NEC4 Professional Services Contract

BRIEFING NOTE ONE: Defined Cost – Rethinking Business Models

The NEC4 suite of contracts was published on 22 June 2017.

As we outlined in our webinar on 25 July 2017 (available to view here), the changes to the NEC3 Professional Services Contract (the PSC) are significant.

A lot of commentary has focussed on the changes to the Engineering and Construction Contract (the ECC). The changes to the PSC have gone “under the radar”. We will explore these changes in a series of briefing notes, starting with the new approach to valuing payment.

Under the NEC3 PSC Secondary Options C (Target Cost) and E (Time Based Contract), the Consultant was paid (and compensation events were valued) on a “Time Charge” basis, i.e. hours at rates. This reflected how consultants’ business models are set up.

However, under the NEC4 PSC, payment under Options C and E (now called “Cost Reimbursable”) is on a “Defined Cost” basis (which the Consultant is paid in addition to the Fee). Compensation events are also assessed on this basis. This change makes the PSC more consistent with the ECC but has caused some real concern.

One reason for this is that, under Options C and E, Disallowed Costs are deducted from Defined Cost when assessing payment. Under the ECC, Disallowed Cost is often used by the Project Manager to deny the Contractor from being entitled to payment. There is a risk this approach could also be adopted by the Service Manager (a new role under the NEC4 PSC). For example, Disallowed Cost includes “costs which are not justified by the Consultant’s accounts and records”. This is open ended and means that sums could be rejected on limited grounds. This will need to be managed carefully; any attempt by a Client to widen the scope of Disallowed Costs should be resisted.

In addition, under Secondary Options C and E, Defined Cost is determined using the Schedule of Cost Components, which entitles the Consultant to the cost of 1) people directly employed to provide the service, 2) Subcontractors; and 3) the overhead percentage of the cost of the Consultant’s employees. To show the cost of employees, the Consultant must 1) divide the total of payments made to the employee by the total time recorded and 2) multiply that sum by the time recorded for work on the contract. This will involve taking into account specific details of the employees’ employment contract, including for example, salary, pensions and insurance. This will be an administrative burden and challenging.

As commented above, failure to justify costs is a Disallowed Cost, so consultants will need to keep evidence of how they have calculated the cost of their employees and provide some of this to the Client/Service Manager. Whilst this is similar to the position under the ECC, consultants’ businesses are not set up to be able to easily delve into this much detail to demonstrate their entitlement to payment.
Much of the information used to calculate employee costs will also be confidential between the employee and the Consultant. It will also include “personal data” and therefore disclosure of it will be limited by the Data Protection Act 1998 (and the forthcoming General Data Protection Regulation, which will come into force in May 2018). The Consultant will therefore need to ensure that any information provided is anonymised sufficiently so as not to fall foul of its confidentiality and data protection obligations. These issues will not arise under Option A, as it uses the Shorter Schedule of Cost Components for compensation events, which simply refers to people rates.

As outlined above, the NEC4 PSC involves a very different approach to valuing payment. Most consultants’ business models are structured on the basis that they will either charge on an hourly rates basis or a lump sum (which is calculated based on those hourly rates), with the link between this and amounts paid to employees confidential, so this is a significant change. It will be important that the fee percentage and the overhead percentage stated in the Contract Data are carefully considered to ensure the Consultant receives the expected margin.

In the next NEC4 PSC briefing note we will consider how the Consultant’s liability has increased from the position under the NEC3 PSC.

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