CECA NEC 4 Bulletins

This month's Bulletin Nr 9 – New NEC4 Contractor proposals and X21 Whole Life Cost Savings

Introduction:

Training and development support is a key part of CECA's core offer for its membership and working in conjunction with GMH Planning it has delivered a programme of training events around the NEC Form of Contract across several CECA UK regions.

In addition to this training a series of monthly NEC Contract Bulletins are being produced for both Contractors and Subcontractors to improve practical awareness on key topics within the NEC. The coverage whilst not exhaustive is intended as a general overview on some of the contractual principles to increase a wider understanding in support of more sustainable outcomes.

For the purposes of these bulletins a contractual relationship between a "Client" and "Contractor" is assumed. The same rules/principles also apply if the contractual relationship is between a "Contractor" and a "Subcontractor" and so the term "Contractor" will be used to describe both parties.

These bulletins are based on the latest NEC4 family of contracts, but the same principles and rules would apply where parties are engaged under an NEC3 form of contract.

Coming next month:

Bulletin Nr 10: Different types of programme float and who "owns" them

Please respond to Leone Donnelly should you require any further information on the CECA NEC4 Bulletins

leonedonnelly@cecasouth.co.uk

Plus include GMH Planning footer words in document.

NEC Contract focus month - New NEC4 Contractor proposals and X21 Whole Life Cost Savings

Two new processes within the NEC4 Engineering and Construction Contract (ECC) allow the Contractor to suggest changes to the Scope for the mutual benefit of both parties. Within the core clauses, section 16 allows the Contractor to suggest value engineering ideas and share in the resultant savings. In addition, secondary option X21 (if selected by the Client) allows whole life cost savings to be considered.

Why the need for value engineering clauses within NEC4? Under NEC3 there was no formal way to encourage value engineering for a Client designed scheme. Generally, if the Contractor suggested any such value engineering on such a scheme, the Project Manager would give an instruction to change the Scope which would then result in a compensation event. This would then likely reduce the Prices by the full amount of the value engineering AND the Contractor would also have to give back their fee percentage as part of the quotation. This would reduce the Contractor's incentive to suggest value engineering options for a Client designed scheme under the Contract, as the Contractor did not necessarily secure financial benefit and technically lost money in the sense of reduced fee percentage*.

*The author recognising the wider and mutual collaborative benefits that providing value engineering proposals might bring to the parties outside of the Contract.

What is the NEC4 process for a Contractor's proposal? Where there is a Client designed scheme, the Contractor can propose a change to the Scope that would reduce the amount the Client pays to the Contractor for Providing the Works. Within four weeks of issuing such a proposal, the Project Manager either:

- accepts the proposal and issues an instruction changing the Scope (which then follows the compensation event process to agree the value of the saving); or
- informs the Contractor the Client is considering the proposal and instructs the Contractor to submit a quotation for a proposed instruction; or
- informs the Contractor the proposal is not accepted and not something they want to proceed with

To be clear, for a Contractor designed scheme, if a Contractor is proposing a change to the Scope for an element of their design, this would NOT be considered under this proposal or be considered a compensation event. Any benefit would be the Contractor's in that situation.

How is any saving shared between the Parties? This depends on which ECC option has been chosen. For options A/B, clause 63.12 confirms that the Prices are reduced by multiplying the assessed effect of the quotation by the "value engineering percentage" stated in contract data part 1. If the Client set the value engineering percentage at 50%, then a £100k value engineering saving would reduce the Prices by £50k and the Contractor gains £50k on their original lump sum price. If the value engineering percentage had instead been set at 70% then the same

£100k saving would reduce the Prices by £70k and the Contractor in effect gains £30k. For options C/D there is no value engineering percentage, but the total of the Prices (the target) does not change in line with the saving. The forecast total of the Prices would reduce in this case by £100k, and subsequently the forecast saving be split between the Parties in the final pain/gain calculation at the end of the project.

Who carries the liability for the value engineering idea? If the project is a Client designed scheme then they will retain the liability of the design change being proposed. This means the Client needs to thoroughly review the change and satisfy themselves that it meets their wider requirements. There will be no automatic new contractual design liability on the Contractor for this element.

How are X21 Whole Life Cost savings different? In simple terms, X21 is about the Client spending more money now to save money for an asset over its whole life. A Contractor could propose to install a more expensive piece of equipment that would cost an additional £10,000 to install, but it would potentially save £3000 maintenance costs each year. The Client can then consider if first they have the budget to pay for it, and secondly if they <u>believe</u> it will give them the longer-term cost benefit overall. If that piece of equipment could last ten years with no or little maintenance required, then the initial £10k cost could be offset by avoiding £30k of maintenance during that ten-year period.

Whose liability would it be if the saving years later turns out not to have realised? This would in general terms be the Client's liability and therefore they need to be confident that the potential saving is realistic and likely to be achieved. If the Contractor, for example, proposed material that in the long term should save money on the Client's heating bills, the Client would not be able to say four years later that "they have not saved money on their heating bills" and be able to claim money back from the Contractor. The Client must interrogate the potential benefit that is being forecast and on that basis either accept or decline the proposal.

Can a Client make their own assessment of the Whole Life Cost proposal? No, the idea is that this offer and acceptance and so no mechanism for them to make their own assessment of the cost of the proposal. However, if they rejected it on the basis that it was too expensive, it would be within the Contractor's gift to issue a lower quotation for that proposal if they chose. This is not a compensation event so does not follow the compensation event quotation process (similarly to an acceleration quotation, which equally the Project Manager is not able to assess themself).

Can a Client reject a proposal and then introduce it later in the project as their own idea? Clause X21.4 prevents the Client from doing this, as they can not change the Scope proposed by the Contractor unless the Contractor's quotation is accepted. This prevents the potentially good idea from the Contractor being taken on board without any benefit going to the Contractor.

Should a Client choose secondary option X21 on every project? There are no disadvantages in having this option, as any time the Contractor suggests such a proposal, the Client is under no obligation to accept it. It should be recommended that Clients include X21 to encourage this process and have a mechanism to be able to agree such an element during the life of the contract.

Summary – Contractor's proposals to change the Client's Scope, along with whole life cost savings are both useful NEC4 processes encouraging good practice and promoting value for money. They could lead to mutually beneficial outcomes for both Parties. The Client, particularly with whole life cost savings, needs to ensure that they concur that the long-term benefits justify the initial increase in project costs before they accept.