NEC 3
NEC 3 SOME PROBLEMS EXPOSED AND DISCUSSED

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COMPANY PROFILE

UK:
- Construction Claims & Dispute Avoidance/Resolution, Commercial Management, Project Management
- Over 200 employees in 14 offices
- Local office in Leeds

International:
- World leader in Project Management & Construction Claims
- Over 3,700 employees in 100 offices across Europe, North and South America, the Middle East, Asia and Australia
- Hill International UK have advised on projects worth in excess of £90 billion

ABOUT US

Dispute Avoidance
- Contractual Advice and Contract Drafting
- Procurement and Partnering Advice
- Construction Defects Diagnosis and Technology
- Seminars and Training

Dispute Resolution
- Adjudication / Mediation / Conciliation / Expert Determination
- Claim Preparation
- Delay and Disruption Analysis
- Expert Witness Testimony

Dispute Management
- Litigation Support
- Cost and Damages Assessment
- Project, Risk and Strategic Management
NEC 3 – ETHOS

DRAFTED ON THE PRESUMPTION THAT PARTIES WILL FOLLOW NEC 3 PROCEDURES!

- It is important to bear in mind that the NEC 3 works on the presumption that the parties will operate the provisions as intended and have bought into the NEC 3 principles.

See extract from p3 of the NEC Guidance Notes:

PRICING AND TENDERING PROBLEMS

FEE PERCENTAGES UNDER MAIN OPTIONS A & B
FEE PERCENTAGES

CONTRACT DATA (PART TWO)

• Fee’s are applied differently under Main Options (A+B) and (C+D).
• There is a “direct fee” and “subcontracted fee” percentage that are to be entered separately in CE (P2).
• Problems with the tendered fee generally arise under Option A and B due to the definition of Defined Cost, which is:

We have not included the causal cost of the contract itself, nor the cost of preparing quotations.

* The assessment of compensation events under Options A and B is based entirely on the effect that the compensation event has on Defined Cost [clause 63.1].

* Note: The definition of “Defined Cost” does not include for payments to subcontractor’s in respect of compensation events.

FEE PERCENTAGES

CONTRACT DATA (PART TWO)

• Subcontract costs incurred when undertaking a compensation event have to be broken down into the SSCC in accordance with the definition of Defined Cost.
• SSCC does not include a cost component for overheads and profit.
• On this basis the subcontracted fee has to recover, not only the Fee of the Contractor, but also the overheads and profit as claimed by the subcontractor in his pricing of the CE or indeed a variation if NEC 3 subcontract is not used.

<table>
<thead>
<tr>
<th>Item</th>
<th>People</th>
<th>Rate</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approved electrician (1)</td>
<td>8</td>
<td>£35.00</td>
<td>£280.00</td>
</tr>
<tr>
<td>Approved electrician (2)</td>
<td>8</td>
<td>£35.00</td>
<td>£280.00</td>
</tr>
<tr>
<td>Labourer</td>
<td>4</td>
<td>£23.00</td>
<td>£92.00</td>
</tr>
<tr>
<td>Equipment</td>
<td>1 day</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cables</td>
<td></td>
<td></td>
<td>£408.00</td>
</tr>
<tr>
<td>Tracing</td>
<td></td>
<td></td>
<td>£200.00</td>
</tr>
<tr>
<td>Materials and fittings</td>
<td></td>
<td></td>
<td>£15.00</td>
</tr>
</tbody>
</table>

**Total, overheads and profit:** £1,406.40

TIME SPENT PRODUCING QUOTATIONS FOR COMPENSATION EVENTS

• “My Quantity Surveyor has spent lots of time producing quotations for compensation events, and I have included his time in the quotation itself, or in my delay claim which is to be submitted separately! How else am I expected to recover his time!!”

• Option A and B

[22) Defined Cost is the cost of the components in the Shorter Schedule of Cost Components whether work is subcontracted or not involving the cost of preparing quotations for compensation events.

• It is deemed to be included in the Fee – the Fee is not just an inclusion for head office overheads and profit.
WHAT IS THE WORKING AREA?

Options C and D

- Cost of preparing quotations is included in the cost of people in the working area.

CLAUSE 11.2.23 WHICH DESCRIBES
Defined Cost does not include the cost of preparing quotations.

- The cost of preparing the quotation is included in the Changes to the Prices and so does not affect the pain / gain share in Option C.

TIME SPENT PRODUCING QUOTATIONS FOR COMPENSATION EVENTS

- Cost of preparing quotations is included in the cost of people in the working area.

COMPLETE QUOTATIONS INCLUDES THE FOLLOWING:
- The cost of preparing the quotation is included in the Changes to the Prices and so does not affect the pain / gain share in Option C.

OPTION A AND B – CASH FLOW PROBLEMS

MAIN OPTION A

MAXIMISING CASH FLOW

- Cash flow problems arise from the definition of the Price for Work Done to Date ("PWDD"), which states:

  "The Price for Work Done to Date is the total of all the Prices for each group of completed activities and each completed activity which is not in a group. A completed activity is one which is without defects which would delay or be caused to be indefinitely following work."

- This is milestone payments. If compensation events prevent an activity from being completed then the Contractor is not paid for this activity under the contract.

- If these situations occur then the contractor is to be reimbursed according to the definition of the PWDD.
MAIN OPTION A

MAXIMISING CASH FLOW

• A typical amendment (Z-clause), might be as follows:

> Add the following third bullet point to clause 11.2(7):

> A proportion of an activity, or group of activities that the Contractor has completed if those activities, or groups of activities, would have otherwise been completed on the assessment date had it not have been for the occurrence of one of the listed compensation events or an Employer risk.

• Contractor’s and subcontractor’s will often attempt to breakdown activities into many smaller activities in order to enhance monthly payments. However, the problem here is that the programme can become unwieldy due to the effect of clause 31.4:

The problem is that the programme can become unwieldy due to the effect of clause 31.4:

> The contractor provides information which shows how each activity on the Activity Schedule relates to the operations on each programme which he submits for assistance.

• Other ways in which the activity schedule can be structured to enhance cash flow would be activities for placing orders, or the delivery of materials to the Site or to an designated off site facility.

• Activity schedules can also be ‘front loaded’ to ensure payment up front (cash in the bank).

MAINTENANCE CASH FLOW

• Such details to be submitted would be as follows:

<table>
<thead>
<tr>
<th>Activity number</th>
<th>Activity description</th>
<th>Price (£)</th>
<th>Programme operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Excavate for wall alignment</td>
<td>20,000</td>
<td>Part of 23</td>
</tr>
<tr>
<td>2</td>
<td>Excavate for central pier</td>
<td>18,000</td>
<td>24</td>
</tr>
<tr>
<td>3</td>
<td>Excavate for east alignment</td>
<td>23,000</td>
<td>Part of 23</td>
</tr>
</tbody>
</table>

EARLY WARNINGS AND RISK REDUCTION PROBLEMS

(The underlying principle of NEC 3 in stimulating effective project management)
Risk Management

NEC3 looks to manage risk in three stages:

1. Early Warning
2. Risk Registers
3. Risk Reduction Meeting

NEC3 – EARLY WARNING

CLAUSE 16

- Project Manager and Contractor each raise warning if either is aware of matter which could:
  - Increase total of prices
  - Delay Completion, or impact on Key Dates
  - Impair performance of works in use (i.e. taken over by the Employer)
  - Must not be confused for discharging an obligation to notify a compensation event under clause 61.4.
  - This is a risk management mechanism that is used to prevent a CE from manifesting

RISK MANAGEMENT

Early Warning

What happens if the Contractor fails to give an early warning notice?

The sanction for failure by the Contractor to give early warning is to reduce the payment due to him for a related compensation event (Clause 63.5)

What happens if the Project Manager fails to give an early warning notice?

Potential breach of Clause 10.1 – entitlement to damages?
**RISK ALLOCATION**

**Employer’s Risks (Clause 80.1)**

Six main categories

1. Employer’s risks relating to his use of the Site or Works
2. Items supplied to the Contractor
3. Loss of or damage to the Works, Plant and Materials
4. Risks arising once he has assumed responsibility for completed work
5. Loss of or damage to the Works and any Equipment, Plant and Materials retained on Site after termination.
6. Additional risks, stated in the Contract Data

**RISK ALLOCATION**

**Contractor’s Risks (Clause 81.1)**

From the starting date until the Defects Certificate has been issued, the risks which are not carried by the Employer are carried by the Contractor

In other words everything else!

**THE NEC 3 RISK REGISTER SEE CONTRACT DATA PARTS (1) AND (2)**

**EARLY IDENTIFICATION OF RISK**

- The Risk Register is defined as included below:-
  - The Risk Register is a register of the risks which are listed in the Contract Data and the risks which the Project Manager or the Contractor has notified as an early warning matter. It includes a description of the risk and a description of the actions which are to be taken to avoid or reduce the risk.
  - The Risk Register does not allocate contractual risk for those events listed

- It is good practice to undertake a risk management workshop to identify those risks inherent with the project in question. Seek to allocate or understand the risk more. These should be included on the risk register on CD(P1) and CD (P2)
THE NEC 3 RISK REGISTER SEE CONTRACT DATA PARTS (1) AND (2)

ENSURING THAT YOUR AGREED RISK ALLOCATION HAS CONTRACTUAL TEETH

If there are additional compensation events:
- These are additional compensation events:
  1. River Irwell exceeds the monthly average for the last 5 years as stated in the Works Information.
  2. 5 years as stated in the Works Information.

To give contractual teeth to agreed allocated risk, the parties generally seek to include negotiated client risk events as an additional Compensation Event.

or,

Add new compensation event by virtue of an amendment to the contract conditions:

T.1 Insert new clause 60.1.20

River Irwell exceeds the monthly average for the last five years as stated in the Works Information

PROBLEMS WITH ASSESSING THE EFFECT OF DELAY UNDER NEC 3

An integral part of the mechanism of the Contract
- Precise requirement as to content and information
- Programme format, content and software may be specified in the Works Information
- If not submitted then \( \frac{1}{4} \) of price for work done to date is retained (50.3)
- A Method Statement is needed for each operation (not activity)

PROGRAMMING
ADJUSTING THE COMPLETION DATE
ON WHAT BASIS IS AN EOT CALCULATED UNDER NEC 3?

NEC/ECC – clause 63.3

A delay to the Completion Date is assessed as the length of time that, due to the compensation event, planned Completion is later than planned Completion as shown on the Accepted Programme.

The first stage in assessing whether the Completion Date or a Key Date should be delayed as a result of a compensation event is to adjust the Accepted Programme to take account of the compensation event with any appropriate adjustments to time risk allowances (Clause 63.3). Any float in the programme before planned Completion is available to mitigate or avoid any consequential delay to planned Completion. However, any terminal float

"NEC 3 Guidance Notes p128"

Clause 63.3
Effect on the Completion Date [CE 28]

NO REVISED PROGRAMME SUBMITTED!
WHAT HAPPENS IF THERE IS NO ACCEPTED PROGRAMME?

CONTRACTOR DEFAULT

• The remedy here is for the Project Manager, as he is entitled to make his own assessment of the compensation event under clause 64.1, and in doing so he can use his own version of the programme. Clause 64.2 states:-

  – The Project Manager assesses a compensation event using his own assessment of the programme for the remaining work if

  • There is no Accepted Programme or

  • The Contractor has not submitted a programme or alterations to programme the acceptance as required by the contract.

• This clause implies that the Project Manager may have to undertake some form of programme analysis to assess critical delay to planned Completion caused by a CE. The level of analysis depends on the state of the Accepted Programme.

• The PM can also instruct the Contractor to submit a revised programme, and the Contractor does so within the period for a reply [Clause 32.2 – first bullet point].

WHAT HAPPENS IF THERE IS NO ACCEPTED PROGRAMME?

PROJECT MANAGER DEFAULT

• Conversely no Accepted Programme may exist as a result of the Project Manager not accepting the programme within the period for a reply, or by not giving valid reasons in rejecting the revised programme submitted.

• The issue here is that when a compensation event occurs, the Accepted Programme maybe out of date, and does not reflect current progress.

• When submitting a quotation for a compensation event, if the programme for remaining work is altered by the compensation event, then an alteration to the Accepted Programme is submitted to PM [Clause 62.2].

• Correct approach would be to take last Accepted Programme and update it to reflect the progress at the time the PM should have instructed the Contractor to submit a quotation for the relevant CE - this accords with rules on revised programmes [Clause 32.1].

• Impact CE onto updated Accepted Programme, and the resultant delay to planned Completion is the Contractor’s entitlement to an EoT.

Questions?
(and perhaps some answers)
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