METROUN
Quantity Surveyors

NEC Options: What do they mean?

Under NEC there are 7 different options for procuring work. This document will provide descriptions of how each option works and explore the pros and cons to establish which option works best for you. Briefly, the options are titled as follows:

1. Option A: Priced contract with activity schedule.
2. Option B: Priced contract with bill of quantities.
3. Option C: Target contract with activity schedule.
4. Option D: Target contract with bill of quantities.
5. Option E: Cost reimbursable contract.
6. Option F: Management contract.
7. Option G: Term contract (for the appointment of a consultant based on a priced schedule of tasks).

Definitions:

1. **Activity Schedule** – A list of activities (prepared by the contractor), which they expect to carry out while providing the works. Each activity is linked to a price (prepared by the contractor) to be paid by the client.
2. **Priced contract** – Price for works to be carried out as stated within the contract documents
3. **Bill of Quantities (BoQ)** – A document which lists specific measured items of works identified by the drawings and specification. Each item will be allocated a price.

Option A: Priced contract with activity schedule

This option contains a priced lump sum contract. The lump sum contract is then linked to a contract programme with an activity schedule. Each activity on the schedule is then allocated a price.

Each interim payment is then made upon the completion of;

1. Each group of completed activities (without defect)
2. Each completed activity not within a group

Often used upon appointment of a contractor to carry out; infrastructure, highways, buildings & process plants. Can be used regardless of the level of design responsibility.

Pros:

- Simplified payment process – it's easier to measure when an activity is completed rather than the output of work completed on an option with a BoQ
- For clients - Greater cost certainty then with a Target Cost option

Cons:

- For contractors – there is no provision for part payment, if there is an issue with completing an activity, no payment is made until the activity is completed

Option B: Priced contract with bill of quantities

This option contains a priced contract which is linked to a Bill of Quantities (BoQ). The BoQ will contain project specific measurements which are derived from the drawings and specifications. Each measurement will then be linked to a rate.

For example, let's say a contractor won a bid for some work under NEC Option B. Within the tender would be a priced contract with a BoQ. Within the BoQ there is an item for installing a new fence around the boundary of a garden:

Description	Quantity	Unit	Rate	Total
Supply & install fencing around garden boundary	20	m	£50	£1,000

The rate as seen above will contain the; labour, plant, material and subcontractor cost required to supply and install the boundary fence. Interim payment will be assessed based on the quantity of work carried out for each individual item. For example at the point of application for payment the contractor may have supplied and installed 10 meters of fence. The contractor will then be paid for that 10 meters based on the £50m/2 rate.

Pros:

- If there is any error of measurement in the BoQ then both parties will know how much extra is to be paid and received
- Greater flexibility for all parties in terms of cash flow

Cons:

- For items which contain multiple elements of work built into a singular rate, it can be difficult to assess the % of work complete

Option C: Target contract with an activity schedule

This option contains a target contract which is linked to an activity schedule. The target contract, contains a price which is more commonly referred to as a target cost.

Under Option C, the interim payment process is as follows;

1. The contractor submits an application for payment to the client's representative (often Project Manager) on a monthly basis.
2. The application will contain a breakdown of the contractors cumulative "defined cost" plus fee minus any "disallowed cost". This combined is known as the "Price for Work Done to Date" (PWDD)
3. The application is then reviewed by the client to ensure all cost is allowable under NEC
4. The agreed cumulative cost is then deducted from the amount previously paid under the contract. This amount is then paid to the contractor.

As the works progress the target cost may be adjusted to reflect any agreed Compensation Event.

Once the works are completed, the final “Defined Cost” plus fee and the Target Cost are compared. The difference between the two is then shared between the contractor and client. This is known as the “pain/gain” mechanism and the method of how the split is calculated will vary from project to project. For example, let’s say there is an agreement that both pain and gain is split 50/50. The contractor finished work and the final PWDD is £800k. This in comparison to the target cost of £1mil means the project is £200k in gain. Due to the 50/50 “pain/gain” arrangement, the contractor will receive and extra £100k on top of their final PWDD. The final account will be issued to the contractor for £900k. Alternatively, assuming the same target cost in the previous example, the final PWDD could have been £1.2 million, resulting in a £200k pain. In this scenario and assuming the same 50/50 split arrangement is in place, the contractor’s final account will be their PWDD minus £100k (£1.1 mil).

Pros:

- This arrangement forces both parties to work more collaboratively as the financial success is shared by both client and contractor. Similarly, the financial failure of a project is shared. This collaborative working can reduce disputes and accelerate innovation

Cons:

- Some share ranges can sometimes be disproportionally unfavourable to contractors. Care should be taken to ensure you are not being put at financial risk.

Option D: Target contract with Bill of Quantities

This contract contains a target cost contract which is linked to a Bill of Quantities.

Like Option C, financial loss and financial gain is shared by both Contractor and Client. However, unlike Option C, this Option utilises a Bill of Quantities to make up the price of works.

This Option is sometimes used on framework agreements, where an agreed Schedule of Rates is in place and used to build multiple Target Cost’s throughout the framework agreement.

It should be noted that unlike Option B this is not a re-measure contract. So, any error in measurement which won’t amend the price and could cause a financial loss.

Option E: Cost reimbursable contract

This option is a cost reimbursable option. Works are paid on an open book basis. Under this option the contractor is paid all of their incurred “Defined Cost” and an agreed overhead and profit percentage. The client often takes on huge financial risk with this option.

Although this contract is often referred to as "Cost Plus", contractors should not get complacent and think Option E means a blank cheque book for works. The terms within the contract should set out clearly what is and isn't to be reimbursed to the contractor.

Pros:

- Works that require immediate attention and cannot be defined at the project outset may benefits from a fast contract agreement

Cons:

- Less cost certainty for Client
- Inability for both partied to accurately plan cashflow

Option F: Management contract.

This option is a cost reimbursable option. Unlike Option E, this option is tailored towards the management contractor procurement route.

The works are constructed by multiple subcontractors who are directly employed by a management contractor. The management contractor will be reasonable for the procurement, co-ordination and implementation of works in exchange for a fee. This means the client often takes on the financial risk.

Pros:

- Beneficial for developers who are just entering the market as responsibility for procuring and managing the works is with the management contractor.

Cons:

- Nearly all financial risk sits with the client

Options G: Term Contract (use with PSC)

This option can either be Cost Reimbursable or pre-agreed Lump Sum. This Option is used with a Professional Services Contract for the appointment of consultants, payed on a time basis or pre-agreed cost.

Consultants employed under this option often include: Architects, QS' and Engineers

Similar to an activity schedule, this option uses a priced task schedule which will list out the different rates for different consultants depending on skill and experience.

Pros:

- Provides flexibility to employ a single person consultant or consultancy firm

Cons:

- Possible confusion of who holds liability for negative eventualities