

# MDA PRESENTS



## FIRST AID FOR CONTRACTS



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### NEC: AN EARLY WARNING OF NEC4'S CHANGES TO THE EARLY WARNING CLAUSE

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**Change is inevitable in construction contracts and the uncertainty associated with it is a major cause of additional time and money on a construction project.**

Unlike some of the other standard forms of contract, the NEC includes an early warning process to serve as a risk management tool. An early warning is a warning of something that may occur in the future that may bring about the abovementioned “change”, but which may not happen at all. The point of the process is to ensure that matters are dealt with before they cause problems, rather than afterwards.

It is important to remember that the early warning process is separate from the compensation event process. Parties should not treat early warnings as merely a precursor to a claim for a compensation event. Sometimes a matter which is notified under the early warning process may become a

compensation event but other times it may not.

It is essential for contractors to ensure that they give early warnings when due because if the matter ultimately becomes a compensation event, the *Project Manager* can request that any savings in time and money that would have been made (had an early warning been given) are taken into account in assessing the effects of the compensation event (i.e. the payment due for the compensation event will be reduced - a disallowed cost).

As most in the industry are now aware, NEC4 was released earlier this year. NEC states as follows on its website – “*The NEC Contracts have been updated and streamlined following feedback from the industry, considering Government priorities and emerging best practice. The result is a contract suite with improved flexibility, clarity and which is easier to use*”.

In light of the importance of early warnings, we thought it prudent to review the changes to the early warning provisions to see if the amended clause lives up to this statement.

Let's start with some of the formalistic changes.

The early warning clause is now clause 15 rather than clause 16. This is not a change of substance, but something to keep in mind when labeling notices for example. The defined term "Risk Register" has changed to "Early Warning Register". This is a welcomed change as the term "Early Warning Register" provides more clarity and distinguishes it as the register drawn up in compliance with the early warning clause.

Now for the changes to the substance of the clauses.

Both clauses 16.1 and 15.1 set out the matters which warrant early warning notices and state that either the *Contractor* or the *Project Manager* may notify the other of these matters. These matters are matters which could 1) increase the total of the Prices, 2) delay Completion, 3) delay meeting a Key Date, or 4) impair performance of the works in use.

In respect of any other matter which could increase the *Contractor's* total cost however, the contracts differ. Under NEC3, the *Contractor* may notify the *Project Manager* of any matter that could increase his total cost. Whereas NEC4 states that the *Project Manager* may also give this notice. It is clear why the position under NEC3 is that only the *Contractor* is to notify matters which increase its total cost as such an increase is not something of direct concern to the *Project Manager*, nor something which the *Project*

*Manager* would have any knowledge or foresight of, so why would the *Project Manager* need to engage in an early warning process in respect of it. The reasons for the change, so as to afford the *Project Manager* the right to notify of such matters, are not entirely clear but it could be to encourage the carrying out of the early warning process as contractors may be hesitant to notify of matters which could increase their costs. However, we submit that project managers might also be hesitant to bring up the issue of increased contractor's costs in any event. It appears likely, that these "matters" that could increase the *Contractors* total cost may have an effect which prejudices the *Contractors* ability to carry on with the Contract. Hence whilst these are not risks that directly affect the carrying out of the work, they could cause difficulties, like for example the effect of liquidity or cash flow constraints.

NEC4 now clarifies, in clause 15.2, that the *Project Manager* is to prepare the first early warning register and is to issue it to the *Contractor* within a week of the starting date. Although this might be considered best practice, the NEC4 reaffirms this position by stating it expressly, making it a specific requirement.

NEC4 further clarifies the conduct of early warning meetings. Under NEC3, either the *Contractor* or the *Project Manager* could instruct the other to attend a risk reduction (early warning) meeting. Under NEC4, the *Project Manager* is to instruct the *Contractor* to attend an early warning meeting within two weeks of the starting date.

Thereafter, subsequent early warning meetings are to be held if either the *Project Manager* or the *Contractor* instructs the other to attend (as is required under NEC3), however, NEC4 requires early warning meetings to be held at no longer interval than the interval stated in the Contract Data until Completion. The aim of these amendments is to ensure that risk management is being carried out as a continuous process. The Contract Data, to be filled in by the *Employer* (now referred to as the *Client* under the NEC 4), contains a new entry to insert the intervals at which these meetings should take place. In keeping with the aim of the contract, these intervals should be fairly regular such as monthly.

Both clauses 16.3 and 15.3 provide what is to be done/decided at a risk reduction/early warning meeting. Both clauses state that those attending the meeting shall decide which matters can be removed from the respective registers. NEC4 elaborates on this by stating that the actions recorded in the Early Warning Register are to be reviewed and it is to be decided if different actions need to be taken and who, in accordance with the contract, will take them.

NEC4 imposes an obligation on the *Project Manager* to issue the revised Early Warning Register within one week of the meeting, whereas NEC3 did not stipulate a time period in which to do so.

And that about sums up the changes to the early warning clause. The changes are few and subtle but have certainly clarified the early warning process.

Our overall impression of the amendments is that NEC4 seeks to ensure the regular and systematic use of the early warning process by specifically setting out what the *Project Manager* is obliged to do and by when. NEC3 provided for an early warning process but did not go as far as stipulating that early warning meetings are to take place within prescribed intervals.

The ultimate purpose of the early warning process is to get the *Project Manager* and the *Contractor* to meet so as to resolve issues before they materialize or to work together to minimize the impact of issues that are guaranteed to materialize. If early warning meetings do not take place regularly, the purpose of the early warning clause is expunged.

Although the amendments may guarantee that regular early warning meetings take place, they cannot ensure that the *Project Manager* and the *Contractor* actually engage in a manner that fulfils the purpose of these meetings. We will have to see how these amendments play out in reality to see whether they are merely another administrative burden or whether they will be used for the purpose intended.

Below is a table setting out the relevant clauses side by side for ease of reference.

Clause	NEC3	Clause	NEC4
<b>11.2(14)</b>	Risk Register – A register of the risks which are listed in the Contract Data and the risks which the <i>Project Manager</i> or the <i>Contractor</i> has notified as an early warning matter. It includes a description of the risk and a description of the actions which are to be taken to avoid or reduce the risk.	<b>11.2(8)</b>	Early Warning Register – A register of matters which are <ul style="list-style-type: none"> <li>• listed in the Contract Data for inclusion and</li> <li>• notified by the <i>Project Manager</i> or the <i>Contractor</i> as early warning matters</li> </ul> It includes a description of the matter and the way in which the effects of the matter are to be avoided or reduced.
<b>16.1</b>	“The <i>Contractor</i> may give an early warning by notifying the <i>Project Manager</i> of any other matter which could increase his total cost.”	<b>15.1</b>	“The <i>Project Manager</i> or the <i>Contractor</i> may give an early warning by notifying the other of any other matter which could increase the <i>Contractor’s</i> total cost.”
<b>16.2</b>	“Either the <i>Project Manager</i> or the <i>Contractor</i> may instruct the other to attend a risk reduction meeting.  Each may instruct other people to attend if the other agrees.”	<b>15.2</b>	“The <i>Project Manager</i> prepares a first Early Warning Register and issues it to the <i>Contractor</i> within one week of the <i>starting date</i> . The <i>Project Manager</i> instructs the <i>Contractor</i> to attend a first early warning meeting within two weeks of the <i>starting date</i> .  Later early warning meetings are held <ul style="list-style-type: none"> <li>• if either the <i>Project Manager</i> or the <i>Contractor</i> instructs the other to attend an early warning meeting, and, in any case,</li> <li>• at no longer interval than the interval stated in the Contract Data until Completion of the whole of the <i>works</i>.</li> </ul> The <i>Project Manager</i> or the <i>Contractor</i> may instruct other people to attend an early warning meeting if the other agrees.  A <i>Subcontractor</i> attends an early warning meeting if its attendance would assist in deciding the actions to be taken.”

<p><b>16.3</b></p>	<p>“At a risk reduction meeting, those who attend co-operate in</p> <ul style="list-style-type: none"> <li>• ...</li> <li>• ...</li> <li>• ...</li> <li>• deciding which risks have now been avoided or have passed and can be removed from the Risk Register.”</li> </ul>	<p><b>15.3</b></p>	<p>“At an early warning meeting, those who attend co-operate in</p> <ul style="list-style-type: none"> <li>• ... [no change]</li> <li>• ... [no change]</li> <li>• ... [no change]</li> <li>• deciding which matters can be removed from the Early Warning Register and</li> <li>• reviewing actions recorded in the Early Warning Register and deciding if different actions need to be taken and who, in accordance with the contract, will take them.”</li> </ul>
<p><b>16.4</b></p>	<p>“The <i>Project Manager</i> revises the Risk Register to record the decisions made at each risk reduction meeting and issues the revised Risk Register to the <i>Contractor</i>.”</p>	<p><b>15.4</b></p>	<p>“The <i>Project Manager</i> revises the Early Warning Register to record the decisions made at each risk reduction meeting and issues the revised Early Warning Register to the <i>Contractor</i> within one week of the early warning meeting.”</p>

The changes to the NEC 3, now incorporated in the new edition, NEC 4, appear to have been largely based on best practices that have been found by experience to have a beneficial effect on the outcome of contracts administered under the NEC forms of contract. It will be interesting to see if they are accepted by players in our local industry and whether they will have the desired effect.