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Middle East Megaprojects: Modern Contracting Models Can Boost Delivery of US\$310bn+ Investment Pipeline

The construction and projects market in the Middle East is primed for a bumper delivery programme. The Saudi Arabian government has forecast US\$160bn of investment in projects as a part of the 'Vision 2030' privatisation programme. Similarly, the UAE have announced US\$7bn of partially private financed infrastructure projects as a part of its US\$150bn 'Projects of the 50' programme.

The initiatives involve a host of headline Gigaprojects and Megaprojects.¹ In Saudi Arabia, flagship projects include NEOM, a smart and sustainable regional development on the Red Sea being built from the ground up, fueled entirely by renewable and alternative energy, and AMAALA, an ultra-luxury destination along the north-western coast, both under the stewardship of the Public Investment Fund Program. The 'Projects of the 50' includes various reforms as well as infrastructure schemes such as the US\$13.6bn UAE Railway Programme.

The enormous scale and tight programme associated with these projects requires an approach to contracting that overcomes inefficiencies in traditional Design-Bid-Build and Design and Build contracting models, as well as to address market-capacity and supply chain issues. In response to these challenges, relationship contracting may be seen as a viable alternative to traditional procurement in help making these multi-billion dollar programmes become a reality.

Traditional Procurement Models

In a traditional Design-Bid-Build or Design and Build procurement process, the roles of the Client and the Contractor are separate and opposing. The Client sets out its time, cost and quality requirements for the Project and pays the Contractor the Contract Price. The Contractor designs (if applicable) and then constructs the Works in accordance with the Client's requirements. The Contract allocates responsibility for



relevant risks that may arise in the course of the delivery of the Works between the Client and the Contractor, with the majority of risks traditionally being allocated to, and priced by, the Contractor. Traditional models place a high value on time and cost certainty as well as Client control over the design of the Works. This has benefits for the Client's programming and budgeting processes. It also attractive to Lenders, who traditionally place a high value on a clearly defined risk profile and minimal exposure to time and cost increases in their assessment of what constitutes a bankable project.

However, the realisation of these benefits requires:

- separate and sequential design and construction phases;
- a risk profile that is allocated diametrically between the Parties – traditionally heavily in favour of the Client – and locked in at the Execution Date;
- a Contract Price that is reflective of the Contractor's pricing of the risks allocated to it at the Execution Date;
- minimal flexibility to develop or vary the scope of the Works after the Execution Date; and
- relatively low degrees of time and cost efficiency and flexibility.

In the context of Megaprojects, Gigaprojects and other highly complex, large scale and high speed construction projects, the protracted pre-Contractual phase necessitated by, and the inflexible, and inherently adversarial nature of, traditional models often proves prohibitive to Clients seeking to meet the unique programme, budget and resourcing requirements necessitated by such projects. Relationship contracting models, by contrast, offer a bold new solution to project procurement and delivery.

Relationship Contracting

Relationship contracting models seek – to varying degrees and by various means depending on the relevant model – to align the interests of the Parties and reduce the degree of risk transfer to the Contractor, thereby reducing the extent to which the Parties are forced into adversarial positions and limiting the incentive and ability of the Contractor to submit claims for time and cost. There are a variety of delivery models that fall within the family of 'relationship contracting', however, the primary models that we are seeing used in the market are:

A. Multi-Stage Contracting (Early Contractor Involvement)

The Contractor is appointed well in advance of the intended commencement of construction of the Works. This allows it to perform design and other Preconstruction Services that the Client would perform or procure itself under a traditional model and to assist the Client in developing a procurement strategy and finalising the Client's requirements for the Works. The benefits of a Multi-Stage Contracting model include expedited commencement, access to Contractor expertise, scope flexibility, streamlined procurement, contractor competition and contractor incentivisation and design responsibility.

B. Management Contracting

Under a Management Contracting model, a Managing Contractor is appointed at the outset of the Project to assist the Client with Project planning and preparation of the Client's requirements for the Works, run procurement processes for all design and construction Work Packages, potentially enter into the Work Package Contracts itself and manage all Works Package Contracts until completion.



In addition to realising the benefits of the Multi-Stage model set out above, the Management Contracting model enables flexibly optimised risk allocation, incentivisation and alignment of objectives and reduced administrative burden on the Client.

C. Delivery Partnering

Under a Delivery Partner arrangement, the Client engages any one or more Contractors to perform Works or Services (typically broadly defined “Project Management Services”) under traditional forms of Contract and additionally requires all Contractors to enter into a Delivery Partner Agreement with the Client to add additional layers of Project-wide obligations and incentives. These can typically include requirements such as for the Contractors to form one unified Delivery Partner to act as a single point of responsibility for all scopes of Works and Services being procured for the Project or an Incentive Regime that implements a ‘gainshare’ and potentially ‘painshare’ mechanism to align the objectives of the Client with those of the Delivery Partner throughout the delivery of the entire Project. The benefits include enhanced incentivisation and alignment of objectives as well as cooperation between the Client and each Contractor

D. Alliancing

A true Project Alliance is the most extreme form of relationship contracting as the traditional opposing and adversarial roles of the Client and Contractor are replaced entirely. Instead, the Client and the Alliance participants form a single Alliance entity to deliver the Project and share the risks and rewards that arise in the course of the Works.

Under an Alliancing model, Participants are engaged at the outset of the Project and work with the Client to develop all aspects of the Project and the Works on a ‘Best for Project’ basis. In this Alliance Development Phase, the Client and Participants work to finalise the scope and requirements for the Works, determine the Target Outturn Cost and Programme for the Works and agree upon key principles as to how the Works will be managed, resourced, and delivered.

Potential Challenges

The further along the spectrum of relationship contracting (from Multi-Phase Contracting to Alliancing), the further the contracting Parties depart from the defining principles of traditional contracting models. Whilst there are benefits to relationship contracting, Clients should be aware that moving away from traditional contracting models towards relationship-based models involves certain trade-offs, including:

- **reduced time and cost certainty:** in moving away from ‘fixed time fixed price’ contract models in search of time and cost efficiencies, Clients will be required to forego a degree of price and time certainty;
- **reduced risk profile definition:** the more that risks are shared between the Parties, the less reliance the Client is able to place on a well-defined and allocated risk allocation in the event that the Project incurs problems or Contractors underperform;
- **reduced availability of project finance:** a consequence of sacrificing degrees of time and cost certainty and risk profile definition is that Lenders may find it difficult to assess the risk profile and potential exposure to time and cost increases in performing due diligence which complicates the traditional means of assessment of the bankability of the Project;
- **reduced recourse to dispute resolution:** the more integrated the Client becomes with the Contractor, most explicitly under an Alliance where the Client Participant forms a part of the Alliance itself, the less able



the Client will be to rely on a formal dispute resolution process. In an Alliance, recourse to formal dispute resolution is precluded other than in the event of wilful default or fraud;

- **reduced Client control:** the earlier in the Project the Contractor is engaged and the more involvement the Contractor has in the planning and design of the Works, the less control the Client will have over the exact look and feel of the final product; and
- **reduced market capacity:** the more the Client seeks to depart from the principles of traditional procurement models and more along the spectrum of relationship contracting models, the more likely they will struggle to find Contractors with adequate understanding of the chosen model and capability to fulfil the role required thereunder.

Conclusions

Whilst these trade-offs must be carefully considered in choosing a procurement model for any project, the unique scales and programme demands necessitated by Megaprojects, Gigaprojects and other highly complex construction projects mean that there appears to be particular benefit to Clients delivering such projects in including relationship-based contracting models in their procurement strategies. In such projects, the need to expedite commencement of Projects that are frequently broadly and vaguely scoped and vast in scale and timeframe can be and continued reliance upon traditional procurement models may be mutually exclusive strategies and, as a result, careful, strategic adoption of relationship-based models may offer a novel and practical way forward that appears particularly appropriate for consideration in the context of such projects.

As a result, relationship contracting models may realise the following benefits which are particularly applicable to Megaprojects, Gigaprojects and other highly complex, large scale and fast track construction projects:

- **expedited commencement:** a shorter procurement period and quicker commencement of the Works made possible by limiting the need for a time and resource intense pre-Contractual period and an increased ability to commence projects where the scope of required Works is extremely broad or diverse or difficult to precisely define at the time of award;
- **time efficiency:** a more efficient delivery phase made possible by commencing earlier and implementing overlapping (rather than sequential) design and construction phases;
- **cost efficiency:** cost savings as a result of a reduced need for the Contractor to price an (often Client friendly) risk allocation position prior to the Execution Date made possible by a reduced risk transfer to the Contractor;
- **access to Contractor expertise:** accessing the Contractor's expertise from an earlier stage in the Project, thereby providing the Client with the benefit of the Contractor's input into designs, and construction methodologies and minimising the risk of future Contractor claims;
- **scope flexibility:** increased scope flexibility throughout the delivery of the Works made possible by earlier Contractor involvement and a less prescriptive risk allocation;
- **Contractor incentivisation and alignment of objectives:** a Contractor motivated by incentives that align with Client objectives as opposed to a Contractor that is incentivised to submit claims for time and cost after the Execution Date; and
- **reduced administrative burden:** increased Contractor involvement in, and reduced Client's burden in respect of, Contract administration.



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¹ The terms 'Megaprojects' and 'Gigaprojects' are commonly used to refer to projects with an overall US Dollar value of up to \$20 billion (Mega) and in excess of \$20 billion (Giga) and which involve a wide-ranging scope and a high degree of complexity in project delivery.