

NECP/08/032

Achieving transparency under NEC contracts
BY **NIGEL SHAW**, NEC PANEL CHAIRMAN

This is the second of a series of briefings prepared by the NEC Panel to help clients, consultants and contractors overcome any difficulties or misconceptions they might experience when first using NEC contracts. The briefing shows how the NEC approach encourages transparency and cooperation, helping to eliminate corruption and promote best practice.

Introduction

The 'original' NEC system was published in 1991 as a groundbreaking best-practice process. Its principal objective is to 'stimulate good management of the relationship between the parties to a contract and, hence, of the work in the contract'.

The drafting team focused on the principal objective and were not influenced by any stakeholders inimical to the public good of creating a process to deliver contract outcomes that were both

- good value for the client
- a reasonable return for the supplier / contractor.

From the outset it was recognised that existing published contracts were inadequate in their approach to certainty of outcome, particularly with regard to cost and programme. The project management of cost was thus seen as a critical element – and the resulting NEC process is in the forefront of providing a properly thought-out framework of cost management.

By its nature, cost management requires the co-operation of the two main parties to the contract. It can only be effective if there is adequate transparency in the resource / cost commitment and accounting.

NEC also recognises the importance of encouraging a behaviour that creates best value. Efficiency thrives where all parties are rewarded for co-operating and achieving contract objectives, and when conflicts of interest are recognised and managed.

Transparency in practice

NEC achieves transparency by making sure that clients and suppliers have access to the same information at the same time, and that there are no hidden transactions. NEC contracts have a range of provisions which help to achieve a high level of transparency.

Avoiding conflicts of interest

A concern arises on some projects when an independent technical consultant, who is responsible for finding solutions to issues which arise on the contract (sometimes issues of their own making), is also responsible for determining the entitlement of the contractor to additional time or costs for implementing the solutions. NEC provides a facility for overcoming such concerns by appointing a project manager as an agent of the purchaser. The project manager will have a responsibility to the purchaser for proper administration of the contract and will not have to face the difficulty of having internal, hidden, conflicts.

The project manager is a key member of the contract team but, as an agent, is not independent of the purchaser. The project manager's duties are stated in NEC but this does not prevent the purchaser from requiring the project manager to follow other appropriate processes before taking action, for example to obtain approval from a funding organisation.

Encouraging openness on risk

NEC includes a duty on both suppliers and project managers to notify each other immediately of any risk they are aware of that could compromise the cost, quality or completion of the project. Failure by a contractor to notify an early warning would result in any subsequent compensation being reduced to the value it would have had if timely early warning had been given.

The process removes any benefit to the contractor for failing to disclose potential problems before they occur, and thus encourages a greater degree of openness.

Disclosing sub-contract terms

NEC requires disclosure of sub-contract terms to the project manager. This helps overcome problems of onerous, usually undisclosed, sub-contract terms that can hinder achievement of the purchaser's objectives.

The project manager is entitled to refuse to accept a sub-contractor if the terms of its sub-contract are not conducive to proper operation of the contract.

A realistic programme

NEC requires the contractor to produce a detailed programme, including method statements and proposed resources, and to show allocation of risks and float within the programme. This can be provided at tender or shortly after as required by the purchaser, and must be updated at regular intervals. The updated programme is required to show progress achieved and the contractor's intentions for completion. The project manager can then make decisions in the full knowledge of how the contractor proposes to carry out the remaining work.

In addition, an activity schedule is prepared on NEC contracts carried out on a lump-sum basis. Each activity on the schedule is linked to the programme, thus adding to the information available to the project manager concerning the supplier's proposals.

Managing change

Variations, claims and modifications are managed as 'compensation events' in NEC contracts. Importantly, notification of events and assessment of cost and time consequences is done *at the time the event arises*. This enables the project manager to take immediate decisions on how to deal with the event rather than trying to work out what cost and extension of time should be awarded for historic events.

Assessment of compensation events comprises the forecast change in cost and delay to completion. Both are assessed on the basis of the supplier's current intentions as shown on an updated programme and not from a historic tender document.

The project manager is entitled to seek quotations for compensation events for different methods of dealing with the event, allowing the project manager to identify the effect on the contractor's operations of different solutions to the problem faced. This provides the information needed to allow a decision to be taken on the solution which best achieves the purchasers' objectives.

Most contracts also provide for *force majeure* events and entitle the contractor to additional time. In such situations, the purchaser normally has little control over the impact of the event on the contract as the contractor will decide how to deal with it and claim the additional time resulting. The contractor's motivation in deciding the most beneficial balance between time and cost is usually hidden from the purchaser.

However, under NEC, *force majeure* events are defined more precisely and the project manager makes the final decision of how to deal with them. The project manager will consult with the contractor to identify the options, then instruct the actions that will best achieve the purchaser's overall objectives.

Understanding cost

Where a cost-reimbursable or target-cost option of an NEC contract is used, the contractor is required to keep detailed cost records and provide forecasts of future costs to the project manager at regular intervals. These make the project manager aware of the contractor's expectations and will reduce the likelihood that major cost increases occur without warning.

For compensation events under all NEC contract main options, details of the proposed cost – based on detailed cost schedules – must be given to the project manager and justified as necessary.

Correcting defects

Unlike most contract forms, NEC imposes an obligation on the contractor to notify the supervisor of defects. There is thus no 'hidden' correction of defects.

In addition, the time when the defects are to be corrected must be shown on each updated programme.

Avoiding and resolving disputes

While NEC's open and collaborative processes allow most disagreements to be avoided, they still recognise that disputes do sometimes occur. In the event of a dispute between the project manager and contractor, or between the contractor and purchaser, an independent third party is immediately appointed to adjudicate a decision promptly.

The process allows the parties to continue with the contract without suffering a breakdown in relationships or loss of transparency that often results from unresolved disputes.

Managing successful outcomes

A key to successful projects is the management of risks *before* they occur and the prompt management of events *when* they occur. If an event occurs, traditional contracts mostly assume one party – usually the supplier – will implement a solution, but there is then nothing the other parties can do to change the outcome except to argue in hindsight.

The NEC philosophy is that managing events is most successful if, before a solution is implemented, all parties contribute their expertise and devise methods of overcoming problems. This is the principle governing early warnings, compensation events, forecasts and so on.

NEC processes are designed to encourage co-operative problem solving based on achieving the best solution for the project. However, people need to be well informed to do this and there is thus a clear synergy between transparency (access to information) and team working (providing knowledge).

By including terms requiring both transparency and co-operation, the NEC simultaneously helps to eliminate opportunities for corruption and to promote best-practice management.

For further information please contact John Hawkins on 020 7665 2217 or email john.hawkins@ice.org.uk.