February 2024

CECA NEC4 Bulletin

CECA Member Briefing:

Bulletin No. 38 - Z Clauses That Could Alter Risk Profile

Introduction

Training and development support is 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 UK 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.

Coming next month:

Bulletin Nr 39 - Role of the Project Manager

Please respond to Leone Donnelly should you require any further information on the CECA NEC4 Bulletins via e-mail: leonedonnelly@cecasouth.co.uk.

For further advice or guidance on the NEC details please visit www.gmhplanning.co.uk or contact GMH Planning Ltd by e-mail glenn@gmhplanning.co.uk.

NEC Contract focus month 38 - Z Clauses That Could Alter Risk Profile

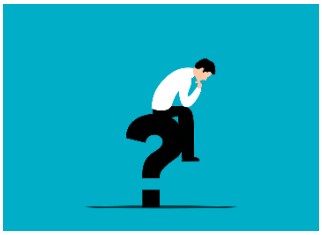
Although the NEC Contract was meant in its base form to be applicable for all construction projects some Clients may still feel the need to supplement or replace standard NEC contract wording for any project. This could be either be in the form of additional clauses, or by altering existing wording to reflect their specific requirements. These are known contractually as "Z clauses", and whilst realistically may be needed, these amendments can also become the biggest cause of ambiguities and disputes within projects. Z clauses are intended to allow different sectors of the industry to fine tune the contract to meet their industry specific requirements. It is also possible to slightly fine tune the risk profile that the Client is seeking to achieve. However, this can sometimes be taken too far, and a Client may end up significantly changing the principles of the contract.

The amendments will not have gone through the same level of thought process, checks and verification that the rest of the contract clauses have had in their 30 years of evolvement and development by the authors of the standard NEC contracts. Contractors, Subcontractors and Consultants need to be both very careful and aware of what they are signing up to as a consequence of these Z clause amendments, as they may significantly alter their risk profile and/or may affect their own insurances. Some clients have affectively created bespoke Contracts with multiple Z clause additions and their associated sub-clauses. The intent of the contract can therefore be lost increasing the need for each party/ industry to rely more and more on the legal profession, the very thing a standard form of contract is intended to avoid. Ultimately increasing the risk for all parties concerned if issues arise and clarification (of untested clauses) is sought. The risk increasing as contractors try and develop supply chain contracts from the amended forms.

Below is a list of relatively common "problematic" amendments that can be included within contracts and the associated risk profile that it could cause. It would be imagined that with hindsight that the Client may not have really wanted or have appreciated the impact that these could have. Clients need to consider the change they feel they need to make against the objective they seeking to achieve. For example, if a Z clause is increasing a Contractor's risk, they will be increasing their tender price accordingly or may decide not to bid at all as the uncertainty or magnitude of the risk might be too great. Equally, an unwary contractor might inadvertently enter into a contract with adverse terms that may impact on the financial outcomes. Is this really achieving the perceived benefit the client initially sought?

Any Z clauses that create ambiguity or subjectivity are undermining the very principle of the NEC contracts that are trying to avoid unnecessary disputes and risk having to go through a formal dispute process. Here are examples of Z clauses to look out for:

Clause 11.2 – defined terms added that are subjective and ambiguous. Examples of these could be Best Practice, Good Industry Practice, Concurrency, Applicable Standards or Reasonable Endeavours, all of which are very woolly and completely open to interpretation. These ambiguities could result in unexpected outcomes when assessed by the Client in any given situation.



Clause 13.8 – Project Manager may withhold acceptance for "any reasonable reason". The reasons for rejection are stated at the various relevant points in the contract (for example, there are four stated reasons to not accept a programme, and three reasons to not accept a revised activity schedule). To say the Project Manager can "reject" for any other reasonable reason would lead to the very type of disputes that the contract fundamentally tries to avoid on the first place.

Clause 17.1 and/or clause 63.10 in dealing with ambiguities or inconsistencies: If there is an ambiguity within the Scope then any instruction to resolve the ambiguity will be a compensation event (unless caused by the Contractor). This is then assessed in favour of the party which did not create the ambiguity. Sometimes a Z clause may alter this risk to make any ambiguities a Contractor risk even if the error was created within the Client's documents, and hence potentially a massive risk for a Contractor to have to bear. Writing such an amendment would also suggest the Client does not have much faith in the quality of their own documents!

Clause 20.1 to Provide the Works in accordance with the Scope: Sometimes other requirements are added which again add subjectivity, like the obligation to act "regularly and diligently" (and note not capitalised so not even an attempt to define what those words mean!)

Clause 21.2 where the only reason stated to not accept a Contractor's design is that it does not comply with the Scope or applicable law. Sometimes extra reasons can be added for not accepting design and these can be particularly subjective and onerous. Any rework on the design and any programme impact would be the Contractor liability if it has been rejected for one of these subjective reasons.

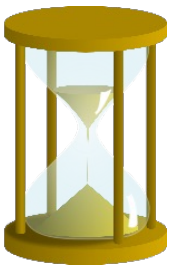
Clause 31.3 which are the four reasons for not accepting a Contractor's programme. Any further subjective reasons added not to accept a programme just creates subjectivity and increases the likelihood of there not being a regular accepted programme. This would be detrimental to both Parties as the latest programme is needed to assess the effects of compensation events and the longer it is not accepted will tend to mean that the agreement of compensation events will also be significantly impacted. As a result, neither party will have a clear understanding of their respective liability.

Clause 32.1 which identifies when a revised programme has to be issued for acceptance. The reasons stated are (a) whenever the Project Manager instructs, (b) whenever the Contractor decides, and (c) otherwise no longer that the interval stated in contract data (typically four weekly or monthly). Sometimes it has been added that a programme for acceptance has to be issued with every compensation event, which is completely impractical and unworkable for a project where there is likely to be significant change.

Clause 36 which states that any acceleration must be by agreement. The Project Manager can only accept or not accept a Contractor's acceleration quotation to bring forward the Completion Date rather than make their own assessment. Sometimes this can be amended to state the Project Manager can instruct the Contractor to accelerate and subsequently make their own Project Manager assessment of the quotation through the compensation event process. This is highly likely to be lower than the Contractor's assessment and their only route to challenge this would be through the dispute process in the contract.

Clause 60.1 which is the list of compensation events the Contractor can claim for. There are 21 standard reasons for which the Contractor would be able to notify a compensation event and be able to recover the cost and/or time effects of that event. Any of these that the Client deletes as a Z clause will mean that item is therefore now a Contractor risk. The more significant ones that could be deleted would be (12) physical conditions that would mean all ground conditions would be Contractor risk, (13) weather in excess of a one in ten-year event so all weather will be Contractor risk, and (19) which is equivalent to a force majeure type event that the Contractor could not then claim for.

Clause 61.3 where Contractor can be time-barred if not notifying a compensation event within eight weeks of becoming aware. The eight weeks is only for events the Contractor is obliged to notify and is not relevant for any the Project Manager is obliged to notify (e.g. instructions changing the Scope). However, sometimes this can be amended by deleting the last part of the sentence "unless the event arises from the Project Manager giving an instruction…" This would mean that the Contractor would be time-barred if they failed to notify ANY compensation events, even the ones the Project Manager is contractually obliged to notify.



Clauses 61.4/62.6/64.4 which are the "deemed acceptance" loops within the compensation event. If the Project Manager fails to respond to (a) a notified compensation event, (b) a quotation, or (c) fails to make their own assessment when they have said they will, the Contractor can notify the lack of Project Manager response. If the Project Manager fails to respond in these instances within a further two weeks, then it would be "deemed accepted". This ensures that both Parties are responsible to move the compensation event process forward and should prevent any agreement to be excessively delayed. Sometimes a Client may delete these deemed acceptances – which would actually be counter intuitive as it would delay the understanding of liability for both Parties which neither should want. The understanding of liability for both time and cost would be left unknown indefinitely until the Project Manager eventually decides to make a decision.

Clauses 61.4, 62.3, 62.6, 64.4 which are the timescales to respond to the compensation event phases. Sometimes these compensation event timescales can be altered where typically the Contractor is given less time to do their elements and Clients award themselves more time to carry out their responses or assessment. Sometimes the deemed acceptance loops that we previously mentioned may be extended rather than deleted. This, once more, has the likely result of delaying the time it takes to get to the agreement, which it should be in both Parties' interest to avoid.

Clauses 60.6/60.7 under option B making errors in the Bill of Quantities a Client risk. Sometimes this can be amended to make any errors in the Bill of Quantities a Contractor risk even though they did not produce it. This again would obviously be a significant risk to the Contractor making it more like an option A type contract.

Clause 11.2(26) for option C-E which are the reasons listed for disallowed costs. These can be added to by the Client which means that there are more elements that could be disallowed, such as all defects being disallowed (rather than just those corrected after Completion), and timescales stated within which the Contractor has to apply for certain costs. This clause is already one of the biggest risks to a Contractor for cost reimbursable type contracts, and having further reasons added that would be disallowed will increase this risk even more.

Schedule of Cost Components: Sometimes these are amended with Clients deleting elements that can be claimed for, which means that the Contractor would have to reflect these items within their fee percentage to be able to recover any associated cost.

Clause 90.2 and amount due upon termination: This is an increasingly common amendment that seems to be creeping into the industry where a Client may delate "A4" as an amount due. This is where the Contractor will be paid their fee on any work that is taken away from them when terminating the contract through no fault of the Contractor. To remove that means the Contractor will significantly lose out if the Client does terminate them.

Summary: Contractors need to be very careful when there have been amendments to the standard contract as these can significantly alter their risk profile, and if not understood and priced for accordingly at tender stage could lead to significant commercial liability on a project.

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