

## **CROSSRAIL LIMITED**

### **PROCUREMENT SUB-COMMITTEE**

**SUBJECT:** Main Civils Contract – NEC conditions of contract – Paper 3

**SPONSOR:** [REDACTED]

**MEETING:** 03 February 2010

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#### **Purpose**

The purpose of this paper is to seek the Procurement Sub-Committee'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**

It is recommended the Procurement Sub-committee APPROVE the nine recommendations as set out below.

#### **Background**

This is the third paper presented to PSC to approve matters relating to the conditions of contract proposed for the main civils contracts.

#### **1. Grounds for withholding acceptance and the acceptance of Subcontractors**

##### Background

The conditions of contract working group has considered the following issues:

- The acceptance process and the possibility of withholding acceptances for reasons not stated; and
- The Project Manager's acceptance of Subcontractors.

Both of these issues are described below.

##### 1a. Withholding acceptance for reasons not stated

There are up to 12 clauses in the conditions of contract, in addition to the *Contractors* design review process described below, that require the *Contractor* to submit items to the *Project Manager* for acceptance<sup>1</sup>. These include a review of proposed key personnel, review of Subcontractor proposals and Subcontract conditions, programming review and a review of the

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<sup>1</sup> Clauses 13.4, 15.1, 21.2, 23.1, 24.1, 26.2, 26.3, 26.4, 31.3, 85.1, 54.2 and X14.2

provision of insurance. All these clauses will be affected if the contract is amended on acceptances.

The working group has considered the following amendments to the standard NEC3 ECC conditions, shown underlined, which are contained in the conditions of contract being used for the Enabling Works Packages:

- 13.8 The *Project Manager* may withhold acceptance of a submission by the *Contractor*. Withholding acceptance for a reason stated in this contract or for any other reasonable grounds is not a compensation event.

Compensation event:

- 60.1 (9) The *Project Manager* unreasonably withholds an acceptance (other than acceptance of a quotation for acceleration or for not correcting a Defect or acceptance of a proposal which does not comply with this contract) for a reason not stated in this contract.

When drafting the NEC the overriding objectives considered by the authors were:

- flexibility
- clarity and simplicity and
- stimulus to good management.

A key point to driving good management is the high level of engagement between the *Project Manager* and the *Contractor* compared with other standard forms of construction contracts. One of the best examples of engagement is a running theme throughout the conditions where the *Contractor* prepares an item and issues it to the *Project Manager* for acceptance as shown in fig 1 below:

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Fig 1 Acceptance process under the NEC

This process forces the *Project Manager* to review submissions from the *Contractor* and either accept them or not. If the item is accepted by the *Project Manager* no further action is

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required. If the item is not accepted, the *Project Manager* states reasons and the *Contractor* resubmits within the *period for reply*<sup>2</sup>.

The *Project Manager* is not compelled to accept an item even if it complies with the reasons stated in the contract. Such a rejection is, however, covered by the compensation event provisions which, if un-amended, entitle the *Contractor* to a compensation event if acceptance is withheld by the *Project Manager* for a reason not stated in the contract. It is also worth noting that the *Project Manager's* acceptance does not mean that the *Contractor* is absolved from liability should an error in his work arise<sup>3</sup>.

The strict timescales required by the NEC contract means that items are constantly being passed between the *Contractor* and the *Project Manager* for review and acceptance with the intention that projects benefit from the engagement and understanding between the two. The clauses in the NEC contract which contain this process always provide reasons for not accepting an item and these reasons are different depending on the specific requirements of

<sup>2</sup> Clause 13.4 of the *conditions of contract*

<sup>3</sup> Clause 14.1 of the standard NEC or Z2.1 of the proposed CRL conditions

the item under review. For example clause 21.2 deals with the submission of the particulars of the *Contractor's* design to the *Project Manager* for acceptance as follows:

21.2 The *Contractor* submits the particulars of his design as the Works Information requires to the *Project Manager* for acceptance. A reason for not accepting the *Contractor's* design is that it does not comply with either the Works Information or Applicable Law.

The *Contractor* does not proceed with the relevant work until the *Project Manager* has accepted his design.

If the *Contractor's* design complies with the Works Information and the Applicable Law the *Project Manager* will accept the design<sup>4</sup>; if it does not, the design may be rejected. A decision is needed promptly as, under this clause, the *Contractor* cannot start the aspects of the *works* until his design related to that section has been accepted by the *Project Manager*<sup>5</sup>.

The process described above is reasonably objective although this is not always the case<sup>6</sup>. Baseline reasons are given for not accepting an item and these are compared with the actual reason to determine whether or not the *Contractor* is entitled to a compensation event. The amendment which was made in the Enabling Works conditions of contract makes the process of acceptance more subjective in that the *Project Manager* can withhold acceptance on reasonable grounds and this does not constitute a compensation event under the contract. There is a possibility that decisions on key issues could be delayed by contract administrators "hiding behind" the term "*reasonable grounds*".

#### 1b. Acceptance of Subcontractors

This process is a further example of the acceptance process but the working group considers that it merits specific attention.

Under standard NEC3, the *Contractor* must submit the name of each proposed Subcontractor to the *Project Manager* for acceptance. The only reason for which the *Project Manager* may reject the proposed Subcontractor, without entitling the *Contractor* to a compensation event, is that his appointment will not allow the *Contractor* to provide the works in accordance with the contract.

The working group has considered the amendment which was made to the conditions of contract used for the enabling works which gave the *Project Manager* an absolute discretion on the decision whether to accept:

"A reason for not accepting the Subcontractor or supplier is that the *Project Manager* believes, in his absolute discretion, that his appointment will not allow the *Contractor* to Provide the Works."

#### Recommendation

Given the overriding objectives of the NEC contract described above, and the potential effect to the decision making process on so many clauses, including the acceptance of

<sup>4</sup> Albeit that, as already mentioned, the *Project Manager* is not compelled to accept the item even if it does comply with the reasons stated in the contract.

<sup>5</sup> This prevention from progressing the *works* is included in some but not every clause where this process applies

<sup>6</sup> The reasons for rejection included clauses 26.2, 26.3, 26.4 (Subcontracting) and part of 31.3 (programming) are the most subjective in the NEC.

Subcontractors, it is recommended that no amendments are made to the general NEC concept that acceptances which are not given for reasons stated in the contract should entitle the *Contractor* to a compensation event. Those reasons should not be widened to include any concept of “reasonableness” and no element of discretion on the part of the *Project Manager* ought to be introduced. **(Recommendation 1)**

This will assist in the management of the contracts by providing that decisions over acceptances can be given on a defined and objective basis and that these decisions should not give rise to challenges or potential disputes over reasons for decisions.

## 2. Payment in respect of Defects

### Background

The working group has discussed the payment for Defects under an NEC3 ECC Option C Target Contract and whether CRL should adopt the standard NEC approach or if the contract should be amended in some way. Two amendments that were included in the CTRL contracts were considered. The first was a general change to what comprises a Disallowed Cost under the contract and the second is a more limited change connected to self certification. Both these changes are described below.

#### (i) General Change to Disallowed Cost definition

The payment for Defects under the standard NEC Option C contract is covered by clause 11.2(25). This states that a Disallowed Cost comprises the cost of:

- “correcting Defects after Completion,
- correcting Defects caused by the Contractor not complying with a constraint on how he is to Provide the Works stated in the Works Information,”

This means that, for Defects notified and corrected during the construction of the *works*, the *Contractor* is paid the cost of initially installing the item incorrectly and the later cost of correcting the defective work. The second bullet point disallows the cost of correcting Defects, both before and after Completion, caused by the *Contractor* not complying with a constraint described in the Works Information (for example defective concrete as a result of pouring during cold weather without taking appropriate precautions described in the Works Information such as references to codes of practice).

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### Options

On first reading, some employer organisations consider the standard NEC3 Option C wording on payment for the correction of Defects unpalatable<sup>7</sup>. They are uncomfortable paying for the *Contractor’s* mistakes and feel that this cost should be borne by the *Contractor*. The first CTRL amendment considered by the working group is shown underlined:

“Disallowed Cost is cost which the *Project Manager* decides:

- was incurred only because the Contractor did not comply with this contract or a subcontract.”

The amendment would mean that any non compliance, however small, has the potential to lead to Disallowed Cost. This would include Defects notified and corrected prior to Completion which is paid for under the standard provisions.

<sup>7</sup> Whilst the actual cost of the Defect is paid, this does not comprise a compensation event and raising of the Target.

In considering whether to adopt the above amendment it is worth considering the following:

- Is it important to take over completed works with as few Defects as possible?
- Does CRL wish to avoid the inclusion of risk premium in tendered bids to cover the correction of Defects?

These options are considered as follows:

#### Minimum Defects

Under clause 42.2 of the standard provisions both the *Supervisor* and the *Contractor* have an obligation to notify each other of a Defect as soon as they find it. Under Clause 43.1

*“the Contractor corrects a Defect whether or not the Supervisor notifies him of it.”*

The *Contractor* has a clear duty to search for and correct Defects whether or not they have been notified by the *Supervisor*.

These clauses complement the standard approach of paying for Defects prior to Completion. As long as the *Contractor* notifies and corrects Defects prior to Completion, and assuming he has complied with any Works Information constraints, he is paid for correcting Defects. He is therefore incentivised to search and correct Defects prior to Completion and the consequence of this is completed work with less latent Defects.

If the cost of correcting Defects is disallowed, this has the potential to suppress the reporting of Defects by the *Contractor* and this is especially significant as self certification will be adopted on Crossrail. The consequences of uncovering and dealing with such Defects much later could potentially outweigh any perceived benefits by the considered amendment.

Whilst quality is improved under the standard provision of Option C, the *Contractor* is still incentivised to reduce the number of Defects as money spent on corrections will increase any potential pain and decrease potential gain on the target contract. Any payment the *Employer* makes on correcting Defects will be subject to the share profile.

#### Risk Premium

The considered amendment assumes that the *Employer* will not pay for the correction of defective work. This is not necessarily true in that for lump sum contracts<sup>8</sup> tenderers will include a premium or risk to cover the correction of defective work. All construction activity will inevitably have an element of non compliant work and *Contractors* will retain historical data on this. Tenders will include risk premium to cover an expected amount of corrective work and the *Employer* pays the premium irrespective of the level of Defects that arise during the course of the works.

Under the standard NEC3 ECC Option C Disallowed Cost provisions, the *Contractor* is incentivised only to include for the risk of correcting Defects as dictated by the share profile. The proposed amendment potentially increases risk premium to the same position as a lump sum contract resulting in increased tender bids.

#### Recommendation

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<sup>8</sup> Including NEC3 ECC Option A

The CRL Construction Quality Working Group comprising CRL and Crossrail Central Quality and Implementation personnel met on 21<sup>st</sup> January 2010 to discuss the above CTRL amendment and agreed that the potential to suppress the notification of Defects by the *Contractor* with the associated potential for more latent Defects was not desirable. Consequently, it is recommended that this CTRL amendment is not adopted in the Crossrail conditions for target based contracts (**Recommendation 2**).

#### (ii) Changes to reflect self certification

The CTRL project ran self certification by Contractors. Consequently the Disallowed Cost provisions in their target contracts were amended to include the following additional provisions shown underlined:

- correcting Defects before Completion caused by the Contractor not complying with the accepted quality plan referred to in the Works Information or in this contract or not complying with a constraint on how he is to Provide the Works stated in the Works Information;
- correcting Defects notified to the Contractor by the Project Manager which the Contractor failed previously to notify to the Project Manager

The amendment in the first bullet point includes a reference to the accepted quality plan. If the quality plan describes the implementation of processes to prevent recurrence of the same Defect then a failure to comply with the quality plan would comprise a Disallowed Cost. This should help prevent the constant recurrence of the same Defect.

The amendment in the second bullet point is interesting in that the *Contractor* is incentivised to report Defects prior to Completion or run the risk of having the cost of correction disallowed if the Defects are notified by the *Project Manager*. This would further incentivise the *Contractor* to notify Defects and thus prevent their suppression.

#### Recommendation

The CRL and Crossrail Central Quality and Implementation meeting on 21 January 2010 also discussed the above CTRL amendment. The meeting felt that, as Self Certification was to be adopted on Crossrail, it was important to ensure that whilst the correction of an individual Defect occurring prior to Completion should be paid for, a failure to comply with the quality plan should be disallowed as this would help sustain an effective self certification regime properly resourced and prevent constant recurrence of the same Defect. It was also felt that provision to disallow the cost of correcting Defects notified by the *Project Manager* should also be included. However, this process should be managed internally so that administrators are

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reminded that working collaboratively to complete the *works* is the primary goal rather than the “scoring of points” against the *Contractor* through an overly aggressive position on Defects.

Consequently, it is recommended that the above amendments to the Disallowed Cost provision for Defects, included in the CTRL contract, are incorporated on the NEC3 Option C target contracts used on Crossrail. (**Recommendation 3**)

### **3. Prevention**

#### Background

The following provision was introduced in the third edition of the NEC form of contract:

**Prevention 19**

19.1 If an event occurs which

- stops the *Contractor* completing the *works* or
- stops the *Contractor* completing the *works* by the date shown on the Accepted Programme,

and which

- neither Party could prevent and
- an experienced contractor would have judged at the Contract Date to have such a small chance of occurring that it would have been unreasonable for him to have allowed for it,

the *Project Manager* gives an instruction to the *Contractor* stating how he is to deal with the event.

The following compensation event was also introduced:

(19) An event which

- stops the *Contractor* completing the *works* or
- stops the *Contractor* completing the *works* by the date shown on the Accepted Programme,

and which

- neither Party could prevent,
- an experienced contractor would have judged at the Contract Date to have such a small chance of occurring that it would have been unreasonable for him to have allowed for it and
- is not one of the other compensation events stated in this contract.

There are concerns over the wording of these provisions since they are potentially very wide and could provide the Contractor with a compensation event for certain events which are arguably within the Contractor's control. The compensation event was previously considered

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by PSG in October 2009 (Paper No 1 on contract conditions) who approved its inclusion subject to certain drafting amendments to exclude subcontractor insolvency and industrial action from the events which give rise to a compensation event.

### Recommendation

The contract conditions working group has now considered these provisions further and recommends that it would in fact be preferable to remove the above provisions from the conditions which are put out to tender (**Recommendation 4**). The contract would therefore reflect the second edition of NEC which did not contain such provisions. It is recognised, however, that this issue is likely to arise in tenderers' qualifications and that some compromise position such as the one previously recommended and approved by PSG might have to be accepted.

## **4. Changes in the law**

### Background

It is optional under NEC3 whether a change in the law which occurs after the Contract Date is a compensation event. If the relevant option clause is included then the risk of change in law passes from the *Contractor* to the *Employer*. The *Contractor* will then be entitled to a compensation event for any change in law, including changes to employment and related taxation law.

CRL has certain obligations under the PDA in respect of its Delivery Contracts, one of which is to “seek to pass to the Delivery Contractors risks arising from a Change in Law to the extent consistent with Best Current Practice and the achievement of best value for money”.

### Recommendation

The view of the working group is that, ideally, the option clause ought to be included such that the *Employer* takes the risk of changes in the law. Ideally this would not be a risk that we should ask tenderers to price in light of the likely duration of the main civils works contracts.

It is, however, recognised that CRL must comply with the requirements of the PDA. It is therefore recommended that CRL ought to invite tenders based upon the Contractor taking the risk of changes in law, with an option for tenderers to provide an alternative price for this risk to be accepted by the Employer (**Recommendation 5**).

## 8. Termination

PSC previously approved the following amendments to the standard NEC termination provisions:

- 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
- 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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### Recommendation

These provisions have been considered further and it is recommended that the Contractor's entitlement in the event that the contract is terminated by the Employer for convenience ought to be as follows:

- if the contract is terminated on or before 31 March 2011, the Contractor is entitled to his Defined Cost and Fee to date, his demobilisation costs but no further Fee;
- if the contract is terminated between 1 April 2011 and 31 December 2011, the Contractor is entitled to his Defined Cost and Fee to date, his demobilisation costs, plus 10% of the remainder of the total Fee for the contract; and
- if the contract is terminated on or after 1 January 2012, the Contractor is entitled to his Defined Cost and Fee to date, his demobilisation costs, plus 25% of the remainder of the total Fee for the contract.

### **(Recommendation 6)**

## 9. Omission of scope

### Background

Various amendments have been considered to the contract in order to preserve some flexibility for CRL to re-package works as may be appropriate after contracts have been awarded, with or without incurring a liability to the contractor for loss of profit. Clearly any amendments which do not allow the contractor to recover his lost profit will cause concern to tenderers.

### Recommendation

It is recommended that a general right to remove scope from an awarded contract without incurring a liability for the contractor's lost profit ought not to be included (**Recommendation 7**).

It is recommended that a more limited right should be included which permits the *Employer* to remove scope if the *Contractor* fails to comply with the Accepted Programme; for the *Employer* to give that work to another contractor; and for the *Employer* to recover his costs of so doing if the other contractor's costs exceed the *Contractor's* target price for the relevant work (**Recommendation 8**). Such a provision was included in contracts on CTRL.

It is also recommended that, when the Works Information for specific contracts is put together, the PDP ought to describe any specific areas of scope which it is contemplated might be removed from the contract at a later date. A provision should be included in the conditions such that, in the event that any of these defined areas of scope are removed from the contract, the *Employer* will have no liability for the *Contractor's* lost profit on those elements (**Recommendation 9**).