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NEC4® Key Commercial Changes

NEC4® User's Group Seminar 2017; 22nd June 2017; County Hall, London

On Thursday (22nd June 17), I was fortunate enough to attend the NEC® User's Group Annual Seminar at County Hall, London. Along with another 400 people, the highlight and main attraction of attending this year's event was the publication of the much anticipated new edition of NEC® on the same date – NEC4®.

Anyone who's ever watched a toddler playing and seen them become fixated on a worthless piece of paper, some stickers, stones, sand, water, a book or a particular toy (a toy lawn mower is my little boy's current obsession) will understand that you come between them at your peril! It is difficult, in fact almost impossible, to remove the said object as things are likely to become very hostile – "MINE!" they will shout! Toddlers don't share, except on rare occasions. However, I felt very much like my two year old on Thursday when, upon registration, I was passed a glossy, pristine, brand new copy of the NEC4® Engineering and Construction (ECC) form of contract... I was not letting go!



Keeping a tight grip on my copy of NEC4®!

Having now had time to open the NEC4® ECC contract and digest the content, I thought it would be a good idea to return to the adult world and share a few of the salient changes, in contrast to NEC3® ECC, from a commercial perspective...

First things first though, I would certainly agree with the drafters that the changes are more an "evolution, not revolution". The layout is very familiar - the same nine core clauses are still there, albeit some have slightly



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different titles (for example, 4 is now 'Quality Management' rather than 'Testing and Defects' under NEC3®). You will also find the same main option clauses (A to F) and secondary option clauses, with their references kept the same as NEC3®, however an additional six options have been added, seemingly to reduce the reliance on the level of Z clauses Client's need to draft or incorporate from scratch for particular contracting scenarios.

Actions:

Whilst it's worthwhile pointing out that clause 10.1 (NEC3®) has now been separated into two distinct requirements, with 10.1 emphasising what the Parties i.e. Client and Contractor, Project Manager and Supervisor should do and 10.2 outlining how they should act, there is no real impact of this change.

Identified and defined terms:

From a commercial perspective, the definition of the Fee (cl. 11.2 (10)) now only includes for one fee percentage. This is a change in comparison to NEC3® in that the subcontract fee percentage is no longer used – presumably to avoid confusion, and to remove any complexity in tender evaluation and ambiguity in assessment of CE's / PWDD, and perhaps also because nine times out of ten, the same fee percentage would be tendered by the Contractor in any case!

The 'Works Information' (NEC3® cl. 11.2 (19)) now becomes the 'Scope' (cl. 11.2 (16)). Whilst the change in terminology is not significant from a commercial perspective, what is worthy of note is that the quality of this documentation is key to the success (time, cost and quality) of the contract. This needs to be a complete and precise statement of the Client's requirements, since if it is not then the Contractor's interpretation is likely to differ significantly from the original intentions.

Finally, the definition of a Subcontractor (cl. 11.2 (19)) has been amended slightly to make clear that the supply of people (labour only subcontractors) falls clearly within the boundaries of people cost under Defined Cost. This is no different to NEC3®, but it does make this point much clearer since this is often a cause of debate.

Early warning:

In a bid to minimise the differences across the suite of contracts and align all clauses with one another, the early warning provisions are now captured under clause 15 (something new to get our heads around having spent the last ten years under NEC3® reciting clause 16 to colleagues!).

NEC4® now clarifies (cl. 15.2) that it is the Project Manager who should produce the initial early warning register, introducing a time period of one week from the starting date for this to be published. Essentially this is the same as NEC3®, since it was considered best practice that the Project Manager would do this in any case, however the drafters have now clarified this expectation by making it a specific requirement.

The term 'early warning register' (defined in cl. 11.2 (8)) replaces the NEC3® 'risk register' – hurrah! Hopefully this will prevent the commonly found confusion with the project risk register that people have tended to associate this term with, whilst helping to reinforce the fact that by merely including a risk in Contract Data Part Two to be added to the register, this does not distort the risk profile within the contract.

Given the level of importance placed on risk management, the drafters have clearly amplified the requirement to schedule early warning (risk reduction under NEC3®) meetings at regular intervals throughout the works. Cl. 15.3 states that the initial early warning meeting should take place within two weeks of the starting date and



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then at no longer than the intervals stated in Contract Data. A new entry has been created for the Client to stipulate this period, but I would suggest that this should be at no longer intervals than 4 weeks. Perhaps they should be arranged to coincide with the recurrent progress meetings, which we all tend to arrange with ease, yet rather than spending the majority of time debating what has happened and which we can no longer influence, perhaps we ought to focus on what is still to come.

Contractor's proposals:

A new clause within NEC4®, clause 16 provides clarity on how to deal with Contractor's proposals.

At first glance, it would appear that NEC4® only deals with cost implications of any proposal; therefore contrasting with NEC's® usual approach, whereby time and cost are assessed in parallel. However, this is clearly so as to enforce the fact that the Completion Date can only be delayed via compensation events (NEC4® cl. 63.5), unless a quotation for acceleration is accepted (NEC4® cl. 36). On that particular front, it should be noted that NEC4® now provides for the Contractor to propose an acceleration (cl. 36.1) whereas NEC3® only afforded the Project Manager the opportunity to do so.

So as to incentivise this approach under Options A and B, a value engineering percentage (to be identified in Contract Data) is applied when assessing the compensation event (cl. 63.12), hence both Parties attain the benefit of any cost savings generated on a pre agreed share basis. This was a major failure under the NEC3® form, whereby the Contractor was not incentivised on a fixed price contract to propose changes in this way, given that such a change would necessitate a change to the Works Information, a compensation event and a reduction in the Prices. Option C and D remain unchanged from NEC3® in that a CE is implemented to reduce the Prices and the savings shared via the Contractor's share (pain/gain) mechanism accordingly (cl. 54).

Programme:

NEC4® has addressed some of the issues encountered and fed back from the field relating to programme. For example, the drafters have tried to clarify, by incorporation of an additional line in cl. 31.2 that the programme should be in a particular form (e.g. Microsoft project), when submitted. By reference to the Scope, the Contractor will be able to easily verify what form they need to submit this in and ensure that they do not fall foul of the provisions within cl. 50.5 i.e. withholding of 25% of the assessment value; potentially severely impacting upon the Contractor's cash flow.

On the other hand, Project Manager's be aware! For those of you who choose to stay silent under NEC3®, or do not respond to programme submissions in line with the contractual timescales (two weeks), NEC4® (cl. 31.3) now introduces deemed acceptance of the programme following the Project Manager's failure to reply within a further week of such a reminder. Whilst I can see the benefit of this, in that it removes the impasse that often prevails under NEC3®, I would be concerned about a programme of poor quality and lacking the level of information required being deemed accepted and becoming the baseline. Although I guess if this was to happen then it would only happen once and a Project Manager would take due care and attention to reply to subsequent revisions.

Cl. 32.1 under NEC4® has been subtly amended to remove the second bullet point currently included under NEC3® i.e. the requirement to show implemented compensation events has now been removed to avoid any potential misunderstanding that non-implemented compensation events are not to be shown (since such events may have a significant impact upon planned Completion).



Payment:

Whilst the Project Manager is still obliged to assess the amount due in terms of payment, NEC4[®] now makes payment conditional upon the Contractor submitting an application for payment (cl. 50.4). Whilst NEC3[®] advocates this as best practice, it is not imperative for the Contractor to do so, hence this is a fundamental change and one to take note of.

Whilst I acknowledge that the Parties should act as stated in the contract (cl. 10.1), I am somewhat uncomfortable with how this particular clause sits alongside cl. 10.2, particularly under Main Options A or B, where assessment of the interim payment is quite straightforward. I would have thought this particular revision would have been best suited to application under Main Options C, D, E and F i.e. the cost based contracts, given the calculation of interim payments is much more complex. The Project Manager is often heavily reliant on an application for payment being submitted so as to have an understanding of the Defined Costs incurred by the Contractor.

In the NEC4[®] cost based contracts (Main Options C, D, E and F), the Contractor will have the ability to instigate a review and acceptance of its total Defined Cost by the Project Manager. Following notification by the Contractor (cl. 50.9), the Project Manager will have thirteen weeks to review the Contractor's Defined Cost and either accept it or advise of any issues. If the Project Manager fails to respond, the Contractor's Defined Cost will be treated as accepted. This is an important change, for it allows Defined Cost to be agreed at regular intervals throughout the contract duration, particularly on long term projects, rather than at the end. For both Parties, it should afford clarity, increased confidence and better working relationships. A point to note is that this appears to be the only instance in the entire contract whereby there is no requirement for the Contractor to notify the Project Manager of his failure to respond prior to deemed acceptance. This seems a little odd, although I dare guess that such an instance would only happen once (if at all) on any one contract!

Another change within NEC4[®], is the introduction of a final account concept under cl. 53. The Project Manager is required under cl. 53.1 to issue a final assessment of payment due to the Contractor within four weeks of the Defects Certificate. Time barring and deemed acceptance are introduced via cl. 53.2, whereby the Contractor can issue its own assessment if the Project Manager fails to do so. Cl. 53.3 states that the assessment (submitted by Contractor or Project Manager) will become conclusive and binding if not challenged by the other party within four weeks, or later via an appropriate dispute resolution process. Again, this is an important change and affords both Parties with clarity and closure, whereas NEC3[®] does not provide for closure of the final account / finality of payment in the same way.

Schedules of Cost Components / Defined Cost:

Changes have been made to simplify the Schedules of Cost Components under NEC4[®]. The Shorter Schedule of Cost Components has been removed from Main Options C, D and E (under NEC3[®] this can be used by agreement to assess compensation events), to make things much simpler. Under NEC3[®], this is perhaps one of the key areas where confusion reigns, and where disputes tend to crystallise, since not many really fully understand what the Schedule of Cost Components is, there is general confusion between Defined Cost and actual costs, the percentages are difficult to calculate and apply, and it is a considerably different approach to other standard forms.



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Quite clearly, users of NEC3® over the last ten years have been on the same page in that they wanted more clarity and a much more simplistic, streamlined method for determining Defined Cost. NEC4® addresses this as follows:

- **Main Options A and B:**
 - o 'Shorter Schedule of Cost Components' to be used (cl. 11.2 (23))
 - o Introduction of People Rates (cl. 11.2 (28)) within Contract Data (as opposed to calculating amounts paid)
 - o New / Additional People Rates may be agreed between the Parties, if required (cl. 63.16)
 - o Omission of the percentage for people overheads ('charges' component 41 under NEC3®)
 - o Omission of the percentage for design area overheads ('design' component 62 under NEC3®)
 - o Inclusion of 'Subcontractors' component (No. 4) (under NEC3®, Subcontractor costs are not recognised, instead they should be split out into the relevant cost components accordingly to replicate the Defined Cost)
 - o Single fee percentage to be applied to all Defined Cost (cl. 11.2 (10))

- **Main Options C, D, E and F:**
 - o 'Schedule of Cost Components' to be used (cl. 11.2 (24))
 - o Omission of the percentage for Working Areas overheads ('charges' component 44 under NEC3®)
 - o Omission of the percentage for design area overheads ('design' component 62 under NEC3®)
 - o Inclusion of 'Subcontractors' component (No. 4) (under NEC3®, Subcontractor costs are not recognised, instead they should be split out into the relevant cost components accordingly to replicate the Defined Cost)
 - o Single fee percentage to be applied to all Defined Cost (cl. 11.2 (10))

I feel that these are very practical amendments that will be welcomed by users. It certainly makes the definition of costs clearer, should encourage more of an open book auditing approach, whilst the use of People Rates under the fixed price contracts (Main Options A and B) is a much more convenient way of assessing the impact of compensation events (almost reverting to a day works approach).

The removal of the various fee percentages for calculating the basis of some of the Defined Costs will help to avoid typical issues such as double accounting, whilst it should also make tendering / estimating much more straight forward i.e. it's either identified in the Schedule or it needs to be covered in the Fee! A word of caution – given the changes and omission of the respective fee percentages, you should take time to familiarise yourself with what is an admissible cost under NEC4® so as not to get caught out!.

Compensation events:

Two additional compensation events have been added to NEC4®. The first new event (cl. 60.1 (20)) covers the instance where the Project Manager notifies the Contractor that a quotation for a proposed instruction is not accepted, allowing the Contractor to recover the cost of preparing the quotation. Proposed instructions are now



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covered by cl. 65 under NEC4®. I think this is a sensible approach since on large scale, long term contracts such requests can be frequent and can detract from the commercial management of projects from a Contractor's perspective. Providing recovery so as to put the Contractor back into the position as if the quotation had not been requested is therefore a welcome addition.

The second addition (cl. 60.1 (21)) affords the Client the opportunity to add additional compensation events via the Contract Data. This should hopefully see a reduction in the number of Z clauses that require specialist, expensive drafting by the Client.

A minor change in terminology can be seen in clause 60.1 (14) and 80.1 whereby 'Employer's risks' under NEC3® now become known as 'Client liability'. Another subtle change, having little or no commercial consequence, is the omission of the final line in clause 61.1 (compared to NEC3®) requiring the Contractor to put "...the instruction or changed decision into effect." I'm not quite sure why the drafters have chosen to make this amendment since, whilst the wording has been omitted, this is no different to the approach under NEC3® since cl. 27.3 is explicit in that "the Contractor obeys an instruction... given by the Project Manager..."

Good news for Contractor's comes via the amendment, under the fixed price Main Option's A and B, to the definition of Defined Cost (cl. 11.2 (23)) whereby the "...cost of preparing quotations for compensation events" is no longer excluded, instead NEC4® intends for this to be recoverable.

Clause 61.2 is an interesting change. It should be noted by Contractor's in particular, since it appears to be the only instance within NEC4® whereby two communications i.e. notification of a compensation event and request for quotation, are wrapped up into a single communication. This doesn't quite fit with the requirement under cl. 13.7 which insists that "a notification or certificate which the contract requires is communicated separately from other communications" so Contractor's should be mindful that the receipt of such a notification will set the clock ticking on provision of a quotation too (again, this shouldn't be too much different to the approach under NEC3® since it must be very uncommon for such communications to be issued on different dates). In fact, it's a shame there aren't a few more examples of this approach so as to scale back on the level of administration required (N.B. NEC4® does now acknowledge via cl. 13.2 that online / web based communication / contract management systems are now frequently used to help mitigate this burden).

When assessing compensation events, cl. 63.1 under NEC4® attempts to provide further clarity on the 'dividing date' between actual and forecast Defined Cost. Furthermore, NEC4® cl. 63.5 (previously cl. 63.3 in NEC3®) clarifies that the programme to be used to assess the impact of the compensation event is that in acceptance at the dividing date (which is defined as the date of notification). This caused a lot of debate during the User's Group seminar given that the Contractor has eight weeks in which to notify an event (prior to becoming time barred). Should the Contractor choose to take the full eight weeks (which is not to be recommended), then there is the potential for two programme revisions to have been submitted and accepted prior to notification. As such, it may prove difficult for the Contractor to demonstrate the impact of the event on planned Completion, given the event needs to be impacted on the accepted programme at the date of the notification i.e. potentially some eight weeks after it happened. I think this is a good point, certainly one which Contractor's should duly consider and ensure that they are proactive and raise notifications in a timely manner (when they are updating the cl. 32 programme, it should really flag that a notification is required in any case)...



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The last line in NEC4® cl. 63.5 clarifies the commonly held belief (under NEC3®) that programme submissions for compensation events only need to show the impact of the event on non-completed operations. I think this is a good move and closes the door on any debate which may arise relating to this issue.

Finally, NEC4® provides a core clause (cl. 63.2) to allow for assessment of compensation events via rates or lump sums in lieu of Defined Cost. This is a sensible inclusion, one which should reduce the timescales involved in dealing with change management, particularly on contracts where the work is of a repetitive nature.

Summary:

Whilst it was never my intention to cover every change under NEC4®, I hope that by covering some of the key changes from a commercial perspective it will serve as a prompt for those about to use the new contract edition for the first time. Having worked with NEC3® for the last ten years, it is very apparent that the drafters of NEC4® have:

- Listened to the feedback received from users
- Addressed some of the more contentious, confusing areas
- Made NEC4® simpler and more straightforward to operate and administer than its predecessor
- Reduced the reliance on Z clauses (although I'm sure the vast majority of NEC4® contracts will inevitably include some amendments and additional conditions!).

It will be interesting to see the 'early adopters' of NEC4® over the next few months and what the take up will be. From my perspective, there is no reason to suggest that improved delivery under NEC3® (for those locked into existing frameworks for example) cannot be achieved by looking at NEC4®, either to resolve issues, or incorporating, by conduct, some of the new features of NEC4®. Steve Rowsell, NEC4® Contract Board Member, made a comment during the seminar which should resonate with those looking to procure works via NEC® forms going forward - "Why wouldn't you use NEC4®? Ten years of learning from NEC3® are now incorporated. You'd be mad, or crazy not to"...

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