

April 2024

CECA NEC4 Bulletin

CECA Member Briefing:

Bulletin No. 40 - Secondary Option “Y” Clauses

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 41 - X20 Key Performance Indicators (KPIs)

Please respond to Lucy Hudson should you require any further information on the CECA NEC4 Bulletins via e-mail: lucyhudson@cecasouth.co.uk.

Bulletin No. 40 has been authored by Glenn Hide & Barry Trebes.

For further advice or guidance on the NEC details please visit www.gmhplanning.co.uk or contact GMH Planning Ltd by e-mail glenn@gmhplanning.co.uk.

NEC Contract focus month 40 - Secondary Option "Y" Clauses

Where a Client has decided to use an Engineering and Construction Contract (ECC) with a Contractor, they would need to choose one primary option (A/B/C/D/E/F) and then any number of secondary options. These will be stated in the first section of Contract Data part 1. The choice of primary options are covered in CECA bulletins 26-29, and a high-level overview of the Secondary Option "X" clauses reviewed in bulletin 3. This bulletin will focus in more detail on the three Secondary Options prefixed with a "Y". These Y(UK) clauses are such named as they are in some way unique/specific to UK legislation and would not be relevant if the contract is being used outside of the UK. They can create additional complexity around a parties obligations under the Contract and need to be fully considered before being entered into.

Y(UK)1 – Project Bank Account: This allows the Client to insist upon a "Project Bank Account" to be used for the project and would be set up within eight weeks of the Contract Date. A trust is set up with a bank account with both the Contractor and Client being the trustees. The intent is to speed up payments to the supply chain as the Contractor gets less benefit by keeping money in the account. It is also much easier to be audited by a Client.

Contract data part 1 will identify who the account holder is, which will be either the "Contractor" or the "Parties" (i.e. set up jointly). Until the account is set up the Client will make payments to the Contractor. A Project Bank Account Tracker should be in the format stated in the Scope and is a register of all the payments made to and from the Project Bank Account.

The Project Bank Account (PBA) is then used to receive payments from the Client/Contractor and to make payments to the Contractor/Named Suppliers. The Contractor, if they are the account holder, submits to the Project Manager for acceptance details of the banking arrangements for the Project Bank Account. All suppliers will be required to sign a Trust Deed for the account which will include provisions for how to manage it. Blank sample Trust Deeds and Joining Deeds are included within the NEC ECC standard contract. All contracts with Named Suppliers will include arrangements for the operation of the Bank Account and the Trust Deed.

The Client makes payment to the Project Bank Account for the amount which is due to be paid each application period. The Contractor and Named Suppliers are then paid from the same account. The Client pays to the PBA the amount certified. The Contractor completes the Authorisation, confirming the payments to Named Suppliers and forwards to the Project Manager for the Client's countersignature. The project bank then makes payments to the Contractor and Named Suppliers. If the PBA does not have sufficient funds to make all payments the Contractor is required to add funds to the account to make up any shortfall. This also ensures that payment can be made to Named Suppliers if the Contractor has become insolvent Named Suppliers can be identified in Contract Data part two or new ones can be proposed for acceptance during the project.

The account holder authorises payment in accordance with the Payment Schedule no later than one day before the final date for Payment. The Client can check amounts paid to the Named Suppliers by inspecting the account. The Contractor updates the Project Bank Account Tracker and submits to the Project Manager within one week of any payments being made. The Contractor pays any bank charges and retains any interest on the account.



Y(UK)2 – Housing Grants, Construction and Regeneration Act: Generally applicable to most UK construction contracts (Section 105 of the HGCRA 96 defines what is a construction operation) and ensures that NEC payment periods and terminology comply with the UK Construction Acts. It ensures that all payment terms are expressly within the contract and avoids additional terms being implied or imposed by the Act.

Dates for payment: Normally in NEC contracts, time periods are stated in weeks to avoid complications of holidays etc. However, for this option time periods are stated in days to be in line with this Act but do exclude Christmas Day and any other bank holidays.



Housing Grants,
Construction and
Regeneration Act
1996

The date on which payment is due is seven days after the assessment date. The final payment will be due within five weeks after the issue of the Defects Certificate or fourteen weeks after the issue of a termination certificate. The Project Manager's certificate is the notice of payment specifying the amount due at the payment due date (which may be zero) and stating the basis on which the amount was calculated.

Notice of intention to pay less: If either party intends to pay less than the notified sum, it notifies the other party not more than seven days before final date for payment by stating the amount considered to be due and the basis on which that sum was calculated. A Party does not withhold payment of an amount due under the contract unless it has notified its intention to pay less as required under the contract.

Suspension of performance: Under the Act, the Contractor has the right to suspend performance if it is not paid in full the amount due under the contract, and if an effective "pay less" notice has not been issued. If the Contractor exercises its right to suspend performance under the Local Democracy and Construction Act 2009 it is a compensation event.

It is important to remember that the Contractor's right to suspend performance may not be exercised without first giving the Client at least seven days' notice of intention to suspend performance, stating the ground or grounds on which it is intended to suspend performance. The right to suspend performance ceases when the Client makes payment in full.

Y(UK)3 – The Contracts (Rights of Third Parties) Act 1999:

The use of Y(UK)3 is more involved than one would initially think. It needs careful consideration, and it may well need the expert advice of a lawyer. It requires an understanding of how it relates to other clauses such as secondary Option X8 Undertakings to the Client and Others and Y(UK)1 Project Bank Account .

Contract (Rights of Third Parties) Act 1999 (hereafter the Act)

In the UK, unless stated otherwise, what the law terms a Third Party (NEC terminology 'beneficiary') **DOES NOT HAVE ANY RIGHT TO ENFORCE THE TERMS OF A CONTRACT. ONLY THE PARTIES NAMED IN THE CONTRACT.**

Therefore, in an NEC contract only The Parties 11.2(13) (Client and Contractor) may enforce the terms of the contract.

The Act, however, provides for the rights of parties to either be dealt with **EXPRESSLY** in the contract under Clause 1(1) (a) of the Act or clause 1(1)(b) which states that a term **purports to confer a benefit on a third party.**

Therefore, in a contract it is better to deal **EXPRESSLY** with the rights of third parties Clause 1(1)(a) of the Act rather than unintentionally have a term of the contract "**purports to confer a benefit on a third party**" clause 1(1)(b) of the Act.

An extract of the Act is included below, with the key words highlighted:

"Right of third party to enforce contractual term.

- 1 (1) Subject to the provisions of this Act, a person who is not a party to a contract (a "third party") may in his own right enforce a term of the contract if—
 - (a) **the contract expressly provides that he may, or**
 - (b) **subject to subsection (2), the term purports to confer a benefit on him.**
- (2) Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party.
- (3) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into."

When is the rights of third parties needed?

If the parties to a contract wish to enable a third party to enforce the terms of that contract, they will need to include within the contract the ability for the contract terms to be enforced by the third party.

Examples where this is required is where there is an existing third party interest in the contract or where a third party will have a future interest in the contract. This could be a party providing project finance, funding, end users, those acquiring the benefit of the contract.

How to deal with the rights of third parties in an NEC contract?

The rights of third parties needs to be dealt with in either one of two ways. Either there is an express clause in a contract which specifically excludes the Act or the contract includes EXPRESSLY states the rights of third parties.

Does the contract need to confer rights to third parties?

No, Not Required

If the Parties do not wish to expressly give rights to third parties then in the data entries for Y(UK)3 "NONE" should be stated in the data entries for the "term" and "beneficiary".

But note that there is still the possibility of unintentionally conferring rights to third parties through other contract terms!

The contract may also include an Express condition of contract to exclude the Act.

Example:

"A person who is not a party to this agreement has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of the agreement, but this does not affect any right or remedy of a third party which exists or is available apart from the Act"

This approach ensures that the rights of third parties is expressly dealt with and that no contract terms confers or purports any benefit to a third party.

Does the contract need to confer rights to third parties?

Yes, Required -select secondary Option X8 Undertakings to the Client and Others

A usual/common way to do this is to put in place a collateral warranty. In NEC4 the selection of secondary option X8 Undertakings to the Client or Others (collateral warranty) achieves this. The negotiation and agreement of collateral warranties is often protracted and incurs legal costs to review and agree the collateral warranty.

This is usually the preferred option when a contract has significant elements of risk for third parties in the future.

Yes, Required -select secondary Option Y(UK)3

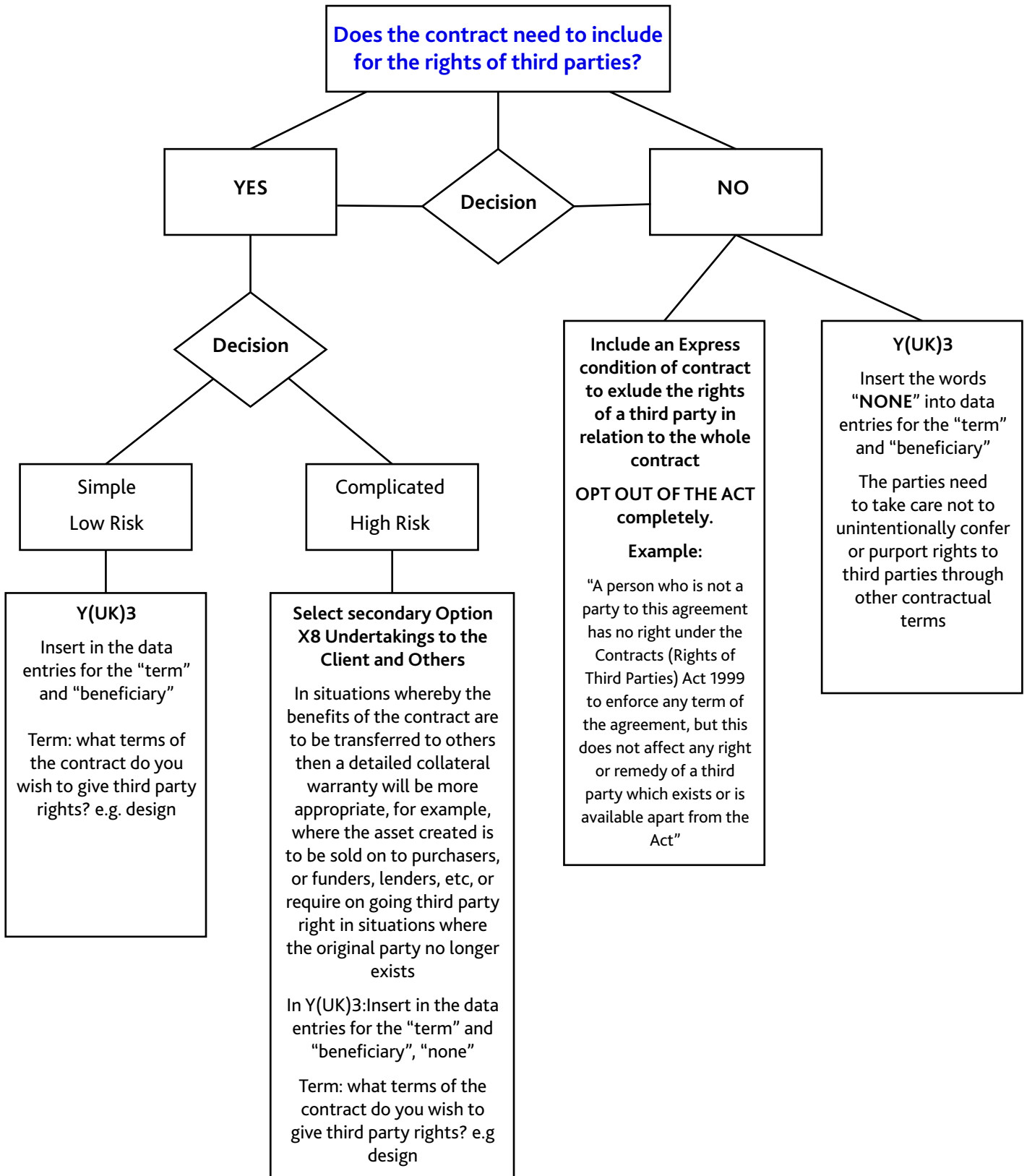
Y(UK)3 is an alternative way of providing a third-party right to a party, who is not a party to the NEC contract. It can be used instead of some form of warranty, which creates a "duty of care" in relation to things such as performance, quality for a named third party (beneficiary).

This is done by identifying the term or terms of the contract that a third party will have the right to enforce and you are required to identify the beneficiary (in NEC terminology a third party).

The selection of Option Y(UK)3 enables the Parties to comply with the Act by EXPRESSLY identifying in the data entries in the Contract Data the specific contract terms, which a third party can enforce:

- **term:** this is the terms of the contract which a third party will have the right to enforce.
- **beneficiary:** NEC terminology for a Third Party.

The diagram below sets out the choices for providing third party rights into an NEC Contract.



Use of Y(UK)3 with Y(UK)1 Project Bank Account

If Y(UK)3 is used with Y(UK)1 the following entries are added to the table for Y(UK)3

- **term:** The Provision of Option Y(UK)1
- **beneficiary:** Named Suppliers

Use of Y(UK)3 with secondary Option X8 Undertakings to the Client and Others

If Y(UK)3 is used with secondary Option X8 the following entries are added to the table for Y(UK)3

- **term:** The Provision of Option Y(UK)1
- **beneficiary:** Named Suppliers

Example of Y(UK)3 data entries

Option Y(UK)3: The Contracts Rights of Third Parties Act 1999	
term	beneficiary
Subcontracting Clause 26/Z5 Payment Y(UK)1	Subcontractor works/design Subcontractor Named Suppliers

What is the Contractor risk if it is/not included?

Given the contents of this bulletin, it would seem to be always best to expressly deal with third party rights within a contract. If a contract remains silent on third party rights, then the risk is that the Contract (Rights of Third Parties) Act 1999 will apply and the terms in a contract may unintentionally as the Act states, "confer or purport" rights to a third party". The consequence of which could be substantial. So, the best way to deal with this would be to have an express terms dealing with third parties.

Summary

Whilst NEC contractual processes are overall relatively straightforward and easy to understand, some contractual elements do require specialist advice either legally or practically, and Y(UK)1 and Y(UK)3 are two such elements. This bulletin aims to present the principles rather than a detailed analysis as to how an organisation should set them up contractually.