

Some thoughts on NEC3, by Humphrey Lloyd



NIGEL SHAW NEC PANEL CHAIRMAN

With increased use of NEC contracts overseas, the NEC panel invited His Honour Humphrey Lloyd QC, a former UK Technology and Construction Court judge, to undertake a review to ensure there were no barriers to its use internationally.

His findings, entitled *Some thoughts on NEC3*, were published in the October 2008 issue of the *International Construction Law Review* journal and subsequently presented at the Institution of Civil Engineers' inaugural management, procurement and law prestige lecture in London on 24 November 2008.

No barriers to international use

His Honour told an audience of over 150 construction legal experts that he had always been a fan of NEC. He voiced his support for the NEC3 Engineering and Construction Contract, and concluded that there are no real barriers to it being used internationally.

He said, 'In a nutshell, there are no real difficulties in using the NEC3 contract either inside or outside the UK. With a couple of exceptions, the core clauses of NEC3 do not contain any significant features that would make it unwise to use it abroad.'

This statement is particularly important, as the NEC panel had always intended to draft a contract that could be used in any country.

Unnecessary Z clauses

I would like to thank Humphrey Lloyd for agreeing to review the NEC3 and for producing such a thorough report. It is great to have the endorsement of such an eminent legal figure, and we hope that the lecture and the accompanying paper – which is repeated on the following pages in full – will help to dispel some of the historical criticisms the contract has received from the legal sector.

These criticisms have influenced clients into adding unnecessary Z clauses that have rarely added any value and tend to cause confusion.

Issues to be looked into

Humphrey Lloyd has outlined a number of issues that will need to be looked into by the NEC panel in greater depth.

Ian Griffiths, our legal consultant, makes an initial assessment of these in an article at the end of this special issue. ○

For further information please contact John Hawkins on +44 20 7665 2217 or email john.hawkins@ice.org.uk.



His Honour Humphrey Lloyd QC was a judge of the UK Technology and Construction Court in London from 1993 to 2005 and has now resumed practice as an arbitrator with Atkin Chambers, London. He has been a barrister specialising in construction law since 1963, including assisting the drafting of the ICE Conditions of Contract, 5th edition. He became a Queen's Counsel in 1979 and has been a member of the Commission on International Arbitration of the International Chamber of Commerce (ICC) since 1980 and has written and lectured widely on dispute resolution.

He has been an editor-in-chief of *International Construction Law Review* since its foundation in 1983 and was a founding member of the Society of Construction Law and its president 1985–1988. He wrote (with Dr Nael Bouni) the ICC report on construction industry arbitrations in 2001 and led and wrote a guide to drafting awards in international arbitration. He is chairman of the review body for the UK Construction Industry Model Arbitration Rules, a fellow of the Chartered Institute of Arbitrators, a professorial fellow at Queen Mary, London and a visiting professor at Leeds Metropolitan University. He is an honorary fellow of both the American and Canadian Colleges of Construction Lawyers.

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Some thoughts on NEC3



HUMPHREY LLOYD¹ ATKIN CHAMBERS

Introduction

The NEC3 Engineering and Construction Contract (ECC) is increasingly and successfully used, not just in the UK but also in other countries. It started life in consultative form in 1991. The 1st edition of the New Engineering Contract was published in 1993² and a 2nd edition in 1995, when it became the ECC. However it is commonly known as the NEC. In 2005 the 3rd edition of the contract was published (and reissued with some small amendments in June 2006). (I shall use ECC and NEC3 interchangeably; the latter is more prominent.)

The advent of NEC3 is an opportunity to look at aspects of the contract. This article arises out of an invitation by the NEC panel of the Institution of Civil Engineers to provide some comments on whether there are likely to be any intrinsic or other legal difficulties in using NEC3, primarily outside the UK.³

In a nutshell I came to the conclusions that there are no real difficulties (with one possible exception—clause 63.5) but that there are some points to look out for. However, as will become apparent, most of the points are peripheral. Some may regard them as legalistic nit-picking. If so, that perhaps reinforces the view of users that NEC3 does not contain any significant features that would make it unwise to use it outside the UK in its present form (but nit-pickers have to be considered for countries where the law is thought to be the epitome of common sense, a view not usually held in the construction industry, unless someone has been a victor). There are however some areas where the intentions of its proponents and current users need to be spelled out so that the NEC will continue to be a basic but comprehensive set of documents which do not require reference to any national law to make them explicable and practical.

At the outset I have to 'declare an interest'—I have always been a fan of the ECC, and I had less difficulty than most with the style of its original drafting. As someone who started practice in construction law at the time of the publication of the Banwell report in 1964,⁴ the NEC seemed to me to be exactly what the UK construction industry required, a view shared later by Sir Michael Latham. Although the group of forms was devised by civil engineers it has always been suited to use in building and other sectors of the industry. There was a need for forms that could be used as widely as the UK government's own forms.⁵ Not surprisingly therefore, NEC3 has been endorsed by the highly influential UK Office of Government Commerce for use in public sector contracts. That approval should satisfy many, not least because

UK government departments are generally averse to using contracts that are legally deficient.

Recently it has been recognised as 'setting the benchmark' for contractual arrangements which ensure that risk is shared by the whole project team. NEC contracts have been used for years outside the UK.⁶ They are now used very widely and for all sizes of projects, both small and large. They were chosen for the new Terminal 5 at London's Heathrow Airport, and for the £7 billion Al Raha Beach development in Abu Dhabi. The UK Olympic Development Authority requires them for £9.3 billion worth of contracts for the Olympic and Paralympic Games in 2012. But my enthusiasm for the policies of the NEC must not lead to myopia about implementation.

Similarly nothing in what I say should be read as a criticism of policy or anybody's decision to use or not to use any part of NEC3. It is all too easy to refer to the ECC or NEC as if it were a traditional form, but it is not. It comprises a number of contract documents which present options (and to which the users will add their own requirements), accompanied by guidance books.⁷ There is a good website⁸ which tells you how to get the documents and which has informative news and newsletters. The contractual and guidance documents are designed to produce the legal framework for project management procedures. The objectives include setting the scene for, and achieving, good management, flexibility and simplicity. Because NEC3 is not a traditional standard form but much more a model form (or series of forms) it is up to each user to decide what should be included or excluded or altered.

For present purposes the NEC comprises, essentially, core clauses and options. The main option clauses cover remuneration (priced or target contracts with activity schedules, priced or target contracts with bill of quantities, cost-reimbursable contract and management contract). There are two dispute-resolution options: W1 and (for use in the UK) W2. The secondary options deal with a variety of subjects (such as delay, damages, change in the law). There are also helpful guidance notes (but see below). This study is limited to the core clauses. An examination of each of the main or secondary options cannot usefully be carried out as they are intended to be part of a wider framework. This article assumes that the reader has access to NEC3. I am not going to quote large parts of it. I have also to make another disclaimer. Once I became a judge I ceased to give legal advice so nothing that I say is or is intended to be (or is to be treated as) legal advice.⁹ My views are intended to promote discussion (and perhaps also some

reaction) and, possibly, action appropriate to the relevant circumstances.

The fact that the ECC has encountered few real legal difficulties in the UK or other countries is perhaps to be discounted. Its success is largely attributable to the care taken by participants in seeing that it required a very different approach—one of genuine collaboration and a real determination to eschew confrontation—as a result of which differences that might otherwise have reached arbitration or the courts have almost always been resolved. It is probably just as well that, with one main exception¹⁰ (to which I shall refer), there are no significant judicial decisions about the ECC which may usefully be used in considering NEC3. Judicial decisions have a tendency to distract, and not to illuminate, at least if one were to look at the experience of other forms of contract. People will chew over them and milk them for any indication. Agreements by parties or concessions that are recorded but which are not flagged as not approved by the court are treated as endorsements whereas in reality they can signify no more than relief that a difficult point has not to be decided.

I am not of the school that believes that there are words and phrases with established meanings that can be transported. The use made of 'plain English' in the ECC and the absence of terminology found elsewhere requires one to focus on what is truly intended and not on what is to be presumed. A good example can be found in clauses 13.8 and 60.1 (9) which make it clear that withholding acceptance must be justifiable for a reason stated in the contract for otherwise it will be treated as a compensation event. In other words, the employer's project manager cannot unjustifiably withhold consent since that would conflict with clause 10.1. Thus NEC3 encapsulates basic legal principles but expresses them as a part of its code.

Whether the reason given was the right reason may be reconsidered under the dispute resolution provisions when it will be decided whether the project manager's action cannot be justified by any reason stated in the contract. (In some instances there may be only one reason available, although it is not always clear what the reason might be, for example clause 26.3 in giving two examples of 'a reason' suggests that there may be other valid reasons.) If not, then there will have been a compensation event. However these considerations do not necessarily meet the understandable worry that legal weaknesses may be revealed in the NEC if it is exposed to people who are not familiar with it.

It is therefore worth looking at how such a diffi-

culty would be dealt with. First, NEC3 provides for a dispute to be referred to an adjudicator under option W1 (W2 for the UK). Whatever reservations there may be about some aspects of adjudication, there is now no doubt that decisions made by adjudicators are generally either accepted by the parties or are used by them as the basis for an agreement to settle the dispute finally. Sir Michael Latham in recommending adjudication as part of his proposals drew on its success under the NEC, especially when it is employed, as it should be, to resolve disputes as they arise—as opposed to leaving them to the end of the contract, and thus converting (some might say perverting) adjudication into a mini-arbitration.¹¹ Option W1 ought therefore to be adopted.

A party that is dissatisfied has the right to take the resulting dispute to the tribunal (court or arbitrator as designated in the contract data). That tribunal decides the dispute referred to it. It does not of course act as an appellate tribunal but as a tribunal of first (and possibly last) instance with the obligation to reach its own decision.¹² However acceptance of an adjudication decision may turn on the competence and experience of the adjudicator, as the guidance notes explain. NEC3 provides for an adjudicator to be named by the employer in the contract data. If an employer or its legal advisers are concerned that a dispute might arise about a tricky legal point then a lawyer (or someone with legal qualifications) whose ability is not in doubt should be selected. It is impossible to guarantee that a legal point will be decided 'correctly'—one has only to look at the decisions of appellate courts in countries where the judges are familiar with construction contracts.

Selection of a competent adjudicator (and, if possible, of any later tribunal) manages some of the risk inherent in dispute resolution. In my view this is especially important for the NEC which has been written on the assumption that those operating it will have been trained in and will understand its concepts and philosophies. Whoever decides disputes arising under any construction contract must have the ability to stand in the shoes, as it were, of those who were there at the time and see things as they were then perceived. Applied to the NEC, this means not only having a good knowledge of ordinary construction industry practice, but also good knowledge of how a project using the NEC will have been assembled and run. A person who might approach an NEC dispute as if it were just another dispute should not be appointed as an adjudicator or an arbitrator. Some of what I say may indicate what might happen if such a person were appointed or if a dispute came to a court unfamiliar with the NEC.

Secondly, the contract data require the employer also to decide whether the tribunal should be an arbitrator or a court, were there to be dissatisfaction with an adjudicator's decision. Arbitration is usually final as there are now very few places where there can be an appeal (or anything like it) from the award of an arbitral tribunal. Equally, there are few countries outside England, Wales and Scotland where there are courts or judges dedicated to construction disputes.

Some countries, for example, the Netherlands, have arbitration systems with tribunals that specialise in construction disputes. So it is more than likely that arbitration will be chosen by the employer—but the employer should be clear about how the arbitral tribunal is to be consti-

tuted. In international arbitration it is usual for the tribunal to comprise three people. It may be difficult to find three people who have the requisite competence and who are available.

Some years ago a group appointed by the Commission for International Arbitration of the International Chamber of Commerce¹³ recommended that a single arbitrator could profitably be used for disputes which are not of high value (that is likely to cover most disputes). That recommendation has been endorsed recently by another group at the International Chamber of Commerce (ICC)¹⁴ (whose conclusions substantially repeat those in the earlier report). Since most decisions are unanimous there may be little risk in having a sole arbitrator. An employer can, by an intelligent use of option W1 and the selection of a sole arbitrator, limit (but not of course eradicate) the risk that a point of legal difficulty might not be decided rightly, in the relatively unlikely event that such were to arise under NEC3.

The reality is that most disputes are factual and are about what is or is not good practice and rarely require decisions on the meaning of standard conditions of contract, still less on points of general law. Three heads can sometimes be better than one, even for factual disputes, but the costs of arbitration must also be managed and, where practicable, kept proportionate to the amount at stake. Although recent studies by the ICC have shown that 80% of the costs of an arbitration are incurred by the parties themselves (i.e. the cost of the arbitral tribunal is not nearly as significant), the extent of those costs can be affected by the directions of the tribunal about the course the arbitration is to take.

General approach

First, the ECC is typical of contract conditions devised primarily for use in a country where the law is English common law¹⁵ or derives from it. Historically disputes under such contracts were decided by juries and as part of a system commonly called 'adversarial'. The law therefore reflected the demands and limitations of trial by jury. Juries are no longer used (other than in the USA) but their shadow lingers. In every civilised country where the rule of law is respected, a decision is reached on the evidence presented to the tribunal.

The 'adversarial' system left the selection of the evidence to the parties; some other systems might leave the selection to the tribunal's directions, although since the parties have to be confronted with the material evidence they still have to be given the opportunity to contest the facts. The net effect is that contracts have tended to spell out the rights and liabilities of the parties so as to avoid or lessen the risk that a lay tribunal (jury or old style arbitrator) might have doubt about the meaning of a contract or one of its provisions.

In addition in the twentieth century the practice of 'boiler plating' emerged, by which every conceivable possibility is covered in drafting a legal document, frequently accompanied by the paradoxically risky practice of declaring that, in the case of a contract, the totality of the parties' agreement was to be found within the written documents ('the four corners' syndrome). This practice is risky since it places a premium on comprehensive and accurate drafting. In reality, and certainly in the construction industry, events occur which (or the effects of which) were not clearly contemplated, so in practice 'boiler plating'



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or 'four corners' tends to produce challenges to the apparent effect of the contract and thus can generate disputes that might otherwise have been avoided. Such an approach has some value where it outlaws reliance on what was said or done (or not said or done) prior to the contract but even then it is quite common for the 'biter' to be 'bit': the party who wanted the contract to record the supposed complete agreement can find itself the party complaining that it does not do so.

To that extent core clause 12.4 in declaring 'This Contract is the entire agreement between the Parties' may lead some into thinking that, for example, there can never be recourse to pre-contract statements. Its utility (in any jurisdiction) is questionable. If it were removed I doubt if it would make any difference, bearing in mind the important obligations in core clause 10.1 (see below). Similarly, although the intention behind clause 12.3 is sound (changes to the contract must be in writing), I doubt if it would apply if there was in fact an agreed change which was not in writing and signed by the parties. Some legal systems might treat clause 12.3 as ineffective or even unenforceable.

In contrast, contracts devised for use in non-common law societies tend to be shorter. General principles are applied to questions of application and interpretation, a notable example being the principle that a contract is to be interpreted and to be performed in good faith. That principle is not of consistent application as its ambit differs from jurisdiction to jurisdiction. Some extend it to pre-contract negotiations, others do not. However the absence of the principle in most common law jurisdictions is in practice minimal as the same effect is achieved by the pragmatic approach that the common law applies to the reading of construction contracts. Thus powers are tempered by a requirement of reasonableness, derived either by inference or, where appropriate, by implying a term to that effect.

The ECC bridges any 'gap' that may exist as a result of a common law jurisdiction not recognising a principle of good faith (some do, e.g. in the USA) by core clause 10.1: 'The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract and in a spirit of mutual trust and co-operation'. This obligation is tantamount to one of 'performance in good faith'. Even if the principle of 'good faith' is not part of the law governing the contract, there is no difficulty in giving effect to such a contractual requirement.

For example, common law courts regularly have to decide whether the obligation of the 'utmost good faith' has been met in the insurance world. Good faith covers deciding whether someone has behaved honestly or reasonably. The phrase 'mutual trust and co-operation' imports not only honesty and reasonableness but may also oblige someone to do more than the contract calls for if the contract is truly to be performed co-operatively. That brings me to my next point.

Governing law

Core clause 12.2 provides: 'This contract is governed by the law of the contract.' That law is one of the contract data to be supplied by the employer. *Pacta sunt servanda* (agreements must be observed) is an established principle in international law. In some jurisdictions it is linked in private (contract) law, not only to the principle

of good faith in the execution of contracts (to which I have referred) but also to the important concept 'the contract is the law of the parties'. In real terms this means that a tribunal (arbitration or court) will give primacy to the contract. It will only not do so or will deviate from it, if compelled to do so by the law governing the contract. Otherwise it has to give effect to what the written contract said. This has considerable implications.

If the wording of the contract is clear and uncluttered by language that is explicable only by reference to the law governing it, then there should only be recourse to that law if it is essential to do so. Thus, if the law governing the contract is not up to date (e.g. in countries that have as yet little or no modern private law), the terms of the contract will be paramount. Since NEC3 is written in plain and simple English, it ought to be capable of being used throughout the world without the possibility of its meaning varying with whatever law governs it. That may not always be true, if only because whoever is to decide what the contract means may not have the requisite background or experience or simply because some of the assumptions upon which the NEC has been constructed are implicit or not sufficiently explicit.

An obvious example is in section 9 (termination). Core clause 91.1 necessarily uses terminology for reasons 1-10 which reflects the law of England and Wales. It should not be used elsewhere without alteration (unless the country in question has laws which are the same as English law). The guidance notes recognise that in places words have been used with a specific meaning in English law. But even the word 'claim' (e.g. in core clause 80.1) may take on a different meaning in other jurisdictions.¹⁶ Although the guidance notes say, correctly, that the simplicity of the text of NEC3 makes it suitable for use outside the UK

and for translation into other languages, it would probably be safer if it was not recommended for use unaltered where the governing law is not derived from or influenced by the laws of the UK or where the governing law is a developed law whose provisions and concepts may be at variance to UK law. As I have said earlier, a number of the assumptions underlying the NEC should be spelled out and not left to be inferred, even with the help of the guidance notes.

The guidance notes

The guidance notes state very clearly that they are not contract documents; that they are not part of the ECC; and that they should not be used for the legal interpretation of the ECC. This is sensible and proper; although in reality arbitral tribunals and courts will rarely now refuse to look at such notes, if presented with them. That is the climate in England and Wales, following what is perceived to be the current approach of the House of Lords to aids to interpretation.¹⁷ In other countries it is not only permissible, but normal before deciding the meaning of a contract, to consider not only pre-contract negotiations and documents, such as the guidance notes. In addition under some international arbitration procedures an arbitral tribunal would be entitled to look at them. Article 17.1 of the Rules of Arbitration of the International Chamber of Commerce (the most widely used in the international construction industry) says: 'In all cases the Arbitral Tribunal *shall* take account of the provisions of the contract *and the relevant trade usages*' (emphasis supplied). Thus, the contents of the guidance notes, in so far as they reflect or record established best practice, would be taken into account. The prohibitions or warnings against such use contained in the guidance notes may not then be effective. Again, it would probably be safer if it was made clear that use may legitimately be made of the guidance notes where the governing law is not derived from or influenced by the laws of the three UK legal systems or where the governing law is a developed law whose provisions and concepts may be at variance to the laws of the UK.

The project manager

The project manager has a key role. There are numerous references to what is expected of the project manager. The employer has to appoint someone who will discharge a wide range of duties as required by the contract. The employer is free to replace the project manager on giving notice of the name of the replacement (see core clause 14.4), although the employer's freedom must not infringe core clause 10. Failure to comply with the contract may render the employer liable to the contractor. In this connection there is a case for an extension of option clause X18 (limitation of liability) to make clear the extent of the employer's liability to the contractor and the circumstances in which there may be any limitation on liability or damages. The core clauses on payment (section 5) and compensation events (section 6) envisage that the project manager will make assessments of money (section 5) and of compensation events (section 6), even though the basic function of a project manager is what I described in one case as 'co-ordinator and guardian of the client's interest'.¹⁸

In a recent case¹⁹ about the administration of

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a contract which used the ECC 2nd edition,²⁰ the judge (Mr Justice Jackson) thought that there were good arguments that, in the circumstances of that contract, the project manager was also a 'certifier', that is 'that when assessing sums payable to [the contractor] [the project manager's] duty is to act impartially as between Employer and Contractor'.²¹ The judge did not have to reach a final conclusion, and did not do so, but I consider that, where NEC3 is to be used in a jurisdiction that follows English common law²² it would be prudent to assume that those arguments are right and would be upheld if they had to be decided finally.

Should the core clauses therefore go further and be specific about such a duty? On balance I think not. Section 5 is clear enough. On the one hand if, as Mr Justice Jackson said, the duty arises in the UK 'by operation of law not as a consequence of custom', then, if NEC3 is to be 'the law of the parties', it ought to spell out either what would be imposed as a matter of law or what is required for effective management. In addition, the project manager is required to act promptly in relation to the notification of compensation events (core clause 61.4), in relation to quotations for compensation events (core clause 62.6), as well as in relation to the assessments of such events (core clause 64.4) for otherwise, by a process of deeming, additional time and costs may be borne by the employer, even if the event was not a compensation event.

On the other hand, the role of the project manager is ultimately defined by the whole of the contract, particularly the options that are selected (especially whatever may be in option Z). In addition, the concept that someone who is primarily appointed by the employer to look after that entity's interest is also obliged to act impartially between the employer and the contractor is, outside common law countries, both difficult to comprehend and to stomach.

The International Federation of Consulting Engineers (Fidic) in its latest edition to its 'Red Book' conditions has, in deference to difficulties such as these, abandoned the concept that the engineer is to act impartially.²³ However the guidance notes ought perhaps to clarify what is implicit in section 5 and what is envisaged by acting reasonably (e.g. is it 'impartially?') and to include a further secondary option clause for use where the law of the contract recognises the concept of 'certifier' and where the project manager's role includes that of certifier. That or some other provision should also make clear in what circumstances an employer can question what the project manager does or does not do.

For example, the table in option W1 illustrates that the employer can challenge a quotation for a compensation event that is treated as having been accepted. However, that table is about who can refer a dispute to adjudication and when it is to be referred. It is not therefore a sure guide to what may be referred, that is what is justiciable by an adjudicator. What is the position if the law governing the contract were to treat the project manager as a certifier? Section 5 of the core clauses (payment) does not explain that a mistake by the project manager can be corrected at the behest of the employer and that such a mistake may be about anything which is the subject of an assessment for payment (see core clause 50.5, read with core clause 50.2). Thus it could cover a mistake in an assessment by the project manager of the

amount due in respect of a compensation event (see core clause 64).

Could it also cover the mistaken acceptance by the project manager of a quotation? The answer may depend on whether the project manager is then acting as a certifier or as the employer's agent. The position should be clarified. Obviously core clause W1.3 (5) and core clause W2.3 (4) in dealing with quotations that are treated as accepted suggest that there could not be a valid dispute between employer and contractor about a quotation that had been accepted by the project manager. But core clause W1.1, and the table in option W1 in referring to 'any other matter', are both widely worded and it would be better if there was no possibility of such an argument. In any case the guidance notes in stating that 'at all times the Project Manager [is] acting on behalf of the Employer' need reconsideration and expansion.

In addition NEC3 appears to provide no mechanism whereby the project manager can revise a decision, for example where there has been an over-estimate of additional time required (and, with it, cost). Core clauses 50.5 and 51.3 deal with mistakes in certificates. Core clause 65.2 creates an ambiguity. It states: 'The assessment of a compensation event is not revised if a forecast upon which it is based is shown by later recorded information to have been wrong.' The ambiguity arises from its inclusion. Has clause 65.2 been included because otherwise an assessment is capable of being revised or simply to make it clear that assessments can never be revised even if a forecast based on 'later recorded information' shows it to have been wrong?²⁴ The debate is in itself instructive. Supporters of the NEC maintain that the NEC requires compensation events to be assessed on the information available at the time—see, for example, core clause 63.1:

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'The changes to the Prices are assessed as the effect of the compensation event upon:

- the actual Defined Cost of the work already done,
- the forecast Defined Cost of the work not yet done and
- the resulting Fee.

The date when the *Project Manager* instructed or should have instructed the *Contractor* to submit quotations divides the work already done from the work not yet done.'

If a forecast cannot be made then under core clause 61.6 the project manager states the assumptions in his instruction to the contractor to submit quotations. If an assumption is later found to be wrong then the project manager notifies a correction. Otherwise the contractor assumes the risk and responsibility for its quotation. Clause 65.2 merely tells the contractor of the implications. This approach may be right but it is based on an understanding of the concept and philosophy of the NEC. To an outsider, especially a lawyer or judge unfamiliar with the NEC and used to assessments made by certifiers being revised, core clause 61.6 might be read as recording the basic position and core clause 65.2 might be read as indicating an exception to it, the premise being that revisions are permitted if simply mistaken.

Implementation in itself is not enough to preclude revision as there can still be a valid dispute about the project manager's assessment and where the quotation is treated as having been accepted. Furthermore it could be said that if the trust and confidence called for by clause 10.1 is present then why should advantage be taken of a mistake? I suggest that the NEC should be clarified to make clear the circumstances in which one of the members of the project team has to accept responsibility for a mistake and when a mistake should be corrected. Notions of waiver and estoppel should not have to be employed as they should not have to form part of NEC relationships.

The risk register

The risk register is an innovation.²⁵ It is defined, somewhat awkwardly, in core clause 11.2 (14) as 'a register of the risks listed in the Contract Data and the risks which the *Project Manager* or the *Contractor* has notified as an early warning matter'. The definition goes on to say that it includes 'a description of the risk and of the actions to be taken to avoid or reduce the risk'. However core clause 16 shows that, for early-warning matters, the process has a number of stages. After notification the matter is included in the risk register; it may then be discussed at a risk reduction meeting; the register is then revised to record the upshot.

The definition is awkward (leaving aside the tenses) because there is no reference to the process of revision which may also result in an alteration of descriptions or actions relating to risks emanating from the contract data. The status of a matter which is the subject of an early-warning notice and which is then entered on the risk register, but for which no risk reduction meeting was called (or which was not discussed at such a meeting), is unclear. In all likelihood the notification will not extend to 'the actions to be taken to avoid or reduce the risk' as core clause 16.1 calls for a notice if something 'could' have an effect. It is also



not clear why a risk reduction meeting is not part of the ordinary arrangements for meetings.

On the major projects for which NEC3 is much used, not all of which are meticulously pre-planned, it must be quite common for numerous matters to appear and be the subject of early-warning notices and for risk reduction meetings to be the norm. The arrival of a new risk requires some discussion and decision, even if it is only to agree that there is nothing to be done. Might it not be better to opt out of a risk reduction meeting rather than to have to decide to have one?

Of more moment is the contractual status and effect of the risk register and of the facultative risk reduction meeting. There is no overt link to the separate procedures under section 6 in relation to compensation events, although the last sentence of core clause 16.1 states: 'Early warning of a matter for which a compensation event has previously been notified is not required.' The impression is left that there is some obligation to give an early-warning notice where the compensation event has not been notified.

Leaving aside that consideration and the circumstances in which the event has already occurred (as they are not the main reason for clause 16), the sentence, although straightforward, is also puzzling. First, the threshold in clause 16.1 appears lower than that in core clause 61.3, from which one would have thought (but that is not apparently the case) that early warning under clause 16.1 (as it is about things which 'could' affect time, cost or performance) would always precede notice under clause 61.3 (which is about compensation events that have happened or which are now expected to happen as a compensation event). Second, it is not clear why there is no link in section 6 to the risk register, as it is difficult to see how any of such compensation events would not require early warning.

Equally, where does the risk reduction meeting fit in with the remaining conditions? Why is there no reference in clause 32.1 to changes in the programme resulting from such a meeting? If the reason is that the programme only deals with events whose consequences are capable of being assessed (i.e. only implemented compensation events) then the NEC ought to say so clearly.

Does any of this matter? On one level the answer is: no. The detachment of the risk register from section 6 makes it clear that it is solely a valuable management tool. On another level the answer is: yes. The ECC has hitherto avoided the customary division between contractual provisions which are purely or largely administrative and the provisions which deal with the consequences of events. Its appeal lies in providing all participants with the opportunity, and the responsibility, to work together, with more harmony than usual, towards the successful management and completion of the project, jointly evaluating the impact of events as they emerge and not leaving them to be dealt with as 'claims'.

However the programme features in the quotation for compensation events (core clause 62.2) and in the assessment of such events (core clause 64.4), so it may be unclear whether the decisions taken at the risk reduction meeting are then to be reflected by the contractor in the programme or whether they are to await another stage and, if so, what stage. In my view there is a gap. In addition, given that the risk register is directly concerned with time and cost, there is in my view a risk of

capital being made if early warning is not given of something which ought to have been the subject of the notice. (The risk should not in practice be great.) Nonetheless some further clarity is desirable even if it is to point out the obvious.

That is not to say that, for example, some sanction should be attached. Nevertheless clause 63 indicates that assessments may take account of the absence of notification. (I deal with core clause 63.5 below.) An employer could reasonably expect some adjustment if, for example, the opportunity to re-programme the works or to use alternative resources had been lost or affected by the absence of an early-warning notice which should have been given (there being the requisite 'awareness') or by a risk reduction meeting that had not been held. There is therefore the possibility of such an argument being developed. In reality if the project has otherwise been well managed, there is unlikely to be mileage in such a case.

If the project has not been well managed then such a case will be no more than additional support. Nevertheless, in view of core clause 63.4 ('The rights of the *Employer* and the *Contractor* to changes to the Prices, the Completion Date and the Key Dates are their only rights in respect of a compensation event') it would be better if the relationship between clause 16.1 and sections 3 and 6 were clarified.

Key date

The same applies to a 'key date'. It is defined in core clause 11.2 (9) and referred to in a number of other clauses, such as 14.3, 31.2 and 60.1 (4). The intention behind the idea of a key date is clear from the guidance notes and is very welcome as concurrent contractors need careful handling. However the employer's rights are quite limited should a key date and, with it, a condition (as defined in core clause 25) not be met.

Clause 25.3 does not cover losses other than payment to others (i.e. to the employer or the others defined in core clause 11 (10)) for additional work (in either case, curiously, also limited to 'the same project'). This clause needs to be clarified. The guidance notes ought to explain to prospective employers the policy reasons for the limitations on the contractor's liability.

Core clause 61.3

Employers are usually concerned about the effectiveness of contractual sanctions. From this aspect, core clause 61.3 is a key provision in the code in clause 61 for notifying compensation events. It states:

'The *Contractor* notifies the *Project Manager* of an event which has happened or which he expects to happen as a compensation event if:

- the *Contractor* believes that the event is a compensation event and
- the *Project Manager* has not notified the event to the *Contractor*.

If the *Contractor* does not notify a compensation event within eight weeks of becoming aware of the event, he is not entitled to a change in the Prices, the Completion Date or a Key Date unless the *Project Manager* should have notified the event to the *Contractor* but did not.'

As a matter of plain English it is hard to see why core clause 61.3 should not work as written. For example, 'becoming aware' is plain: it means actual knowledge by the senior management ultimately responsible for the contract since they have to form the necessary belief that an event is a compensation event. It is not the 'awareness' to be expected of an 'experienced contractor'. That objective criterion is applied in core clauses 19.1 and 60.1 (19)²⁶ and core clause 60.2 to determine the eligibility of a risk or event.

Clause 61.3 is also an object lesson in the difference between the 'philosophy' of NEC3 and the 'philosophy' of other traditional contracts. In this article I use the word 'philosophy' with caution since the only 'philosophy' of any construction contract is that which can be seen from its wording (and, where permissible, from documents such as the guidance notes). In the case of the core clauses of NEC3 it is epitomised by clause 10.1. The financial arrangements of NEC3 are also not like other contracts. However NEC3 and other contracts²⁷ have in common a desire that the employer should always be kept in the picture about the likely financial out-turn. Clause 61.3 strikes a sustainable balance.

For compensation events upon which the employer must necessarily rely on the contractor it is by no means unreasonable that the contractor should lose its rights if it does not give notice within eight weeks. The contractor is not at risk if the event was one that ought to have been notified to it by the project manager, especially since the contractor is as likely to be aware of the effect of most events. Moreover the period of eight weeks is not ungenerous as it starts with the contractor 'becoming aware'. This is a somewhat subjective criterion, particularly where the awareness must be that of senior management.

Clause 61.3 is not related to any constraint set out in the works information or contract data which may establish a key or other date by which the contractor has to provide the works, still less to the payment of delay damages (as they are the subject of an optional clause). That is not to say that a set of option or option Z clauses might not be devised which would make the employer's right to recover delay damages contingent on prompt action by the project manager in assessing a compensation event. But that would require quite a radical recasting of NEC3.

Core clause 63.5

Core clause 63 is about assessing compensation events. Although the text of clause 63.5 is unchanged from clause 63.4 of the previous edition, it remains unclear. It states:

'If the *Project Manager* has notified the *Contractor* of his decision that the *Contractor* did not give an early warning of a compensation event which an experienced contractor could have given, the event is assessed as if the *Contractor* had given early warning.'

Core clause 16.1 requires early warning of matters that could be a compensation event, but not if the event has already been notified. Clause 61.3 requires notice by the contractor of a compensation event within eight weeks of becoming aware of the event. At first sight there appears to be an error: why should it be assumed that early warning which ought to have been given by a

contractor was not given? And given when: when it should have been given or when it was given? Is it clear that the notice in this clause is that to be given under clause 16.1? On any view the statement in the guidance notes that this provision states a sanction requires explanation, both in NEC3 and in the guidance notes.

The answer seems to be twofold. First, if it was given, albeit 'late' but still within the eight-week period in clause 61.3, then the lateness is taken into account. An example was given to me. If the contractor should have given notice of one week's delay (applying the 'experienced contractor' test) but did not do so (because the contractor was not aware—see clause 16.1) whereby the project manager was prevented from taking steps that might have reduced the delay to one day, the compensation event would be assessed on the basis of one day's delay. The contractor would be left with the cost of making up the lost time (if it still could do so) or the consequences of not having done so. That seems entirely in accordance with the spirit of core clauses 10.1 and 16.1, and also of the letter of the latter which creates an obligation only on becoming aware. (It is somewhat difficult to conceive how the project manager could also have been unaware of something which an experienced contractor should not have missed.)

Secondly, if the notice was not given at all, then it is assumed that normally an instruction to submit a quotation would have been given (although clause 63.1 says 'should have been given'). Presumably in order to make an assessment the

project manager has to construct a notional quotation, but is it done on the basis of the work done at the time when the quotation would have been required or the work to be done at that time?

Clause 63.1 makes a distinction between the two. I am also unclear how the employer can be sure of avoiding payment for costs of having to make up time that would not have been incurred had the early-warning notice been given at the 'right' time.

Despite the fact that users seem not to have problems with its application, perhaps because, for the reasons indicated, the situation rarely arises, I think that clause 63.5 ought to be reconsidered. Even if clause 63.5 is left unchanged, the guidance notes need amplification as to what might happen and whether there is really a sanction and not just a consequence of something which falls within the contractor's field of risk and responsibility. It is certainly not stated in clause 63.5 as suggested by the guidance notes and there is room for confusion, particularly where the guidance notes may be used outside the UK as a legitimate aid to the interpretation of NEC3. If clause 63 contains true sanctions, whether directly or indirectly, then there must be no doubt, either commercially or legally, about their nature and extent.

For further information please contact the author on +44 20 7404 0102 or email hllloyd@atkinchambers.com. This article was first published in *International Construction Law Review*, October 2008.

The financial arrangements of NEC3 are also not like other contracts. However NEC3 and other contracts have in common a desire that the employer should always be kept in the picture about the likely financial out-turn. Clause 61.3 strikes a sustainable balance.

Notes

1. The author is one of the editors-in-chief of *International Construction Law Review*.
2. See Barnes, 'The New Engineering Contract' [1991] ICLR 247.
3. The views expressed in this article are the author's own and not those of the NEC panel or of the ICE. The author is grateful to members of the NEC panel and others for their observations on earlier versions.
4. *The Placing and Management of Contracts for Building and Civil Engineering Work* (HMSO, 1964). Such was its importance that it had to be reprinted three years later.
5. GCWorks and the like.
6. For South Africa, for example, see Baird, 'The NEC—A Management Summary for Plant Users' [1994] ICLR 114.
7. The NEC contract has been the subject of commentaries. See, for example, the two-part article by McInnis, 'The New Engineering Contract—Relational Contracting, Good Faith and Co-operation', Part 1 [2003] ICLR 128, Part 2 [2003] ICLR 289 (and that author's *The NEC—A Legal Commentary* (2001)).
8. www.newengineeringcontract.com or www.neccontract.com.
9. Obviously my views about the laws in countries other than England and Wales come from a variety of experience, not knowledge.
10. *Costain Ltd v. Bechtel Ltd* [2005] EWHC 1018 (TCC).
11. Although if a sensible time is then allowed so that there can be confidence in the procedure the result can be commercially acceptable.
12. See *Castle Inns v. Clark Contracts* [2005] Scot CS CSOH 178: 'proceedings... are not an appeal... [they] do not involve any reconsideration of the adjudicator's decision, but are entirely freestanding.'
13. It was co-chaired by Dr Nael Bunni and myself. The report was published in this *Review*: [2001] ICLR 644 and the *Bulletin of the International Court of Arbitration*, Vol. 12, No 2, Fall 2001.
14. *Techniques for Controlling Time and Cost in Arbitration*, ICC Document 420, 535.
15. Or with adaptation, Scots law.
16. See Hök, 'Difficulties Encountered in the English-French Translation of FIDIC's Standard Form Contracts' [2007] ICLR 271 at 279 on the translation into French of 'claim'.
17. See *Investors' Compensation Scheme Ltd v. West Bromwich Building Society* [1998] 1 WLR 896 at 912F–913E, but see also *BCCI v. Ali* [2001] 1 AC 251 at 269D, [39].
18. *Royal Brompton Hospital NHS Trust v. Hammond (No 8)* [2002] EWHC 2037 (TCC), [23].
19. *Costain Ltd v. Bechtel Ltd* [2005] EWHC 1018 (TCC).
20. But with provisions which are not part of the core clauses in NEC3.
21. See para. 53 of the judgment in *Costain v. Bechtel*.
22. That is a jurisdiction that follows English law.
23. The obligation was explicit in clause 2.6 of the previous edition (1987). Fidic now calls for a 'fair determination' which in reality must be the product of an impartial determination.
24. This may be easier to say than to do. Ordinarily a dispute is resolved taking account of all the knowledge then available. Most find it difficult to ignore relevant facts that have occurred and which affect an assessment.
25. Even the guidance notes do not make it clear that the risk register is not an initial formal contract document but is created after the award of contract. The notes in para. (14) to clause 11.2 could usefully be clarified. Although the register is created for the purposes of contract management it has contractual status as it features in the contract.
26. Clause 60.1 (19) covers situations which are extremely unlikely to occur so I do not discuss it although it may be meat and drink to some lawyers. Many contracts sensibly do not leave *force majeure* to be defined by reference to the applicable law, especially since in relation to modern construction contracts the term would exclude some events which are not regarded as within a contractor's sphere of risk.
27. As was made clear for the ICE Conditions of Contract some 40 years ago in *Crosby v. Portland UDC* (1967) 5 BLR 121 at 132.

Response from the NEC panel



IAN GRIFFITHS NEC LEGAL ADVISOR

The NEC panel welcomes the endorsements of the NEC3 suite of contracts by His Honour Humphrey Lloyd QC and is grateful for his valuable suggestions on achieving greater clarity.

Clarity is one of the key principles of NEC3 contracts. Where an eminent commentator such as Humphrey Lloyd is unclear as to the intent of a provision, or considers the intent of a provision to be unclear, then this should be addressed through further guidance and training. The form and content of such further guidance is now being considered by the NEC panel.

Three key areas raised by Humphrey Lloyd merit discussion in this brief article, namely

- the project manager and impartiality
- the risk register and compensation events
- clause 63.5.

The project manager and impartiality

English law clearly recognises that a professional administering a construction contract has a dual role. As stated in the 2006 case of *Scheldebouw BV v. St James Homes* by Mr Justice Jackson, a contract administrator – in this case a construction manager – has both an ‘agency function’ and a ‘decision-making function’. In the latter or certifying role, the administrator is to act impartially.

The NEC panel agrees with Humphrey Lloyd that ‘impartiality’ should not be made an express obligation on the project manager under NEC3 contracts. There would be difficulty also in expressly excluding the operation of English Law to counteract the implied term that a certifier is impartial. This tension in the role of the project manager as certifier is present in all other construction contracts but the NEC3 has a particular approach to the issue.

The NEC3 approach to the project manager is similar to that of Lord Morris in the case of *Sutcliffe v. Thackrah* [1974] speaking of an architect certifier: ‘His duty to act fairly does not conflict with, but rather is part of, his duty to safeguard and look after the interests of the building owner who has employed him’.

The guidance notes to NEC3 contracts may be guilty of overstating the position: ‘at all times the Project Manager [is] acting on behalf of the Employer’, but they outline the NEC3 philosophy of framing the project manager’s responsibilities to provide a convergence of the agency function and decision-making function rather than a dual approach. NEC3 seeks to achieve this by the following.

- Being prescriptive on certification and thereby offering the project manager less discretion.
- Promoting the science of project management in the administration of contracts rather than providing for project designers to assume the role of contract administration. This removes the potential con-

flict often seen in other forms of contract between those responsible for design and those responsible for workmanship.

- Providing for adjudication of disputed decisions. This issue is less relevant in the UK, where the Housing Grants, Construction and Regeneration Act 1996 provides adjudication as a statutory right for parties to a construction contract, but is still relevant in other countries which have not adopted this form of dispute resolution.
- Requiring the parties to NEC3 contracts and the project manager to act in a spirit of mutual trust and co-operation.

The risk register and compensation events

Humphrey Lloyd’s suggestion that it might be better to opt out of risk-reduction meetings rather than deciding to have one is useful and could save time on administration of meetings. There are examples of this position being adopted on projects adopting NEC3.

A query is raised by Humphrey Lloyd as to why there is no overt link between the early-warning provisions of clause 16 and the compensation-event provisions of clauses 60 – 65, and why the risk register does not directly impact the programme. This is a question which is often raised at NEC3 training events. Another question he asks is why the threshold for early-warning events at clause 16.1 is lower than that contained in clause 61.3 for compensation events.

The NEC3 early-warning procedure is an early-warning mechanism for potential change. There would, therefore, be a lower threshold in clause 16.1 than in clause 61.3. By definition there is no need for an actual change to be made to the programme at that stage. In the event that change is necessary, the effects of change are handled by the compensation-event provisions and it is at this point that the programme is revised.

Clause 63.5

It is recognised that the provision of clause 63.5 does require further explanation, not least as it appears counter-intuitive on first glance. It may be helpful to make the following points on this provision

- clause 63.5 is best understood when read with clause 61.5
- the clause applies to the giving of a notice of the compensation event, not the early warning of it.

The implication of a contractor not having provided an early-warning notice is that the project manager can request that any cost or time savings which could have been made had the early warnings been given are taken into account in assessing the effects of the compensation event. ○

Ian Griffiths is a construction partner of law firm Thrang Townsend Lee & Pembertons. For further information please contact him on +44 117 930 9548 or email igriffiths@ttuk.com

All articles in this newsletter are the opinions of the authors and do not necessarily reflect the views of the NEC Users’ Group, NEC office or NEC panel.

Constructive contributions to the newsletter are always welcomed and should be emailed to the editor Simon Fullalove at simon@fullalove.com, telephone +44 20 8744 2028, fax +44 20 8891 2462.

Current and past issues of the newsletter are also available on the NEC website at www.neccontract.com. All other enquires should be made to the NEC manager Rekha Thawrani, NEC, 1 Heron Quay, London, E14 4JD, telephone +44 20 7665 2446, fax +44 20 7538 2847, email nec@neccontract.com.

