperate on the basis a non-binding target of delivering the project in a manner that meets the owner's requirements. Instead, project alliances are generally based on a well-structured and legally binding alliance contract which encompasses express provisions setting out the principles of best for project, mutual trust and good faith together with detailed and targeted financial incentives for the non-owner alliance participants in the form of the 'gainshare/painshare' mechanism. The gainshare/painshare mechanism will usually, in fact, allow for a level of cost overruns to be funded through the 'painshare' as this arrangement generally sees the non-owner participants agree to put their normal profit margin and non-project specific corporate overheads at risk. The gainshare/painshare mechanism is the 'hard' contractual structure that drives the behaviour of the alliance participants and, notwithstanding the very limited liability structure of alliance arrangements, represents a formal arrangement which should form an important part of the lenders' assessment of a project alliance.

Furthermore, an alliance arrangement does not preclude the potential for subcontractors to be engaged by the alliance using traditional fixed price, fixed time subcontracts, thereby giving the owner and the lenders a degree of cost and time certainty in relation to the subcontracted packages. Where certain aspects of a project can be suitably subcontracted on such a basis without materially affecting the best for project ethos underpinning the alliance (such as, for example, by subcontracting for large pieces of equipment), project finance lenders should be able to take comfort that at least some aspects of price and time are 'fixed', albeit subject to the same caveats as those discussed earlier in relation to traditional fixed price, fixed time construction contracts.

Collective and transparent risk management

In an alliance project, the management and mitigation of risk is, from a contractual point of view, collectively and transparently assumed, meaning that all participants (as well as the lenders) will at all times understand how the project is performing, the risks to be overcome and the issues that have arisen. In the field, of course, the alliance participants will work in a manner that best uses each participant's skills and experience; however, any failure is borne collectively, just as any success results in a benefit for the alliance as whole. The adoption of these principles is intended to result in the alliance participants being less self-serving and more productive for the benefit of the project and, therefore, the benefit of the owner and the lenders. Anecdotally, there is much to recommend this approach with alliance-based projects reporting a higher rate of success in terms of timely completion within the agreed budget than traditionally procured projects.

Government involvement in alliance projects

For projects that have a basis in public procurement, lenders should take some comfort from the significant support for the project alliancing model that has come from a range of public and government entities involved in the procurement of projects and services. Government sponsored publicly-funded alliance projects are commonly found throughout Australia, particularly in the State of Victoria. The State Government of Victoria has for some time been utilising alliance models for a range of projects, particularly in the transport and water infrastructure sectors, and has recently prepared an alliance policy and standard alliance contracting documents. At a higher level, the support of governments for the alliancing model, particularly given the usual adversity to risk exhibited by the public sector, illustrates that a detailed analysis of the alliance model can lead to even the most risk averse of organisations accepting that traditional fixed price, fixed time contracts do not necessarily deliver the best overall results.

No disputes

The collective assumption of risk by the alliance participants is underlined by the no-dispute provisions found in alliance contracts by which the alliance participants agree to not commence formal legal or arbitral proceedings except in very limited circumstances. The no-dispute culture is intended to facilitate the early disclosure of material issues for shared resolution, something which should be viewed positively by project finance lenders.

Earlier in this article we discussed the limited liability position common to project alliances, which is, of course, intrinsically linked to the no-dispute provisions also associated with project alliances. However, the no-dispute culture that a project alliance seeks to encourage, while seemingly counter-intuitive, can actually be seen to allow the interests of lenders to be more effectively taken forward: where there is no risk of being taken to court, parties will do everything within their power to deliver the project's objectives so as to gain the greatest commercial benefit from the project. Disputes are diametrically opposed to such outcomes and therefore (and barring exceptional circumstances) ruling out formal dispute resolution from a project alliance arguably acts to mitigate the risk of disputes arising.

Such a structure can be compared with traditional contracting models, where disputes regarding a range of issues associated with claims for additional costs and time are a consuming part of the owner's contract management and, in many cases, form the basis of the contractor's strategy to generate profit from the work. By removing these ultimately distracting and costly activities, the overall project should benefit with time and cost saving on both sides of the normally adversarial relationship.

Therefore, while project alliances would initially appear to raise seemingly insurmountable issues for project financing, there are number of salient features of the alliance model that should give lenders comfort when addressing the bankability issues associated with any given project.

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Further considerations

There are further options and considerations that project finance lenders may wish to take into account when considering project alliancing in the context of a limited recourse financing.

'Pure' v 'impure' alliances

Practitioners familiar with project alliancing will often distinguish between 'pure' and 'impure' alliances. An 'impure' alliance contains elements that are borrowed from traditional fixed-price and fixed-time contracts. For example, in an impure alliance some aspects of the works may be subject to fixed prices with the alliance participant performing for those works responsible for them in the same manner that a contractor would be responsible under a traditional construction contract. Other common shifts from a 'pure' alliance model are to impose a greater degree of liability than the traditional alliancing approach and to include a guaranteed maximum price, something which is likely to be of particular interest to lenders as it will allow the formation of a worst case scenario on which the project financing may be based.

The addition to project alliance arrangements of 'impurities' targeted at particular bankability sensitivities may seem attractive to project finance lenders. However, while an analysis of the benefits and risks of impure alliance models is beyond the scope of this article, we would note that the inclusion of any 'hard risk' or similar concepts into an alliance structure risks undoing the 'best for project', 'single team', 'high achievement', 'creative solution' environment that project alliancing is meant to foster. As soon as a risk is imposed on a party (including the risk of costs exceeding a guaranteed maximum price), that party will be naturally incentivised to act in a way to ensure that risk never becomes a liability. By doing so that party will negate the very benefits that alliancing is supposed to deliver to the owner.

Procurement and enhanced due diligence

The procurement process for project alliances tends to differ from applicable to traditional fixed-price, fixed-time construction contracts. For the latter, there is an undeniable focus on the price proposed, often to the detriment of other important considerations – including the winning bidder's capability and capacity to deliver the works and that bidder's track record in comparable projects. For a project alliance, extensive due diligence is undertaken as part of the procurement process which goes far beyond that normally seen in the construction market. Such due diligence includes the technical and engineering competencies and plans of the bidder (including, for example, with respect to interface issues, subcontracting and the adequacy of time and cost contingency allowances) and the alliance track records of the bidder and the individuals which the bidder proposes to allocate to the alliance team.

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For publicly-sponsored projects, a rigorous and transparent selection process, as prescribed by the relevant regulations, will generally apply. Project alliances have been tendered successfully under applicable law in Australia and Europe, including in the latter case in the Netherlands for the A2 Hooggelegen project. For that project, the Dutch Department of Transport selected an alliancing approach and ran a competition in accordance with the EU procurement regime which placed placing a high emphasis on team performance.

While perhaps not directly relevant to the main concerns of project finance lenders, the detailed procurement processes generally applicable to project alliances should provide lenders with significant confidence that the selected alliance participants can actually deliver the project within the agreed budget and by the agreed time. This is not always the case for traditional contracts, where lenders are often forced to accept the sponsor's selection of the cheapest contractor. In our view, and leaving aside the reliance that should or should not be placed on the contractual rights available to an owner under a fixed price, fixed time contract, moving forward with a contractor selected solely on a merits basis and delivering to an agreed target appears to be preferable to utilising a contractor selected primarily on the basis of, and delivering to, a price that may have been deliberately underbid with the intention of winning the engagement and later maximising claims.

Two-stage alliances

It is not uncommon for alliance projects to be structured in two stages: firstly, a development stage, leading to a project plan which includes the budget for the works, and secondly, an implementation stage, in which that plan will be executed. To a certain extent, this alliance structure resembles that of an 'early contractor involvement' construction contract, an innovative project delivery method that augments the traditional construction contract model. Where two stage alliances are adopted, any project financing would logically be put in place on completion of the project plan, at which time project specifications, expected risks and forecast capital expenditure will have been agreed between the participants, assumingly to the satisfaction of the lenders. As the key variables have been determined, the lenders will be able to form their base case, albeit with the key risks of cost and time overruns remaining. While such a structure is not manifestly different from more traditionally structured alliances where much of the development stage is carried out before the formation of the project alliance, the formalisation of such an arrangement may be perceived as evidencing an established close collaborative relationship even before implementation commences. The structure also allows project finance lenders to be involved as the project plan is developed and finalised so as to verify that appropriate risk allowances have been made and that the final plan, including the final budget, represents a rational and reasonable forecast for the performance of the project.

Structuring a project financing to suit a project alliance

Notwithstanding the details applicable to a project alliance, ultimately project finance lenders when considering whether those arrangements are bankable will need to reconcile the risk of construction costs exceeding the budgeted price on which the project debt is based, meaning that additional funding will be required to complete the project and, potentially, the economics of the project being fundamentally altered from the assumptions on which the initial financing was provided. In this article we have discussed the various aspects of project alliances that should mitigate the risk of such circumstances arising. We have also noted that such risks exist even where the construction of a project is to be procured pursuant to a traditional fixed price, fixed time contract. To the extent that concerns regarding the viability of a project financing based on an alliance procurement remain, a variety of options are available to lenders which are external to the alliance arrangement and which should, in our view, support any bankability analysis. While a detailed discussion of such options is beyond the scope of this article, we would note the following matters that should be considered by project finance lenders if the project alliance itself is not as capable of supporting the limited recourse debt.

Financing structure

The key risks to project finance lenders associated with a project alliance, being cost overruns and delays to completion, may, to the extent that lenders cannot be made comfortable that the project alliance actually addresses such issues, be addressed by defraying those risks to other parties at a financing (rather than project) level. Some of the ways in which this may be arranged include (whether individually or in combination):

- requiring a greater level of initial equity investment by the sponsors. Additional equity effectively means that lenders will be provided with a greater buffer before cost and time overruns begin to affect the borrower's ability to repay the project finance loans;
- requiring contingent equity to be put in place by sponsors to fund cost overruns. While such a requirement is unlikely to be popular with sponsors, a contingent equity arrangement directly addresses any remaining lender concerns regarding the potential for a project to cost more than the projected budget;
- including in the financing structure cost overrun debt facilities (typically attracting a higher margin and repayable by a cash sweep). Such facilities may be attractive to lenders if the economics of the project are such that cost overruns will not fundamentally alter the financial sustainability of the project and, in any case, may be used in conjunction with a contingent equity arrangement;
- requiring sponsors to provide completion guarantees (in an appropriate form), effectively transferring the risk of delay from the project and to the sponsors; and
- requiring a much greater involvement in the project by the lenders' technical advisor. While such an arrangement does not, in a risk allocation sense, address the key issues, it will allow lenders to be fully involved in and informed about (at a far greater level than normal) the project's progress and any issues that may arise.

Of course, the above requirements (other than, perhaps, the greater involvement of the lenders' technical advisor) may not in all cases be acceptable to the project sponsors. However, from a sponsor point of view, a balance may need to be struck between the benefits (including a greater equity return) that may be delivered to a project through the use of an alliancing structure and the risks entailed in providing additional equity, completion support or other forms of additional sponsor contribution.

Reserved matters

The normal requirement that the alliance board may only act on the basis of consensus may be of concern to project finance lenders which could view such a structure as risking delays to a project over commercial or internal alliance issues. For the reasons discussed throughout this article, this should never occur in a properly structured alliance as such delays would actually be prejudicial to the interests of all participants. However in order to address such concerns a 'reserved powers' arrangement could be introduced to the project alliance under which particular topics of concern (such as functional or output specifications or emergencies) are removed from the competence of the alliance board and placed under the exclusive control of the owner. Such structures are not uncommon in project alliances where the owner-participant is a government agency with overriding public service obligations and, provided that such powers are limited to those matters of fundamental importance to lenders, there is no reason why particular issues could not be addressed in the same way in a project financed deal.

Insurance

As with all significant construction projects, the insurance arrangements applicable to project alliances form an important tool in ensuring that risks are appropriately managed and mitigated.

In this respect, it should be noted that a number of the risks (particularly with respect to injury to persons and damage to property) that are allocated between the parties under traditional fixed price, fixed time contracts are ultimately backed by insurance and, absent such risk allocation, the position of the owner (leaving aside insurance deductibles and assuming appropriately drafted policies) would not be materially different if that contractual allocation did not exist. The same coverage of the same risks should generally be achievable for an alliance procurement through careful structuring of the project and tailored drafting of the alliance contract and the project's insurance policies. Proper engagement with the insurance market in this respect is necessary in order to ensure that the collective risk assumption under the alliance contract is both understood by insurers and will not vitiate any policy that is placed.

For completeness, we would note that obtaining professional indemnity insurance is particularly difficult in a project alliance procurement due to the exclusion of liability for negligence and that, in this respect, tailored insurance wording would be required to make a professional indemnity policy effective. We would note, however, that in the context of a significant infrastructure or energy project and the cost of professional indemnity insurance in relation to the coverage offered, a failure to obtain such insurance is unlikely to be a determinative factor as to whether a particular alliance project is able to be project financed.

> *'[p]roject finance lenders should take a more flexible approach to the procurement structures proposed for the delivery of any given project…'*

A matter of education?

In this article we have attempted to explain both why traditional fixed-price, fixed-time construction contracts do not necessarily provide the certainty that may be expected and how project alliances, used for an appropriate project, may help foster a better overall project outcome. We are firmly of the view that project finance lenders should take a more flexible approach to the procurement structures proposed for the delivery of any given project so that the solution that is best for that particular project is utilised.

Our analysis in this article will, in some parts of the construction industry, no doubt be accepted as simply expressing an already understood position. Nevertheless, we are of the view that the lending community remains uninformed both as to the benefits that project alliancing may bring and the manner in which the key risks associated with a construction project may be managed so as to ensure the best project outcomes. As discussed in this article, innovative construction arrangements do not necessarily need to leave the lenders in a materially worse position that they would be under a traditional fixed-price, fixed-time contract. Where the sponsors consider that project alliancing offers significant value and also intend to raise project financing, it will be essential for those sponsors to make lenders comfortable with the proposed alliancing set-up and to involve lenders throughout the procurement and establishment process. In the meantime, professionals in the project finance industry should continue to educate project finance lenders as to the nature of the construction risk and that the 'one size fits all' policy currently adopted with respect to construction contracts does not necessarily deliver the best overall project outcomes.

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