



Technical

## NEC Contracts Pricing - Managing - Recovering the Cost of Change

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### Use of NEC Contracts

1. NEC contracts are being used more and more particularly with public Works. In the current climate it is important to be able to effectively tender and then manage these contracts. The use of this family of contracts will increase over the coming years as it is the preferred option of most public bodies. With 25 years combined experience of managing and dealing with problems in NEC contracts and subcontracts Ramskill Martin is well placed to help with some of the common problems, issues and pitfalls of these contracts. Some of the most frequently asked questions that we deal with are summarised below.

### How do I price an NEC Contract?

2. In NEC contracts there are several phrases and terms such as direct fee, subcontract fee, defined cost, people overheads, working area overheads and various other similar terms. Some of these terms have similarities with such phrases in JCT contracts but others have no direct comparison whatsoever. However, they all have a major bearing on a tender and the amount that will ultimately be recovered. Some of these terms also operate differently depending upon which NEC

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contract option is used. A practical understanding of these terms is essential for the successful tendering and managing of NEC contracts.

### What forms an NEC contract?

3. While the constituent parts of the contract are in some respects similar to JCT contracts there are also major differences. One of the most important parts of the contract is the Contract Data. This part of the contract must be completed by the contractor or subcontractor and it is essential that there is a proper understanding of what the various components of the Contract Data mean. You also need to have a good understanding of what works information and site information are and the difference between the various pricing options.

### How do I get to grips with the terminology used in NEC contracts?

4. It is true that the NEC uses very different terminology to JCT contracts. This causes confusion. Many of the courses around do not offer a translation or nuts and bolts practical advice on how to easily understand and manage NEC contracts. A starter training course with a bottom-up approach will help with understanding NEC speak.

### I have heard that programming is of great importance in NEC contracts - is this so?

5. Many will say that the programme is the most important document in an NEC contract. 25% of all payments due can be retained until such times as an NEC compliant programme is submitted. To be compliant the programme must in accordance with the NEC contract clause 31.2. If you compare these requirements with those of a JCT contract you might consider them to be onerous or at least very demanding. The fact is that if a detailed NEC programme is prepared it will be invaluable in ensuring that you obtain your entitlement under the contract and can also be used for properly managing the Works on site. We find that the majority of contractors and subcontractors do not properly follow the requirements and this can soon result in a loss of entitlement. If you do not have the resources to carry out programming as required by NEC contracts, it is important that your staff are properly trained or

alternatively you employ the services of someone who fully understands NEC requirements and processes.

## How does the payment process work in NEC contracts?

6. This depends on which main option you are working under.
7. Option A is a fixed price lump sum contract and interim payments are based upon the completion of activities which are included in an Activity Schedule. It is important that you understand how to produce an Activity Schedule and manage change to it as the work proceeds.
8. Another example of an NEC option is Option C which is a target price contract where you will be paid defined cost assessed against the Schedule of Cost Components.
9. Whichever option is used it is important to know that the payment process and programming cannot be divorced from each other and time and money must be assessed as the work progresses. There is no final account process under NEC contracts.

## What is the Schedule of Cost Components?

10. There are two forms of the Schedule of Cost Components:
  - the Schedule of Cost Components; and
  - the Shorter Schedule of Cost Components.
11. There is no directly similar document in a JCT contract. Whether the SCC or SSCC is used is dependent upon which contract option in the NEC suite is used. Again, it is essential that this is understood when assessing risk at the tender stage and also in evaluating compensation events.

## What are Compensation Events and how does this process work?

12. In simple terms, Compensation Events are the equivalent to variations under JCT contracts. However, the process is fundamentally different. If you do not understand and follow the procedures and timescales set out in this process you run a high risk that you will lose your rights to recover the cost and time for additional work even if that work has been undertaken.

13. Sometimes project managers and contractors ignore this process and get on with the job until there is an overspend when each side reverts to the contract to try and avoid liability. **You should avoid this problem by following the NEC procedures.**
14. It is true that one of the NEC's core principles is to act in 'a spirit of mutual trust and co-operation'. However, although this sounds fine in practice we find that the parties to the contract often enforce the contract terms rigorously and you should not think that the mutual trust and co-operation will be a get out if you do not follow the procedures. Indeed, NEC is clear in that it says you should rigorously follow the procedures to avoid long winded disputes about Compensation Events (variations) long after work on site is complete.
15. You should also be aware that often NEC contracts are subject to audit procedures. This emphasizes the need to be rigorous in your approach.

### How are the various percentage additions applied to Compensation Events?

16. The application of the various percentage additions which are derived from the Contract Data varies depending upon which contract option is used. Some of the percentage additions for such things as people overheads and direct fee are cumulative but others are not. Understanding how these mechanisms work is essential in assessing tenders and likely recovery from compensation events.

### How is it that I can lose my rights under NEC Contracts?

17. Under the NEC 3 contracts there are conditions precedent which in effect say that if you do not follow the procedures within the NEC contracts rigorously then you will lose your rights.

### How do I learn about NEC contracts?

18. There are various training providers dealing with NEC contracts. Ensure that:
  - your provider understands the nuts and bolts of NEC contracts;
  - that they can offer bottom-up training at a practical hands on level; and

- you procure training that is prepared with your own company in mind rather than an off the shelf package that you might find will not meet your requirements.
19. It is likely that the biggest cost involved in the training will be your own employees' time and the impact that will have on your business, rather than the base cost of the training itself. Yes, of course, the cost of the training does need to be competitive and it will be a little more expensive if it is prepared specifically for your business, but it will be more effective and it is likely that the cost of such training will be recovered many times over if you properly understand how to price NEC contracts, how to manager them properly on site and how to recover the cost of change.

<p><b>Sheffield</b></p> <p>The Annexe 260 Ecclesall Road South Ecclesall Sheffield S11 9PS</p> <p>Tel – 0114 230 1329 E-mail – <a href="mailto:frances.sawicki@ramskillmartin.co.uk">frances.sawicki@ramskillmartin.co.uk</a></p>	<p><b>London</b></p> <p>Adam House 7-10 Adam Street London WC2N 6AA</p> <p>Tel – 020 7520 9295 E-mail – <a href="mailto:clive.ramskill@ramskillmartin.co.uk">clive.ramskill@ramskillmartin.co.uk</a></p>
<p><b>Birmingham</b></p> <p>Birmingham Business Park 4200 Waterside Centre Solihull Parkway Birmingham B37 7YN</p> <p>Tel – 0121 481 2381 E-mail – <a href="mailto:clive.ramskill@ramskillmartin.co.uk">clive.ramskill@ramskillmartin.co.uk</a></p>	<p><b>Manchester</b></p> <p>3 Hardman Street Manchester Lancashire M3 3HF</p> <p>Tel – 0161 932 1535 E-mail – <a href="mailto:nick.cheetham@ramskillmartin.co.uk">nick.cheetham@ramskillmartin.co.uk</a></p>
<p>Head Office The Annexe 260 Ecclesall Road South Sheffield, S11 9PS UK</p> <p>Tel – 0114 230 1329</p>	