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How NEC Contracts Support the Construction Playbook

Article 4
Key policy: risk allocation / payment mechanism and pricing

> *"Ensuring that risks are owned or jointly owned by the party or parties best able to manage and bear them, and understanding how they intend to handle them, is key to delivering value for money and successful outcomes."*

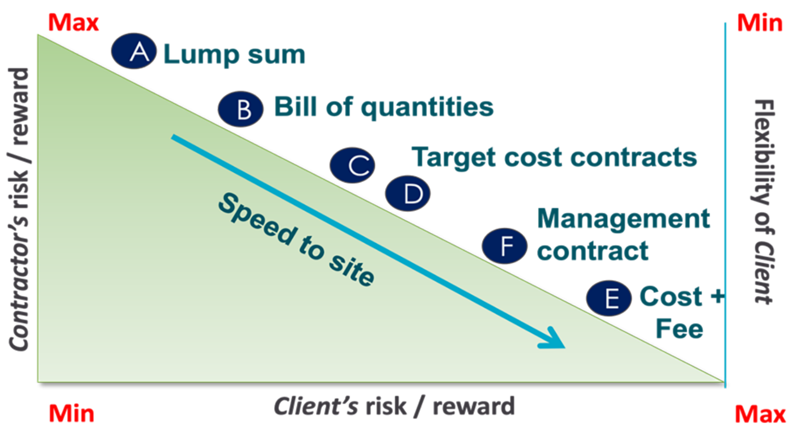
The correct allocation of risk is key to the success of any project or programme and a sensible view needs to be taken on who is best placed to carry risk, recognising that simply transferring a risk to the supply chain does not remove the risk or the likelihood of its occurrence.

NEC4 contracts are inherently flexible in how risk is allocated between the parties, and they provide the freedom to alter risk allocation to suit the nature of the project and capabilities of the parties.

NEC4 offers a choice of contracts including the NEC4 Alliance Contract in which the majority of risk and reward can be shared across the members of the alliance creating a truly collaborative contracting arrangement.

NEC4 main contracts offer a choice of main and secondary Options which can be used to tailor risk allocation to suit the parties. As an example, the relative risk and reward potential of the main Options in the NEC4 Engineering and Construction Contract (ECC) are outlined in the diagram below.

Financial risk reward of the main Options



This highlights how pricing risk and cost risk can be allocated in various degrees to the supplier, the client or shared under a target cost arrangement.

Secondary Options can be used to allocate risk between the parties as well as cap risk to the supplier. Options allow for allocation of risks such as inflation, changes in law, completion, design, performance and climate change related matters to be addressed. Secondary Option X18 allows the client to limit the supplier's liability for certain types of risk and to place an overall cap on the supplier's liability.

The drafting of NEC contracts provides a balanced and fair allocation of risk between the parties with clear identification of events for which the supplier will carry the risk of and for those which they will be compensated by the client if they occur.

NEC4 contracts also have in-built risk identification and mitigation processes in the form of early warnings, a regularly updated programme and the compensation event mechanism.

Acknowledgements

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