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NEC3 (Option C) Target Cost Contracts: What you need to know!

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Introduction

- What is an NEC3 Option C Target Cost Contract?
 - The philosophy
 - How do you work out what the Contractor gets paid?
- Common disputes on NEC3 Option C Target Cost Contracts:
 - Defined Costs
 - Disallowed Costs
 - Compensation events
 - Omissions and termination for convenience?

NEC Objectives (1)

- The parties are to act in a spirit of mutual trust and cooperation
- Collaborative working requiring early identification of problems and proactive approach to addressing problems
- Issues resolved as works progress
- Absence of final account process
- Proactive approach is policed by prescriptive procedures
- Use of clear language

NEC Objectives (2)

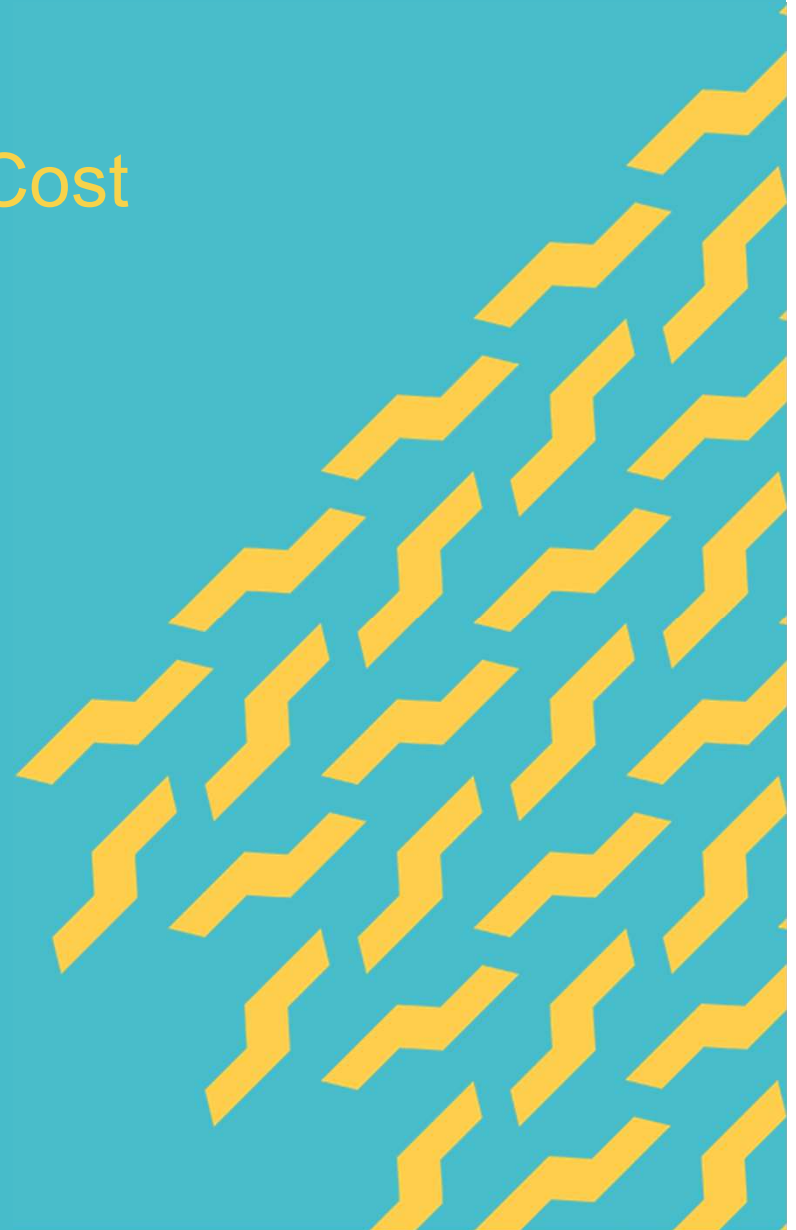
- Different mind set from both the Contractor and the Project Manager is essential
- Both the Contractor and the Project Manager have to properly understand and administer the contract
- Following the contract processes is essential
- For pricing purposes adequate commercial and programming support is essential
- Good and effective document management essential

The Reality?

- Cost disallowed at the end of the project with no warning
- Game playing
- An absence of Accepted Programmes
- An absence of agreed compensation events (“CEs”)
- Uncertainty as to the assessment of CEs
- Traditional final account negotiations at the end of the project
- Lack of case law on what provisions mean



How does an Option C Target Cost Contract work?

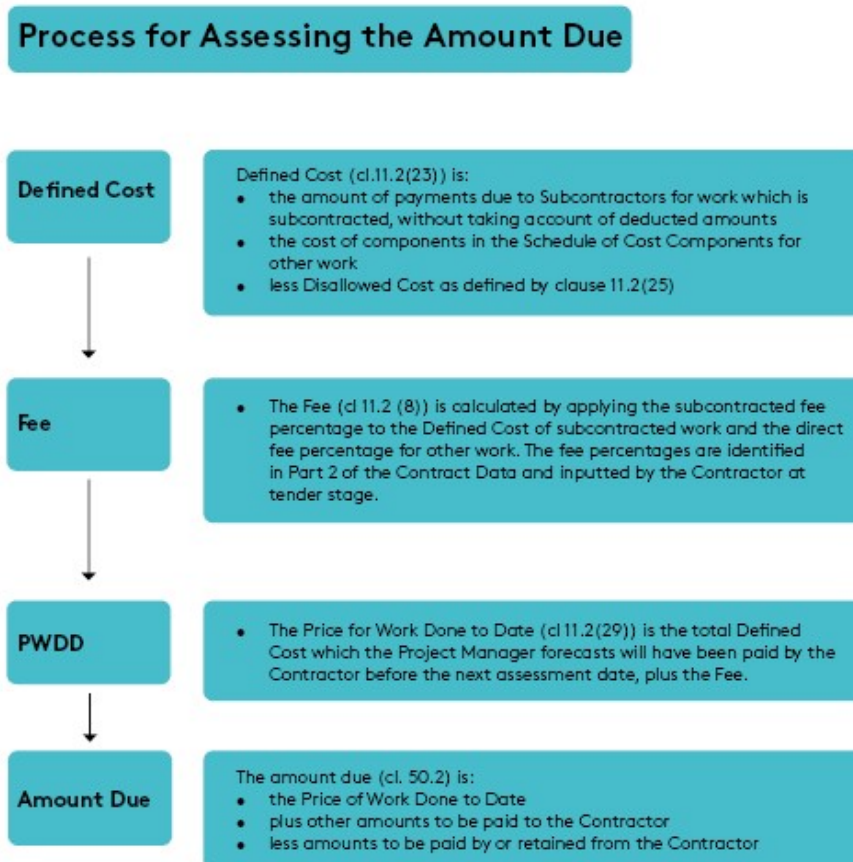


Overview – Target Price

- Prices are the lump sum prices for activities on Activity Schedule
- Contract Data Part 2:
 - Identifies the Activity Schedule and gives the tendered total of the Prices
- Activity Schedule breaks down component parts of the Works
- Activity Schedule is not Works Information - 54.1
- Tendered total of the Prices is the target at the date of Contract
- Subject to adjustment for CEs

Overview – Price for Works Done to Date

- Defined Cost + Fee
- Disallowed Costs
- Record Keeping
- Project Manager's Assessments
- Pain share v gain share

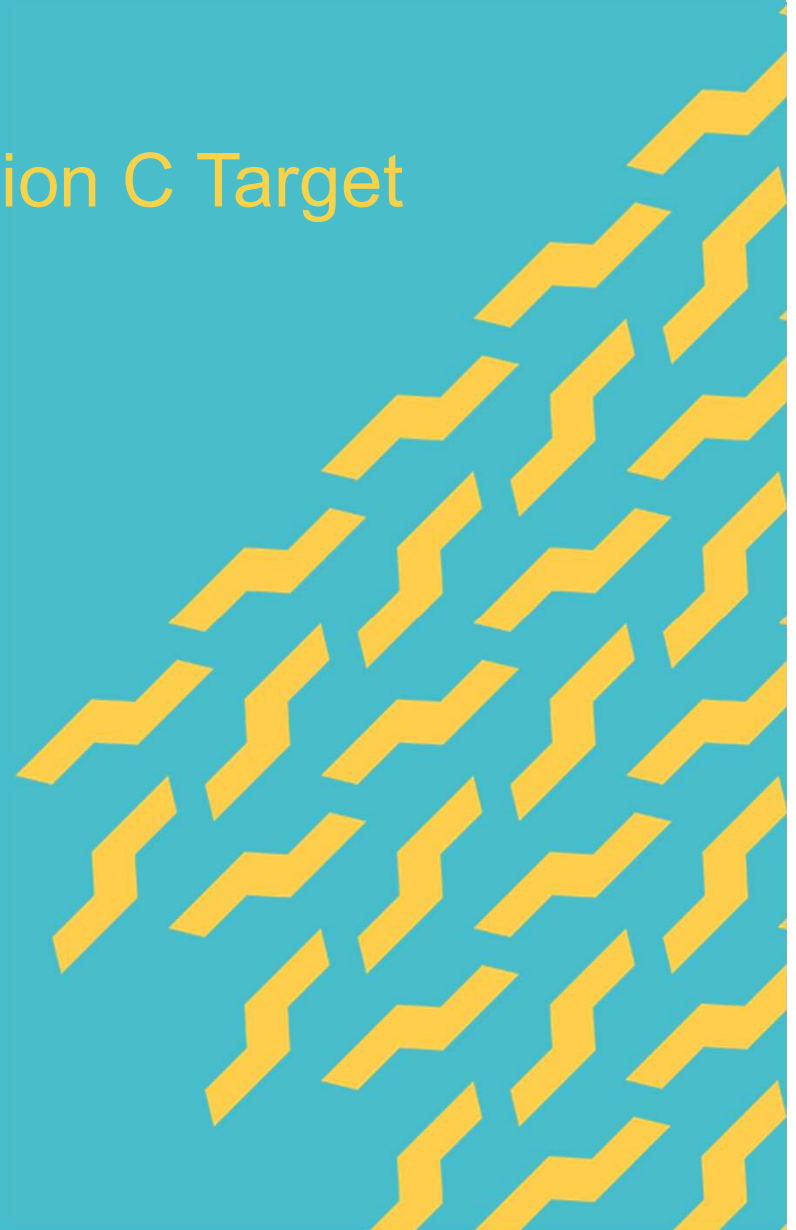


Contractor's Share – Pain v Gain

- Clause 53
- Preliminary assessment on Completion
- Final assessment once final figures known
- Contractor's share may be "gain or pain"
- Calculated as a percentage of difference between PWDD and total of the Prices
- Set out in Contract Data Part 1



Common disputes on NEC Option C Target Cost Contracts



Defined Cost

- Defined Cost
 - Amounts due to Subcontractors
 - Cost of components in the Schedule of Cost Components
 - people, equipment, plant and materials, charges, manufacture and fabrication, design and insurance
 - LESS:
 - Disallowed Cost
- Clause 52.1:
 - *“All the Contractor’s costs which are not included in the Defined Cost are treated as **included in the Fee**”*
 - Have you double checked whether you need to add anything into the SCC?

Schedule of Cost Components

- **People:**
 - “*Working Areas*”
 - Have you defined the Working Areas adequately?
 - How do you prove someone was working in the Working Areas that day?
 - Double check you are happy with amendments re:
 - Holiday and sickness pay
 - Severance related to work on the Contract
 - Is it a long term contract?
 - Is there a wide ranging omissions clause or a right to terminate for convenience?
 - If there are any bespoke amendments for rates etc
 - How are people’s job roles described?
 - Do they match the schedule of rates?

Amounts due to Subcontractors

- the amount of payments due to Subcontractors for work which is subcontracted without taking account of amounts deducted for
 - retention,
 - payment to the *Employer* as a result of the Subcontractor failing to meet a Key Date,
 - the correction of Defects after Completion,
 - payments to Others and
 - the supply of equipment, supplies and services included in the charge for overhead cost within the Working Areas in this contract
- Check your procurement processes:
 - Clause 52.1
 - “*other amounts at open market and competitively tendered prices...*”
- Double check that amounts paid don't include the amounts above

Record keeping for Defined Costs

- Record keeping
- Clause 52.2 provides that the following records must be kept:
 - Accounts of payment of Defined Costs
 - Proof that payments have been made
 - Communications about and assessments of compensation events for Subcontractors and
 - Other records stated in the Works Information
- Clause 52.3:
 - The Contractor allows the Project Manager to inspect at any time within working hours the accounts and records which he is required to keep
- Think about actively inviting detailed inspections throughout the Works
- Make sure your records are airtight!

Disallowed Costs 11.2 (25)

- Cost not justified by records
- Cost that should not have been paid to a Subcontractor
- Failure to follow a procurement procedure
- Failure to give an Early Warning
- Failure to correct defects after Completion
- Resources not used to Provide the Works
- Preparation for and conduct of adjudication proceedings

“... you do not simply disallow costs because you think they should be disallowed; they are disallowed because the contract says so” – Robert Gerrard

Defects

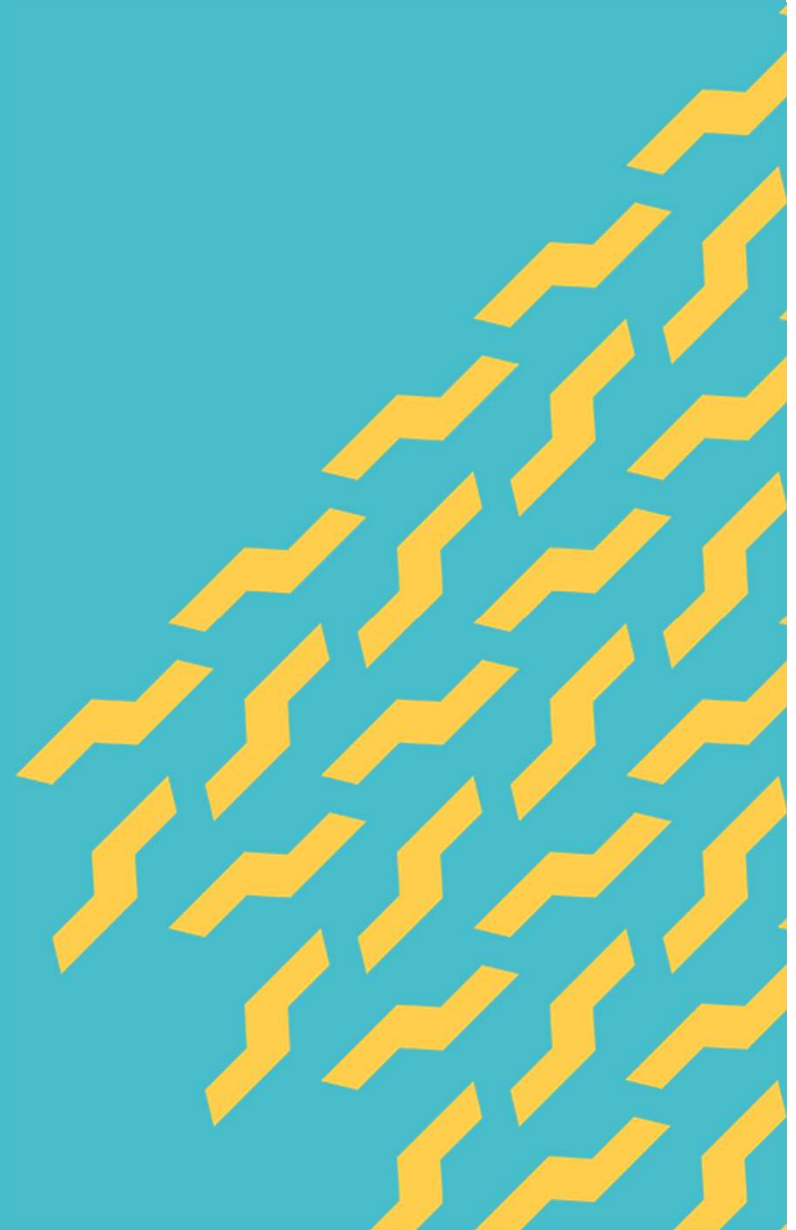
- Pre-completion v Post-completion
- Fault?
- Big picture and balancing interests



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Compensation events



Change: Compensation Events

- Key events:
 - Changes in Works Information
 - Late Access
 - Employer failing to do something shown on the Accepted Programme
 - specified Project Manager Instructions
 - Others failing to work as shown on the Accepted Programme
 - Supervisor related events
 - Ground conditions
 - Correction to an assumption
 - Employer breach of contract
- Crucial to maintain keep adjusting your target and keep on top of the admin!

Assessing CEs

- Meant to be forward looking:
 - EWNs
 - Time bars to encourage early notification
 - Clause 61.3:
 - *“The changes to the Prices are assessed as the effect of the compensation event upon*
 - *The actual Defined Cost of the work already done,*
 - *The **forecast Defined Cost** of the work not yet done, and*
 - *The resulting Fee.”*
- Too often not the case

Time Bars

- **Clause 61.3:**
 - Notify within eight weeks of becoming aware of an event or no relief
 - **Who is aware?**
 - **Exception:** *“unless the event arises from the Project Manager or the Supervisor giving an instruction, issuing a certificate, changing an earlier decision or correcting an assumption.”*
- **Notify!**
 - *“It’s better to regret what you have done than what you haven’t”*
 - Be careful of gentlemen’s agreements not to notify or to deal with time in the round later on

Accepted Programme: Game Playing?

- Is there one?
- Clause 31.3 PM to accept the programme or give reasons within 2 weeks
 - Reasons for not accepting include:
 - Plans not practicable
 - Doesn't include the required information
 - Doesn't represent the Contractor's plans realistically
 - Does not comply with Works Information
- NEC 3:
 - PM can assess if no Accepted Programme (Clause 64.2)
- NEC 4: Deemed acceptance (Clause 31.2)



Retrospective Assessment of Compensation Events

Northern Ireland Housing Executive v Healthy Buildings (Ireland) Ltd [2017] NIQB 43

“Evidence from time sheets and other material, of what the consultant actually did in that period, particularly with reference to the change in instructions, is not only relevant evidence but clearly the best evidence to assist the court in calculating the “compensation” to which the consultant is entitled...

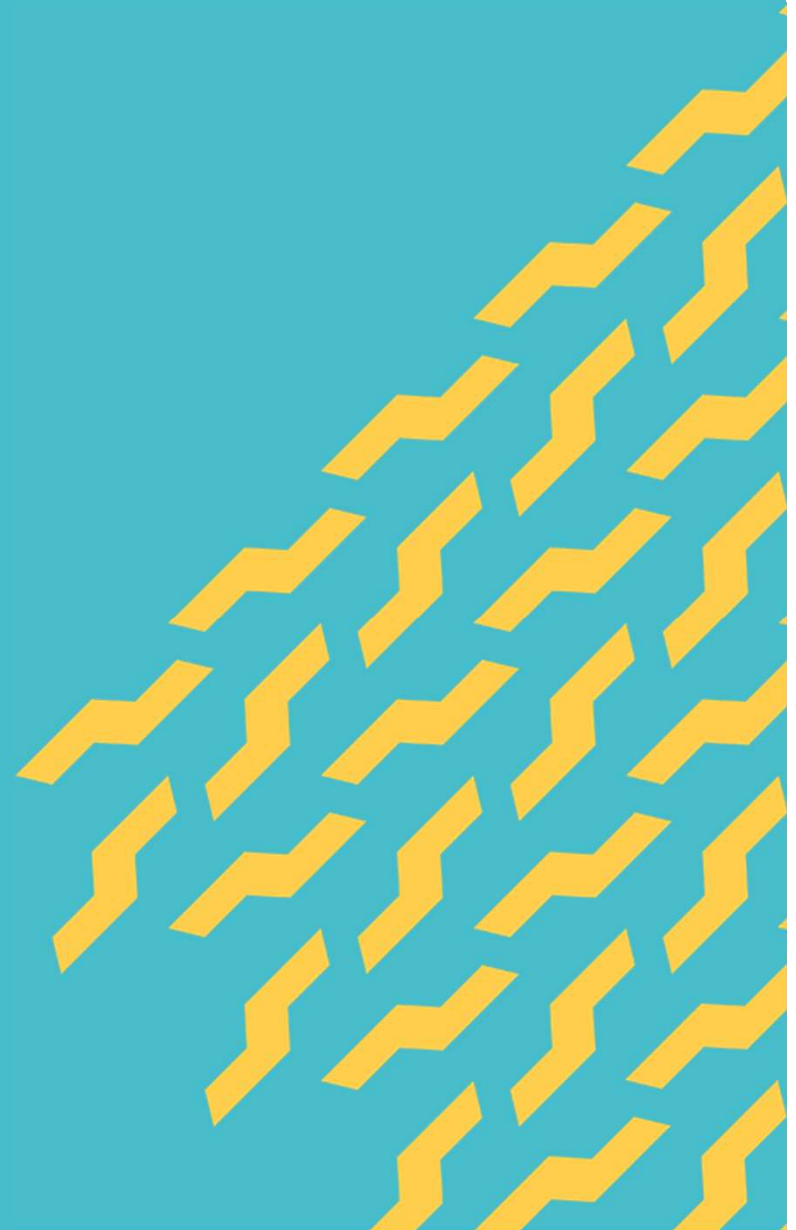
... why should I shut my eyes and grope in the dark when the material is available to show what work they actually did and how much it cost them?”

- Deeny J

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Omissions and Termination for Convenience



Omissions (1)

- No right to omit works and give them to third parties unless this is expressly provided for
- Omission with the intention of giving the works to someone else
 - Breach of contract
 - *Abbey Developments Ltd v PP Brickwork Ltd*
- Clause 60.1 (18):

“A breach of contract by the Employer which is not one of the other compensation events in this contract”
- Clause 63.4:

“The rights of the Employer and the Contractor to changes to the Prices, the Completion Date and the Key Dates are their only rights in respect of a compensation event”

Omissions (2)

- *Van Oord v Dragados* [2020] CSOH 87
 - Breach of contract to omit and give works to third party
 - Assessed as a compensation event
 - calculation resulted in a reduction of the Defined Cost
 - reduced the rate payable to the sub-contractor for the work remaining to be done
 - *“the use of Defined Cost is intended to provide an objective method of calculating change that, occurs as a consequence of a breach of contract in a way that does not leave the contractor either better or worse off”*
 - Reality?

Omissions (3)

- Is this Scottish case correct?
- Paragraph 7-124 of Keating on NEC provides:

“This clause seeks to make clear that the compensation event procedure is intended to set out the Contractor's entire rights in respect of a compensation event, i.e. all the costs and time that he might put forward in a claim arising out of the compensation event. Although the clause is not expressly worded as an exclusion clause, clause 60.1(18) makes any breach by the Employer a compensation event. Thus, it is arguable that save for rights to termination under section 9 of the ECC and at common law, the clause attempts to make changes to the Prices, the completion date and key dates the exclusive remedies available to the Contractor for a breach of contract by the Employer, thus potentially excluding damages for consequential losses. However, given that exclusion clauses are construed strictly and against the party relying on them, that is probably not the effect. The reference to rights in the clause may be construed as being to rights under the contract; a claim to consequential losses under the general law being unaffected.”

Termination for convenience?

- A1, A2 and A4 provide for compensation in the event of an Employer's termination for convenience
- A4: *"The direct fee percentage applied to an excess of the total of the Prices at the Contract Date over the Price of the Work Done to Date"*
- A4 routinely deleted from amounts payable on termination for convenience
 - No consequences for termination for convenience
 - No chance to recover any "lost profit"
 - Check your contract terms!
 - Terminations for convenience are increasing exponentially