

“NEC Contracts in Hong Kong – The Legal Landscape and Beyond”

International Contracting with NEC for Greater Bay Projects

The Good, Bad and Ugly of Contractual Collaborating/Partnering

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The Presenter made reference to a variety of articles and Publications in compiling these slides.

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The Presenter would also like to take this opportunity to acknowledge the references made within this presentation.



Constraints for the GBA

- Local projects
 - The most commonly used form of contract is the Model Construction Project Contract, the latest version of which came into use on 1 October 2017.
 - In addition, the Ministry of Construction has also published contracts relating to project design, survey, site supervision, engineer consulting and subcontracting.
 - Chinese law does not require developers and contractors to adopt standard contracts.
 - Construction contracts must however be recorded and filed with the local construction department where the project is located in the required format for the particular locality. Developers may therefore need to consult with local authorities.
- International projects
 - Model contracts published by the International Federation of Consulting Engineers (*Fédération Internationale des Ingénieurs-Conseils*) (FIDIC) are preferred for international contracts.
- The key is **why change** when the current practice of adversarial nature of contracting works

What are the potential challenges in delivering an NEC in the GBA?

- Getting buy-in from key stakeholders;
- Training for staff including Employers, Contractors, Sub-Contractors and Consultants
- Ensuring that any modifications to the contract are consistent with the terms and concepts used in NEC and its collaborative ethos rather than just replicating traditional forms of contract and administrative procedures
- Engaging experienced NEC practitioners throughout the process and seeking support from top management
- Implementing necessary administrative resources in managing NEC specific features
- Keeping up with NEC's stringent programme requirements in relation to notification, submission and assessment processes.

NEC3 vs. FIDIC - the Challenges

“Variations”

- **NEC3**

- Same contractual machinery for both i) variations and ii) contractor claims (i.e. Compensation Events – or ‘CE’s”)
- Variations dealt with via core clause 6, ordinarily clause 60.1(1) [*An instruction changing the Works Information...*]
- Time and cost entitlement both flow automatically once a CE is established
- The burden of proof is more difficult – a balance of probabilities
- Valuing retrospective and prospective impact
- Not bound by BOQ rates in valuing (see detailed discussion below)

- **FIDIC**

- Different contractual machinery for dealing with variations, on the one hand, and claims, on the other
- Variations are dealt with via clause 12 and 13 under FIDIC Red [*Variations and Adjustments*] and [*Measurement and Evaluation*]
- Time and cost entitlement must be established separately
- The burden of proof is arguably easier because, at least in relation to Cost, a variation is not valued as a contractor’s claim
- Valuing retrospectively (mostly)
- Bound by BOQ rates in valuing (see detailed discussion below)

For NEC to be adopted one needs to be aware of the following ten commandments

- Designs Must be Fit for Purpose
- **Programming is Key - Completion**
- Disallowed Cost and Defects
- Importance of Early Warnings
- Correction of Defects
- No Provisional Sums
- **Assessing the Cost of Compensation Events**
- Notifications must be Separate
- Acceleration is Optional
- Adjudication is Compulsory

The Overall Concept

“Is Partnering Right for me?”

*“A **long term commitment** between two or more organisations for the purposes of achieving specific business objectives by maximising the effectiveness of the resources of each participant. This requires changing traditional relationships to **a shared culture** without regard to organisational boundaries. The relationship is based on **trust**, dedication to **common goals**, and an understanding of each other’s **individual expectations and values**”*

Construction Industry Institute, USA, 1991

Partnering aims to achieve

The main requirement for partnering is a desire for all parties to a contract to work together and improve on project delivery.

- meeting the mutually agreed project objectives by cooperation, teamwork and mutual trust (rather than confrontation)
- placing value on long-term relationships
- equitable risk allocation
- improving communication and understanding
- lowering project costs, reducing project time and improving quality
- encouraging innovation and better long-term profitability
- minimising disputes
- achieving a better project outcome through early involvement of all the members of the supply chain
- establishing a responsive project organisation focused on decision making

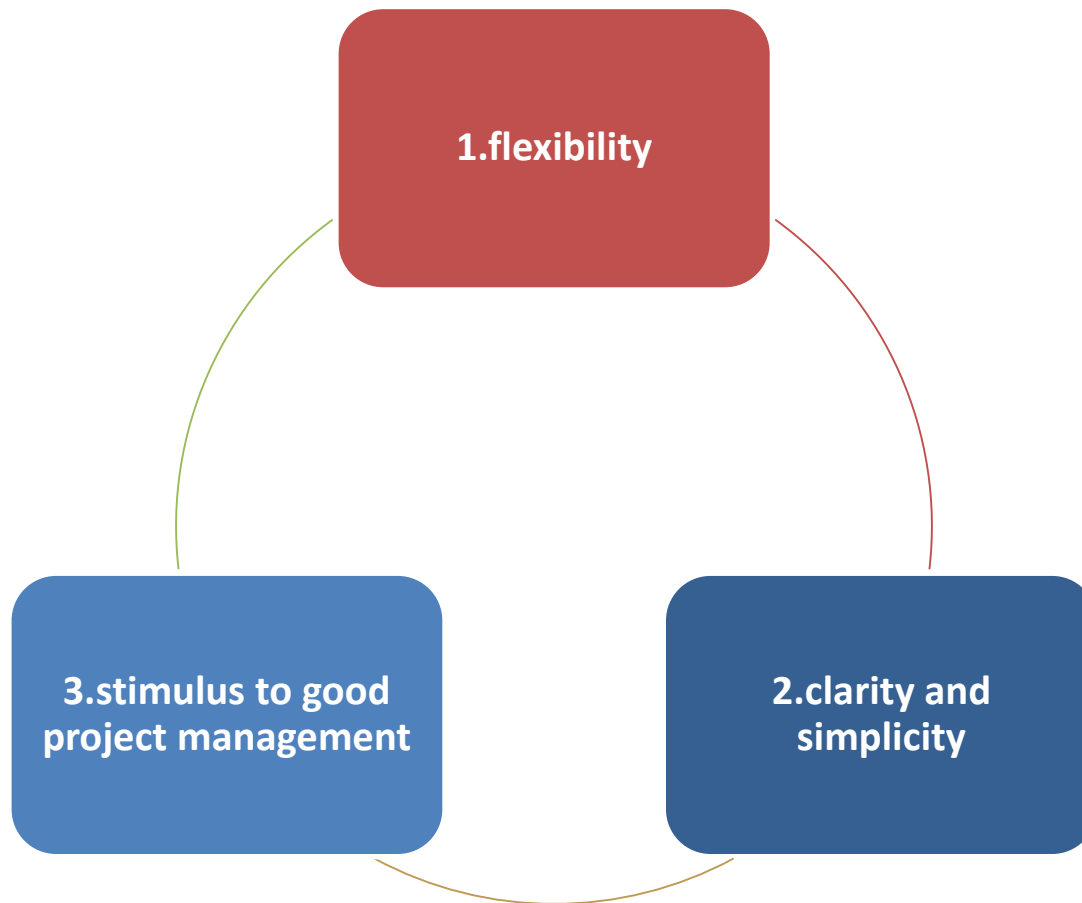
The Good of NEC

- In an era of project and strategic alliances, target cost contracts, outcome/performance based specifications, delivery partners, multi-disciplinary projects, it is difficult to match the level of flexibility and range of applications that NEC contracts provide. Some classify such as “**fit for purpose contracting**”.
- Encourages good project management through collaborative working and increases professionalism in the engineering and construction sectors.
- Clarity and ease of use.
- Written in clear language that encourages understanding and greater awareness of the associated risks and one’s responsibilities under the contract.

What are the anticipated benefits of using NEC

- change of mindset leading to a more collaborative and co-operative attitude from project participants at all levels
- stronger commercial drivers to deliver common goals through the use of pricing options such as target cost with pain/gain sharing
- increased focus on the proper planning of projects with early contractor involvement
- emphasis on speedy decision making that assists project progress
- more equitable risk sharing and better risk management
- early agreement of variations, thereby reducing delay and uncertainty through the final account process
- faster and safer construction better quality with fewer defects and improved financial outcome.

The Good of NEC



The NEC3 form of contract adopts a system of core clauses, main options and bolt-on secondary options to provide for traditional arrangements, as well as target, cost reimbursable and management contracts.



NEC3 ECC

1. Core Clauses (mandatory)

- section 1, section 2,, section 9

2. Main Options – Payment (choose 1)

- Option A, Option B,, Option F

3. Dispute Resolution Options (choose 1)

- Option W1, Option W2

4. Secondary Options (optional)

- Option X1, Option X2,, Option X20

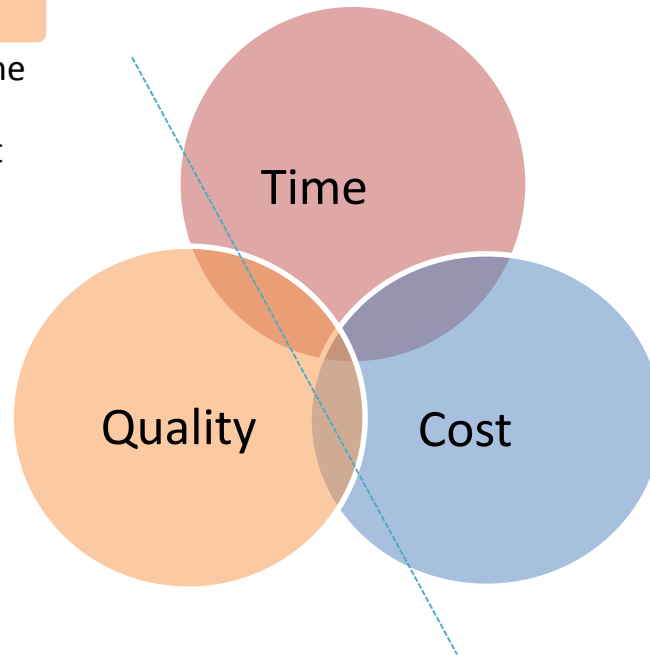
5. Contract Data (must complete), Works Information and Site Information

Clear Roles and Responsibilities

- The role of the Project Manager is clearly delineated from that of the Supervisor:

Supervisor

- essentially checks whether the works are constructed in accordance with the contract
- also oversees identification and rectification of defects, and is responsible for issuing the defects certificate



Project Manager

- essentially manages the contract for the Employer with the intention of achieving the Employer's business objectives
- has authority to change the scope of works, instruct the Contractor, certify payments and generally apply his managerial and engineering judgment.
- must act strictly in accordance with the contract

Early Warning Process

Early Warning Notice

- A key feature of ECC is that both the Contractor and Project Manager are required to notify the other in writing of any matter or risk they become aware of which could adversely affect time, cost or quality of the project. (Clause 16.1)

Risk Reduction Meeting

- Upon this notification, either the Contractor or Project Manager may require the other party to attend a risk reduction meeting at which they are required to cooperate in identifying actions to avoid or mitigate the matter or risk in question. (Clauses 16.2 & 16.3)

Risk Register

- The Project Manager is required to record all these risks on a "Risk Register" (which also includes risks identified in the Contract Data prior to the commencement of the contract). The purpose of the Risk Register is to record both the identified risks and the actions to be taken to address them. (Clause 16.4)

Pros and Cons of NEC

Overview	
Pros	Cons
<ul style="list-style-type: none">▪ Plain English / simple wording▪ Collaborative?▪ Wide choice of options▪ Drives proactive project management and contract administration?▪ Risk management▪ Strong emphasis on programme▪ Sanctions – time bars, default acceptance?	<ul style="list-style-type: none">▪ Lack of certainty over wording▪ Change in mind set needed to deliver benefits▪ Limited case law▪ Administrative burden?▪ Limited use outside UK▪ Time and cost for force majeure▪ Lack of retrospective provisions

The Bad of NEC

- There are many competing forms of contractual provisions and some have vested interests in preserving these standard forms of contracts, which creates confusion in the work place. For GBA to adopt the NEC a complete change of attitude and mind set is required.
- Some Employers do not believe in the collaborative way and emphasis that when one enters into a legal relationship one needs to absorb the associated risks as they occur creating a confrontational approach to contracting.
- The format and terminology is entirely different from the traditional forms of contracts and for one to understand this new way of contracting when one has not had the experience to do so is risky to say the least.
- Open to abuse and possible corruption.

What are the critical factors in the successful implementation NEC?



NEC3 – Clause 10.1

- ***“The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract and in the spirit of mutual trust and cooperation.”***
- Despite this provision, disputes do arise from time to time.
 - In ***Cleveland Bridge UK Ltd v Sarens (UK) Ltd [2018] EWHC 751 (TCC)***, the court had to determine the terms and interpretation of a subcontract.
 - The defendant, Sarens, had carried out work for CBUK, on the M6 link road. CBUK had engaged Sarens as a sub-sub-contractor in 2014, providing cranes and associated equipment necessary to install six bridges along the route.
 - CBUK was itself retained as sub-contractor by main contractor Costain under a modified form of NEC3 contract.
 - Delays arose during the course of the project, and in 2016 Costain and CBUK reached a settlement concerning liability for the delays, which resulted in CBUK agreeing to pay Costain £956k and waiving entitlement to a further £893k.
 - CBUK then sought to recover the sum paid to Costain from Sarens.

Sitol Limited v Finegold & Anor [2018] EWHC 3969 (TCC)

Background

- Mr. and Mrs. Finegold engaged Sitol, a specialist ceramic and tiling company, to undertake tiling work as part of a much larger refurbishment and building project on their home in Hampstead.
- A dispute arose between the parties and in a subsequent adjudication, Sitol was awarded £44, 838.38, that being the outstanding sum for the services it provided. The present case concerns an application by Sitol for summary judgment in order to enforce the adjudication award.
- The second defence that was relied upon was that Sitol was out of time when it referred the dispute to adjudication. This defence relied on clause 93.3 of the standard form **NEC3** Engineering and Construction Short Contract which provided:

“A party may refer a dispute to the adjudicator if the party notified the other party of the dispute within four weeks of becoming aware of it and between two and four further weeks have passed since the notification.”

- The main take away from this case is that the Court has confirmed the effectiveness of adjudication time bars in NEC.

ICI v Merit Merrell Technology [2018] EWHC 1577 (TCC)

- The contract between the parties was an **NEC3** (Option A) with additional Z clauses.
- The court looked at the legal status of a project manager's assessment of a compensation event and of agreements reached between the contractor and a project manager regarding the value of compensation events.
- The question for the court was confronted with is it competent for the employer to challenge assessments or agreements?
 - In relation to the project manager's assessments the court rejected this analysis and pointed to the terms of the dispute resolution provisions in the contract which empower an adjudicator to "review and revise any action or inaction of the project manager".
 - The court found that although the scope and extent of an adjudicator's powers are not determinative of jurisdiction the court certainly cannot have less power than an adjudicator's.
 - In relation to agreements reached between the contractor and the project manager, the court found that this was a question not only of law but of evidence.
 - The court required to consider each agreement to determine whether the parties had intended the agreed position between them to be the final position or an interim position meantime.
- This case provides some assurances that a project manager's assessment can be revisited by dispute resolution down the road.

Compensation Events

Clauses 60.1 and 61.3

- **Compensation events** are **NEC3** terminology for variations, loss and expense and extensions of time; a single assessment that deals with the entire effect of an **event** on time and money. Includes situations where:-
 - The Project Manager gives an instruction alternating Works Information (a variation);
 - The Employer not permitting access to the work site as stated in the project accepted programme;
 - The Supervisor does not respond to the Contractor within the time limits;
 - Adverse weather conditions; and
 - Works being suspended.
- The compensation events attempt to prevent the Contractor from being out of pocket for events that are outside its control

Compensation Events - Examples

- The Employer or Others do not work within the times shown on the Accepted Programme, within the conditions stated in the Works information..... (60.1(5))
- The Project Manager or the Supervisor does not reply to a communication from the Contractor within the period required by the contract (60.1(6)) or changes a decision that he has previously communicated to the Contractor (60.1(8))
- The Project Manager withholds an acceptance..... for a reason not stated in the contract (60.1(9))
- The Supervisor instructs the Contractor to search for a Defect and no Defect is found..... (60.1(10))
- An event which is an Employer's risk (60.1(14))
- The Project Manager notifies a correction to an assumption which he has stated about a compensation event (60.1(17))
- A breach of contract by the Employer which is not one of the other compensation events in this contract (60.1(18))

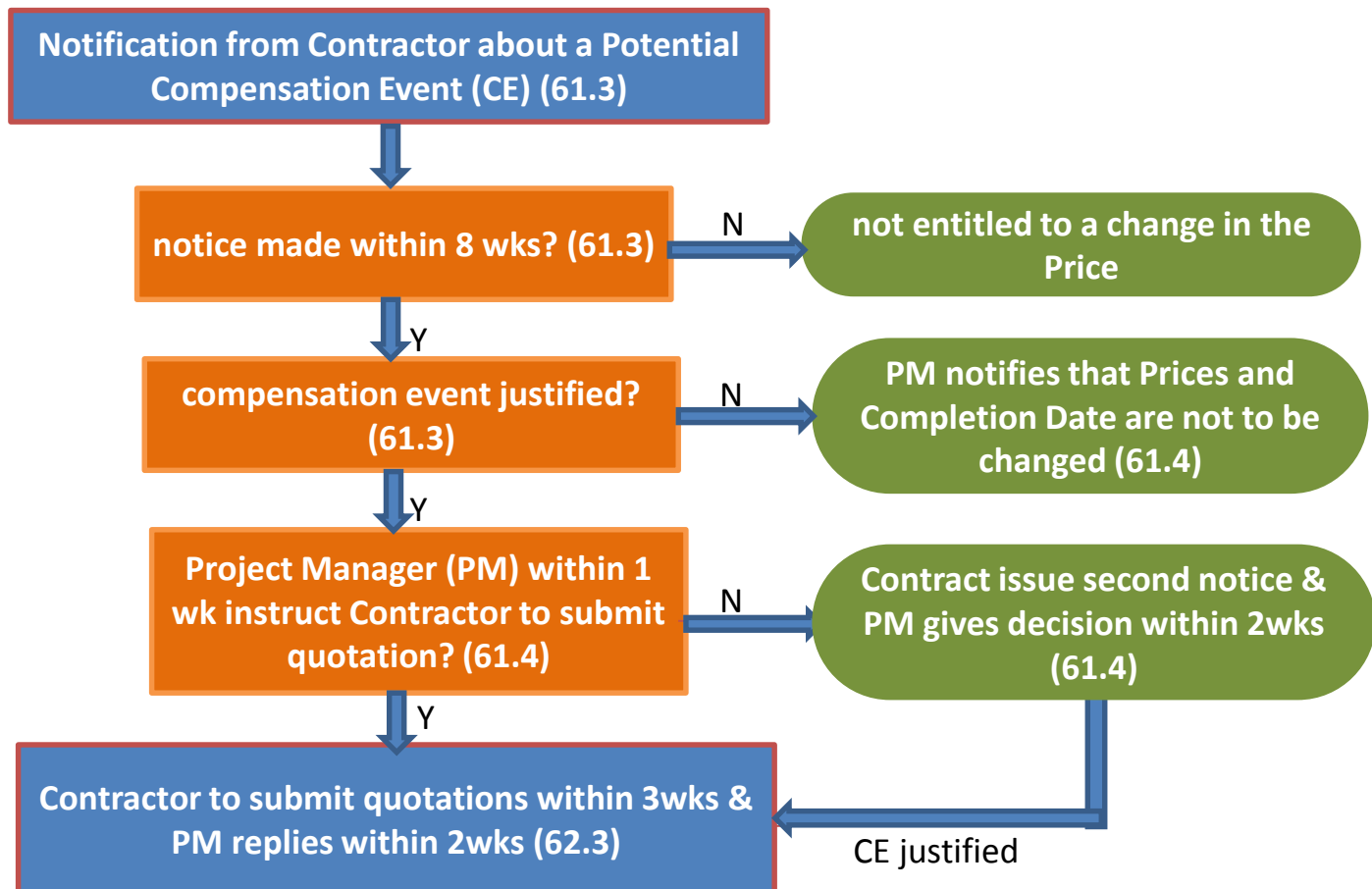
Compensation Events

Clauses 60.1 and 61.3

- The grounds for compensation events are listed in Clause 60.1 (19 grounds).
- Other sources of compensation events include: main and secondary options(7 grounds depending on the main and secondary option selected) and potentially Z clauses.
 - Examples include:
 - The Project Manager gives instruction changing the Works Information.....(60.1(1))
 - The Employer does not allow access..... (60.1(2))
 - The Employer does not provide something which he is to provide.....((60.1(3))
 - The Project Manager gives an instruction to stop or not to start any work or to change a Key Date (60.1(4))

Compensation Event

The compensation event process is summarised as follows



Compensation Events

Clauses 60.1(12) and 61.3

- The assessment of compensation events tend to be the most contentious areas of NEC3 and provide the greatest scope for a dispute to occur.
 - Clause 61.3 for the notice to be given by the Contractor to the Project Manager within 8 weeks of the Contractor becoming aware that the event is considered a Compensation Event.
 - Should a default occur, the Contractor will not be entitled to any alteration in the price under clause 61.3.
- This confusing requirement for notification by the Contractor and Project Manager is rather confusing, an onerous administrative task if not well coordinated or managed.

What can one do to minimise issues associated with Compensation Events in the spirit of cooperating and partnering

- Avoid going into long protracted legal arguments, as the NEC3 Guidance Notes suggest, the conditions of contract are intended to stimulate effective project management.
- Proactive monitoring and alerting everyone on the project team of possible contractual problems before they occur and discuss possible solutions as to mitigate one's risk.
- Having multiple requests relating to notifications, one should handle them in a systematic way and where possible acknowledge them and provide a possible date as to when you will respond to them.
- In your response you should attempt to provide as much reasons as to why a notification is not considered to be a Compensation Event

How does one define “Completion”

- NEC3 deals with completion at clause 11.2(2) :

“Completion is 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.”

The Problem

- As drafted, the clause does not require the works to be fully complete and the Works Information might identify work falling short of all of the works which the Contractor is to complete by the completion date.
 - At what stage can it be identified that the Contractor has done all the work necessary for the Employer or Others to use the works?
 - Does full or partial use satisfy the test?
- To solve this issue:-
 - What is required for completion for each section should be identified and each section should have its own sectional completion date. If there is any further work to be completed by the completion date, then this should appear, with an appropriate completion date for any further work (Option X5)

The Ugly

How can governance risks including perceptions of collusion associated with partnering be minimised?

- The ICAC has given the following useful guidelines in relation to partnering:
 - Choose partners committed to ethical practices (code of conduct, past records, management integrity etc.)
 - Know your partners (with multilayer subletting, it may be difficult to reach out and solicit commitment from the lower tiers)
 - Control the relationship (avoiding lavish entertainment, gambling, financial interest etc.)
 - Partnering does not mean loosening supervision (supervision is fundamental in ensuring quality and detecting problems)
 - Trust but don't sacrifice checks and balances (system integrity is essential in fraud prevention)
 - Observe the principles of fairness, openness and justice, but not favouritism (this is essential to maintain public accountability)

How can governance risks including perceptions of collusion associated with partnering be minimised?

- The ICAC has given the following useful guidelines in relation to partnering: (cont'd)
 - Flexibility but not unfettered discretion (delegation but still have to maintain management control and supervisory checks)
 - An aid but not a quick-fix to everything (hence still need a sound management infrastructure and control system)
 - Communication but not taking shortcuts (proper documentation for accountability and to provide an audit trail)
 - Mutual benefits without jeopardising public interest (such as restrictive practices, harbouring bad-performers, favouritism etc.)
 - Over-empowerment without management control leads easily to manipulation and covering up (management input to contain excessive discretion)
 - Do not delegate the non-delegables to your partners (such as the compliance testing function and the supervision roles)

Way Forward

Mind set Change

<https://www.linkedin.com/pulse/benefit-standard-forms-contract-fidic-vs-nec-james-clough/>

Criteria	FIDIC	NEC3 ECC
Terminology	Legal	Simple wording
Clauses nature	Adversarial	Collaborative
Program	Peripheral importance	Key to the functions of contract mechanisms
Pricing options	Limited to traditional norms	6 options, can be used together
Risk management	Limited	High awareness of risk, requires parties to register risks officially
Maturity and case precedence	Very mature, over 60 years with many precedence cases in law	20 years in use. Limited cases precedence in law.
Administrative requirement	Minimum	High, requires parties to document extensive amount of written communication
Dispute resolution	Dispute adjudication boards	Adjudication



Thank You