THE NEC CONSTRUCTION AND ENGINEERING CONTRACT: TO AMEND OR NOT TO AMEND?

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Introduction

The NEC3 Engineering and Construction Contract ('NEC3') is being increasingly used in the UK construction industry, notably for high profile projects such as the London 2012 Games, NHS Procure21+ and the decommissioning of nuclear power stations. So much has already been written elsewhere about the structure and ethos of NEC3 that it would be superfluous to repeat it here.[1] Suffice it to say that NEC3's focus on management procedures, collaborative working and relationships appears to have contributed to the success of projects for which NEC3 has been used.

Although it is generally accepted that NEC3 places a greater administrative burden on the parties compared with other standard forms of contract, NEC3's numerous supporters point out that the additional focus on day-to-day management activities required by NEC3 should benefit the smooth running of the project. Furthermore, the lack of reported court cases relating to NEC contracts is cited as an indication that NEC3 contracts are less likely to result in disputes. No doubt factors such as these influenced the recent decision of the Council of the Institution of Civil Engineers (ICE) to endorse NEC3 in preference to the ICE Conditions of Contract.[2]

Despite the apparent benefits of NEC3, for some observers at least, it remains a controversial choice – particularly within legal circles.[3] The sheer brevity of NEC3 gives rise to concerns about a lack of detail, especially when NEC3 is compared with contracts such as JCT 2009, which contains detailed provisions about the parties' rights and obligations in different scenarios.[4] In addition,

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1 See for example, Brian Eggleston, *The NEC3 Engineering and Construction Contract: A Commentary* (2nd edition Blackwell Publishing, 2006); 'NEC3: Construction Contract of the Future?' by Nicholas Gould (paper presented to the Society of Construction Law's Singapore Conference in September 2007); and Humphrey Lloyd, 'Some Thoughts on NEC3' ICLR, October 2008.

2 Decisions of the ICE Council in August 2009 and July 2010.

3 See for example, Martin Bridgewater and Andrew Hemsley, 'NEC3: A Change for the Better or a Missed Opportunity?' ICLR 2006 39; Ben Beaumont, 'Dispute Resolution in NEC3 – User Unfriendly?' CLJ (2009) Vol 25, No 8.

4 References in this paper to 'JCT 2009' mean the Standard Building Contract With Quantities SBC/Q, Revision 2, 2009, published by The Joint Contracts Tribunal Ltd, unless otherwise stated. As an example of the differing levels of detail between JCT 2009 and NEC3, JCT 2009 contains detailed provisions dealing with the consequences of major damage to the works and the reinstatement process (see Schedule 3). In contrast, core clause 8 of NEC3 contains very little detail on this subject.

NEC3's near universal use of the present tense causes discomfort to some lawyers who have spent their careers dealing with more conventionally worded contracts such as those published by the Joint Contracts Tribunal (JCT).

In this regard, the comments of Edwards-Stuart J in *Anglian Water Services v Laing O'Rourke Utilities* are likely to be widely quoted.[5] The judge commented that construing NEC was made more difficult by NEC's use of the present tense:

> 'No doubt this approach to drafting has its adherents within the industry but … from the point of view of a lawyer, it seems to me to represent a triumph of form over substance.'

It was perhaps inevitable that the unconventional language of NEC would be the subject of early judicial comment – after all, it is difficult to see how the use of the present tense can constitute plain English when such usage is directly contrary to everyday speech.

Lawyers who comment adversely on NEC3 do however risk being criticised by proponents of NEC3, who describe such points as overly legalistic or even nit-picking. NEC3 supporters point out that using NEC3 involves a conscious decision *not* to legislate for every eventuality, but to place one's faith in the relationship of the parties and the project management processes. Contracts, they say, are for projects, not for lawyers.

In my view, it is entirely legitimate to consider the potential legal issues that may arise from the use of NEC3. Quite apart from the fact that many of the major NEC3 projects in the UK are ultimately funded by the taxpayer and should therefore be open to a reasonable degree of public debate, the terms of a contract can of course have a substantial impact on the fortunes of the parties who enter into that contract.

The aims of this paper

The aims of this paper are to highlight certain legal issues arising from NEC3, namely the language and terminology adopted, the absence of various market standard provisions, and certain specific differences in NEC3's risk profile compared with conventional construction contracts; and to consider the interaction between the compensation event regime and the Employer's and Contractor's risks.

Some of these issues are suitable candidates for 'Z clauses',[6] because the issues are either not dealt with at all in NEC3, or are dealt with only very briefly. Other issues concern some fundamental aspects of risk allocation, which differ from the position under other standard forms of contract used in

5 *Anglian Water Services Ltd v Laing O'Rourke Utilities Ltd* [2010] EWHC 1529, 131 Con LR 94 (TCC). The case involved an NEC2 contract rather than NEC3, but both contracts share the use of the present tense which was the subject of the judge's comments.

6 NEC3 provides a secondary Option Z, for 'additional conditions of contract', hence the expression 'Z clauses'.

the UK and may therefore constitute a trap for the unwary. These issues are considered in turn below.

It should be noted that at the risk of appearing somewhat one sided, this paper does not attempt to weigh up any of the legal issues considered below against the benefits of NEC3 (including the benefits from a project management perspective). As noted earlier,[7] the benefits have been the subject of numerous other commentaries and for reasons of space it would not be appropriate to rehearse those benefits here. Nor does this paper seek to pass judgment on the merits or otherwise of selecting NEC3 for any particular project – as for any other form of contract, the choice is a matter for the parties, based on their own particular needs and preferences. Similarly, this paper does not attempt to deal comprehensively with all possible legal issues arising from NEC3, but focuses on areas which to my knowledge have to date received little or no coverage elsewhere (especially in relation to the interaction between the compensation event regime and the Employer's and Contractor's risks). This paper also assumes that the reader has at least some familiarity with the NEC3 standard form.

Lack of reported cases on NEC3 disputes

Before considering the specific legal issues which are the subject of this paper, it is useful to briefly consider whether the lack of reported cases on NEC3 has a bearing on the significance – or otherwise – of the issues identified in this paper. Given that there are so few reported cases, can it safely be assumed that any legal criticisms of NEC3 can be ignored?

The short answer is 'no'. The problem here is that the lack of reported disputes does not necessarily show that the detailed wording of NEC3 is working. Indeed, commercial deals might be done behind closed doors, specifically to avoid having to decide an unclear point. Moreover, a substantial proportion of the NEC3 contracts entered into in the UK are based on Option C (target contract with activity schedule). Option C contracts are effectively cost reimbursable contracts, subject to the 'pain / gain' mechanism in clause 53. Accordingly, provided the target price is set at a sufficiently high level (so that it is not exceeded by the sum of the Defined Cost plus the Fee), there is little reason for the Contractor to become embroiled in a dispute, because the Contractor will be paid his costs anyway.[8] At a more general level, the widespread use in the UK of adjudication, where adjudicators' decisions are unreported, will also tend to mask disputes. Furthermore, there is often a time lag before new forms of contract end up in court, so it may simply be too soon to judge NEC3's track record in relation to disputes.[9]

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7 See note 1.

8 In addition to the pain / gain mechanism in clause 53 of Option C, the definitions of Defined Cost and Disallowed Cost, taken together with the requirements of clause 52.1 regarding open market or competitively tendered prices, will control the amounts that may be recovered by the Contractor.

9 For example, although large numbers of collateral warranties were signed from the early 1990s onwards, there was a lack of reported cases on collateral warranties until relatively

That said, it does appear that NEC3 disputes are now beginning to be heard more frequently by the courts,[10] and anecdotal evidence tends to confirm that is the case. This is not entirely surprising given NEC3's widespread usage, but it will be instructive to see how it fares when subjected to judicial scrutiny.

The legal issues which are the subject of this paper are considered below.

The language and terminology of NEC3

NEC3's unusual use of the present tense has already been mentioned above. One example of such usage is clause 20.1, which states that 'The Contractor Provides the Works in accordance with the Works Information'. This can be contrasted with the more conventional wording one might encounter in other forms of contract, such as 'The Contractor shall carry out and complete the Works in accordance with the Contract'. Unlike the latter wording, the NEC3 wording does not clearly place an obligation on the Contractor to carry out the Works; instead it reads as if it were merely a description of what happens, as a matter of fact. In my view, although the use of the present tense in NEC3 conflicts with normal language, the intention is reasonably clear, and it is likely that the courts would give effect to that intention.[11] That said, it is questionable whether the decision of the drafters to depart from conventional language was a wise one. The use of the present tense is somewhat contrived, and means that prior case law on the meaning of commonly used legal phrases may be of little assistance when construing the equivalent provisions in NEC3.

Whilst those in favour of using NEC3 emphasise its simplicity, it is difficult to deny that the drafting of some clauses is unclear. This is particularly true of the vital 'pain / gain' mechanism in clause 53.1 of Option C,[12] which has been described as 'a masterpiece of obfuscation'.[13] It should not be necessary to resort to the Guidance Notes to work out what such clauses mean. In my view, it would be preferable to completely redraft clause 53, using more conventional language.

Another example of a lack of clarity arises, ironically, from the drafters' desire to use the same terminology across the main Options, in the name of flexibility. Notably, nowhere in Option C is the expression 'target price' used.

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recently, eg *Scottish Widows Services Ltd v Harmon / CRM Facades Ltd* [2010] CSOH 42 (Scot CS).

10 See for example *RBG Ltd v SGL Carbon Fibers Ltd* [2010] CSOH 77 (Scot CS) and *Anglian Water Services*, note 5.

11 This may be the effect of clause 10.1 of NEC3, which (unlike the rest of NEC3) does use the word 'shall'; it provides that 'The *Employer*, the *Contractor*, the *Project Manager* and the *Supervisor* 'shall act as stated in this contract and in a spirit of mutual trust and co-operation'.

12 Clause 53.1 reads: 'The *Project Manager* assesses the *Contractor*'s share of the difference between the total of the Prices and the Price for Work Done to Date. The difference is divided into increments falling within each of the *share ranges*. The limits of a *share range* are the Price for Work Done to Date divided by the total of the Prices, expressed as a percentage. The *Contractor*'s share equals the sum of the products of the increment within each *share range* and the corresponding *Contractor's share percentage*'.

13 *The NEC3 Engineering and Construction Contract*: note 1, page 205.

This is because of the drafters' determination to use common terminology (ie the 'Prices') across all main Options: but it would surely be more user friendly if the language of Option C actually referred to the target price, instead of the rather unwieldy expression 'the total of the Prices'.[14]

One also wonders whether the use of common terminology across NEC3's main Options may have unintended legal consequences. For example, what is the effect on Option C of clause 63.4 of the core clauses? Clause 63.4 provides that '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.' The potential quirk here, however, is that under Option C, the Price for Work Done to Date (which is what is payable to the Contractor) is not the 'Prices', but rather the Defined Cost plus the Fee. Taken literally, therefore, in the context of Option C, clause 63.4 states that the Contractor has no entitlement to be paid for compensation events! That is surely not the intention,[15] and in my view it is unlikely that the courts would uphold such an interpretation. But it is clearly undesirable for parties to proceed on the basis of an assumption that a contractual provision does *not* mean what it says.

An additional factor which must be taken into account is the requirement in clause 10.1 that the parties must act as stated in the contract and 'in a spirit of mutual trust and co-operation'. It is not clear how – if at all – this requirement might affect the meaning of any particular provision. At a practical level, clause 10.1 may encourage the parties to resolve issues by mutual agreement. Equally, however, clause 10.1 may give rise to a degree of legal uncertainty in the event that an amicable resolution is not possible.[16]

An invitation to add Z clauses?

To NEC3's credit, the contract expressly caters for 'Z clauses', which form a vehicle for additional conditions of contract – although there is a preference that any Z clauses should be minimised. The difficulty here is that NEC3 omits a number of provisions which are normal in many other standard forms. These are outlined below.[17] Admittedly, these provisions may not be essential or appropriate in every case. But their omission (or in some cases, the extreme brevity of the wording on the relevant topic) is practically an invitation to add Z clauses to address the points in question. It is to be hoped that standard clauses to cover at least some of these points can be included in the next

14 The expression 'total of the Prices' is used in clauses 53.1, 53.2, 53.3 and 53.4, dealing with the 'pain / gain' mechanism.

15 It is to be hoped that the courts would construe clause 63.4 in the light of clause 50.2, which sets out the amount due (notably the Price for Work Done to Date). In my view, in the context of Option C, it should be made clear that clause 63.4 does not affect the Contractor's entitlement to payment of Defined Cost plus the Fee (subject to the pain / gain mechanism in clause 53).

16 The same would apply if secondary Option X12 (Partnering) is incorporated into the contract.

17 For reasons of space, the points listed here are not intended to be exhaustive, and are restricted to the core clauses and options. Other aspects of NEC3, for example the Schedule of Cost Components, have been the subject of comments by others – see for example Martin Bridgewater and Andrew Hemsley: note 3, pages 52-56.

version, whether in the core clauses or as new secondary Options. The points in question are as follows:

1. NEC3 omits a clause dealing with the priority of the contract documents. Accordingly, there is a risk that a provision in another contract document could override the conditions of contract. Although under clause 17.1 the Project Manager is required to issue an instruction to resolve an ambiguity or inconsistency in or between *any* of the contract documents, rather strangely, that instruction will only constitute a compensation event if it changes the Works Information (but not any other contract document).

2. NEC3 omits a contractual obligation to comply with applicable statutory requirements, and also a clear statement of the minimum standards to apply to materials, goods and workmanship. Although these matters could certainly be dealt with in the Works Information,[18] it is difficult to see why they should not be covered in the conditions of contract, as is customary. This would also remove the risk that these matters are omitted from the Works Information as the result of an oversight.

3. On a similar note, NEC3 exports to the Works Information the whole question of what is to be designed by the Contractor. In other standard forms such as JCT 2009,[19] the subject of design responsibility is more fully covered in the conditions of contract, usually in conjunction with contract particulars or an appendix which must be completed with project specific details.[20] Again, NEC3's approach creates the risk that the Works Information will not clearly specify those parts of the works which must be designed by the Contractor.[21]

4. It is difficult to understand why the core clauses of NEC3 are silent on the standard of skill and care which must be exercised in relation to the design of the works. This means that in the UK, unless secondary Option X15 is selected, fitness for purpose or absolute design responsibility will be implied.[22] This will often mean that the Contractor will not be protected by professional indemnity insurance, which usually provides cover for a failure to exercise reasonable skill and care rather than indemnifying the Contractor for *any* design error. Even if secondary Option X15 is selected, its wording is unusual. Option X15 appears to reverse the usual burden of proof, in that it states that the Contractor is not liable for defects due to his design so far as the Contractor proves

18 As appears to be envisaged by clause 20.1 of NEC3, which states that 'The *Contractor* Provides the Works in accordance with the Works Information'.

19 JCT 2009, note 4.

20 For example, in JCT 2009, the entries in the Recitals and Contract Particulars require the parties to specify which parts of the works are to be designed by the contractor, and which technical documents contain the design requirements for those parts of the works.

21 I have encountered precisely this situation in practice.

22 See for example *Viking Grain Storage v TH White Installations Ltd* (1985) 33 BLR 103 (OR), as well as the express obligation in clause 20.1 to Provide the Works in accordance with the Works Information.

that he used reasonable skill and care to ensure that his design complied with the Works Information.[23] In my view, it would be preferable to use a more standard provision here.

5. NEC3 omits a requirement for the Contractor to maintain professional indemnity insurance where the Contractor is responsible for the design of all or parts of the works. This would be an ideal candidate for a secondary Option. In my experience, users often attempt to expand the insurance table in clause 84.2 to include professional indemnity insurance, but then fail to amend the requirement for all insurances to be in the joint names of the parties. This is problematic because professional indemnity insurance provides cover to the Contractor rather than the Employer.

6. Unusually, there is no prohibition in NEC3 on the assignment of the contract. Accordingly, the position on assignment will be subject to the governing law of the contract. This creates a degree of uncertainty which could easily have been avoided by dealing with assignment in the core clauses.

7. The NEC3 provisions on intellectual property rights ('IPR') are extremely brief. Again, NEC3 exports what is essentially a 'legal' point to the Works Information. Clause 22.1 contains a short list of purposes for which the Employer may use and copy the Contractor's design, and refers to 'other purposes as stated in the Works Information'.[24] Accordingly, unless the Works Information is carefully worded, it is questionable whether the Employer may use and copy the Contractor's design in connection with (for example) the advertisement or sale of the works. Moreover, there is no clear entitlement on the part of the Employer to grant sub-licences, or to transfer the IPR licence, as is customarily required in the marketplace.

8. It is notable that unlike (for example) JCT 2009,[25] the NEC3 conditions of contract do not expressly deal with provisional sums.[26] Given the widespread use in the UK building industry of provisional sums (for example in relation to work done by utility infrastructure providers), it would be desirable for this to be dealt with, either in the core clauses or as a secondary Option.

9. Whilst NEC3 does include a secondary Option in relation to third party rights, namely Option Y(UK)3,[27] the use of collateral

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23 See clause X15.1.

24 Clause 22.1 provides that, 'The *Employer* may copy and use the *Contractor*'s design for any purpose connected with the construction, use, alteration or demolition of the *works* unless otherwise stated in the Works Information and for other purposes as stated in the Works Information'.

25 JCT 2009, note 4.

26 Although this may not be an issue in main Option E (Cost reimbursable contract), it is potentially problematic in main Options A to D, where there is no provision for the Prices to be adjusted for provisional sums (unless the Project Manager issues an instruction to change the Works Information, which will not always apply).

27 Option Y(UK)3 (The Contracts (Rights of Third Parties) Act 1999).

warranties remains more popular throughout the UK. In addition, the Contracts (Rights of Third Parties) Act 1999 does not apply in Scotland. It would be relatively straightforward to deal with the requirement for collateral warranties in a secondary Option.

Inevitably, if the above issues are to be addressed, whether by Z clauses or by future amendments, the length of the documentation will increase. In the interests of minimising the overall length, it would be worth considering whether NEC3 could be simplified by dropping most of Option W2 in favour of the adjudication provisions in the statutory Scheme for Construction Contracts.[28] At over two and a half pages, Option W2 seems disproportionately long in a contract aimed at brevity.[29]

In my view, the above matters could usefully be addressed in NEC3's core clauses or in further secondary Options. In addition, users in the UK construction industry need to be aware that the risk allocation under NEC3 may be significantly different in a number of respects to other standard forms such as JCT 2009.[30] Some specific differences are considered below.

Specified perils / existing structures

It is important for users to note that under NEC3, loss or damage caused by what is known in JCT as a 'Specified Peril' may not entitle the Contractor to an extension of time, because it is not one of the listed compensation events in clause 60.1.[31] In this context, 'Specified Peril' includes events such as fires, explosions, floods, storms and the escape of water from pipes or similar apparatus. This means that if the works are damaged as the result of (for example) a negligently-caused fire, the Contractor will be fully liable for the resultant delay in completion. In this regard, it should be noted that a construction all risks policy, if taken out by the Contractor, will not normally provide cover for the costs and losses arising from delay in completion – only the reinstatement costs will be covered by insurance.[32]

Separately, users should note that NEC3 contains none of the detailed provisions dealing with works to existing structures as are found in JCT 2009,[33] and extra care must be taken when preparing the contract in such

28 As contained in The Scheme for Construction Contracts (England and Wales) Regulations 1998 (SI 1998 No 649) and The Scheme for Construction Contracts (Scotland) Regulations 1998 (SI 1998 No 687).

29 For example, Option W2 is longer than section 8 (Risks and insurance) and is nearly as long as section 9 (Termination), each of which is arguably a more important subject, especially when an alternative adjudication procedure is readily available in the form of the statutory Scheme (see note 28).

30 JCT 2009, note 4.

31 Unless clause 60.1(19) covers the circumstances in question – which it may not – or unless an additional compensation event has been added by the parties, eg in the Contract Data. This contrasts with JCT 2009, where loss or damage caused by a Specified Peril is a ground for an extension of time under clause 2.29.9.

32 If the Construction All Risks policy is taken out by the Employer, it may be possible for the Employer to purchase additional cover for delay in start up (DSU) or advance loss of profits (ALOP).

33 See Schedule 3 to JCT 2009, note 4.

circumstances. In some instances, it will be appropriate for the existing structures and their contents to be insured by the Employer rather than the Contractor.

Interim payments under Option A

Option A is one of the most commonly used NEC Options. Its users – especially Contractors – should be aware of a potential issue in the payment mechanism under Option A (Priced contract with activity schedule). Most Contractors in the UK construction industry operate on the basis of monthly interim payments. Under Option A, however, there is a potential trap for the Contractor. This is because under Option A, the definition of 'Price for Work Done to Date' refers to the Prices for each group of *completed* activities, and each *completed* activity which is not in a group, as set out in the Activity Schedule. (A completed activity is one which is without Defects which would either delay or be covered by immediately following work.)

Accordingly, the Activity Schedule is not merely a JCT-style contract sum analysis. Instead, its content and layout will have a critical impact on the level of interim payments. Indeed, it would appear quite possible for a Contractor to almost eliminate its entitlement to receive interim payments, simply by grouping too many activities together in the Activity Schedule.

Employer's Risks and Contractor's risks

From the perspective of the Contractor, perhaps the most important feature of NEC3's risk allocation is the rather sweeping wording dealing with Employer's risks and Contractor's risks.

Clause 80.1 sets out a relatively short list of Employer's risks. Under clause 81.1, from the starting date until the Defects Certificate is issued, the risks which are not carried by the Employer are carried by the Contractor. This may satisfy the desire of the drafters to achieve a clear risk allocation, but clause 81.1 is extraordinarily wide, and endures beyond Completion. Clause 81.1 is supported by clause 83.1, under which each party must indemnify the other party against claims and costs due to an event which is at his risk.

This blanket allocation of risk to the Contractor may prove highly onerous for the Contractor. For example, unless expressly inserted as an additional Employer's risk in the Contract Data, the risk of loss or damage to the Works caused by terrorism would appear to be a Contractor's risk, for which the Contractor must indemnify the Employer.[34] It is also conceivable that the Contractor would have to indemnify the Employer in relation to delays in receipt of planning permission or other statutory approvals, given that under

34 Although it is possible that terrorism would be covered by the compensation event in clause 60.1(19), the relationship between compensation events and Employer's and Contractor's risks is unclear, as discussed more fully below. In any event, in my experience, it is not unusual for Employers to delete clause 60.1(19) because it is perceived as being wide enough to cover matters such as subcontractor insolvency.

clause 27.1, the Contractor must obtain approval of his designs from Others where necessary.[35]

Furthermore, it is not clear how NEC3's allocation of Employer's and Contractor's risks under core clause 8 interacts with the compensation event regime under core clause 6. This is considered in more detail below.

Interaction between Employer's and Contractor's risks with compensation events

At first glance, the interaction between Employer's risks and compensation events seems relatively straightforward, because all Employer's risks are expressly classified as compensation events.[36] But on the other hand, by virtue of clauses 80.1 and 81.1, *not all compensation events are Employer's risks*. This raises a number of difficult questions as to how Contractor's risks, which also happen to be compensation events, should be treated:

1. If a matter is a compensation event but is also a Contractor's risk, how can the Contractor be entitled to an extension of time and payment of costs, if the Contractor is supposed to carry the risk of (and indemnify the Employer in respect of) that event?

2. Even if an increase to the Prices is granted under the compensation event regime, and even if the Contractor is entitled to be paid for that compensation event, what is the effect of the indemnity under clause 83.1? Can the Employer give with one hand (under the compensation event regime) while taking away with the other (under the Contractor's indemnity to the Employer regarding Contractor's risks)?

3. On the same reasoning, could this apply to the financial implications of the Employer granting an extension of time? It may be that the Completion Date is postponed (which would mean that any delay damages under Option X7 would be averted) but the Employer might still suffer a loss because the extension of time would deprive the Employer of delay damages that would otherwise have compensated the Employer for its loss. Consider for example if an office development were delayed by a matter that constituted a compensation event but was also a Contractor's risk (ie simply because it was not listed as an Employer's risk in clause 80.1). In that situation, the postponement of the Completion Date under the compensation event regime would deprive the Employer of delay damages under Option X7, and the Employer might still suffer loss of revenue, in the form of the rental income that would have been received if the development had been completed on time. Could the Employer claw back that

35 It is not clear whether any of the compensation events listed in clause 60.1 would provide comfort to the Contractor, since that might depend on exactly what is stated in the Accepted Programme (see for example clause 60.1(5)). There is no general ground for an extension of time for delay in receipt in statutory approvals as there is (for example) under clause 2.26.12 of the JCT Design and Build Contract, Revision 2, 2009.

36 Clause 60.1(14) of NEC3.

> loss from the Contractor by virtue of clauses 81.1 and 83.1? If so, this would displace the usual assumption that liquidated damages for delay are an exclusive remedy for delay, and would leave the Employer with an alternative route for recovery of its loss.

From a commonsense perspective, it would seem rather odd if the compensation event regime could be completely undermined by the risk allocation provisions in clauses 80.1, 81.1 and 83.1. Indeed, a significant number of compensation events are probably covered by the definition of Employer's risks anyway. Of the nineteen events listed in NEC3, at least eight could be classified as Employer's risks, for example because they arise from the fault of the Employer or interference with legal rights (namely clauses 60.1(2), (3), (4), (5), (6), (14), (16), (18) and possibly (8), (9), (11) and (15) too). Furthermore, one of the most common compensation events is where the Project Manager gives an instruction changing the Works Information. It is difficult to see how the Project Manager's instruction could be classified as an Employer's risk. It was presumably not the intention of NEC3's drafters that the Contractor's entitlement to payment – along with an extension of time – would be eliminated because the Project Manager's instruction is not listed as an Employer's risk under Clause 80.1.

The difficulty remains that this commonsense approach does not appear to be supported by the express provisions of clauses 80.1, 81.1 and 83.1. NEC3 does not seem to recognise that some risks are usually shared risks – it simply allocates risk on an absolute basis, as per clauses 80.1 and 81.1.[37] If a court were to analyse the detailed list of compensation events (whereby some compensation events are Employer's risks and others are Contractor's risks) it may be that the court would consider there must be a reason for this distinction.

With this in mind, it may be that ultimately, the contractual risk allocation for compensation events would not be determined on a 'blanket' basis for all compensation events, but on a case-by-case basis depending for example on whether or not the compensation event is also an Employer's risk. The court's treatment of certain compensation events might differ if the event were 'neutral', for example unexpected site conditions under clause 60.1(12) or adverse weather conditions under clause 60.1(13).

The uncertain relationship between compensation events and Employer's and Contractor's risks is further complicated by clause 63.4. As noted earlier,[38] clause 63.4 provides that 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 the compensation event.

Indeed, the NEC3 Guidance Notes (although they state they are not to be used for legal interpretation) clearly envisage that clause 63.4 should operate as an

37 For example, under JCT 2009 (note 4), loss or damage to the works caused by specified perils is effectively a shared risk, because the contractor is granted an extension of time, while the employer suffers the loss of liquidated damages that would otherwise have been recoverable.

38 Clause 63.4 was mentioned on page 5 in connection with Option C.

exclusive remedies provision.[39] But given that *all* Employer's risks are compensation events by virtue of clause 60.1(14), where does this leave the Employer's indemnity in clause 83.1? This is a relevant question because the amount payable by the Employer under clause 83.1 could differ from the amount payable under the compensation event regime, which is calculated on a different basis. And in addition, in Option C, where the Prices are used solely for calculating the target price rather than what the Contractor is paid,[40] if a change to the Prices is the Contractor's only right in relation to a compensation event, and that compensation event is *also* a Contractor's risk, does clause 63.4 reinforce the possibility that under Option C at least, the Contractor may need to indemnify the Employer for costs attributable to that event?

In my view, given the apparent contradictions within NEC3, it is difficult to be certain about the ultimate allocation of risk in the absence of relevant case law. Ideally the ambiguities surrounding risk allocation and compensation events should be clarified by drafting amendments to the clauses concerned.

Summary

Although NEC3 is being increasingly used in the UK construction industry and has been endorsed by Government, it remains controversial, particularly within legal circles. The brevity of NEC3 gives rise to concerns about a lack of detail, while uncertainties remain about the language adopted by NEC3. NEC3 omits a number of market standard provisions which could usefully be inserted, while contractors may wish to address specific features of NEC3's risk profile to bring it more into line with conventional construction contracts. The way in which NEC3's compensation event regime interacts with the Employer's and Contractor's risks provisions is unclear and raises important questions about risk allocation that have yet to be addressed by the courts.

Conclusions

This paper has aimed to highlight certain legal issues arising from NEC3. Some of these issues could be addressed relatively easily, by adding new clauses or by inserting additional compensation events or Employer's risks. Other issues are potentially more complex, in that they are linked to the fundamental allocation of risk under NEC3, and careful amendments to a number of core clauses would be required to deal with those points.

On one view, it could be argued that a detailed legal analysis of NEC3 misses the point, because NEC3 is a project management tool based on the principles of collaborative working, rather than an attempt to legislate for every eventuality. In my view, however, if things do go wrong and a dispute does arise, it is to the contract that the parties will look for the answers. The danger

39 The NEC3 Guidance Notes state at page 78 that, 'If any of the compensation events occurs the Parties' sole remedy is to use the compensation event procedure. Therefore if the Employer breaches the contract the Contractor must use this route (see Clause 60.1(18), rather than pursuing damages …'.

40 Subject to any calculation of the Contractor's share under the pain / gain mechanism in Clause 53.

for NEC3 – and possibly for at least one of the parties to the dispute – is that the court deciding the dispute will focus on what NEC3 actually says, without having absorbed the background values and mindset that are so important to the successful operation of an NEC3 contract.

For this reason, unless NEC3 is amended to address the issues outlined in this paper, and indeed issues that have been raised elsewhere, we should expect that lawyers will continue to alter or supplement NEC3 by way of Z clauses. That may not please those in favour of using NEC3 in its unamended form, but there is no reason why good project management principles should not go hand in hand with clear legal drafting. It should not be necessary to sacrifice legal clarity and precision in order to promote good project management and collaborative working.

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'The object of the Society
is to promote the study and understanding of
construction law amongst all those involved
in the construction industry'

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