

# Insight

*Insight* provides practical information on topical issues affecting the building, engineering and energy sectors.

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NEC4: A Dispute Resolution  
Perspective



## NEC4: A Dispute Resolution Perspective<sup>1</sup>

The NEC form of contract was first published nearly 24 years ago and prides itself on “helping the industry do things differently and better.” It is now used on a wide range of projects not just domestically but also internationally. For example, the Crossrail project uses a range of contracts from the NEC3 Suite including the Project Services Contract and the Engineering and Construction Contract Option C.<sup>2</sup>

Despite its aim of encouraging best practice, the number of disputes arising out of NEC contracts does appear to be increasing.<sup>3</sup> We are certainly seeing an increased number of adjudications arising out of NEC contracts. The case law on the NEC forms, although still sparse compared to other standard forms, is also becoming more abundant than it was.

The next generation of the NEC form of contracts (NEC4) was launched in June 2017 and states that it has taken into account “user feedback”.<sup>4</sup> This *Insight* reviews the NEC4 from the perspective of those involved in resolving the disputes arising out of NEC contracts. We examine whether the changes made are likely to make disputes less likely or, at the very least, cut down on the types of arguments now commonly seen between the parties to NEC contracts particularly where “good project management” hasn’t happened quite as it should.

### The Accepted Programme – is there one?

A common theme in the NEC time related disputes we see is that, for one reason or another, there is no Accepted Programme against which to apply for compensation events or measure them, or that the Accepted Programme is not updated monthly as required in the standard form. This is a major problem in the NEC form because the Accepted Programme is a key project management tool that is designed to enable extension of time claims to be dealt with prospectively as, and when, they arise rather than retrospectively. If the Accepted Programme is not up to date in “real time” with progress on the project prospective assessment of compensation events soon becomes difficult, if not impossible, for the Project Manager to implement.

As a result, the lack of an updated Accepted Programme sometimes results in extension of time claims failing to be dealt with during the currency of the project as intended (i.e. prospectively). Debates as to why there is no Accepted Programme and/or who is to blame include:

1. The Project Manager acted unreasonably in not approving it and/or did not approve it prospectively such that it no longer reflected reality on the project;
2. The contractor has not provided the requisite information required in order that the updated programme can be accepted by the Project Manager;

3. The contractor claims that it never had the information to provide one; or
4. The changes to the programme were too numerous to keep up with contemporaneously.

Without an Accepted Programme an NEC contract cannot be administered as intended. The bases upon which compensation events can be claimed, assessed and implemented are integrally and inextricably linked to the Accepted Programme.<sup>5</sup>

In NEC4, new provisions have been added which mean a Project Manager can be deemed to have accepted the programme submitted if he doesn’t get his skates on after a warning notice.

Clause 31.2 now provides:

*“If the Project Manager does not notify acceptance or non-acceptance within the time allowed, the Contractor may notify the Project Manager of that failure. If the failure continues for a further one week after the Contractor’s notification, it is treated as acceptance by the Project Manager of the programme.”* [Emphasis added]

This is undoubtedly helpful and should hopefully reduce some of the games that we now see in NEC disputes on compensation events arguing for an extension of time. However, it won’t cure all ills in relation to the Accepted

Programme (for example where a Subcontractor considers, or argues, they do not have sufficient information to produce an Accepted Programme).

### Simplification – The Schedule of Cost Components and the Fee

The Schedule of Cost Components (“SCC”)<sup>6</sup> or the Shorter Schedule of Cost Components (“SSCC”)<sup>7</sup> are used “to define those components of the Contractor’s costs which are included in Defined Costs for all main options except Option F”<sup>8</sup>. The origins of the SCC and SSCC are found in research carried out during the 1970s and 1980s which established disputes could be reduced if there was a schedule of costs against which a contractor would be directly reimbursed with everything else included in the fee.<sup>9</sup>

A common problem associated with the SCC and SSCC is that a failure to give them proper consideration at tender stage (which from our experience is a more regular occurrence than one might think) can result in a contractor being out of pocket. This is because costs which are not included in Defined Cost are not recoverable unless they have been factored into the Fee already.<sup>10</sup> As a result, the true cost incurred by the contractor may not necessarily be reflected under the various components of the cost components of the SCC or the SSCC.<sup>11</sup> This is obviously a potential recipe for disputes because it will encourage claims on other grounds if an accidental, and arguably unfair, loss has resulted.

The NEC4 has sought to simplify the position for contractors by reducing the room for errors by contractors the likelihood of errors being made by them. This has been done in the following ways:

1. Subcontractor Costs have been amalgamated into the SCC<sup>12</sup>/SSCC<sup>13</sup> instead of being subject to separate percentages as they were under NEC3;
2. The "Fee" has been simplified<sup>14</sup> – there is now only one rather than the two there were previously (a direct fee and a subcontractor fee). Essentially having the two fees previously complicated the process of calculating what was due (or not) to all parties and in doing so created room for errors and arguments. Simplification can only therefore reduce the scope for disputes;
3. "All contracts now include Schedules of Cost Components which are used to assess Defined Cost".<sup>15</sup> The SSCC is now only available for Options A and B and no longer an option for Options C to E which should cause less confusion.

The decision to include subcontractor costs in the SCC and the SSCC should overcome the issues commonly found by contractors tendering for works under the NEC3 form. This was namely that subcontractors either did not want to provide detailed breakdowns in their tenders which the contractor required to fill in their SCC/SSCC, or did not have the capability or understand why they needed to do so.

Now subcontractor's costs are included in the SCC/SSCC and in Defined Cost.<sup>16</sup> Those costs can be used to value compensation events. This should not only make life easier for all parties concerned but also, in making the position simpler, reduce the number of disputes surrounding the valuation of compensation events which entail additional subcontractor costs being incurred.

## Compensation Events

Under both the NEC3 and NEC4 forms, compensation events are events which are not the fault of the

contractor / subcontractor.<sup>17</sup> NEC4 has made a few changes to this section of the contract which should make life easier for those claiming and assessing compensation events.

Perhaps one of the most useful in terms of increasing certainty, and reducing disputes, is the concept of the "dividing date" which has been added to Clause 63.1 dealing with assessing compensation events. This removes any doubt as to which *Accepted Programme* a compensation event should be implemented against.

The process of identification, notification, assessment and implementation of a compensation event often takes several weeks, if not months, from the date of the original event. Properly administered and managed it is likely that at least three programmes will have been "accepted" during the diary of a compensation event. This can result in the question: once assessed, against which programme should the compensation event be implemented?

The "dividing date" resolves this. The dividing date is the date of a communication of an instruction or notification by the *Project Manager* or *Supervisor* that is a compensation event or, for all other compensation events, the date of notification of that compensation event. Any delay to the Completion Date is assessed against the *Accepted Programme* current at the dividing date.<sup>18</sup>

The NEC4 has also added a new compensation event in clause 60.1 (20) which recognises that there is a cost involved in obtaining a quotation for proposed instruction which is then not used<sup>19</sup> for whatever reason. This is undoubtedly helpful as it is not unknown for project managers to ask for repeat quotations which can be expensive and time consuming. This new compensation event should stop any such "abuse" of process.

The second "new" compensation event is at clause 60.1 (21) and states: "Additional compensation events in *Contract Data part one*". The benefit of this is said to be "that clients can now alter the standard risk profile contained in NEC4 contracts, without

the need for the clause amendments".<sup>20</sup> How this works out in practice remains to be seen but it should provide a useful tool if used properly.

Finally, it should also be noted that there has been a small amendment to the time limit imposed by clause 61.3. Clause 61.3 now states:

*"If the Contractor does not notify a compensation event within eight weeks of becoming aware that the event has happened, the Prices, the Completion Date or a Key Date are not changed unless the event arises from the Project Manager or the Supervisor giving an instruction or notification, issuing a Certificate or changing an earlier decision".*  
[Emphasis added]

The time bar itself isn't new but abiding by it will, it goes without saying, avoid the need to try and argue around it thereby reducing unnecessary arguments between the parties.

## Mutual Trust and Co-operation

One of the key overarching principles enshrined in NEC contracts is that of "mutual trust and co-operation".<sup>21</sup> However, there is remarkably little practical guidance or legal authority on what that means! *Keating on NEC3*<sup>22</sup> noted that, whilst apparently unclear, it has been placed within the contract and as such effect should be given to the words.

Earlier this year, Coulson J considered this obligation in *Costain Ltd v Tarmac Holdings Ltd*.<sup>23</sup> He considered the words suggested positive obligations and drew parallels (using *Keating on NEC3*) between "mutual trust and cooperation" and obligations of "good faith". The Court also considered NEC3 Clause 10.1 in *Northern Ireland Housing Executive v Healthy Buildings (Ireland) Ltd*.<sup>24</sup> In that case Deeny J held that records of actual time and costs incurred relating to a compensation event should be disclosed to the Employer. He held that failure to do so would be "entirely antipathetic to a spirit of mutual trust and co-operation".

The NEC4 has clearly tried to continue this principle in the new suites of contract but has split the obligation into two parts:

*“10.1 The Parties, the Project Manager and the Supervisor shall act as stated in this contract.*

*10.2 The Parties, the Project Manager and the Supervisor shall act in a spirit of mutual trust and co-operation”.*

This may be better written but doesn't really resolve the issue of what mutual trust and co-operation means in practice (and the extent to which damages can result if a party breaches this obligation). It may be that further case law will be required before this becomes clearer. In the meantime, those in disputes will continue to rely on it where contract procedures have not been followed.

## Dispute Resolution under NEC4

Adjudication remains mandatory under the NEC4 suite of contracts where Option W2 applies (i.e. where the Housing Grants, Construction and Regeneration Act - the **“Housing Grants Act”** - applies.<sup>25</sup> Whether this is helpful varies from case to case. However, in some circumstances it can lead to an additional and unnecessary layer of cost. For example, it would be better to get the Courts to determine a matter of law or of contractual interpretation once and for all via part 8 proceedings rather than having to go to adjudication and then via the courts, notwithstanding the fact that either party could take the matter to adjudication in any event.

For international contracts, where the Housing Grants Act doesn't apply the NEC4 has made a new dispute resolution “option” available. Option W3 provides for the use of a Dispute Adjudication Board (“DAB”). The DAB is tasked with visiting the site regularly and helping to identify potential areas of dispute as early as possible and provide recommendations as to how to resolve them (which are non-binding).<sup>26</sup> This new option is similar to the approach taken in the FIDIC form of contracts in relation to dispute avoidance. However, it is only really

suitable for larger scale projects where the costs can be justified.

## Conclusion

The amendments outlined above are undoubtedly helpful and should (hopefully) prevent some of the more generic arguments often seen in NEC3 disputes particularly around the Accepted Programme and whether there is one. However, the NEC4 ultimately requires the parties to work together and adhere to the contractual and project management tools built into it if it is to work.

The problem with this is that when disputes do arise it is all too often because this hasn't happened in practice. Buying into the NEC “ethos” therefore remains the key to avoiding disputes under NEC contracts. When disputes do arise the relative paucity of case law as to the meaning of some obligations (e.g. that of mutual trust and co-operation) remains an issue because it give the parties more room to argue as to the scope of their obligations. That said, guidance in case law is less rare than it was and this can only assist dispute resolution under NEC contracts going forwards.

## Footnotes

1. By Claire King. With thanks to Laura Bowler for her research and assistance and to Jonathan More for his practical insights.
2. Target contract with activity schedule. See <https://www.neccontract.com/NEC-in-Action/Case-Studies/Crossrail>.
3. See for example “A pain in the NEC” By James Bessey 30 April 2010, in Building Magazine.
4. See NEC4 Engineering and Construction Contract, Preface, page vii.
5. See clauses 60.1(2) - “The client does not allow access to and use of each part of the Site by the later of its access date and the date for access shown on the Accepted Programme”, 60.1 (3) “The Client does not provide something which it is to provide by the date shown in the Accepted Programme”, and 60.1 (5) “The Client or Others - do not work within the time shown on the Accepted Programme, - do not work within the conditions stated in the Scope or - carry out work on the Site that is not stated in the Scope.”
6. Used within NEC3 Engineering and Construction Contract Options C, D and E for target price contracts.
7. Used within NEC3 Engineering and Construction Contract Option A and B for price based options.
8. NEC3 Guidance notes, page 6.
9. John Broome, “NEC3: A User's Guide” (ICE publishing, 2012), Chapter 2.3.3.1.

10. David Thomas QC, “Keating on NEC3” (1 Edn., 2012) Para. 6-147. The SCC “defines the cost components for which the Contractor will be directly reimbursed and defines the cost components which are included in an assessment of changed costs arising from a compensation event” (NEC3 Guidance notes, page 124). The SSCC “is used to define the cost components only when assessing a compensation event”. (NEC3 Guidance notes, page 124).
11. Rowlinson “A Practical Guide to the NEC3 Engineering and Construction Contract” (pg 154).
12. The SCC defines these costs as “Payments to Subcontractors for the work which is subcontracted without taking into account any amounts paid to or retained from the Subcontractor by the Contractor, which would result in the Client paying or retaining the amount twice”. (NEC4 Engineering and Construction Contract, Schedule of Cost Components, 4(41)).
13. The SSCC defines these costs as “Payments to Subcontractors for work which is subcontracted”. (NEC4 Engineering and Construction Contract, Short Schedule of Cost Components, 4 (41)).
14. Now defined under Clause 11.2(10) of NEC as “...the amount calculated by applying the fee percentage to the amount of Defined Cost”
15. *Nec4 The next generation: An explanation of changes and benefits* (the “White Paper”).
16. Defined under NEC ECC Clause 52.1 as “All the Contractor's costs which are not included in the Defined Cost are treated as included in the fee. Defined Cost includes only amounts calculated using rates and percentages stated in the Contract Data and other amounts at open market or competitively tendered prices with deductions for all discounts, rebates and taxes which can be recovered”.
17. The NEC3 user guide defines compensation events as “events which, if they occur, and do not arise from the Contractor's fault, entitle the Contractor to be compensated for any effect the event has on the Prices and the Completion Date or a Key Date”. (NEC3 Guidance notes, page 68).
18. See Jonathan More's blog on the Fenwick Elliott website titled “The new NEC 4 – it's not revolting!” See also Clause 63.1 of NEC4 (engineering and construction contract, Option A: Price contract with activity schedule).
19. See the NEC4 user guide, *Managing an Engineering and Construction Contract*, (Volume 4, 2017), page 56.
20. See the NEC4 White paper (For full reference see footnote 19).
21. NEC3 Engineering and Construction Contract, Clause 10.1.
22. David Thomas QC, “Keating on NEC3” (1 Edn., 2012) Para. 2-004.
23. [2017] EWHC 319 (TCC).
24. [2017] NIQB 43.
25. See NEC4 Engineering and Construction Contract, Clause W2.4.
26. See NEC4 Guidance, “Managing an engineering and construction project”, (Volume 4, 2017) page 84.

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