CECA Scotland NEC4 Bulletin No. 3

March 2021: Secondary options NOT being included and the indirect risk that can bring to a Contractor

Introduction

Training and development support are a key part of CECA's core offer for its membership and, working in conjunction with GMH Planning, it has delivered a programme of training events around the NEC Form of Contract across several CECA nations and regions.

In addition to this training, a series of monthly NEC Contract Bulletins are being produced for both Contractors and Subcontractors to improve practical awareness on key topics within the NEC. The coverage, whilst not exhaustive, is intended as a general overview on some of the contractual principles to increase a wider understanding in support of more sustainable outcomes.

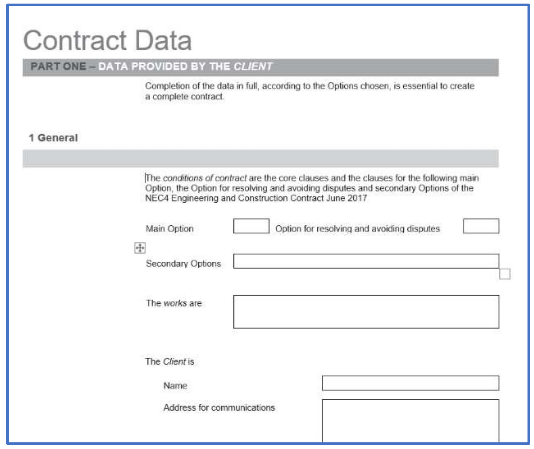
For the purposes of these bulletins a contractual relationship between a "Client" and "Contractor" is assumed. The same rules/principles also apply if the contractual relationship is between a "Contractor" and a "Subcontractor" and so the term "Contractor" will be used to describe both parties.

These bulletins are based on the latest NEC4 family of contracts, but the same principles and rules would apply where parties are engaged under an NEC3 form of contract.

Secondary options NOT being included and the indirect risk that brings

Most contractors would understand the different risk profile that comes with the different primary options of the Engineering and Construction Contract, i.e. option A being a lump sum contract is the most risk but equally may provide the most opportunity, whereas option C is more of a shared risk/opportunity between the Parties. At tender stage you will know which option has been chosen and will be pricing that risk accordingly. What is less obvious is which secondary options have been included or not, and what that does to a contractor's risk profile as a consequence.

How will I know which secondary options have been included? You will find out by looking in Contract Data part 1. As well as the Client identifying which primary option they have chosen, you will see that there is a box for the Client to populate the secondary options that have been chosen. It is important to recognise that this is about positive inclusion rather than excluding ones they do not want. Any that have been included may alter the risk profile but equally <u>any that have been left out may also alter your risk profile</u>.


Contract Data

PART ONE – DATA PROVIDED BY THE *CLIENT*

Completion of the data in full, according to the Options chosen, is essential to create a complete contract.

1 General

The *conditions of contract* are the core clauses and the clauses for the following main Option, the Option for resolving and avoiding disputes and secondary Options of the NEC4 Engineering and Construction Contract June 2017

Main Option | Option for resolving and avoiding disputes

Secondary Options

The *works* are

The *Client* is

Name

Address for communications

Which secondary options, if they are not included, will be a risk to the Contractor? These first four secondary options listed are a particular risk if they are not included within your contract. Although in theory as a Contractor you have no choice in which secondary options the Client selects, you can ask at tender stage if they would be willing to select any that have not been included. If nothing else, this would raise awareness to other tenderers as to what that risk would be and create a more level playing field for pricing the tender:

X2 – Changes in the law: If there is a change in law or legislation that affects the project, with this included it would become a compensation event. Any demonstratable cost and time effects directly due to this will be able to be assessed and claimed for accordingly. <u>If X2 is not included then this would be a contractor risk and potentially create a massive liability</u>, which would be very difficult to price sensibly for at tender stage.

X7 - Delay damages: It might sound good news if there were no delay damages on a project, but in the UK if there are no ascertained damages in a contract it means <u>that they “are at large”</u> and could legally be claimed separately at whatever costs a client incurs. Where the Client is trying to make it clear they do not intend to charge delay damages and do not wish the Contractor to price that risk, X7 delay damages <u>should be included but stated as being £0 or even £1/day</u>. That makes it <u>clear the damages are ascertained</u> and there would be no other legal recourse for claiming additional cost.

X15 – Contractor’s design: This is only an issue if the Contractor has elements of contractor’s design. If X15 is being included it limits your design liability to “reasonable skill and care”. Whilst that may be subjective in itself, it is clearer and less onerous to demonstrate compliance with than the default alternative which is “fit for purpose” which is even more subjective, and you <u>may well not be insured for “fit for purpose” type liability</u>.

X18 – Limitation of Liability: If X18 is included then it limits the contractor liability to the values indicated within contract data. Whilst these may be limited to large numbers, they are at least limited. If X18 is not included, then this would mean <u>unlimited liability,</u> something a contractor may not be able to get insurance for.

The next few secondary options below could also be an issue depending on the nature of the project and how they have been introduced which again could further alter the risk profile and/or your tender price:

X1 – Price adjustment for inflation: Where included there will be an agreed baseline within the contract for the inflation rate that the tender price is based upon. If at any stage inflation is recognised to have increased from that baseline then with X1 there is an agreed mechanism to allow the contractor to increase their costs by a fixed percentage at that point. The process and amounts will be identified within contract data 1. This is only likely to be a significant risk on longer duration projects that would be more difficult for a contractor to sensibly price. For shorter duration contracts this is generally accepted as a minimal risk and not so much of an issue if not included.

X4 - Ultimate holding company guarantee/X13 Performance bond: Normally one of these will be included to give the Client protection on the event of the Contractor defaulting on being able to fulfil their contract works. X4 means a parent company (the ultimate holding company being a parent of the parent if one exists) will step in to see the works through. Alternatively, where there is no parent company, an X13 performance bond would pay out a sum of money to allow the Client to get someone else on board to complete the works. Normally the only issue/risk here is agreeing the wording of the ultimate holding company guarantee that both sets of legal teams are happy with, or for X13 the amount of performance bond the Contractor has to provide and hence consider within their bid. Some Clients do not permit an either/or approach to X4 or X13 being used as secondary options, defaulting to one or the other subject to the nature of the business engaged. This can create challenges for those businesses with a more remote ultimate holding company. It may be worth raising this an issue during the procurement process.

X20 Key Performance Indicators: These are requirements to achieve certain measurable objectives related to matters such as quality, safety or contractual compliance. It should then be clear what benefit the Contractor would receive if they achieve that objective, but equally could otherwise be how they would be penalised if they fail to achieve them. <u>KPI's therefore can be a positive or a negative incentivisation</u>.

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Here is a brief explanation of the other secondary options that are less likely to be significant but at least need to be understood:

X2 Multiple currencies (options A/B only): Deals with who takes risk of movement of exchange rates if paying someone in another currency.

X6 Bonus for early Completion: Contractor incentivised with a bonus (defined in contract data) for each day they finish early - don't expect that one too often!

X8 – Undertaking to the Client or Others: Commonly known as “collateral warranties” where another party is required to warrant they have complied with their professional appointment. The wording and format of these are not standard and often something for the lawyers to get involved with to try to agree words that the Parties are willing to sign up to.

X9 Transfer of rights: Where Contractor has been paid to design for the Client, by including X9 it verifies that the Client owns the rights to that design that they have paid for.

X10 Information modelling: Commonly known as BIM (Building Information Modelling) and where applicable just brings those processes such as the Information Execution Plan and the Information Model into the NEC contract.

X11 Termination by the Client: Allows the Client to terminate for any other reason (not due to the fault of the Contractor) not already identified in the termination section (9) of the contract. If the Client is terminating for any other reason, then the Contractor would at least be entitled to be paid their fee on the proportion of the work that is being taken for them (as well as being paid for what they have already done).

X12 Multiparty collaboration: Where specific KPI’s are established to allow parties from different contracts to work together and be incentivised accordingly to do so (not very often used in practice).

X14 Advanced payment to the Contractor: Allows Contractor to be paid sums in advance where it suits the Client (not generally offered but was a key directive by government to government contracting bodies during the COVID-19 pandemic to keep Contractor cash flow within our sector moving).

X16 Retention: Allows Client to retain a percentage of the “Price for Work Done to Date” each period cumulatively, with half the amount released at the point the Contractor achieves status of Completion and the other half retained until the Defect Date (to encourage correction of defects).

X17 Low performance damages: This is where the Client sets a performance specification to be achieved e.g. build me a plant that generates X amount of electricity per day. If this performance level is not achieved then damages will be charged to the Contractor for that under performance. For most projects this would simply be a defect that is expected to be corrected and hence X17 is not often used but can be quite onerous if it is.

X21 Whole life cost: A new NEC4 option where the Contractor can propose a whole life cost saving i.e. spend extra £X now to save £Y in long run. Contractor can propose as a quotation and the Client either accepts or rejects (i.e. no option for a Client to assess themselves). A good initiative that the Client should include as they can always say “no” to any proposal.

X22 Early Contractor Involvement: Allows the Contractor to be brought on board for stage 1 to help develop the design on a cost reimbursable basis. This is with a view of them being appointed to go onto stage 2 if the Client is happy with their work to date and that their final cost/programme that has been proposed. Otherwise, the Client can end the contract with the Contractor at the end of stage 1 and go out to the market for stage 2.

Y(UK)1 – Project Bank Account: Option for a "project bank account" to be set up and for the Client to pay into. The Contractor then certifies payment to subcontractors out of that account.

Y(UK)2 – Housing Grants, Construction and Regeneration Act: Generally applicable to most UK construction contracts and ensures that NEC payment periods and terminology comply with this act.

Y(UK)3 – The Contracts (Rights of Third Parties) Act: Allows a third party, if named, to enforce a term of that contract in certain circumstances.

Summary: At tender stage understand the secondary options that have been included and equally by default the ones that have not been included and then consider and price that risk accordingly.

Coming next month:

Bulletin No. 4 - Pricing compensation events and the use of assumptions.

Please respond to Grahame Barn should you require any further information on the CECA Scotland NEC4 Bulletins grahame@cecascotland.co.uk