



# Understanding the value of NEC





NEC creates the conditions for successful project delivery. It is the only standard contract built around proven best practice in project management and a collaborative approach to risk management. It is a worldwide benchmark in the procurement of capital works, services and supplies that has supported the delivery of thousands of projects worldwide since its launch in 1993. It can be used in any economic sector and any jurisdiction.

## Why does contract choice matter?

Allocation and management of risk is the core of the legal and commercial relationship established by a project's contract. This allocation must be fair and sustainable through the life of the project. The party holding a risk should also be able to count on the co-operation of the other party to identify and resolve issues as they arise. NEC is therefore built around procedures for sensible risk allocation and ensuring that when risks do emerge the parties collaborate to deal with them quickly and decisively.

Unfortunately, many contracts do not support this collaborative approach to risk management. They start from the assumption of failure and attempt to offload risk and costs on to suppliers.

Any security or protection this appears to give the client is illusory. This type of contract creates a defensive, adversarial environment, in which information is withheld and the best minds of the project devote their energies to defending their commercial position. The result is often multiple legal claims and counter claims which can continue for many years after the project has been completed.

## Why is NEC needed?

Business and governments need projects to secure their goals. Unfortunately, too many projects are delivered late, over budget or simply do not meet their objectives. Performance varies between sectors, but a reliable study of large industrial infrastructure projects puts the failure rate as high as 65%<sup>1</sup>.

NEC is unique. It is the only standard contract whose development has been led by project practitioners rather than lawyers. Their insight means that the use of NEC stimulates good management of the relationships within the project and the work the parties deliver together.

1. Merrow, E (2012) *Industrial Megaprojects: Concepts, Strategies and Practices for Success*

**"The use of NEC4 on public sector projects will help to deliver the Government Construction Strategy as we seek to improve central government's capability as a construction client to deliver further savings in the order of £1.7bn across the Government estate."**

Tony Meggs, Chief Executive, Infrastructure and Projects Authority

*Reporting to Cabinet Office and HM Treasury. As issued in the Foreword to the NEC4 Suite of Contracts*

## Where in the world and on what types of project can NEC be used?

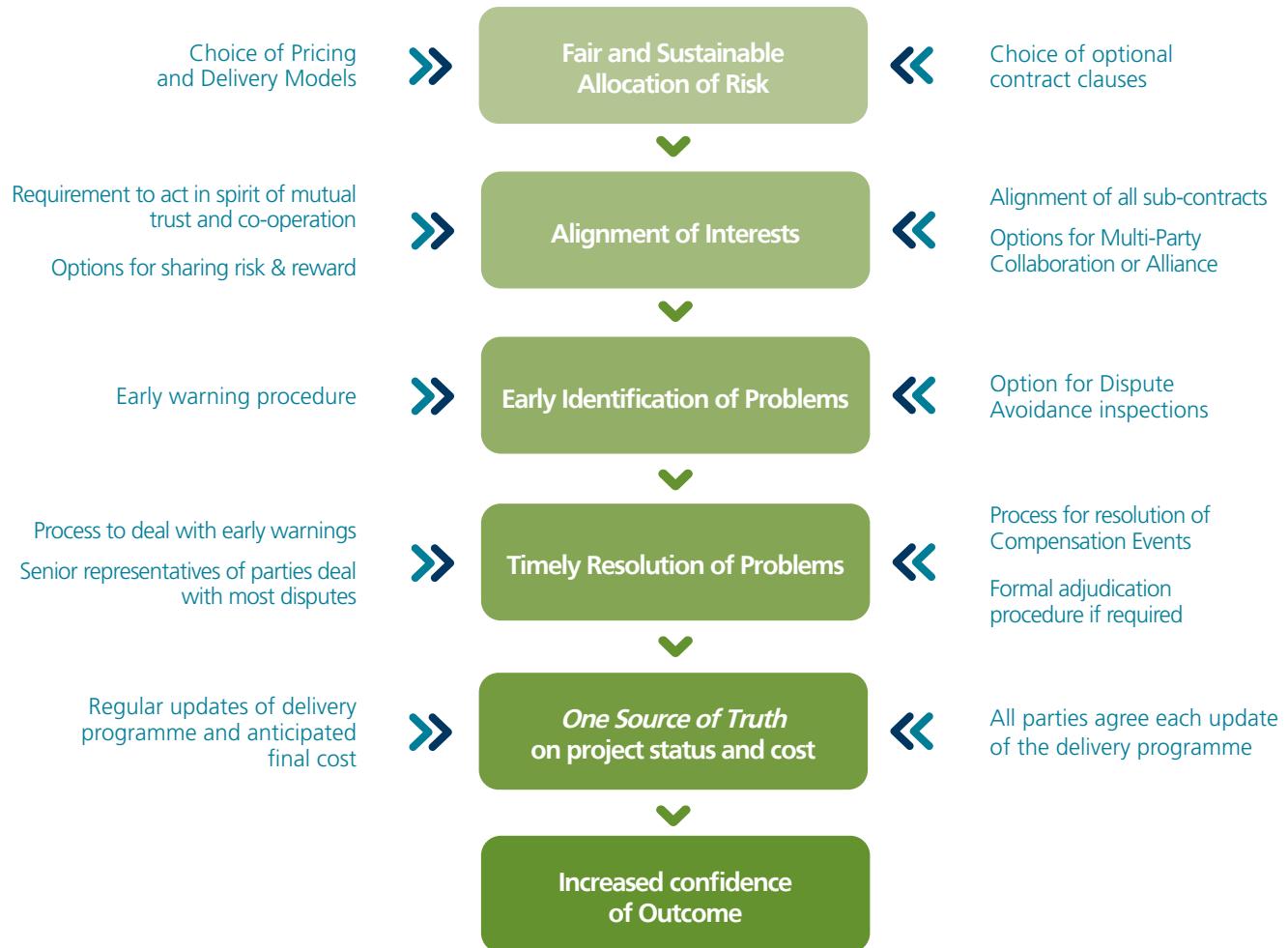
NEC can be used anywhere in the world. It is written in plain English, supporting ease of use and understanding. Optional Y Clauses allow specific provisions of local law to be incorporated into contracts. It is in use in the UK, Hong Kong, South Africa, New Zealand, Australia, France, Germany, Ireland, the Netherlands, USA and the UAE. In 2019 NEC delivered the venues and facilities for the Pan-American and Parapan Games in Peru.

NEC can also be used in any sector. The contract was first developed in the construction sector under the leadership of the Institution of Civil Engineers, one of the world's most respected professional bodies. Over the last three decades its use has spread into sectors as diverse as oil & gas, facilities management, telecoms and pharmaceuticals.

NEC is a suite of contracts that covers capital works and associated professional services and supplies. The Term Service Contract allows NEC to support operations and the subcontract forms extend the use of the contract beyond the main contractor. This allows clients to create a consistent and easily understood legal and commercial environment through the whole project lifecycle and into operations.

The NEC Users' Group provides access to specialist advisors, who can help users with any queries on how to deploy the contract. It also functions as a global network for sharing experience and insight on how to get the most out of NEC's three key characteristics of flexibility, clarity and stimulus to good management of contractual relations.

## How does NEC help achieve better project performance?



NEC delivers its benefits via a series of often unique features that are summarised in the diagram and text above. Taken together they have a proven track record of delivering projects that meet their client's objectives within budget, time and quality requirements.

### Establishing a fair and sustainable allocation of risk and aligning project participant's interests

#### What is the issue?

Project should allocate risks to the party best placed to manage them. This judgement normally flows from an assessment of a project's complexity and size. Complexity creates more risks, while size increases the financial impact of a risk being realised. In both cases suppliers

will normally expect to be able to demand a higher price for taking on higher levels of risk. At higher levels of complexity, it may, however, not be possible to price risks. Also, for larger projects, contractors and their sub-contractors may lack the financial strength to accept their share of project risk. In these circumstances both sides are likely to be better served by a pooling of risk and reward, or alternatively the client accepting that it should hold the risk.

In a tight market or where a client has a dominant position in the sector, there may be a temptation for the client to use their power to *offload* risk on to their suppliers in a way that is not fair or sustainable.

**“Through our Partnering for Success program, we’re looking to use the NEC4 suite of contracts to benefit Sydney Water, our partners and ultimately our customers by incentivising high performance and increasing productivity. By doing this, we’ll give our partners more certainty, and drive better decision making across the whole lifecycle of our assets, improving our productivity and delivering value for our customers.”**

Mark Simister, Head of Delivery Management, Sydney Water

As noted above any short-term benefit in term of initial price is likely to be offset by long term pain as suppliers seek to improve their position by taking an aggressive commercial stance within the project. Time and energy on all sides is dedicated to claim and counter claim, relationships deteriorate, and the project suffers.

Achieving a fair and sustainable allocation of risk will go a long way to aligning the interests of a client and individual suppliers. Projects also need to establish a co-operative environment across the multiple contracts that cover the client’s relationships with different suppliers servicing different, often overlapping parts of the project from design, through delivery and into operations.

### How does NEC help?

NEC offers a range of options for payment and delivery models that allow the risk to be allocated to the parties appropriate to complexity and scale of the project.

- Straightforward work, where a supplier is willing and able to manage a project’s risks: clients can let projects using a fixed price contract and benefit from cost certainty.
- Complex or larger projects, where client and supplier are willing to pool risk: clients deploy a target cost contract, which incorporates a pain/gain mechanism for sharing any savings or overspends.

- Projects where the client believes it is best placed to manage risks: clients use a Cost-Reimbursable Contract, in which suppliers receive their costs plus an agreed fee or a Management Contract, in which suppliers are paid a fee for managing the sub-contractors delivering the works.

These basic choices are complemented by a full range of optional contract clauses which allow the parties to agree up front how they will deal with issues including: changes to the law during the contract, bonuses for early completion, performance bonds and limitations on liability. These options also allow contracts to reflect public policy priorities such as a fair payment or local content provisions.

NEC can also be used as the legal and commercial basis for a multiparty alliance, in which the client and all suppliers act as a single enterprise to deliver the project, sharing all risks and rewards through the lifecycle. The suite also supports framework contracts and design, build and operate options.

Finally, the full NEC suite ensures that all sub-contracts and consultancy work is being delivered using the same processes, procedures and terminology as the main contract.

## Early identification & timely resolution of problems and establishing one source of truth on project status

### What is the issue?

Risk allocation is not the same as risk management. It is essential that the parties to the project co-operate to ensure that problems are identified and dealt with as soon as they arise. A project should have a single view of live risks and how they will be dealt with. This shared view must extend to the implications of any action taken for the project budget, its delivery programme, and the quality of what will be delivered.

### How does NEC help?

The foundation of the NEC contract is an obligation on all parties, "to act in a spirit of mutual trust and co-operation". This obligation is brought to life by NEC's unique *early warning* process. This is a risk management process that requires all parties to give each other early warning of any matter that could increase the costs of the works, delay completion, or impair the performance of the works in operation. An issue that will increase the contractor's costs can also be the subject of an early warning, giving the contractor the opportunity to propose alternative ways to achieve the project objectives at a lower cost.

A register of the early warning matters must be maintained and regular early warning meetings are held to identify how the impact of each matter can be avoided or reduced. These meetings decide what actions are needed and who should carry it out.

The contract requires that the delivery programme and budget forecast are updated regularly to reflect the impact of actions agreed to deal with early warning matters. Both parties sign off each new version, ensuring there is one source of truth on the condition of the project.

The contract also includes a comprehensive list of *compensation events* that describe the circumstances under which the supplier is entitled to additional

fees or extra time to complete the project and the process for logging those claims. These may or may not be a consequence of an early warning matter. If a formal dispute arises about the client's assessment or rejection of a *compensation event* or any other matter the contract sets out a process to encourage its rapid resolution without recourse to legal action.

In the first instance the dispute is referred to a *Senior Representative* of each party who are named in the contract. If the Senior Representatives cannot resolve the issue the matter can be referred to an adjudicator. The adjudicator can also be named in the contract or the parties can ask a relevant professional body to make an appointment. If, and only if, the matter has first been considered by the adjudicator but either party remains unhappy, a formal and binding tribunal can be convened.

In the spirit of dealing with problems before they become disputes, NEC also offers the option of appointing a Disputes Avoidance Board. This Board consists of one or three members who will periodically inspect the work in progress. If the Board identifies a potential dispute that might endanger the successful completion of the project it makes a non-binding recommendation for how it can be resolved in a way that is fair to both parties.

**“The use of NEC4 on public sector projects will help improve central government’s capability as a construction client, increase productivity in the sector and get good quality projects and better value for money for the taxpayer.”**

David Hancock, Construction Director for the Infrastructure and Projects Authority at the Cabinet Office

## Government Endorsement

### The Government Construction Board, Cabinet Office UK

The Government Construction Board (formerly Construction Clients’ Board) recommends that public sector organisations use the NEC contracts and in particular the NEC4 contracts where appropriate, when procuring construction. Standardising use of this comprehensive suite of contracts should help to deliver efficiencies across the public sector and promote behaviours in line with the principles of the Government Construction Strategy.

### The Development Bureau, HKSAR Government

The Development Bureau recommends the progressive transition from NEC3 to NEC4 in public works projects in Hong Kong. With suitable amendments to adapt to the Hong Kong local environment, NEC4 is expected to further enhance collaborative partnering, unlock innovations and achieve better cost management and value for money in public works projects.



## **NEC**

1 Great George Street  
London  
SW1P 3AA  
UK

**E:** [info@neccontract.com](mailto:info@neccontract.com)  
**T:** +44 (0) 20 7665 2305  
**W:** [neccontract.com](http://neccontract.com)



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