



**Berkley**  
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## **Alliance Contracts**

Is this the way forward?



Many countries hope to undertake transformative infrastructure projects in an effort to restart their economies and accelerate their financial recovery. Canada is a strong proponent of infrastructure spending (we invested \$85 billion in both private and public projects in 2018). Today, the total value of Canada's public and private infrastructure stands at over \$900 billion (~8% of national wealth).

While Canada is a world leader in the procurement of infrastructure, truly transformative projects are technically complex and present significant execution risk. Over the past several years, many design firms and construction companies have raised concerns over the liabilities imposed when participating on these projects (leading some to stop participating altogether). Beyond the technical complexities, many participants note that the frameworks (used to procure these projects) include a series of legal swords and shields; promoting conflict rather than partnership.

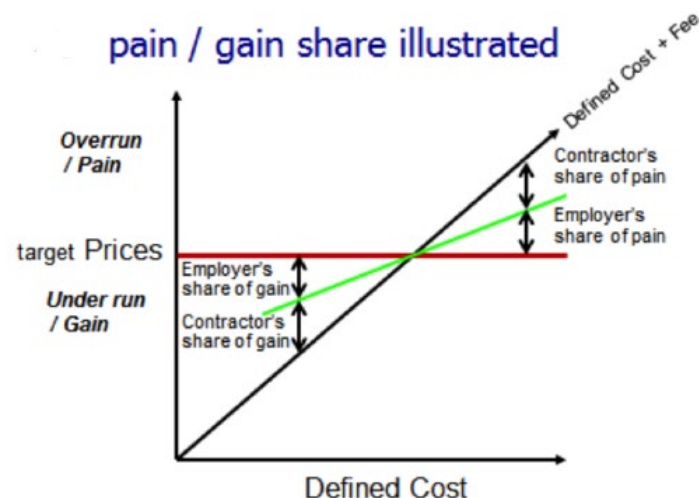
## INNOVATION IS NEEDED!

EXISTING INSURANCE PRODUCTS ARE INCOMPATIBLE WITH THE LIABILITY SHARING PROVISIONS OF ALLIANCE CONTRACTS

### Enter Alliance Contracts

Alliance contracts offer a new approach centered on a “painshare – gainshare” compensation model. This model forces all parties to commit to teamwork, trust and transparency of costs. In fact, many alliance contracts mandate open-book accounting and the sharing of all uninsurable risks between all project members. To ensure fairness, the project team develops a target cost (together) using various benchmarking tools and an open book estimation process. This ensures the project team members focus on direct project costs while removing any hidden profits associated with typical mark-ups (e.g., salary costs, material costs). Finally, the target cost is validated by comparing it against an additional cost estimate developed using an independent process.

Once an agreed target cost is set, actual construction costs (incurred during the course of construction) will determine if the team “wins” or “loses”. As discussed above, the model ensures everyone shares in any cost savings or overruns equally, ensuring alignment of interests.



### Alliance Contract Structure

While alliance contracts come in all forms, they generally do not allow for claims between parties, except under very specific circumstances (e.g., gross negligence or willful misconduct). Ideally, all critical participants are included in the agreement: the project owner, lead contractor, lead designer and any specialty sub-contractors.

Alliance contracts build on public-private partnership contracts (e.g., DBFO&M contracts) by shifting from a partnership model to an alliance model. Under a partnership model, entities agree to work closely and collaboratively (attempting to limit competitiveness and adversarial behaviours associated with fixed-price or design-build contracts). Alliance contracts take this one-step further by ensuring all parties jointly share all risks and rewards based on a pre-determined process (i.e., a true alliance).

Alliance contracts also differ in their approach to risk transfer. Under traditional construction contract models, each participant accepts specific risks (often referred to as owner, designer or contractor obligations). Under Alliance contracts almost all obligations are shared collectively (meaning no one party is solely responsible for a given risk). Again, this ensures all parties are putting forth their best ideas and solutions for all elements of the project.

### The GAP

The most significant challenge associated with alliance contracts pertains to uninsured risk. As stated, the goal of the alliance contract model is to share any uninsured risks between all project team members. Unfortunately, not all risks can be shared (e.g., the project team may refuse to accept certain risks). When this occurs, the project owner must accept sole responsibility for these risks or the project cannot proceed under an alliance model. This gap (i.e., uninsured risks) represents a significant impediment to the success of projects procured via alliance contract.



## Insurance Considerations

Beyond challenges associated with uninsured risk, alliance contracts must also overcome the challenge of inadequately designed insurance products. Stated simply, traditional liability insurance models (like construction contracts of the past) are inadequate to deal with the risks associated with complex infrastructure projects delivered via alliance contract. For example, how does a traditional liability insurance model work under a framework that does not allow claims? To insure alliance contracts, a new form of insurance product is required. This new product must respond when certain risks present themselves or when certain events take place, rather than when liabilities are alleged or legal demands made. This is particularly relevant with respect to environmental risks.

### 1. Pollution Risk

Pollution liabilities are difficult to delineate which in turn makes them difficult to manage. For this reason, owners generally retain all costs and liabilities associated with any existing pollution at a project site. When existing pollution is likely or known to be present, prudent owners will undertake characterization in order to develop site condition models and cost projections prior to the start of construction. Once shared with the contractor, this information helps establish more accurate costs associated with the management or cleanup of impacts within the project footprint.

Traditional insurance products work under the circumstances described above. If a contractor mismanages the project and worsens conditions at the site, the owner can make a claim against the contractor for damages (*e.g.*, additional costs incurred to manage or cleanup the site). Under an alliance contract, pollution liabilities are *ideally* the responsibility of entire project team. In fact, the project team should also be responsible for any additional costs associated with encountering unknown or unanticipated pollution during the

course of construction. This poses a serious challenge to the viability of the project if the pollution risk is uninsured (*i.e.*, designers and contractors will not want to assume this risk).

To address this gap, projects delivered under an alliance contract model should look to a Project Pollution Policy that provides **both** first party contractor liability and fixed site cover. Specifically, “discovery” of a pollutant by any project team member must be sufficient to trigger cover for cleanup (*i.e.*, no need for a claim). This is the only available policy structure that ensures the adequate transfer of both site (unknown pollution) and contractor (worsening of known pollution) risks from the project team members to an insurance partner.

### 2. Project Delay

Encountering unanticipated pollutants at a job site can cause project delays, which in turn will delay the start of earnings and extend the accrual of financing charges. Under traditional construction contracts, delay risk is addressed via a “liquidated damage” clause. Such clauses do not exist under an alliance contract model. Here to, the Project Pollution Policy helps, by addressing the risk via accelerated cleanup. This cover enhancement minimizes project delays by amending the insurance carrier’s obligation with respect to cleanup. Specifically, this enhancement mandates selecting the cleanup technique that will achieve remediation in the shortest period (even if that approach is more costly than other available remediation techniques).

For example, one method of cleanup might involve risk assessment (a process that can take several months or years to complete, but may be the least costly) while another cleanup method might involve excavation and disposal (generally, a faster process that may be more expensive). A policy with accelerated cleanup cover ensures that any project delay incurred during cleanup is minimized, reducing the ultimate financial loss to all project members.

### 3. Archaeological and Cultural Heritage Risk

Like pollution liabilities, Archaeological and Cultural Heritage (ACH) risks are difficult to assess and quantify. Encountering ACH artifacts during the course of construction can add significant costs to the project and cause significant delays. While ACH risks are usually retained by the project owner, they are insurable subject to adequate due diligence (e.g., Stage 1 ACH Assessment, Stage 2 ACH Surveys). Similar to pollution risk, transferring ACH risks to an insurance partner helps ensure the project members do not face unexpected costs. This specialty cover ensures expenses such as securing a site; consulting and advisory services; cataloging of artifacts (including cleaning and preservation); and excavation, relocation and storage ACH artifacts.

#### Final Thoughts

Canada needs transformative infrastructure to ensure our economy recovers and to remain competitive in the decades to come. Similarly, we need innovative insurance products to support complex projects procured using alliance contracts.

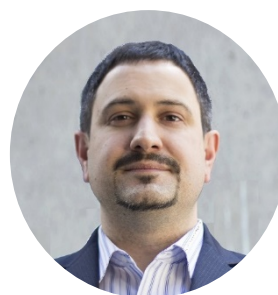
Put simply, traditional insurance contracts are not compatible with this new liability framework. Using traditional insurance exposes project team members to two significant risks:

- Inability to attract competent design and construction partners; and
- Unexpected project costs associated with any uninsured environmental risks.

Alliance contracts will play a vital role in the procurement of infrastructure, by aligning the interests and priorities of project owners, contractors and designers. Similarly, the Environmental Team at Berkley Canada strives to be a helpful partner by delivering insurance solutions that promote the feasibility of alliance contracts.

By focusing our expertise and creativity on solving complex environmental challenges, we hope Canadian projects will benefit from being able to engage top tier designers and contractors. This in turn, should ensure Canada remains a world leader in the delivery of complex infrastructure.

To learn more about how the Environmental Team at Berkley Canada can help you and your clients be successful, please visit [our website](#) or get in contact with one of our team members below.



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