

CROSSRAIL LIMITED

EXECUTIVE COMMITTEE (PSG) MEETING

SUBJECT: Main Civils Contracts – NEC conditions of contract – Paper 1

MEETING: 28 October 2009

Purpose

The purpose of this paper is to seek the Procurement Steering Group's approval to a number of issues relating to the NEC conditions of contract which are currently being prepared for the main civils contracts.

Recommendation

PSG is requested to endorse the recommendations set out below or to give direction as to any alternative approach to be taken.

Background

NEC conditions of contract were previously prepared by CRL for the enabling works framework agreements. These were produced with advice from Ashurst and input from the EWMA and CRL Procurement. A review of TfL's NEC conditions of contract was also carried out and their approach was followed where considered to be appropriate.

There is a need for these conditions to be revisited for the main civils works contracts given the different nature and scale of the works. In addition, in light of the Project Delivery Partner's fundamental role in the project and under the contracts (acting as Project Manager and Supervisor) it is important to reflect its views on the conditions which are to be used.

A working group has therefore been formed consisting of representatives from CRL Legal, CRL Delivery, PDP Contracts and Procurement and Bechtel Legal. The working group is carrying out a review of the conditions used for the enabling works frameworks and has revisited all amendments which were made to the standard form NEC in those contracts. In addition, the PDP has provided input from its experience on CTRL.

The working group is considering a large number of detailed issues and conditions of contract will be produced based on the outcome of their discussions. However, a number of points have been identified by the working group as requiring the endorsement of or direction by PSG before the recommended approach is implemented. This Paper sets out those issues and provides commentary as well as a recommendation.

As the working group discussions continue, further papers may subsequently be submitted.

Conditions of contract – issues for consideration

PSG is requested to consider the following matters:

1. Compensation events

The working group has considered the entire list of compensation events under the standard form NEC. Under an Option C NEC contract, these events are matters which will lead to an adjustment of the target price. Other than affecting what the Contractor might be paid (or pay) under the pain/gain share arrangement, they do not affect what the Contractor is paid since he is paid Defined Cost in any event.

Of the entire list of compensation events, the working group considers that PSG ought specifically to consider the following compensation events:

Physical conditionsBackground

Under standard NEC, it is a compensation event if the Contractor encounters physical conditions (including, but not limited to, ground conditions) which an experienced Contractor would have judged to have such a small chance of occurring that it would have been unreasonable for him to have allowed for them. He is assumed to have taken into account the Site Information, publicly available information and other information which an experienced Contractor could reasonably be expected to have or obtain.

Recommendation

The Crossrail project proposes to use Geotechnical Baseline Reports (“GBRs”) in line with the Tunnelling Joint Code of Practice. GBRs will fix the ‘baseline’ for certain (but not all) physical conditions. Any conditions which are encountered which are different from those set out in the GBR would constitute a compensation event. Any compensation event in respect of conditions which are not addressed in the GBR would be dealt with in accordance with standard NEC provisions.

It is recommended that the physical conditions compensation event is retained on the standard NEC basis and that GBRs are used to fix the baseline for certain conditions as appropriate to each contract.

WeatherBackground

Under standard form NEC, it is a compensation event if weather conditions occur which can be shown, based on fixed weather data, to occur on average less frequently than once in ten years.

Recommendation

It is recommended that this compensation event should be retained since it provides an objective approach to the measurement of the effects of weather and it is considered that it does not greatly increase the risk to CRL.

Prevention

Background

This compensation event covers anything which stops the Contractor doing his work (at all or to programme) which neither party could prevent and which an experienced Contractor would have judged to have such a small chance of occurring that it would have been unreasonable for him to have allowed for it. This was removed from the enabling works conditions upon advice that it could give rise to a compensation event in the event of subcontractor insolvency.

Recommendation

It is recommended that this compensation event ought to be retained but that the drafting be amended as necessary to make it clear that certain specific risks would not constitute compensation events e.g. subcontractor insolvency and industrial action affecting the Contractor's workforce.

Changes in the law

Background

This compensation event is an optional clause which may be adopted under NEC and has the effect to remove the risk of changes in law from the Contractor.

Recommendation

It is recommended that this should be included as a compensation event since, given the duration of the main civils contracts, the Contractors should not be asked to price a risk which they cannot quantify.

2. Compensation event process

Background

In line with the its approach of dealing with matters promptly as they arise, the NEC contract provides for the assessment of compensation events at the time of the event. To reinforce this approach, the NEC provides that, where the parties fail to meet various deadlines for their respective actions relating to the assessment of compensation events, 'deemed acceptance' provisions apply as follows:

- The Contractor has 8 weeks within which to notify a compensation event, otherwise he loses his entitlement to that event;
- The Project Manager must respond to the Contractor's notification within 1 week; if he fails to do so, the Contractor may (not does not have to) remind him; if the Project Manager fails to respond within a further 2 weeks, he is deemed to have accepted that there is a compensation event;
- The Project Manager must respond to the Contractor's quotation within 2 weeks; if he fails to do so, the Contractor may (but does not have to) remind him; if the Project Manager does not respond within a further 2 weeks, he is deemed to have accepted the Contractor's quotation.

CRL needs to ensure that this procedure is capable of operation in practice and in the situation where the PDP may need to seek client authorisation to higher value compensation events.

Recommendation

It is the working group's recommendation that the principle of these deadlines, including the deemed acceptance provisions, should be retained in order to encourage the right behaviours and to incentivise the parties to operate in the manner envisaged by the NEC form of contract.

It is also recommended that the NEC time frames should be retained (save in the case of the Contractor's initial notification where a shorter time frame (4 weeks) should be sought) for the following reasons:

- It is considered that in terms of the Project Manager's response to the initial notification, this is a PDP action and the PDP is comfortable with the NEC time frame.
- In respect of the Project Manager's response to the Contractor's quotation, it is considered that a total 4 week period ought to be sufficient to enable the PDP to evaluate the Contractor's quotation and for CRL to provide any necessary authorisation.

In the interests of maintaining the prompt resolution of compensation events, it is not therefore proposed that these time periods ought to be extended.

It is also recommended by the working group that the reminders by the Contractor which are currently optional should be made mandatory.

3. Payment issues

There are a number of issues associated with the Option C target cost contract:

Financial disincentive for exceeding the target

Background

Under standard NEC3 Option C, the Contractor is paid Defined Cost plus his Fee, even once he has exceeded the target price.

Recommendation

It is recommended that no Fee should be paid to the Contractor after he has exceeded the target price. This was the position adopted on CTRL and was accepted by contractors. It is also the basis on which tenders are being invited for the Royal Oak Portal package. It is not, however, the standard position under the EWFAs.

Forecast Defined Cost

Background

Under NEC Option C, the Contractor is paid Defined Cost which the Project Manager forecasts will have been paid by the Contractor before the next assessment date plus the Fee.

Recommendation

There is proposed to be a 4 week assessment interval on all contracts meaning that the Contractor would be paid 4 weeks forecast cost. On CTRL the forecast period was 7 weeks. It is recommended that 4 weeks is an appropriate forecast period. This forecast payment (in conjunction with the project bank account) is designed to ensure that the Contractor is kept cash neutral. In the event that this forecast period proves to be insufficient for this purpose, the working group will revert to PSG.

Payment cycleBackground

CRL must adopt a payment process which is compliant with the Housing Grants Construction and Regeneration Act 1996 (“HGCRA”) and which also reflects the commitments which CRL intends to give through the Fair Payment Charter. This payment process has been considered in detail by the Project Bank Account working group and their proposal has been considered by this working group.

Recommendation

The following payment cycle proposed by the Project Bank Account working group is endorsed by this NEC contract conditions working group. This reflects the requirements of the HGCRA and provides for the fair payment commitment of a 30 day payment period for subcontractors:

Day	Activity
0	Contractor submits application
7	Project Manager makes assessment and certifies payment. The contract will state that this certificate will be the notice of payment by the client as required under the HGCRA.
7	Due date for payment
17	Latest date for service of withholding notice under the HGCRA. This is served by CRL only if it intends to withhold any amount from the amount certified.
23	Final date for payment

Between the date of the Project Manager’s certificate until the final date for payment (a 16 day period) CRL will need to go through its internal finance processes:

- Finance logs the certificate and forwards it to the budget holder
- The budget holder authorises the certificate and returns it to Finance

- Finance forwards the certificate to the relevant Executive member for authorisation
- The relevant Executive member authorises the certificate
- Finance posts the certificate on the accounting system and processes the payment

Retention

Background

CRL needs to decide whether it will adopt retention arrangements on the main civils contracts and, if so, what the appropriate arrangements and level of retention should be. The following options can be considered:

- Cash retention; or
- A retention bond (we could ask the tenderers to price this separately before deciding whether it should be required); or
- A performance bond which reduces at Completion (again this could be priced separately before any decision is taken).

Recommendation

The working group recommends that neither retention nor a retention bond should be adopted. The ODA has not used retention or retention bonds on the Olympics save in limited occasions where specialist or bespoke contractual arrangements are applicable when justification and a specific commercial reason is required. It is considered that this approach will have set a benchmark in the industry and therefore that, if appropriate, a performance bond should be used instead.

4. Termination

Background

Standard NEC permits the Contractor to terminate for specified reasons:

- Insolvency of the Employer;
- Non-payment by the Employer within 13 weeks of a certificate;
- An instruction to stop or not to start was given and no instruction to re-start or start has been given within 13 weeks (unless the instruction was due to a default by the Contractor);
- The parties have been released under law from further performance.

It permits the Employer to terminate for any reason.

Depending upon the reason for any termination by either party, the process and the payments due on termination vary:

If the event of any termination for any reason, the Contractor is entitled to:

- an amount due assessed as for normal payments;
- the Defined Cost for Plant and Materials
 - within the Working Areas; or
 - to which the Employer has title and of which the Contractor has to accept delivery;
- other Defined Cost reasonably incurred in expectation of completing the whole of the works;

- any amounts retained by the Employer; and
- a deduction of any un-repaid balance of an advanced payment.

If the Contractor terminates the contract for certain (Employer fault based) reasons or if the Employer terminates the contract for convenience, the Contractor is also entitled to:

- The forecast Defined Cost of removing the Equipment.
- The *direct fee percentage* applied to any excess of the total of the Prices at the Contract Date over the Price for Work Done to Date.

Recommendation

It is recommended that the standard provisions are retained save as follows:

- if the Contractor terminates the contract or if the Employer terminates the contract for convenience, the Contractor should not be entitled to the entire Fee and that this should be restricted to 25% of the Fee. This was the position on CTRL; and
- the working group recommends that a specific right to terminate at Review Point 4 is introduced with appropriate provisions to ensure that the Contractor is not out of pocket and is therefore paid his Defined Cost and Fee to date, his demobilisation costs but no further Fee. In addition, we should exclude any right for the Contractor to make any claim for loss of profit, loss of opportunity etc.

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