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Construction Law Update: Spotlight on the NEC3 Engineering and Construction Contract

Tom Pemberton, Partner

James Vernon, Associate

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Introductions

- + Tom Pemberton
 - Partner, Projects and Construction Contracts Advisory

- + James Vernon
 - Associate, Construction Dispute Resolution + Health & Safety Advisory



Webinar Outline

- + Introduction and overview
- + Recap of structure of NEC3 ECC
- + Partnering ethos
- + Contractor's design
- + Limitation of liability
- + Programme
- + Completion and delay damages
- + Key dates
- + Early warning
- + Compensation events
- + Risks and insurance
- + Dispute resolution



Overview of NEC3 ECC

- + Core principles
 - Flexibility, simplicity and clarity
 - Designed to be a stimulus for good management
- + Use in relation to major projects domestically and internationally



Recap of structure of NEC3 ECC

- + Contract Data Part one
- + Contract Data Part two
- + Works Information
- + Site Information
- + Schedules of cost components
- + Core clauses
- + Main option clauses
- + Option W1/W2 (dispute resolution)
- + Secondary option clauses
- + Option Y



Main option clauses and dispute resolution

- + Option A – priced contract with activity schedule
- + Option B - priced contract with bill of quantities
- + Option C – target contract with activity schedule
- + Option D – Target contract with bill of quantities
- + Option E – Cost reimbursable contract
- + Option F – Management contract
- + Dispute resolution options
 - Option W1 - for use in respect of projects to which the Construction Act does not apply
 - Option W2 - for use in respect of projects to which the Construction Act does apply





Secondary option + Option Y clauses

- + *X1 Price Adjustment for Inflation*
- + *X2 Changes in the Law*
- + *X3 Multiple Currencies*
- + *X4 Parent Company Guarantee*
- + *X5 Sectional Completion*
- + *X6 Bonus for Early Completion*
- + *X7 Delay Damages*
- + *X12 Partnering*
- + *X13 Performance Bond*
- + *X14 Advanced Payment to Contractor*
- + *X15 Limitation of the Contractor's liability for his design to reasonable skill and care*
- + *X16 Retention*
- + *X17 Low performance damages*
- + *X18 Limitation of Liability*
- + *X20 Key Performance Indicators*
- + *Y(UK)1 Project Bank Account*
- + *Y(UK)2 The Housing Grants, Construction and Regeneration Act 1996*
- + *Y(UK)3 The Contracts (Rights of Third Parties) Act 1999*

Limitations of partnering ethos

Clause 10.1 provides as follows:

“The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract and in a spirit of mutual trust and co-operation”

- + Effect considered in the case of *Mears Limited v Shoreline Housing Partnership Limited* (July 2015)

Mr Justice Akenhead noted

- + “...the spirit of partnership, which was at the very least advertised in the period leading up to the Contract...began to break down...”.



Limitations of partnering ethos (continued)

- + Contractor argued that by departing from commercially agreed (but not contractual) terms varying the pricing mechanism, the Employer was acting in breach of clause 10.1.
- + Contractor was successful in resisting repayment of amounts “overpaid” by the Employer to date on basis of estoppel principles
- + However, Akenhead J concluded that clause 10.1 would not prevent the Employer from relying on express terms of the contract, including an "entire agreement" clause, to maintain its defence that only the contractual terms expressly set out in the contract were applicable.
- + Judgment is consistent with earlier case-law including *TSG Building Services Plc v South Anglia Housing Limited* [2013]
- + Conclusion: clause 10.1 does not over-ride express contractual terms



Contractor's design

- + Contractor's core obligation is set out in clause 20.1 as follows:

“The Contractor Provides the Works in accordance with the Works Information.”

- + Clause 11.2(13) includes the following definition:

“To Provide the Works means to do the work necessary to complete the works in accordance with this contract and all incidental work, services and actions which this contract requires.”

- + Clause 21.1 provides as follows:

“The Contractor designs the parts of the works which the Works Information states he is to design.”

- + In the absence of express terms qualifying the design obligation, the Contractor will normally have an implied fitness for purpose (FFP) obligation to the extent that he is responsible for design.



Contractor's design – excluding an implied fitness for purpose obligation

- + FFP obligations not covered by professional indemnity insurance
- + Contractor should therefore ensure that secondary Option X15 is incorporated:
- + Option X15 provides that the Contractor is not liable for Defects in the works due to his design so far as he proves that he used reasonable skill and care to ensure that his design complied with the Works Information.
- + Peculiarities of Option X15

Option X18 - Limitation of liability

- + Liability only limited under ECC if Option X18 is incorporated, as follows:
 - X18.1 The Contractor’s liability to the Employer for the Employer’s indirect or consequential loss is limited to the amount stated in the Contract Data.
 - X18.2 For any one event, the liability of the Contractor to the Employer for loss of or damage to the Employer’s property is limited to the amount stated in the Contract Data.
 - X18.3 The Contractor’s liability to the Employer for Defects due to his design which are not listed on the Defects Certificate is limited to the amount stated in the Contract Data.



Option X18 - Limitation of liability (continued)

- X18.4 The Contractor's total liability to the Employer for all matters arising under or in connection with this contract, other than the excluded matters, is limited to the amount stated in the Contract Data and applies in contract, tort or delict and otherwise to the extent allowed under the law of the contract.
- The excluded matters are amounts payable by the Contractor as stated in this contract for
 - loss of or damage to the Employer's property,
 - delay damages if Option X7 applies,
 - low performance damages if Option X17 applies and
 - Contractor's share.
- X18.5 The Contractor is not liable to the Employer for a matter unless it is notified to the Contractor before the end of liability date.

The programme

- + Accepted Programme is defined as
 - “the programme identified in the Contract Data or ... the latest programme accepted by the Project Manager. The latest programme accepted by the Project Manager supersedes previous Accepted Programmes.”
- + If a programme is not identified in the Contract Data, the Contractor must submit a first programme to the Project Manager for acceptance within the period stated in the Contract Data.
- + Consequences of failure to submit a first programme to the Project Manager for acceptance if it is not identified in the Contract Data (clause 50.3)





The programme (continued)

- + Information to be included in the programme detailed in clause 31.2
- + Reasons for Project Manager to withhold acceptance (clause 31.3)
- + Obligation to submit revised programmes at prescribed intervals (clause 32)
- + Significance of programme for assessing and implementing compensation events.
- + Consequences for the assessment if there is no Accepted Programme or the Contractor has not submitted a revised programme for acceptance as required.

Completion and key dates

+ Pursuant to clause 30.1, Completion is defined as when the Contractor has

done all the work which the Works Information states he is to do by the Completion Date and

corrected notified Defects which would have prevented the Employer from using the works and Others from doing their work.

If the work which the Contractor is to do by the Completion Date is not stated in the Works Information, Completion is when the Contractor has done all the work necessary for the Employer to use the works and for Others to do their work.

+ If sectional completion is required, secondary option X5 must be included.

+ Delay damages (i.e. liquidated damages) only applicable if secondary Option X7 applies

+ In the absence of Option X7, the Contractor would be liable for general damages for delay.

+ .





Key dates

- + Key dates are distinct from sectional completion dates.
- + Only relevant if identified in the Contract Data – on many projects they will not be needed.
- + A Key Date is defined as the date by which work is to meet the Condition stated, as defined in the Contract Data.
- + It is envisaged that the Condition will be something less than Completion - challenge is to define the required Condition in a precise way which avoids later disputes as to whether the Condition has been achieved.



Key dates – continued

- + Under clause 25.3, if the Project Manager decides that the work does not meet the Condition stated for a Key Date by the date stated and, as a result, the Employer incurs additional cost either
 - in carrying out work or
 - by paying an additional amount to Others in carrying out work
- + on the same project, the Contractor must pay the additional cost which the Employer has paid or will incur. The Employer's right to recover the additional cost is his only right in these circumstances.
- + Liability would not be liquidated and would be uncapped (except to the extent that it covered by an aggregate cap on its liability under Option X18).



Risk register and early warning

- + Early warning procedure and a requirement to maintain a risk register characterise the strong focus of the ECC form on risk management
- + The Risk Register is defined as 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.
- + Register should include a description of the risks and a description of the actions which are to be taken to avoid or reduce the risk.
- + Risk register does not change the apportionment of risks provided by section 8 of the form.



Early warning

- + The Contractor and the Project Manager are required to give an early warning by notifying the other as soon as either becomes aware of any matter which could
 - increase the total of the Prices,
 - delay Completion,
 - delay meeting a Key Date or
 - impair the performance of the works in use.
- + The Contractor may give an early warning by notifying the Project Manager of any other matter which could increase his total cost. The Project Manager must enter early warning matters in the Risk Register.
- + Risk reduction meetings
- + Consequences if Contractor fails to give early warning of a matter in respect of which it subsequently gives notifies a compensation event



Compensation Events

- + Compensation event procedure in Section 6 of the ECC form is fundamental to the operation of the ECC.
- + 19 compensation events are listed in clause 60.1 of the ECC form, although typically the list is amended by employers.
- + Each compensation event potentially results in the Contractor being entitled to claim both additional time and money.
- + Detailed rules governing the assessment of additional time and cost following the notification of a compensation event to be considered at more length in a future webinar.



Time-bar for notifying compensation events

- + Failure by the Contractor to follow the compensation event procedures in Section 6 could have seriously damaging consequences.
- + Clause 61.3 provides that the Contractor is to notify 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 event arises from the Project Manager or the Supervisor giving an instruction, issuing a certificate, changing an earlier decision or correcting an assumption.



Time bar for notifying compensation events (cont'd)

- + Is the time-bar effective even if the compensation event is a breach of contract by the Employer (*i.e.* the compensation event in clause 60.1(18))?
- + Some Commonwealth courts have refused to uphold contractual time-bars in these circumstances on the basis of the prevention principle which means that an employer cannot benefit from its breach. (e.g. in the Australian case of *Gaymark Investments Pty Ltd v Walter Construction Group Ltd* [1999])
- + Scottish and English courts have taken a harder line in enforcing contractual time-bars in this situation on the basis that the contractor's loss was caused by the contractor's failure to serve an appropriate notice. *City Inn v Shepherd Construction* [2001] ScotCS 187, 2002 SLT 781 (Court of Session, Outer House); *Multiplex v Honeywell Control Systems (No 2)* [2007] (TCC).



Who needs to be 'aware' of the compensation event for the purposes of clause 61.3?

- + Note that it is a subjective test
- + Key is to identify the 'directing mind' within a company. Per Denning LJ (as he then was) in Bolton v Graham:

'Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Other are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such.'



Time bars applicable to Project Managers

- + Project Manager's failure to respond to compensation event notices and quotations within the prescribed period for can result in their being deemed to have accepted the notices/quotations
- + But risk is not equivalent to the Contractor's failure to notify within the contractual time-bar under clause 61.3, since under Option W1/W2 the adjudicator is empowered to alter a quotation which has been treated as having been accepted





Varying the compensation event procedure

- + Potentially onerous administrative burden of operating the compensation event procedure for both the Contractor and the Project Manager
- + Often parties agree to vary the procedure/relax the timescales for example to provide for retrospective assessment (as is the norm under other construction contract forms). Any variation should be recorded in an agreement between the Employer, the Project Manager if not set out in Option Z clauses at the outset.

Risk and Insurance: introduction

- + Allocation of risk not dependent on insurance
- + Section 8 of the ECC does not deal with financial risks
- + Clause 80.1 sets out the Employer's risks – 6 categories
- + Clause 81.1 sets out the Contractor's risks – widely defined

Employer's risks (1): clause 80.1

+ 6 categories:

(1) Claims, proceedings, compensation and costs payable which are due to

- use or occupation of the Site by the *works* or for the purpose of the *works* which is the unavoidable result of the *works*,
- negligence, breach of statutory duty or interference with any legal right by the *Employer* or by any person employed by or contracted to him except the *Contractor* or
- a fault of the *Employer* or a fault in his design.

Employer's risks (2) & (3): clause 80.1

- + Loss of or damage to Plant and Materials supplied to the *Contractor* by the *Employer*, or by Others on the *Employer's* behalf, until the *Contractor* has received and accepted them

- + Loss of or damage to the *works*, Plant and Materials due to
 - war, civil war, rebellion, revolution, insurrection, military or usurped power,
 - strikes, riots and civil commotion not confined to the Contractor's employees or
 - radioactive contamination



Employer's risks (4): clause 80.1

- + Loss of or wear or damage to the parts of the *works* taken over by the *Employer*, except loss, wear or damage occurring before the issue of the Defects Certificate which is due to
 - a Defect which existed at take over,
 - an event occurring before take over which was not itself an Employer's risk or
 - the activities of the Contractor on the Site after take over.

Employer's risks (5) & (6): clause 80.1

- + Loss of or wear or damage to the *works* and any Equipment, Plant and Materials retained on the Site by the *Employer* after a termination, except loss, wear or damage due to the activities of the *Contractor* on the Site after the termination
- + Additional *Employer's* risks stated in the Contract Data

Contractor's risks: clause 81.1

- + Very wide – those risks not covered by the Employer
- + Time limit: up to the defects certificate being issued
- + Consider impact of risk transferring to Employer on take over



Repairs: clause 82.1

- + Until the Defects Certificate has been issued and unless otherwise instructed by the *Project Manager*, the *Contractor* promptly replaces loss of and repairs damage to the *works*, Plant and Materials



Indemnity: clause 83

- + 83.1 Each Party indemnifies the other against claims, proceedings, compensation and costs due to an event which is at his risk.
- + 83.2 The liability of each Party to indemnify the other is reduced if events at the other Party's risk contributed to the claims, proceedings, compensation and costs. The reduction is in proportion to the extent that events which were at the other Party's risk contributed, taking into account each Party's responsibilities under this contract

Insurance: clause 84

- + Clause 84.1 contains a table of insurance
- + Sets out the insurance to be provided by the Contractor – provided in joint names (clause 84.2)
- + Further explained in the Contract Data e.g. extent of cover to be provided
- + Contractor not provide insurances in Contract Data that the Employer is to provide



Insurance table

+ 4 categories:

- (1) Loss of or damage to the works, Plant and Materials: the replacement cost, including the amount stated in the Contract Data for the replacement of any Plant and Materials provided by the Employer
- (2) Loss of or damage to Equipment: the replacement cost



Insurance table (continued)

- (3) Liability for loss of or damage to property (except the *works*, Plant and Materials and Equipment) and liability for bodily injury to or death of a person (not an employee of the *Contractor*) caused by activity in connection with this contract: the amount stated in the Contract Data for any one event with cross liability so that the insurance applies to the Parties separately

Insurance table (continued)

(4) Liability for death of or bodily injury to employees of the *Contractor* arising out of and in the course of their employment in connection with this contract: the greater of the amount required by the applicable law and the amount stated in the Contract Data for any one event

- + Project Manager not included in the insurance requirements – presumption of reliance on their PI insurance



Insurance: Clauses 85, 86 and 87

- + Clause 85: rights and obligations in respect of insurance policies
- + Clause 86: When the Contractor does not insure
- + Clause 87: Insurance by the Employer

Dispute resolution

- + Two options:
- + W1 = where the Construction Act 1996 does not apply
- + W2 = where the Construction Act does apply
- + Must adjudicate before a dispute can be referred to “the tribunal” – either Court or Arbitration, dependent on what the parties have agreed



Common features of W1 and W2

- + Single adjudicator appointed at out set of Project for the duration of the Project
- + Employer names the Adjudicator
- + Adjudicator only involved when a dispute is referred
- + Adjudicator's decision interim but binding – must give reasons for decision
- + To challenge a decision, must serve notice of dissatisfaction

Main differences between W1 and W2

+ Procedure:

- Defined in W1, with timings for bringing a dispute, dependent on the ground relied on

- W2 mirrors the Construction Act, so any party can bring a dispute at any time

- + W1: 4 grounds for dispute – each ground has specific timings for bringing the dispute and who can bring it

W1: grounds for bringing the dispute (1)

- + This is set out in a table at Clause W1.3(1)
- + First ground: Project Manager or Supervisor takes an action which is disputed by the **Contractor**.
- + Contractor has 4 weeks from the date he first becomes aware of the action to **notify** the dispute to the Employer and Project Manager.
- + The Contractor must then **refer** the dispute to the Adjudicator between 2 and 4 weeks of the date of notification.

W1: grounds for bringing the dispute (2)

- + Second ground: Project Manager or Supervisor fails to take an action.
- + The **Contractor** has 4 weeks from the date he first becomes aware of the action to **notify** the dispute to the Employer and Project Manager.
- + The Contractor must then **refer** the dispute to the Adjudicator between 2 and 4 weeks of the date of notification.

W1: grounds for bringing the dispute (3)

- + Third ground: A quotation for a compensation event which is treated as having been accepted under clause 62.6 or 64.4.
- + **Project Manager** gives notice of the dispute to the Employer and Contractor not more than 4 weeks after the quotation was treated as accepted.
- + **Employer** must refer the dispute to the Adjudicator between 2 and 4 weeks of the notification.

W1: grounds for bringing the dispute (4)

- + Fourth ground: any other matter.
- + **Contractor** and **Employer** can rely on this ground.
- + Any adjudication referred must be done within 2 and 4 weeks after the notification.

NB: the timings above can be extended by the Project Manager before the notice or referral is due.

Adjudication procedure

- + W1 is different to W2 – W1 is not compliant with the Construction Act.
- + Under W1 the Referring Party includes with the Referral information it considers relevant.
- + Any additional information to be provided within 4 weeks (subject to an agreed extension) – can be submitted by either party.
- + In reality, under W1.3(5) the Adjudicator will give directions.

Adjudication procedure (2)

- + Under W1, Adjudicator's decision due within 4 weeks of the end of the period to receive information.

- + Total period under W1: 14 to 16 weeks from the relevant event to the decision:
 - 8 weeks from Referral to decision;
 - 10 to 12 weeks from notification to decision (1st 3 grounds); and
 - 14 to 16 weeks from the relevant event.

Adjudication procedure: W2

- + Scheme compliant.
- + Within 7 days of notice, Referral submitted plus information relied on.
- + Further information from a party within 14 days of Referral (subject to an extension).
- + Adjudicator's decision within 28 days of Referral (subject to an extension).



Referral to the Tribunal

- + To refer to the Tribunal a party must serve a Notice of Dissatisfaction.
- + To be served within 4 weeks of the decision - but under W1 can refer a dispute to Tribunal once it has been referred.

Court guidance

- + Minimal case law on NEC3 (or NEC2).
- + What case law we have has adopted common sense approach for interpretation.
- + Case of interest: *SSE Generation Ltd v Hochtief Solutions AG and another* [2015] CSOH 92. Parties' liability under NEC2 ECC not displaced by their joint names CAR insurance.
- + Reached by focussing on contractual wording, not the fact joint names insurance in place.





Conclusions and practical tips

- + As with any contract it is critical that the parties understand their contractual rights, obligations and risks prior to entering into an NEC3 ECC contract
- + If operated properly, it can be an effective project management tool in which the parties deal with problems as they arise
- + Ensure understanding of, and compliance, with contract mechanisms – including early warning notices and compensation event process from the outset.
- + Use templates/precedent forms – agree a joint approach

Approaching Webinars

- + Further spotlight on NEC3 ECC, including consideration of the payment options/provisions and the duties of the Project Manager - **date to be confirmed, invites will follow soon**
- + Managing Legal Risk in the Middle East – Issues arising in the UAE – 25th April (9.30am UK time / 12.30pm UAE time). Register on our website at www.beale-law.com/events





Contact Details

Tom Pemberton

+ t.pemberton@beale-law.com

+ +44 (0) 20 7469 0416



James Vernon

+ j.vernon@beale-law.com

+ +44 (0) 20 7469 0424

