



## **NEC3: Early Warning and Compensation Events**

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The NEC is a major attempt to draft a simple and direct standard form contract from first principles without attempting to build upon the standard forms that already exist. The authors of the NEC gathered under the auspices of the ICE, and were principally led by Dr Martin Barnes. The specification prepared by him in 1987 set out the aims of those drafting the NEC. These included:

- To achieve a higher degree of clarity when compared to other existing contracts;
- To use simple commonly occurring language and avoid legal jargon;
- Repeat identical phrases if possible;
- Produce core conditions and exclude contract-specific data to avoid the need to change the core terms;
- Precisely and clearly set out key duties and responsibilities;
- Aim for clarity above fairness; and
- Avoid including details which can be more adequately covered in a technical specification.

In summary, the three core principles might be said to be flexibility, simplicity and clarity, and a stimulus for good management. On the basis of these principles the authors drafted core claims that apply to all NEC contracts. The core clauses were then used as the basis for six main options (each with varying risk allocation and reflecting modern procurement practice):

- Option A (priced contract with activity schedule);
- Option B (priced contract with bill of quantities) provides that the contractor will be paid at tender prices. Basically, a lump sum contract approach;
- Option C (target contract with activity schedule);

- Option D (target contract with bill of quantities) provides that the financial risks are shared between the contractor and the employer in agreed proportions;
- Option E (cost reimbursable contract); and
- Option F (management contract) is a cost reimbursable contract, where the risk is therefore largely taken by the employer. The contractor is paid for his properly incurred expended costs together with a margin.

One of the most noticeable features of the NEC are its short direct clauses. The simplicity of language is apparently to reduce the instance of disputes. A review by the drafting panel led to the launch, in June 2005, of NEC3.

Of greater interest are the early warning procedures included in clause 16. These provide:

- The contractor to give the project manager warning of relevant matters;
- A relevant matter is anything which could increase the total cost or delay the completion date or impair the performance of the finished works;
- The contractor and project manager are then required to attend an early warning meeting if one or the other party request it. Others might be invited to that meeting; and
- The purpose of the early warning meeting is for those in attendance to co-operate and discuss how the problem can be avoided or reduced. Decisions focus on what action is taken next and who is to take that action.

It could be said that this is a partnering-based approach to the resolution of issues before they form into disputes. Co-operation between the parties at an early stage of any issue identified by the contractor or project manager provides an opportunity for the parties to discuss and resolve the matter in the most efficient manner.

This is a departure from the usual approach of the contractor serving formal notices. A contractor may receive compensation for addressing issues raised by way of the early warning system. On the other hand, if a contractor fails to give an early warning of an event which subsequently arises, and that he was aware of, then the contractor is assessed as if he had given an early warning. Therefore, if a timely early warning would have provided an opportunity to identify a more efficient manner of resolving the issues, then the contractor will only be paid for that economic method of dealing with the event.

Core clause 60 deals with compensation events. If a compensation event occurs, which is one entitling the contractor to more time and/or money, then these will be dealt with on an individual basis. If the compensation event arises from a request of the project manager

or supervisor then the contractor is asked to provide a quotation, which should also include any revisions to the programme. The project manager can request the contractor to revise the price or programme, but only after he has explained his reasons for the request.

NEC3 has adopted a more strict regime for contractors in respect of compensation events. Core clause 61.3 is set out in terms:

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.

Clause 61.3 is effectively a bar to any claim should the contractor fail to notify the project manager within 8 weeks of becoming aware of the event in question. The old formulation of a 2-week period for notification has been replaced with an 8-week period, but with highly onerous consequences for a contractor. This clause must also be read in conjunction with clause 60.1(18) which states that a compensation event includes:

A breach of contract by the *Employer* which is not one of the other compensation events in this contract.

Clause 61.3, therefore, effectively operates as a bar to the contractor in respect of any time and financial consequences of any breach of contract if the contractor fails to notify.

The courts have for many years been hostile to such clauses. In more modern times, there has been an acceptance by the courts that such provisions might well be negotiated in commercial contracts between businessmen.<sup>(1)</sup>

The contractor must of course be “aware of the event” in order to notify the project manager under clause 61.3. There will no doubt be arguments about when a contractor became aware or should have become aware of a particular event, and also the extent of the knowledge in respect of any particular event. Ground conditions offer a good example. Initially, when a contractor encounters ground conditions that are problematic, he may

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<sup>(1)</sup> See for example *Photo Production Limited v Securicor Limited* [1980] AC 827.

continue to work in the hope that he will overcome the difficulties without any delay or additional costs. As the work progresses the contractor's experience of dealing with the actual ground conditions may change such that the contractor reaches a point where he should notify the project manager. The question arises as to whether the contractor should have notified the project manager at the date of the initial discovery, rather than at the date when the contractor believes that the ground conditions are unsuitable. The answer must be that the contractor should give notice when he encounters ground conditions which an experienced contractor would have considered at the Contract Date to have had only a minimal chance of occurring and so it would have been unreasonable to have allowed for them in the contract price having regard to all of the information that the contractor is to have taken into account in accordance with clause 60.2.<sup>(2)</sup>

A further question arises in respect of clause 61.3, and that is, who precisely needs to be "aware"? Is it the person on site working for the contractor, the contractor's agents or employees, or is it the senior management within the limited company organisation of the contractor? Case law suggests that it is the senior management of the company and not merely servants and agents.<sup>(3)</sup>

The prevention principle considered elsewhere in this paper may also apply in respect of any employer's claim for liquidated damages. If the contractor does not make a claim, then the project manager cannot extend the Completion Date under NEC3, and so an employer will be entitled to liquidated damages. However, those liquidated damages could be in respect of a period where the employer had caused delay. The employer can only recover losses for delay in completion for which the employer is not liable.

It might be said that the true cause of this loss was in fact the contractor's failure to ensure a notice. However, judgments such as they are are divided. The case of *Gaymark Investments Pty Limited v Walter Construction Group*<sup>(4)</sup> is a decision of the court of the Northern Territory of Australia. That decision follows the English case of *Peak v McKinney* holding that liquidated damages were irrecoverable as the completion date could not be identified as time had become "at large".

Finally, the contractor may be able to rely upon the equitable principles of waiver and/or estoppel. It may be that the contractor does not serve a formal notice because, by words or conduct, the employer or indeed the project manager represents that they will not rely upon the strict 8-week notice period. The contractor would also need to show that it relied upon that representation and that it would now be inequitable to allow the employer to act

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(2) Clause 60.2 deals with physical conditions.

(3) *HL Bolton Engineering Co. Limited v TG Graham & Sons Limited* [1956] 3 ALL ER 624, in particular the judgment of Denning LJ.

(4) (2000) 16 BCL 449.

inconsistently with the representation made by the employer or project manager. In addition, this approach could be further supported by core clause 10.1 which requires the parties to act “in a spirit of mutual trust and co-operation”.

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