



Coronavirus: Dealing with it under NEC



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It now looks likely that the UK construction industry will be adversely affected by the outbreak of coronavirus / COVID 19. It is therefore important for parties to NEC contracts to be aware of how the contract deals with this event.

This article sets out, in a fair amount of depth, the key mechanisms within the NEC3 Engineering & Construction Contract (ECC) that can be used to help deal with the effects of the coronavirus outbreak. The mechanisms in this contract are materially the same as its NEC4 counterpart, as well as those within the other forms of NEC contract.

Before reading on, please note that the information below is based on the NEC3 ECC in its unamended form. If your project is likely to be affected by the coronavirus outbreak, then you should check to see if any of the clauses referenced below have been amended.

Early Warning

Clause 16 of the contract contains the early warning mechanism. Given that it now seems inevitable that projects will be disrupted by the coronavirus outbreak, all parties involved should use the early warning mechanism as soon as possible in an attempt to mitigate its effects.

Under clause 16.2, the Project Manager or the Contractor can instruct the other to attend a risk reduction meeting. The Employer can also be asked to attend.

A face-to-face risk reduction meeting may not be the best idea at this point in time (for obvious reasons). I would therefore recommend to the Parties that they arrange to have a risk reduction meeting via telephone or skype as soon as possible with the Project Manager, Contractor and Employer all in attendance, the aim of this being:

- To discuss the likely impact of the coronavirus outbreak on the Accepted Programme;
- To discuss the likely impact of the coronavirus outbreak on the Contractor's supply chain, design

submittal processes, access requirements etc.;

- To discuss the likely impact of the coronavirus outbreak on Others, for example statutory undertakers, utility providers, the planning office, regulators etc.;
- To identify the specific impact that self-isolation measures would have on each party and the project;
- To discuss contingency measures in case any key individuals are affected by the coronavirus outbreak; and
- To talk through the contractual mechanism regarding 'prevention events' to ensure that each party is aware of its obligations (I explain this in more detail below).
- To discuss the likely impact of the coronavirus outbreak on the Contractor's supply chain, design submittal processes, access requirements etc.;
- To discuss the likely impact of the coronavirus outbreak on Others, for example statutory undertakers, utility providers, the planning office, regulators etc.;
- To identify the specific impact that self-isolation measures would have

on each party and the project;

- To discuss contingency measures in case any key individuals are affected by the coronavirus outbreak; and
- To talk through the contractual mechanism regarding 'prevention events' to ensure that each party is aware of its obligations (I explain this in more detail below).

The list above is not exhaustive. The point of the risk reduction meeting is to discuss the issue in order to determine what action needs to be taken, by who and by when. It is quite possible that, following the risk reduction meeting, the parties might agree to a course of action that would result in a compensation event. We discuss that mechanism separately below.

Prevention

Clause 19.1 of the contract deals with events which 'stop' the Contractor completing the works on time, or at all. The Project Manager is required to instruct the Contractor on how it is to deal with such an event if the event satisfies all three of the bullet points below:

- The event stops the Contractor completing the works or completing the works as per the Accepted Programme;
- The event could not have been prevented by either party; and
- The event was so unlikely that no reasonable contractor would have allowed for it.

If the Contractor's labour and/or office staff are required to self-isolate because of coronavirus, it is likely that this will stop the works being completed as per the Accepted Programme, triggering the requirement for the Project Manager to give the clause 19.1 instruction.

In terms of an observation, as at the date of this article, we are probably not at the point where a Project Manager's instruction under clause 19.1 is required. That said, cases of coronavirus are increasing rapidly. If this increase gets to the point where a Contractor can no longer put resources on the project, then undoubtedly the clause 19.1 instruction would be required.

The Project Manager's clause 19.1 instruction could be for the Contractor to stop work for a period of time. If this is the case, then that instruction would be a compensation event under clause 60.1(4) i.e. an instruction to stop work, not to start work or to change a Key Date.

This takes us neatly on to the compensation event mechanism.

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Compensation Event – Which one? Who should notify?

The coronavirus outbreak could result in a number of the

compensation events being triggered under clause 60.1, such as:

- **60.1(2)** – if the Employer does not allow access to the site by the date shown on the Accepted Programme – this could well be the case if your site is within a population centre and 'lockdown' conditions are imposed by the government;
- **60.1(4)** – the Project Manager gives an instruction to stop or not to start any work – I have had several clients who have confirmed they have already received instructions to this effect, I believe this will be very common in the coming weeks;
- **60.1(5)** – the Employer or Others do not work within the times shown on the Accepted Programme – this is likely to be one of the major issues faced by projects moving forward, especially if the project is heavily reliant on Others such as statutory undertakers, utility providers etc.;
- **60.1(6)** – the Project Manager does not reply to a communication within the required time frame – this could well be a practical issue moving forward if lines of communication are not clearly established during any imposed period of self-isolation;
- **60.1(17)** – the Project Manager notifies a correction to an assumption which they have previously stated about a compensation event – this is arguably one of the most important clauses when it comes to assessing the impact of a compensation event triggered by coronavirus, I explain why in the next section of this article; and
- **60.1(19)** – an event occurs which satisfies all four of the following points: (1) the event stops the Contractor completing the works or completing the works as per the Accepted Programme (2) the event could not have been prevented by either party; (3) the event was so unlikely that no reasonable contractor would have allowed for it; and (4) the event is not one of the other compensation events listed in the contract.

In terms of who should notify the compensation events above, the answer depends on which compensation event has occurred. I have summarised the notification requirements below:

- Under clause 61.1, the Project Manager should notify compensation events 60.1(4) and 60.1(17) at the time of giving the communication triggering those compensation events; and
- Under clause 61.3, the Contractor should notify all of the others within eight weeks of becoming aware of them.

If I was to speculate, I would say that there is going to be a number of fall-outs in the coming months over who should have notified the effects of the coronavirus outbreak as a compensation event. There is also likely to be arguments over whether or not a Contractor who did notify, did so within the eight week 'time bar' set out at clause 61.3.

To try and avoid these arguments taking place, and spending unnecessary legal fees to sort them out, I would recommend that the parties adopt the following three-part procedure:

(1) Contractor notification under clause 61.3 as soon as possible

- This notification should set out that the Contractor

'expects' the coronavirus to happen as a compensation event. This notification will stop the eight week notification timer.

- When giving this notification, give as much detail to the Project Manager as possible to help them understand why the coronavirus outbreak will be a compensation event. Reference can be made to it potentially stopping the works being completed as per the Accepted Programme etc.

(2) Project Manager decision under clause 61.4 within one week

- There are four reasons listed within clause 61.4 which the Project Manager can use to decide that the coronavirus outbreak is not a compensation event.
- If one of those reasons are valid, then the Project Manager should rightfully decide that the coronavirus outbreak is not a compensation event. Given that we are at the very early stages of the outbreak, a decision that the event is not expected to happen may be perfectly reasonable.
- If, however none of the reasons are valid, then the Project Manager should instruct the Contractor to provide a quotation.

(3) If the Project Manager decides that the 'expected' event is not a compensation event, then be aware of clause 60.1(8)

- Given that the UK Government's approach to dealing with coronavirus is rapidly evolving, a decision to reject the Contractor's compensation event notification may be correct on one day, but wrong the next.
- If this is the case, then the onus would be on the Project Manger to change its decision about the Contractor's compensation event notification.
- This change of decision is itself a compensation event under clause 60.1(8). No 'time-bar' attaches to this compensation event.

If the mechanism outlined above is adopted and clearly backed by correctly issued communications under clause 13, then it would be very difficult for either party to argue that the other did not correctly notify the coronavirus outbreak as a compensation event.

Compensation Event - How will it be assessed? Does the Contractor get time and/or money?

Regardless of what compensation event the coronavirus outbreak falls under, it will be assessed in accordance with clause 63 of the contract using the normal assessment principles used for all compensation events.

This means that the Contractor is entitled to:

- Additional money under clause 63.1 – assessed based on the effect the coronavirus outbreak upon the Contractors actual and forecast Defined Cost plus the resulting Fee; and
- Additional time under clause 63.3 – assessed based on the impact the coronavirus outbreak will have on the Contractor's planned completion date.

The main difficulty in assessing a compensation event triggered by the coronavirus outbreak will be the requirement to forecast its effects into the future. This is a difficulty which is bespoke to the NEC contract because the NEC compensation event mechanism is premised upon compensation events being assessed whilst a project is on-going, instead of waiting until the end when all of the effects of the event are known.

Because there is a requirement to forecast the effect of a compensation event, clause 63.6 requires the assessment to include a cost and time risk allowance for matters which have a 'significant' chance of occurring.

When it comes to pricing a compensation event triggered by coronavirus, a Contractor is therefore entitled to price in risk allowance for risks which have a significant chance of

NEC3 Engineering and Construction Contract

Only the difference between the weather measurement and the weather measurement shown in the weather data show to occur on average less frequently than once every 10 years is taken into account in assessing a compensation event.

(14) An event which is an Employer's risk stated in this contract.

(15) The Project Manager certifies take over of a part of the works, both Completion and the Completion Date.

(16) The Employer does not provide materials, facilities and samples for tests and inspections as stated in the Works Information.

(17) The Project Manager notifies a correction to an assumption which he has stated about a compensation event.

(18) A breach of contract by the Employer which is not one of the compensation events in this contract.

(19) An event which

- stops the Contractor completing the works or
- stops the Contractor completing the works by the date shown on the Accepted Programme,

and which

- neither Party could prevent,
- an experienced contractor would have judged at the Contract Date to have such a small chance of occurring that it would have been unreasonable for him to have allowed for it and
- is not one of the other compensation events stated in this contract.

60.2 In judging the physical conditions for the purpose of assessing a compensation event, the Contractor is assumed to have taken into account

- the Site Information
- published

61.4 If the Project Manager decides that an event notified to him

- arises from a fault of the Contractor,
- has not happened and is not expected to happen,
- has no effect upon Defined Cost, Completion Date or the Key Dates, or
- is not one of the compensation events stated in this contract,

he notifies the Contractor of his decision that the event is not a compensation event, otherwise, he notifies the Contractor accordingly.

The Project Manager notifies his decision to the Contractor that the Prices, the Completion Date or the Key Dates are to be changed, he instructs him to submit quotations before the end of the period to which the Contractor has notified him.

- one week after the Contractor's notification to the Project Manager does not notify his decision to the Project Manager of his failure. A failure by the Contractor to submit quotations that the event is a compensation event is treated as a failure to submit quotations.

61.5 If the Contractor notifies the Project Manager of his failure to submit quotations that the event is a compensation event, the Contractor is assumed to have taken into account

occurring. The question is, what risks have a significant chance of occurring?

Well, there is the very real risk that the UK could go down the route of Italy/Spain by effectively placing the country into lockdown. If this was to happen, then massive project delays and increased costs will be inevitable. On the other hand, we could potentially see a vaccine in the coming months that might end any disruption. There is then a range of different options in between which will affect different types of project in different ways.

In terms of advice, Contractor's should be erring on the side of caution when calculating the potential time and money effects of the coronavirus outbreak. That means taking into account the worst-case scenario. It is going to be a difficult conversation to have, but it needs to be done. The NEC does however have a mechanism for dealing with the assessment of events which are very difficult to forecast. I have described this mechanism in the bullet points below.

- Under clause 61.6, if the Project Manager decides that an event is too uncertain to forecast reasonably, then they should state assumptions about the event for the Contractor to price. In terms of the coronavirus outbreak, this could include for example: assumptions that the site will not be closed, that Others will not hinder the Contractor, that the Contractor will always have access to 75% of its planned resources, that the Contractor's supply chain will be unaffected.
- Under clause 61.6, the Contractor is required to price the compensation event quotation based on the Project Manager's assumptions. In reality, this means that the Contractor does not need to price in the same level of cost and time risk allowance, dramatically lowering quotations.
- Under clause 61.6, if the Project Manager's assumption later turns out to be wrong, then the Project Manager is required to notify a correction to its assumption. For example, if an assumption is made that the Contractor's supply chain would not be affected by the coronavirus outbreak, but it later transpires that the Contractor's entire supply chain is shut down, then the Project Manager would need to correct its initial assumption.
- Under clause 60.1(17), a Project Manager correcting an assumption is a new compensation event. Continuing our example above, this would then

entitle the Contractor to all of the time and money repercussions of its supply chain shutting down.

Termination

To validly terminate an NEC3 ECC, there must be a valid reason for termination and the parties must follow an appropriate termination procedure.

It is far too early to be talking about terminating contracts because of the coronavirus outbreak. That said, it is worth unpacking the termination provisions of the contract to see how and when a valid reason for termination may arise in light of current events.

The 21 valid reasons (R1 – R21) for termination are listed at clause 91 of the contract. I do not review each reason in detail, as several will not be triggered by the coronavirus outbreak. The reasons I have reviewed below are what I consider to be the most likely reasons to arise out of the coronavirus outbreak.

Reason R1-R10: Insolvency, administration, winding up etc.

These reasons entitle EITHER party to terminate the contract if the other party enters into some form of insolvency procedure.

It is too early to speculate on the impact that the coronavirus outbreak will have on company finances. I have no doubt that all parties to the contract will face financial strain in the coming months, and that as a result, some companies will become insolvent.

Reason R11: Contractor substantially fails to comply with its obligations

This reason entitles the EMPLOYER to terminate the contract if the Contractor is notified of a substantial failure in its performance and such a default is not '*put right*' within four weeks of the notification.

If a Contractor is unable to comply with its obligations, because its resources have been placed into self-isolation, then you may initially think that this reason for termination becomes valid. It is not as straightforward as that.

This reason for termination is always troublesome because the drafting is slightly ambiguous. It is not particularly clear what will amount to a '*substantial failure*'. It is also not particularly clear what it means to '*put right*' the substantial failure. These are questions for another article!

In addition, as discussed above, it is likely that the coronavirus outbreak would result in a number of compensation events being triggered under clause 60.1. If this is the case, then the Contractor's substantial failure to perform would be excused by the intervening compensation event.

Taking the points above into consideration, I would advise Employers to tread with extreme caution if considering R11 as a reason to termination because of coronavirus.

Reason R17: Released under law from future performance

This reason entitles EITHER party to terminate the contract if the parties have both been released under the



law from further performance of the whole of the contract.

It is generally thought that R17 is not relevant under English Law. People often cite this clause when discussing topics such as 'frustration' and 'force majeure'. Neither of these legal concepts link to R17.

In English Law, the concept of frustration operates to 'kill the contract and discharge the parties from further liability under it' (KNS Industrial Services (Birmingham) Ltd v Sindall Ltd (2001)). As a result, if frustration was to occur, there would be no need for the parties to exercise their rights of termination under the contract as the contract is no more, it has ceased to be, it has expired and gone to meet its maker (to quote John Cleese).

Similarly, the concept of 'force majeure' has no place in this clause. In English Law, force majeure refers to a clause that relieves one of the parties of performance in circumstances of the intervention of a higher force, that is not the responsibility of either party. Under the NEC3, this is covered by clauses 19 and 60.1(19), which are discussed above, as well as R21 which is discussed below.

Reason R20: Project Manager instructs Contractor to stop or not to start any substantial work

This reason entitles EITHER party to terminate the contract if (1) the Project Manager instructs the Contractor to stop or not to start work (2) the work is not allowed to re-commence within 13 weeks and (3) the reason for stopping the work was not due to a default of the Contractor or Employer.

As set out previously, if the Project Manager instructs the Contractor to stop work because of the coronavirus outbreak, then that instruction is a compensation event under clause 60.1(4). This reason for termination is effectively a 'back-stop' which enables either party to terminate the contract if the works are not recommenced within 13 weeks.

It is almost impossible to forecast the trajectory of the coronavirus outbreak. The optimist in me says that it is very unlikely that projects will be fully stopped for 13 weeks. If this is the case, then this reason for termination is unlikely to arise.

Termination under R20 would entitle the Contractor to the costs it has incurred to date, plus an allowance for removing any Equipment from the site.

Reason R21: Event occurs which delays completion by more than 13 weeks

This reason entitles the EMPLOYER to terminate the contract if (1) an event occurs which stops the works being completed or (2) an event occurs which is forecast to delay Completion by more than 13 weeks.

This clause could be extremely important in light of current events. As discussed previously, the outbreak of coronavirus is likely to be a compensation event under the contract which would entitle the Contractor to recover additional time and money as a result.

The ability to claim additional money, coupled with the uncertainty of how long projects are going to be affected by coronavirus, is likely to lead to Contractor's being entitled to very large claims for additional payment under the contract. Employer's will be faced with making a commercial decision as to whether it is more favourable to pay this amount, or alternatively, to terminate the contract under R21.

Termination under R21 would entitle the Contractor to the costs it has incurred to date, plus a lump sum payment which is calculated by applying the direct fee percentage to any work not yet completed (I have paragraphed the NEC language here).

Conclusion

I appreciate that this is a rather long article, but hopefully you found it useful. To summarise:

- The outbreak of coronavirus is likely to trigger several compensation events under the contract;
- Parties to the contract should immediately take steps to notify the event as a compensation event, to avoid arguments later down the line;
- Contractors are entitled to both the time and money effects of dealing with compensation events, to be assessed in accordance with clause 63;
- It is too early to conceivably start thinking about termination, but if the time comes, there are several reasons for termination that could arise out of the coronavirus outbreak; and
- If you haven't already entered into a contract but are about to do so, give me a call!

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