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Construction Law Update:
NEC3 Engineering and Construction
Contract Part 2 -
Compensation events
The role of the Project Manager

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Introductions

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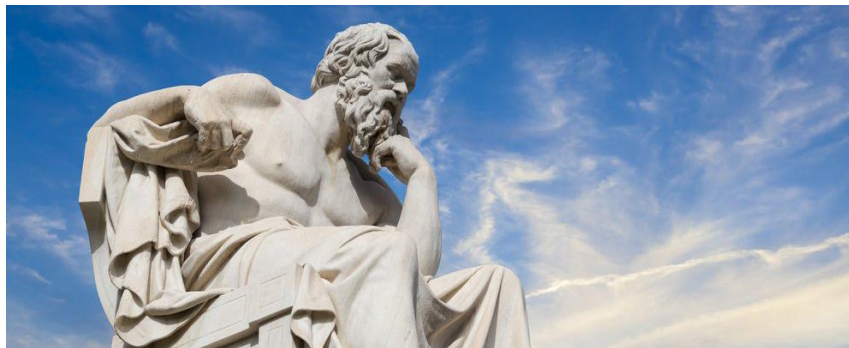
Underlying NEC3 philosophy

- + Compensation event (CE) procedure is at the heart of the NEC3 approach

“The philosophy of the NEC Conditions is to avoid disputes at the end of a project by having intensive management machinery to deal with issues during the process of a project.”

Ramsey J in *WSB Cel Ltd v Dalkia Utilities Services plc* (TCC, 2013)

- + NEC3 core philosophy also includes simplicity and clarity



Early warning

- + Clause 16 - Obligation to give early warning of matters having adverse impact on cost or programme
- + Separate requirements to give early warning notices (EWNs) and CE notices must not be confused
- + EWN obligation is not confined to notifying matters which may become CEs
- + However, if an EW matter is subsequently notified as a CE, and the Project Manager (PM) notifies the Contractor of his decision that it has failed to give early warning “which an experienced contractor could have given”, this must be taken into account by the PM when assessing the CE (clause 63.5)



Outline of CE provisions

- + Core clauses 60-65 set out relevant provisions
 - 60 - Description of CEs
 - 61 - Obligations to notify CEs
 - 62 - Obligations for Contractor to provide quotations
 - 63 - Basis of assessment
 - 64 - Procedure for assessment by PM where Contractor's quotation has not been accepted
 - 65 - Implementation
- + Dual impact of CEs on cost and time entitlements differentiates NEC3 approach from other standard forms

The range of CEs

- + Clause 60.1 lists 19 CEs ranging from
 - 60.1(1) - an instruction by the PM changing the Works Information to
 - 60.1(19) – an event which neither party could prevent and is so unlikely that that it would be unreasonable to expect an experienced contractor to have allowed for it

- + Additional CEs in the main option and secondary option clauses

- + Contract Data may identify additional employer's risks

Notifying CEs (1)

- + Pursuant to clause 13.7, notification of CEs must be communicated separately from other communications
- + 61.1 – PM must notify CEs where these arise from specified actions by the PM or Supervisor, with instructions to Contractor to submit quotations
- + 61.2 – PM may instruct the Contractor to submit quotations for a proposed CE



Notifying CEs (2)

- + 61.3 – If the PM has not notified a CE:
 - “If the Contractor does not notify a CE within 8 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 it arises from specified actions by the PM or the Supervisor
- + “Deemed acceptance” that an event is a CE if PM fails to respond to Contractor’s notices (including “chaser”) within contract timescales
- + But deemed acceptance can be reviewed and revised by the Adjudicator

Assumptions and forecasts

- + Importance of differentiating assumptions from forecasts
- + 61.6 - PM may state assumptions about the CE in his instruction to the Contractor to submit quotations
 - Assessment of the event is based on these assumptions.
 - If any of them is later found to have been wrong, the PM notifies a correction
- + 63 - Correction of an assumption may result in reduction of the Prices if the effect of the CE is to reduce total Defined Cost. However Completion Date and Key Dates cannot be brought forward in this situation.
- + 65.2 - Assessment of a CE is not revised if a forecast upon which it is based is shown by later recorded information to have been wrong.

Quotations and assessments - Cost

- + 62.1 PM may instruct Contractor to submit alternative quotations after discussing with the Contractor different ways of dealing with a CE which are practicable.
- + 63.1 - The changes to the Prices are assessed as the effect of the compensation event upon
 - the actual Defined Cost of the work already done,
 - the forecast Defined Cost of the work not yet done and
 - the resulting Fee.
- + Options A, B and D allow Contractor and PM to base assessment on rates and lump sums rather than Defined Cost
- + Prospective basis of assessment



Quotations and assessments - Time

+ 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...."

+ Contractor owns any float between planned Completion and the Completion Date

Acceptance of quotation/PM's assessment

- + 62.6 – Deemed acceptance of the quotation by the PM if there is a failure to respond within contract timescales.
- + But Adjudicator may review and revise any “inaction” of the PM
- + PM's assessments
- + Implementation

Administering CEs – challenges for the PM and the Contractor

- + Complex set of rules and heavy administrative burden
- + Parties often seek to reduce the administrative burden by agreeing “traditional” ICE/ICC approach, e.g.
 - final valuation of CE to be agreed on “retrospective” basis after Completion
 - bundling CEs in monthly updates
 - Agreeing a value threshold below which the CE regime does not apply
- + The above should be reflected in agreed Z clauses/amendments where relevant!



Administering CEs – Relevance of clause 10.1/NEC3 partnering ethos

- + Process depends on effective collaboration and transparency
- + But a party failing to comply with CE procedures cannot rely on clause 10.1!
- + Different effects of Contractor and PM failing to give notices/take actions within period required by NEC3 ECC

Outline

- + Key players under the ECC
- + The role of the PM under the NEC3 ECC
- + Duties of the PM
- + Risk Management
- + Contract Administration
- + Communication and CE
- + *Costain v Bechtel [2005]*
- + Practical Tips

NEC3 ECC – Key Players

+ Contracting entities / Parties

- Employer
- Contractor

+ Participants

- PM
- Supervisor (clause 40 (Tests and Inspections))

+ Others

- Subcontractor(s)
- Supplier(s)
- Adjudicator
- Others

Role of the Project Manager in ECC

- + Administers the NEC3 ECC and is generally the Employer's agent
- + Emphasis on **PM and partnership** - duty is to champion NEC philosophies
- + Central role and effectively "runs the show"
- + Duty of impartiality and balancing the interests of the employer and contractor
- + Role of the PM under an NEC3 ECC may be more complex and onerous than an alternative form
- + Employer has no contractual right to challenge the actions / decisions of the PM
- + Use NEC3 PSC?



Project Manager Duties in ECC

- + NEC3 ECC full of actions for the PM including:
 - Issuing instructions and monitoring progress (throughout);
 - Replying to communications within the period for reply (usually 2 weeks) – clause 13.3;
 - Maintaining the risk register – clause 16.1;
 - Reviewing and accepting the Contractor’s design - clauses 21.2;
 - Accept replacement key person – clause 24.1;
 - Accepting proposed Subcontractors and their conditions of contract – clauses 26.2, 26.3;
 - Assessing Completion – clause 30.2;
 - Certify taking over part of the works – clause 35.3;
 - Arrange access for Contractor to correct Defects – clause 43.4;
 - Assessing the amount due and certifying - clause 50.1 and 51.1;
 - Assessing compensation events – clause 60;
 - Accept Contractor’s certificates of insurance – clause 85.1; and
 - Issuing the Termination Certificate – clause 94.1.

Key Area - Risk Management

- + Proactive risk management is a central feature of NEC3 ECC
- + PM has leading role in identifying risks at the outset of the project and evaluating probability and impact on risk
- + Clause 16 – Early Warnings
 - Give EW notice of risk of which he becomes aware (clause 16.1)
 - Manage and update the risk register; enter every notified risk in the risk register (clause 16.1, 16.4)
 - Manage risk review process by means of risk reduction meetings (clause 16.2). Should be an ongoing process through the life of a project



Key Area - Contract Administration

- + PM has an important contract administration role
- + Many obligations require actioning within short periods of time
- + ECC comprises of a large number of provisions that require the PM to issue instructions (not all give rise to CE). For example:
 - Changing the “Works Information” and “Key Date” (clause 14.3)
 - Resolving ambiguity or inconsistency (clause 17.1)
 - Instruction if a prevention event occurs (clause 19.1)
 - Provide quotation for compensation events (clauses 61.2 and 61.4)
- + Certifying payment to the Contractor:
 - Assess amounts due and certify payment (clauses 50 and 51)
- + Certifying Completion:
 - Likely to involve close liaison between the PM and Supervisor (clause 30.2)

Key Area - Communication



- + NEC3 prescriptive about how communications are handled – in writing
- + Compensation event if PM fails to reply to a communication within the time specified (clause 60.1(6))
- + Particular onus on PM to respond promptly to notifications and quotations in respect of CE:
 - Clause 61.4 – within one week or “prompt” notice for CE notified by the Contractor
 - Clause 62.6 – within two weeks of receiving contractor’s quotation for CE
 - Clause 64.4 – within two week or prompt notice to assess CE
- + No verbal communications permitted

Costain v Bechtel [2005] – Impartiality!

- + Bechtel was the lead party in a consortium appointed as PM for HS1
- + The contract: *'The Employer, the Contractor and the Project Manager act in the spirit of mutual trust and co-operation and so as not to prevent compliance by any of them with the obligations each is to perform under the Contract.'*
- + Costain concerned that Bechtel administering the contract unfairly and adversely to them
- + Bechtel argued that the PM was obliged to look after the Employer's best interests and therefore owed no duty to act impartially
- + Held: PM had duty to **act impartially between the Employer and the Contractor**, and balance interests

Conclusion and Practical Tips

- + PM should be seen as a driver more than an administrator
- + Not traditional “sort it out at the end” approach
- + Ensure understanding and awareness of contract mechanisms – i.e. early warning notices and compensation event process from the outset
- + Use templates/precedent forms – agree a joint approach
- + Keep track (e.g. a register) and circulate to all parties
- + Regularly review contentious quotations
- + Lead the process
- + Champion of the NEC philosophy – “spirit of mutual trust and co-operation”

Questions/topics raised following our first webinar on NEC3 ECC

- + Is there a “gap” in design liability as between the NEC3 ECC (with or without the use of Option X15 - Limitation of Contractor’s liability to reasonable skill and care) and the NEC3 Professional Services Contract?
- + Which party bears the risk under NEC3 ECC of delay or other defective performance by statutory undertakers?
- + Option X12 (Partnering);
- + Additional clause issued by NEC3 in November 2015 for early contractor involvement
- + Contractor-initiated proposals to change the Works Information.



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