

Overview

The New Engineering Contract (NEC3) is a family of standard form contracts that facilitates the implementation of sound project management principles and practices, as well as defines legal relationships.

This information sheet sets out introductory information on the following:

- ◆ The NEC3 form of contract
- ◆ NEC3 and the Hinkley Point C project
- ◆ The benefits of using NEC3 contracts

We also explain how the Hinkley Supply Chain Professional Services Group can assist you in negotiating and operating NEC3 contracts.

Relevance

Hinkley Point C is a nationally critical infrastructure project, the construction of which will last for over 10 years. Service and construction contracts will run for many years and hence the opportunities for the supply chain are likely to exist and persist for much longer than in a typical construction project. The opportunity to benefit and grow from the catalyst provided by Hinkley Point C is a 'once in a generation' opportunity which should be grasped.

Now the first set of supply contracts for Hinkley Point C (HPC) have been negotiated, the employer's (EDF Energy's) requirements are being better understood by the supply chain. This knowledge can be applied to ensure more efficient contract negotiations for those wishing to benefit from the opportunities such a project offers.

The experience gained in developing the contract strategy, the required contract documents and the practical issues associated with the HPC contracts will be beneficial as contracts are developed down through the supply chain, setting a framework for delivery to meet the needs and demands of EDF Energy and their Tier 1 partners.

What?

- ◆ Bearing in mind the wide variety of contracts required to facilitate the HPC project, EDF Energy have chosen to base the contract for most of the contracts to be entered into on HPC on the most recent version of the New Engineering Contract (NEC3).
- ◆ NEC3 is a family of standard form contracts that facilitates the implementation of sound project management principles and practices, as well as defines legal relationships.
- ◆ NEC3 is a government-backed base contract, widely used in the UK across a spectrum of projects including construction, engineering and facilities management, and with particular preference for use in the public sector.

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- ◆ Across the suite of NEC3 contracts, each contract follows a familiar structure by including the core clauses, the main options (to select the pricing model), the secondary options, the contract data and the works/service information.
- ◆ Each standard form NEC3 contract is supported by helpful guidance notes and flow charts describing the procedures to be followed, all of which are available to download online alongside the suite of contracts.
- ◆ The suite consists of various contracts including the ECC (Engineering and Construction Contract), PSC (Professional Services Contract) and the TSC (Term Service Contract). The TSC is a contract for the provision of a service (not limited to a professional or construction service).

Why?

- ◆ The NEC3 suite of contracts is flexible and can be adapted to any supply contract, as well as be used for construction and engineering elements.
- ◆ NEC3 is aimed at practical usage and uses plain English. It is intended to be clear and simple, written in the present tense and without legal terminology.
- ◆ NEC3 is intended to stimulate good project management during the entirety of the contract period. NEC3 is a live contract that can be shaped by the parties to deliver a successful result. For example, it focuses on a collaborative approach, uses an early warning system and prescribes a proactive management style to identify risks and encourage a resolution of outcomes – all of which are necessary in the context of a large project in the public eye. NEC3 contracts should not be shut away in a drawer once signed, they should be sat on your shoulder at every meeting and every site visit.
- ◆ Effective communication is paramount under an NEC contract and the contract places various obligations on the parties to notify each other of certain matters in a prescribed manner. The NEC philosophy is centred around open exchanges of information and a shared approach to problem solving between the parties. In addition to the early warning mechanism (see below), there are various provisions in the contract obliging the parties to promptly notify one another on the occurrence of certain events. The NEC is highly prescriptive as to the timing of notifications and their form.
- ◆ Notifications and communications can be managed with the help of an electronic system, such as the NEC3 bespoke online communications system, CEMAR (Contract Event Management and Reporting), which centralises all contract communications. CEMAR is an online web-based system for NEC3 management. It produces contract compliant numbered communications, updates letters based on user selections to ensure the correct communications are issued and recorded and allows multiple users from all parties to log in and work in the same contract environment, using shared registers.

Key features of the NEC3

Some of the Key features of the NEC3 suite include:

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- ◆ **Early warnings.** The clause is mandatory and requires both parties to notify each other of anything they become aware of which could result in increased cost or delay or which could impair the performance of the works in use, or, in the context of the TSC, impair the effectiveness of the services. The contractor cannot simply store up claims until the end of the project (and similarly, the employer cannot leave the contractor to discover and sort out any problems of which the employer becomes aware).
- ◆ **Risk management.** The risk register is an important risk management tool. It should set out the identified risks and a description of the actions to be taken to avoid or reduce the risks. However the risk register does not deal with the allocation of legal liability if the risk occurs (which should be dealt with in the contract conditions) rather, it is a tool for managing and reducing risks. The risk register is updated as early warning notices are given.
- ◆ **Works information/service information.** Under the TSC the contractor is required to provide the service in accordance with the service information (the term works information or Scope are used in the other versions of the NEC3 form). The service information is therefore critical and must clearly specify and describe the service which the contractor is to provide and state any constraints on how the contractor is to provide the service. The NEC produces a useful 'how to' guide giving guidance on how to write the service information. A key part of the collaborative approach to the project is that the service information will be developed jointly between employer and contractor.
- ◆ **Compensation events.** Events which may entitle the contractor to additional money and/or relief from other obligations such as performance measures (KPIs) are known as compensation events. There is a process for the submission and approval of quotations dealing with the effects of compensation events. Notification within the prescribed period (eight weeks) is a condition precedent to the contractor's entitlement to additional payment and it is therefore essential that the contractor is on top of this and gives timely notifications in the required form, possibly facilitated by an electronic system, such as CEMAR.
- ◆ **Pricing.** The NEC3 offers the parties various pricing options. The TSC contains options for:
 1. A priced contract (Option A), where the employer pays for the completion of an item of work as described in the price list;
 2. A target cost contract (Option C), whereby the contractor is paid the actual cost of the service plus an uplift for overheads and profit with a pain/gain share mechanism under which the parties share the difference between the outturn cost and the agreed target price (in pre-agreed shares); and
 3. A cost reimbursable contract (Option E) under which the contractor is paid cost plus overheads and profit but without a pain/gain share mechanism.

The NEC3 and the HPC project

- ◆ As with any industry recognised standard form contracts, the NEC3 is often amended by bespoke provisions to reflect project-specific requirements. These amendments are known as Z clauses in the NEC3. EDF Energy have already prepared a small suite of precedent contracts based on the NEC3, which take account of the issues that need to be reflected in all the contracts for a project of the size and complexity such as the HPC project. This precedent contract methodology assists EDF Energy with the practical administration of the contracts and the project on a day-to-day operational basis, provides for agreed base contracts that give stakeholders confidence (such as funders and insurers), and means suppliers will become quickly familiar with EDF Energy's requirements across the diverse spectrum of contracts to be placed by EDF Energy.
- ◆ EDF Energy have structured some of their contracts in a framework style, whereby a supplier is appointed to carry out construction work or to provide design or advisory services on an 'as instructed' basis during the time period of a contract. For these types of contracts, EDF Energy may issue instructions to carry out prescribed works or services (known as task orders) during the term of a contract. In such circumstances, the relationship between EDF Energy and the supplier is governed by both the overarching framework style contract, along with each task order instruction EDF Energy issues under it.
- ◆ In advance of tendering for one of the HPC contracts, suppliers should give full consideration to all aspects of their engagement, including the scope of works, the commercial and technical documents to be incorporated into the contract, their pricing structure, their insurance arrangements and their ability to provide, associated documents such as bonds, guarantees and collateral warranties to interested third parties.

Where next?

The Professional Services Group is a **collaborative group of key professional service providers** in the region that have been briefed on the project and understand the processes involved in the bidding, winning, mobilisation and delivery of contracts, either with EDF Energy or Tier 1 contractors.

The Professional Services Group, **co-ordinated by the Hinkley Supply Chain Team**, is able to offer critical services to suppliers seeking support, through their collective expertise in: **Accounting and Finance, Legal Services, Human Resources, and Project Management.**

We have experience of assessing capability and developing a strategy with action plans to grow organisations and assemble winning teams, and can assist you with information and advice that you will need to develop your capability and readiness to deliver.