To be, or not to NEC: that is the question

Part 3 – The core clauses of the NEC Contract

In the first part of our series, we looked at the use of the NEC contract in Australia and in part 2, we explored the arrangement of the contract. In the final part of our series, we examine in more detail the most unique aspects of some of the core clauses, and how they differentiate the NEC from more traditional forms of contract.

The core clauses

To re-cap, the fundamental differences between other more traditional forms of contract and the NEC can be found in the core clauses, which are common to all six main Options (part 2 of this series refers to each main Option). Some of the main Options do, however, add to the core clauses, rather than alter or delete them. Within the third edition of the NEC **(“NEC3**”) the core clauses are arranged in nine **sections** comprising:

1. General
2. The Contractor’s main responsibilities
3. Time
4. Testing and Defects
5. Payment
6. Compensation
7. Title
8. Risks and insurance
9. Termination

Whilst the provisions associated with each core clause are too numerous to discuss in this paper, it is sections 1 (General), 3 (Time) and 6 (Compensation) that are considered most unique.

Section 1 (General)

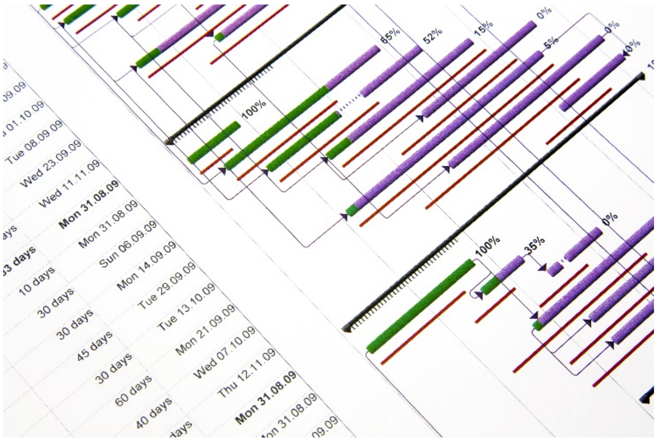
For example, clause 16 (included under section 1) deals with an early warning procedure (“**EWP**”) for identifying and managing risk. Insofar as every procedure under the NEC has been designed so that its implementation should contribute to, rather than detract from the effectiveness of management of the work, then there is no better example. This is because the application of the EWP is binding on both parties and carries financial sanctions for failure to administer. So, whilst the NEC aims to allocate the risks between the parties clearly and simply in section 8 (Risks and insurance), the EWP effectively reduces the likelihood of those risks occurring and their subsequent impact if they do occur. This is achieved by the application of collaborative foresight and risk reduction procedures, which include the operation of a formal risk register of notified events, and an obligation on the parties to meet to discuss mutually-beneficial solutions to overcome those risks that may:

- increase the amount that the Employer has to pay;
- delay completion of the works;
- impair the performance of the works, once completed; or
- affect others working on the project.

The overarching purpose of the EWP is to lead to a much-reduced risk to the Employer of cost and time overruns and of poor performance of the completed projects.[1] Evidence also suggests that there is a significantly higher likelihood of the Contractor and its subcontractors and suppliers achieving a profit.

Section 3 (Time)

With respect to Time, many of the detailed procedures rely upon the fact that an up-to-date and realistic programme maintained by the Contractor is used in joint decision making. Indeed, the Contractor is encouraged to include '*time risk allowances*' in its programme as part of its realistic planning to cover its risks – these time risks are then retained in the assessment of any delay to planned completion due to the effect of a compensation event.[2] Accordingly, the use of the programme is defined in detail and in such a way that, again, the Contractor is motivated to keep it up to date and realistic.[3]



Section 6 (Compensation)

Similarly, almost all circumstances that may give rise to additional payment to the Contractor are identified as compensation events and include a review of both cost and time implications. This approach contrasts with more traditional and bespoke forms of contract in which the procedure for dealing with compensation can often differ, dependent upon the nature of the event.[4]

Compensation events are events which are at the risk of the Employer that may lead to the payment to the Contractor changing or the completion date. A principle of the NEC is that, when such an event occurs, the Project Manager (who has considerable authority to act and make decisions on behalf of the Employer under the contract) should, whenever possible, be presented with options for dealing with the problem from which they can choose, directed by the interests of the Employer.[5] Conversely, the NEC is also designed to ensure that the Contractor will be unaffected by the choice that the Project Manager makes. To achieve this, the Contractor prepares a quotation for the valuation of the compensation event(s) that is based on a forecast of the impact the change or problem will have on the cost of carrying out the work – as forecast by the Contractor at the time the event is assessed.[6]

In main Options A and B, the change to the amount that the Contractor is paid for the work is based on the prospective quotation. The Contractor, therefore, carries the potential risk or reward if its forecast of the cost impact is wrong, and the Employer has a firm commitment. In main Options C and D, the quotation is used to vary the target cost, and so the parties will share the risk and reward under the share mechanism.[7]

In summary, the core clauses seek to address the more confrontational characteristics of traditional types of contracts that necessitate a team-based approach, which must be adopted by the parties to the contract to ensure the success of the project. Culturally, this is a significant change for most people using the NEC for the first time, one that must be wholly embraced to truly benefit from the collaborative approach the NEC engenders. Accordingly, few issues relating to valuation of the work or extensions of time remain should remain unresolved after the event.

Conclusion

Only time will tell if use of the NEC3 (or indeed NEC4) gains further traction in Australia. However, the recent appointment of a dedicated NEC representative in Australia should help increase awareness of the contract. It should also provide a means by which project organisations can access advice and training to appreciate how the NEC3 (or NEC4) can provide a modern method for employers, designers, contractors and project managers to work collaboratively – a goal that has been achieved successfully on many other major projects undertaken elsewhere in the world.

> *"I hope to build on the success of the Pithara project and encourage the widespread adoption of the NEC suite of contracts in Australia to improve procurement and encourage collaborative working practices for the benefit of all stakeholders".*
> **NEC Representative: Australia**[8]

Furthermore, when coupled with increasing demands from both Government and industry leaders to address concerns about the lack of collaboration between contracting parties, late and/or non-payment and the extent of costly disputes under the Securities of Payment Act, then it is highly likely the NEC suite of contracts will feature in any contractual and/or cultural revolution that may finally be on the horizon.

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[1] Guidance notes for the Engineering and Construction Contract (An NEC document) April 2013; Introduction (Objectives; Stimulus to good management); page 3

[2] ibid; Section 3 Time (Core clauses; The programme); page 47

[3] ibid; Introduction (Objectives; Stimulus to good management); page 3

[4] ibid (Objectives; Clarity and simplicity); page 2

[5] Ibid (Objectives; Stimulus to good management); page 4

[6] ibid

[7] ibid

[8] Mr. Steven Evans, NEC Representative: Australia (+61 (0) 455 449488)

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