

nec4 | **Improvement**
through collaboration

NEC Conference 2017

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Agenda



HK Gov't Practice

Seminar and Workshop

NEC Case Law

Seminar

HK Government Practice (NEC 3)

- **DEVB Practice Note** issued Oct 2016, updated March 2017 focused on use of NEC3. Key objectives:
 - Guidance
 - Performance benchmarks
 - Standardise practices
- Identifies key topics to be considered by Project Officers
- Commitment to NEC including for contracts > HKD 1bn
- Standard Amendments and Additional Conditions of Contract
- There is latitude for WDs to take different approaches

HK Government Practice (NEC 3)

- **Ground Conditions** risk sharing – baseline reports
- A move towards **positive cash flow** on target cost contracts but applies to contractor own costs only (but not subcontract)
- A move to **sample checking** of costs on target cost contracts but limited to costs < HKD 0.3m after first 6 months and excludes People costs, insurance and subcontracts
- *“**Disallowed Cost** is not meant to be used as a restrictive measure on the Contractor but as a method to encourage the Contractor to operate the contract and carry out the works in a proactive manner”*

HK Government Practice (NEC 3)

- **Target contracts** – pain share capped at 110% of target
- **Time not money** for following compensation events:
 - Weather (except severe weather on target contracts)
 - Shortage of labour
 - Delay by Utilities, Employer, Others (ref Programme)
- **Use of rates and prices** – in lieu of cost on CEs
- **Constraints on Project Manager's independence** – must ensure employer has no objection to actions incurring in excess of HK\$300k

HK Government Practice (NEC 3)

- **Tender Requirements for Subcontracting (target contracts Options C and D and subcontracted compensation events Options A and B)**
- >\$50k – no need for tenders
- >\$50k <\$200k – more than one tender / lowest price
- >\$200k <\$300k – five or more tenders / lowest price
- >\$300k <\$7m – submit list of proposed tenderers to PM for acceptance two weeks in advance / lowest price.
- >\$7m – as before but more information to be provided to justify suitability of proposed tenderers. Scope for PM to agree lowest price does not have to be accepted or 5 tenders not needed but PM has 3 weeks to decide.

HK Government Practice (NEC 3)

- **Tender Requirements for Subcontracting (cont'd)**
 - Cannot amend work items or tender prices after tender opening
 - Must co-operate with and allow access to ICAC.
 - Have to justify use of associated companies
 - No two stage processes with associated companies
 - Contractor must follow its own tendering procedure submitted and accepted by the PM
 - Tenderers cannot qualify tenders
 - Unless otherwise accepted by the PM the HKCA domestic form is to be used.

HK Government Practice (NEC 3)

- **Contractor Design (where applicable)**
- Same liability as professional designer and no overall obligation to ensure fitness for purpose. But:
 - Selected plant, materials and goods must be reasonably fit for purpose
 - Warranty of conformance with any *“performance specification or requirement...in this contract...”*

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WORKSHOP:

- Schedule of Cost Components
- Compensation Events
- Subcontracting
- Contract Amendments Examples

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Scenario – Part A

- You are tendering for a major NEC3 Option C Target Contract for a road bridge over a valley
- The Defined Cost and Price for Work Done to Date are in accordance with clause 1.2(23) - as provided to you
- Part 1 of the Schedule of Cost Components is amended – as provided to you

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Scenario – Part A (continued):

- What do you need to take into account in terms of recovery of People costs when preparing your tender?
- How will costs be recovered for the following:
 - Site Engineer employed on an agency basis
 - Agency worker based on site 2 days a week but also spends days visiting casting yards in China
 - Directly employed accountant based in head office who visits site for 2 days once a quarter to check and update information for company accounts

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Scenario – Part B

- Having successfully won the tender and started work...
 - The PM instructs increases to reinforcement and the grade of concrete with significant additional supply cost. But no delay. The PM requests a quotation using actual costs for management and supervisory staff – can he do this?
 - A site of archaeological interest is found. Work stops for 9 weeks for investigations. No subcontract work is undertaken and limited costs are incurred during this period except for contractor's site staff. Can the contractor prepare a quotation for this compensation event using the actual costs of its site staff?

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Scenario – Part C

- The PM instructs the addition of some large electronic traffic information boards which will have to be procured from one of a small number of possible specialist suppliers. The value is likely to be HK\$3.5m. The PM notifies a compensation event and requests a quotation.
- You have a preferred supplier you have worked with before who can be appointed without causing delay but only if you can get a price from them and appoint them within 2 weeks.
- What considerations arise for the Contractor in this situation? Would the position be different under NEC Option A or B?

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Contract Amendments (1)

People Costs in the Fee not in the Schedule of Cost Components

- Replaced Clause 11.2(8)

“The Fee is the sum of the amounts calculated by applying the fee percentage to the Defined cost. Without prejudice to clause 52.1, the Fee includes but is not limited to :

People – The following components of the cost of:

- People who are directly employed by the Contractor and whose normal place of working is within the Working Areas and
- People who are directly employed by the Contractor and whose normal place of working is not within the Working areas but who are working in the Working Areas. ...”

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Contract Amendments (2)

Amendment to Defined Cost for Subcontractors:

- Amend Clause 11.2(23)

“Defined Cost is

- The amount of payments due to Subcontractors for work which is subcontracted and executed in accordance with the Works Information without taking account of amounts deducted for:
 - Retention
 - Payment to the Employer as a result of the Subcontractor failing to meet a Key Date
 - ...”

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Contract Amendments (3)

Cash Flow

- Unamended Clause 11.2(29)

“The Price for Work Done to Date is the total Defined Cost which the Project Manager forecasts will have been paid by the Contractor before the next assessment date plus the Fee.”

- Amended Clause 11.2(29)

“The Price for Work Done to Date is the total Defined Cost which the Project Manager ~~forecasts will have been paid by the Contractor before the next~~ assesses the Contractor has paid at each assessment date plus the Fee.”

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Contract Amendments (4)

Contractor's Share

- New bullet point to Clause 50.2 (payment)

“less the *Project Manager's* interim assessment of the *Contractor's* share, if the *Project Manager's* forecast of the final Price for Work Done to Date exceeds his forecast of the final total of the Prices”

- New Clause 53.2A

“The Project Manager makes interim assessments of the Contractor's share on each assessment date using his forecast of the final Price for Work Done to Date and his forecast of the final total of the Prices. The Project Manager informs the Contractor of his interim assessment of the Contractor's share.”

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Contract Amendments (5)

Delete Compensation Event for Neutral Act of Prevention

- Delete Compensation Event 60.1(19)

“An event which

- stops the Contractor completing the works or
- stops the Contractor completing the works by the date shown on the Accepted Programme,
- An experienced contractor would have judged at the Contract Date to have a small chance of occurring that it would have been unreasonable for him to have allowed for it and
- Is not one of the other compensation events stated in the contract.

And which

- Neither Party could prevent.”
- Replace with

“A change in Law as defined in Clause A1 of the additional conditions of contract.”

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Contract Amendments (6)

Shortage of Labour – New Compensation Event

- Add New Compensation Event 60.1(21)

“A shortage of labour which would have been unreasonable for an experienced contractor to have allowed for at the tender closing date.”

- Add New Clause 60.4

“For compensation events which arise from shortages of labour, the Contractor is not entitled to any change to the Prices notwithstanding any other provisions in this contract.”

HK Practice – the ‘wish list’

- Move away from target cost cap 110% cap
- Allow full independence for PM actions and assessments
- Fully cash positive payment on target contracts
- No payment of management and supervisory staff through Fee
- Greater freedom for sub-contracting
- Development of sophisticated sub-contracting practices
- Cull and re-draft of additional conditions to NEC style

Significant NEC Cases

Costain v Bechtel Ltd (2005)

Facts

- Costain was part of a contractor JV on Channel Tunnel Link project using NEC2 Target Cost. Bechtel was part of Project Manager JV.
- Mr B of Bechtel instructed PM team to be strict in disallowing costs
- Costain went to court to require Bechtel to act impartially in administering the contract
- Bechtel contended that prescriptive nature of NEC provisions meant it was not required to act impartially in payment applications and instead had to look after the employer's best interests

Costain v Bechtel Ltd (cont)

“When the project manager comes to exercise his discretion in those residual areas, I do not understand how it can be said that the principles stated in Sutcliffe do not apply. It would be a most unusual basis for any building contract to postulate that every doubt shall be resolved in favour of the employer and every discretion shall be exercised against the contractor.

...Upon examining these provisions, I am unable to find anything which militates against the existence of a duty upon the project manager to act impartially in matters of assessment and certification.”

Costain v Tarmac Holdings (2017)

- Facts
 - Contract used Framework Conditions and Supply Conditions.
 - Different dispute resolution provisions in each contract.
 - Supply contract provided for adjudication with time bar for referral to arbitration (Clause 93) but no such provision in the framework contract
 - Costain argued Tarmac estopped from relying on time bar and arbitration provisions and that NEC Clause 10 “*mutual trust and co-operation*” meant Tarmac obligated to point out scope, nature and effect of Clause 93 but Tarmac’s lawyers had been silent

Costain v Tarmac Holdings (cont)

Held:

- That clause 10 equated to an obligation of good faith.
- Endorsed Australian good faith authority that:
 1. Good faith depends on the circumstances and context.
 2. Good faith does not require parties to put aside self-interests
 3. Normal reasonable business behaviour is permitted but the court will consider whether a party has acted reasonably or unconscionably or capriciously and may have to consider motive.
 4. The duty is one *“to have regard to the legitimate interests of both the parties in the enjoyment of the fruits of the contract..”*.
- Judge *“uneasy”* about a more general obligation to act fairly.
- In present case, *“it would extend to a positive obligation...to correct a false assumption obviously being made ...that clause 93 was not going to be operated or that the time bar...was not going to be relied on.”*

Anglian Water v. Laing O'Rourke (2010)

- Facts
 - Dispute over whether notice of arbitration validly served on party's solicitors as opposed to last notified address of the party.

- NEC clause 13.2 provides

“A communication has effect when it is received at the last address notified by the recipient for receiving communications or, if none is notified, at the address of the recipient stated in the Contract Data”

Anglian Water v. Laing O'Rourke (2010)

- Held:
 - *“compliance with the mode of delivery specified...is the only means of achieving ...effective delivery ...because the communication only takes effect when...received at the prescribed address”*
 - *“I have to confess that the task of construing the provisions in [NEC] is not made any easier by the widespread use of the present tense...No doubt this approach...has its adherents within the industry but, speaking...from the point of view of a lawyer, it seems to represent a triumph of form over substance”*

ICI v Meritt Merell Technology (2017)

Facts

- ICI entered into a contract with MMT for a new paint plant on NEC3 Option A
- Variation considerably expanded the scope of MMT's works to an extent that took it out of ICI's budget.
- ICI become increasingly involved in the contract and required their approval before the PM could exercise his powers.
- The PM resigned his appointment as a result of this requirement.
- MMT alleged substantial non-payment by ICIC whereas ICI alleged considerable defective welding work by MMT

ICI v Meritt Merell Technology (Cont)

Held

- NEC contract designed to have separate entities as Employer and PM.
- The requirement for ICI to sign off on any assessments of PM Instructions constituted interference in the duties of the PM
- The appointment of an employee of ICI's parent company as PM was ineffective as that person was not sufficiently independent
- Such appointment amounted to repudiatory breach of the contract

RWE Npower Renewables v JN Bentley (2013)

Facts:

- Section 2 defined differently in Option X5 and the Works Information
- RWE argued for the definition in the Works Information.
- JN claimed that the conflicting definitions rendered sectional completion obligations and LDs unenforceable
- Issue: which definition of section 2 was applicable?

Held

- Contract documents should read as complementing each other
- Only if there is 'clear and irreconcilable discrepancy' do you look at the order of precedence.
- In this case the two clauses could be read harmoniously as the definition in X5 was more general description of what was said in the works information

Vinci Construction v Beumer Group (2017)

Facts:

- Vinci appointed Beumer to work on the baggage system at Gatwick Airport using NEC Sub-contract with sectional completion
- Section 5 was 'baggage' and Section 6 was 'remaining works'
- Issue was whether disconnecting existing BHS was in Section 5 or Section 6 and if LD provisions were certain enough to be enforced

Held:

- The works within each section were sufficiently identifiable so that the LD provisions were enforceable

SSE Generation v Hochtief Solutions (2016)

Facts:

- SSE engaged HS for a hydro-electric tunnel.
- After completion and taking over of the tunnel there was a rock collapse
- SSE contended that the tunnel was required to provide *'reliable service...without significant capital expenditure'*
- HS contended that under Option X15 it was only required to exercise reasonable skill and care

Held

- Option X15 did not impose a guarantee of performance
- SSE's approach required fitness for purpose which contradicted Option X15

AMEC Group v Secretary of State for Defence (2013)

Facts

- Amended NEC target contract. Contractor's pain capped at £50m
- Issue: Once the cap was exceeded could AMEC only recover Actual Costs (as defined) reasonably incurred or all costs?
- Argument existed because amended pain share provisions referred to 'actual costs' not defined term 'Actual Costs'

Held

- 'actual costs' and 'Actual Costs' defined were interchangeable
- The entire NEC pricing and payment regime used Actual Costs so it was only reasonable for Actual Costs to be recoverable

Northern Ireland Executive v Healthy Buildings (Ireland) (2014)

Facts

- NIHE appointed HB to carry out asbestos survey works
- NIHE instructed a variation to the scope of works (WI). However, NIHE did not notify as a compensation event.
- HB notified a compensation event after > 8 weeks
- NIHE contended that such notification was time barred

Held:

- The 8 week time bar in Cl 61.3 does not apply to CE such as variations which should be notified by the PM
- This is the case even if the PM does not think it is a CE
- The existence of a CE is an objective event

Northern Ireland Executive v Healthy Buildings (Ireland) (2017)

Facts

- Works complete when NIHE requested quotation for CE
- HB refused to provide details of actual costs and insisted on recovering its (retrospectively) forecast costs
- Issue: Should the effect of the compensation event be calculated using forecast costs or the actual costs?

Held

- Evidence of actual costs is clearly the best evidence.
- It should be used unless the contract prevents such use which the NEC does not
- Refusing to provide this evidence is contrary to the spirit of '*mutual trust and cooperation*'

Atkins v SoS for Transport (2013)

Facts:

- Fixed price road repair framework contract. Atkins encountered far more potholes than anticipated
- Atkins claimed for excess potholes on basis *“an experienced contractor would have judged at the Contract date to have such a small chance of being present that it would have been unreasonable for him to have allowed for it”*

Held

- Volume of potholes not relevant. Risk was allocated to Contractor who allowed for it and it was extremely difficult to identify how many potholes should be foreseen under the contract in any event
- What might be relevant was instances of potholes arising from unforeseeable or remote causes

Mears v Shoreline Housing (2015)

Facts:

- Housing maintenance under NEC Term Service target contract which used rates to set the target
- There were no rates for reactive maintenance
- Parties created and Mears paid based on separate rates for such works for 6 months prior to signing contract
- SH then sought to apply the NEC target contract payment provisions and deduct 'overpayment' resulting from the rates

Held:

- Arguable case of estoppel by convention or representation
- Parties proceeded on basis rates applied and Mears had relied on this and did not have records to apply the NEC payment terms

Q&A

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Improvement

through collaboration

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