
Chapter 1

Introduction

1.1 Development of NEC contracts

NEC 3 is a generic name for a family of contracts published for the Institution of Civil Engineers by Thomas Telford Services Ltd. NEC stands for New Engineering Contract and it is by this name that the contracts are generally known. The main contract and the subcontract were first published as consultative editions in January 1991. First formal editions followed in March 1993; second editions in November 1995; and third editions in June 2005.

It was always intended that there would be a family of New Engineering Contracts and in the short space of time between 1991 and 2005 other contracts were produced such that by 2005 the NEC 3 family comprised:

- the NEC 3 Engineering and Construction Contract
- the NEC 3 Engineering and Construction Subcontract
- the NEC 3 Professional Services Contract
- the NEC 3 Short Contract
- the NEC 3 Short Subcontract
- the NEC 3 Adjudicator's Contract
- the NEC 3 Term Services Contract
- the NEC 3 Framework Contract

The contracts are supported by officially published guidance notes, flow charts and an advisory document entitled *NEC 3 Procurement and Contract Strategies*. The Engineering and Construction Contract has six main procurement options, and although one document (the *Black Book*) covers all six, each option is separately published. In all, as at June 2005, the complete set of NEC 3 documents comprised twenty-three volumes.

Background to NEC contracts

The background to the development of the New Engineering Contract does much to explain its style and content. In the 1980s there was on-going debate within the Institution of Civil Engineers, the lead body for the production of the ICE Conditions of Contract – at that time the standard form used for most civil engineering works in the UK – as to the direction of future contract strategies. At issue were questions as to whether the then existing standard forms adequately served the best interests of the parties by focusing on the

obligations and responsibilities of the parties rather than on good management, and whether an entirely new approach was needed to promote co-operation and to reduce confrontation. The prevailing view was that something new was needed, particularly for sizeable contracts where attention to good project management was the key to successful completion. So although confidence remained high that the standard ICE forms would remain the popular choice for routine civil engineering works, the Institution embarked upon the drafting and production of what is now the New Engineering Contract.

The drafting team was charged with three specific objectives for the contract:

- that it should be more flexible in its scope than existing standard forms
- that it should provide greater stimulus to good project management than existing forms
- that it should be expressed more simply and clearly than existing forms

It was, therefore, a matter of policy that the New Engineering Contract should be different from other standard forms in style and content.

For users of the contract the difference is of very significant practical effect. It used to be said that a good contract was never taken out of the drawer until it was needed. For the New Engineering Contract that rule does not apply. It is as much a manual of project management as a set of contractual conditions – and it should never be taken off the desk and put in the drawer.

Prospects for the future

The rapid expansion of use of the New Engineering Contract has been a remarkable success story. Contrary to intentions and to expectations the contract has within just a few years replaced ICE Conditions of Contract as the contract of popular choice for civil engineering works and it is already in widespread use for building, process and plant works. Although much used for major projects it is also used at more mundane levels. With the support base it has now built amongst clients and professionals, and with the range of contracts now available, there are real prospects that the New Engineering Contract in its various forms will become the dominant contract of the future.

1.2 Characteristics of NEC contracts

As noted above the New Engineering Contract was drafted with the objectives of achieving flexibility, stimulus to good project management, clarity and simplicity.

Flexibility

Flexibility is perhaps the most ambitious of these objectives. Thus the NEC 3 Engineering and Construction Contract aims to be an all purpose contract for all construction and engineering disciplines at home or abroad. It offers this through a combination of uniquely drafted provisions and a complex structure of options. Four distinct features are presented:

- discipline specific terminology and references to the practices of particular industries are avoided. Reliance is placed on a framework of general provisions written largely in non-technical language
- responsibility for design is not fixed with either the employer or the contractor but can be set at any amount from nil to total with either party
- primary options give a choice of pricing mechanism from lump sum to cost, *plus*
- secondary options allow the employer to build up the provisions in the contract to suit his individual policies

Stimulus to good management

Again, as noted above, much of the inspiration for the development of NEC contracts came from a belief that existing forms of contract no longer adequately served the best interests of the parties. The argument was put that expanding procurement strategies, changing practices in contracting, and developments in project management required contracts to focus as much on management as on the obligations and liabilities of the parties. So NEC contracts lay great emphasis on communications, co-operation, programming, and the need for clear definition at the outset of various types of information. Reports from users of NEC contracts suggest that improvements in project management are being achieved and that job satisfaction for those involved is better than with traditional contracts.

Clarity and simplicity

The approach adopted by the drafting team towards the objective that NEC contracts should be expressed more simply and clearly than existing forms of contract was to start from scratch rather than to build on old foundations. So NEC contracts are intentionally and conspicuously different from other standard forms in style and structure. They are written in non-legalistic language using short sentences and avoiding cross-references. Familiar phrases such as 'extension of time' and 'variations' are absent as is the regular use of the word 'shall' to signify obligations.

However, there is a price to pay for this brevity. Taken by themselves, the contracts are, at least for first time readers, more of a mystery than a model of clarity and simplicity. Fortunately, there are guidance notes and flow

charts to assist in general understanding and the application of the contracts.

Legal interpretation of the contracts is not so easily solved. Neither the guidance notes nor the flow charts are intended to be used for legal interpretation and the application of legal precedents from traditional forms of contract written in conventional drafting style can only be surmised. Which raises the question, have NEC contracts sacrificed legal certainty in pursuit of a new order? There are certainly some who feel that discarding conventional drafting amounts to discarding the accumulated contractual wisdom of generations. Throwing the baby out with the bath water is how one eminent construction lawyer put it. But others are far more optimistic and they suggest that to focus on the words of NEC contracts is to miss the point of the message; and that the courts, if called upon to do so, will have no difficulty in discovering the true intentions of the parties.

1.3 Structure of the NEC 3 Engineering and Construction Contract

In this chapter and thereafter in this book, NEC 3 means the NEC 3 Engineering and Construction Contract. ECC 2 means the second edition of the Engineering and Construction Contract.

Each NEC 3 contract is uniquely put together to meet the employer's needs by assembling clauses from the option structure and by particularisation in accompanying documents.

Option structure

In order to create a set of NEC 3 conditions for a particular contract, the employer:

- makes a selection from the six main options as to which type of pricing mechanism is to apply
- includes in the contract the nine sections of core clauses
- specifies which dispute resolution option applies
- includes such selection (if any) from the seventeen detailed secondary option clauses as he thinks fit
- includes in the contract under secondary option Z any additional clauses required by him or as agreed with the contractor

Main options

The main options comprise six types of payment mechanism:

- 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

Each of the main options is published in a separate volume which includes the relevant core clauses for the particular option. Additionally there is a single volume (the *Black Book*) covering all six options.

Core clauses

The core clauses are grouped into nine sections, numbered as follows:

- (1) general
- (2) contractor's main responsibilities
- (3) time
- (4) testing and defects
- (5) payment
- (6) compensation events
- (7) title
- (8) risks and insurance
- (9) termination

For each section there is a common set of core clauses and for some of the main options there are additional core clauses. There are two sets of dispute resolution clauses, labelled Options W1 and W2, from which a choice must be made.

Secondary options

The secondary option clauses are labelled under X, Y(UK)2, and Z prefixes. Not all would normally be regarded as secondary. Included within them are some matters such as retention and liquidated damages for late completion which most traditional contracts treat as essential. Other matters such as performance bonds and performance related damages are more obviously contract specific. The full list of secondary option clauses is considered in Chapter 3.

1.4 Feedback from ECC 2

It was evident from the usage growth of ECC 2 that the contract had many admirers and satisfied users. Anecdotal evidence suggested that when ECC 2 contracts were properly prepared, adequately staffed, and administered by a project manager who understood the philosophy of the contract and recognised the duties involved, they generally operated well. However, there were

reports of contractors losing large sums of money on some ECC 2 contracts and it is no secret that many disputes were referred to adjudication on both small and large ECC 2 contracts.

Feedback indicated various types of problems, in particular:

- preparation problems – these mainly related to incomplete works information and to a lesser extent incomplete contract data
- staffing problems – there is little doubt that it took some time for employers, contractors, and project managers to recognise the staffing needs of ECC 2 contracts – with the result that some contracts were understaffed and never properly operated, whilst others were staffed to the required strength but non-recoverable costs were sustained
- people problems – the requirement in ECC 2 for the parties and the project manager to act in a spirit of mutual trust and co-operation was frequently not understood or followed – one particular problem being the involvement of persons with management styles inherited from old style adversarial contracts
- compensation event problems – these were many and various with perhaps the most common being complaints of procedural overload, difficulties and costs of assessments, failures to use the quotation system, and confusion over time-bars

Preparation, staffing and people problems can hopefully be resolved by training and experience. Some of the compensation event problems of ECC 2 have been addressed in NEC 3.

1.5 Changes from ECC 2

The amount of change from ECC 2 to NEC 3 is quite small in volume terms – perhaps no more than 5% or so of the text. However, that belies the importance of the changes. There are new provisions of considerable potential impact and changes which significantly affect the operation of the contract. And as with changes generally to contracts and other formal documents, a change in one clause, however small, can have effects not immediately apparent on other clauses. For these reasons and because there has been quite an amount of re-arrangement and re-numbering, NEC 3 is best treated as a new contract rather than an update of ECC 2.

Significant new features

- key dates
 - these are dates set by the employer by which the contractor has to bring a stated part of the works to a specified condition
- risk register
 - a register maintained by the project manager and intended to include all risks stated in the contract data or subsequently identified by the project manager and the contractor

- key performance indicators – aspects of performance for which targets are set in an incentive schedule
- prevention provisions – new clauses by which the employer carries the time and cost risks of events similar to, but potentially wider than, *force majeure*
- entire agreement clause – statement that the contract is the entire agreement between the parties
- quotations treated as having been accepted – new provisions indicating the contractor's right to submit quotations for compensation events
- limitation of liability – new option clause limiting the contractor's liability to the employer for indirect or consequential loss
- delay damages – proportioning down clause included for parts of the works taken over before completion

Significant changes

- cost schedules – increased use of shorter schedule of cost components to simplify assessment of compensation events
- rates and lump sums – by agreement rates and lump sums can be used to assess compensation events
- fee percentages – separate fee percentages for subcontracted work and direct work
- conditions precedent – revised and clarified provisions on notices and timing restrictions for the submission of compensation events
- interest – revised and clarified provisions on entitlements to interest
- dispute resolution – choice to be made between alternative sets of provisions

1.6 Points of interest in NEC 3

Entire agreement

New NEC 3 clause 12.4 states that the contract is the entire agreement between the parties. Precisely what this means is open to debate but there are various possibilities – all of which give rise to potentially important consequences. Lawyers will probably seek to clarify this clause for particular contracts.

Exclusion of common law rights

The question of whether the compensation event system acts to exclude the contractor's common law rights to damages for breach is not entirely settled

in NEC 3. New clause 12.4 may have a bearing on the matter as may the new clause 63.4 which refers to rights of the parties. However, there remain aspects of the compensation event system which are difficult to reconcile with the concept of loss of common law rights.

Conditions precedent to entitlement

ECC 2 was far from clear as to what was legally intended by its requirement for compensation events to be notified within two weeks. New provisions in NEC 3 aim to rectify the situation by limiting entitlement to cost and time changes to notifications given within eight weeks of an event. However, this does not apply to compensation events which the project manager should have notified. There are various other aspects of the clause itself which add doubts as to the likely efficacy of its application. Perhaps a bigger problem is that there does not appear to be anything in NEC 3 empowering the project manager to concern himself with conditions precedent and time-bars.

Powers of the project manager

The intention of ECC 2 was probably that the project manager would act more as the employer's agent than as an independent contract administrator and supervisor. This view of his role took something of a knock in the 2005 case of *Corber v. Bechtel*. But by entirely separate development NEC 3 seems to have moved towards a more restricted role for the project manager. New clause 12.3 requires changes to the contract to be agreed and signed by the parties – a provision which would fit naturally into most contracts but less so in NEC 3 where many contractual restrictions and obligations are found in the works information.

Changes to works information

The extent of the project manager's power to change the works information under ECC 2 was not expressly restricted in the conventional manner to changes necessary or desirable for the completion and functioning of the works. However, common sense dictated that there should be some restriction. Under NEC 3 the proper approach to considering what changes to the works information are permissible may be to examine where the project manager derives his power from and how the contractor's obligations are defined rather than examining possible restrictions.

Prevention

The inclusion in NEC 3 of provisions putting the risk of what are called 'prevention' matters on the employer will concern many employers and their

lawyers. The matters covered by the provisions include what might normally be called '*force majeure*' or 'beyond control of the parties' matters, and the usual rule would be that loss lies where it falls. For that reason alone some employers will wish to see the provisions deleted. Another likely reason is that the provisions as drafted are capable of very wide interpretation and their scope could be argued to extend to all manner of problems encountered by the contractor.

Quotations for compensation events

Strengthening of the quotation system for compensation events by the inclusion in NEC 3 of provisions whereby default by the project manager in operating the contractual rules leads to quotations being treated as accepted will be welcomed by contractors. However, it is something of a surprise that such quotations can be disputed by the employer and altered by an adjudicator. In this respect they are either not being treated as accepted or it is the case, which seems unlikely, that all quotations accepted by the project manager can be challenged by the employer and reviewed by an adjudicator.

Assessment of compensation events

The changes for simplification of assessments of compensation events by greater use of the shorter schedule of cost components and possible use of rates and lump sums will be generally welcomed. There will, however, be disappointment that the changes do not address the fundamental problem that the assessment rules are not suited to low value events or for contracts with frequent and multiple events. There may also be concern as to how the new provision in NEC 3 that assessments should divide actual and forecast costs according to when instructions for quotations were given or should have been given is intended to operate. Retrospective forecasting may be envisaged but it is difficult to see it applying in adjudication.

Dispute resolution

The inclusion in NEC 3 of alternative dispute resolution procedures for contracts which are subject to the Housing Grants, Construction and Regeneration Act 1996, and contracts which are not, will not necessarily lead to the choice which might be expected. The statutory right to adjudication under the Act still applies to qualifying contracts even if the non-compliant alternative is chosen. The big difference between the two alternatives can be simply expressed – one imposes time limits and restrictions on the disputes which can be referred to adjudication, the other allows any dispute to be referred at any time. Subject to retention of any statutory rights it is a matter for the parties as to which of these they prefer.

One surprising and disappointing aspect of the dispute resolution procedures of NEC 3 is that they fail to include the range of procedures now becoming commonplace in construction contracts. Most notably, they fail to include conciliation or mediation which, given the complexities of the contract and its requirement for the parties to act in a spirit of mutual trust and co-operation, might well be the best choice the parties could make for resolving their disputes.

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