USING THE NEW ENGINEERING CONTRACTS (NEC3) TO CONSIDER AND EVALUATE THE LEGAL LIABILITIES ARISING FROM CONTRACTUAL FAILURES: A CASE STUDY RESEARCH

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Abstract: Sometimes in building and construction projects, the sub-contractor may bring a claim made by the main contractor or the employer against the contractor, and then the latter will often seek to settle this claim. The case “John F Hunt Demolition Ltd v ASME Engineering Ltd [2007] EWHC 1507 (TCC)”, which was under the Joint Contracts Tribunal (JCT), provides an example of this situation when the contractor (as sub-contractor in this case) settles the employer’s or main contractor’s claim, and then claims against his sub-contractor (as sub-subcontractor in this case) to recover these sums. This research is undertaken to discuss contractual issues connected to the above mentioned case, and to appraise the legal liabilities that associated with its contractual failure, and then it will appraise those liabilities under the NEC3 form of contract in order to enhance an interpretation of the NEC contracts and provide evaluation of legal implications under different legal provisions.

Keywords: NEC3, Joint Contracts Tribunal (JCT), NEC contracts, legal liabilities, contractual failure.

دراسة حالة في استخدام نظام عقود NEC3 في تشخيص، تحليل و تسوية الألتزامات القانونية الناجمة عن الأخطاء التعاقدية

الخلاصة: أحيانًا في المشاريع الإنشائية، يكون المقاول الثانوي سببًا في رفع دعوى قضائية يقدمها المقاول الرئيسي أو صاحب العمل ضد المقاول، ثم الأخير يدربه على الدعوى القضائية. هذه الدعوى القضائية تلتزم بالدعاوى القضائية التي يرفعها المقاول الثانوي ظاهراً بالشرعية. قضية “John F Hunt Demolition Ltd v ASME Engineering Ltd [2007] EWHC 1507 (TCC)”, التي تمتد تحت قانون قضايا العقود، تقدم Instanceًا لظاهرة هذا الوضع عندما تم تسوية الدعوى القضائية التي قدمها المقاول الرئيسي في قضية المقاول الثانوي في قضية مطلحة للفشل التعاقدية. استمراد ما تم دفعه من أموال في هذه التسوية. تم تقديم هذا البحث لمناقشة المسائل التعاقدية المتعلقة بالدعاوى القضائية المحكمة، وفرض الالتزامات القانونية الناجمة عن الأخطاء في التفاوض، واتخاذ التدابير والتقديرات من أجل تخفيف الضرر. NEC3 من العقود أيضًا تقييم الآثار القانونية المرتبطة بموجب أحكام العقود الإنشائية المختلفة.

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1. Introduction

The case "John F Hunt Demolition Ltd v ASME Engineering Ltd [2007] EWHC 1507 (TCC)" [1] provides an example of this situation when the contractor (as sub-contractor in this case) settles the employer’s or main contractor’s claim, and then claims against his sub-contractor (as sub-subcontractor in this case) to recover these sums. This research is undertaken to discuss contractual issues connected to the above mentioned case, and to appraise the legal liabilities that associated with its contractual failure, and then it will appraise those liabilities under the NEC3 form of contracts in order to provide evaluation of legal implications under different legal provisions and enhance an interpretation of the NEC contracts against other forms of contracts such as the JCT.

1.1. The JCT Forms of Contracts

The Joint Contracts Tribunal (JCT), which was firstly established in 1931, has produced standard forms of construction contract, guidance notes and other standard forms of documentation for use by the construction industry. Main contracts and sub-contract forms are included in the JCT contract families to reflect the range of collaborative procurement methods used by construction industry. Traditional, Design and Build, Management, and Partnering contracts are all provided in order to ensure that these contracts support a wide range of construction activities, including complex and large-scale projects [2].

This different number of JCT contracts is designed for different types of building projects aiming to reduce risks. However, these forms are quite complicated and they push costs up. There are some simpler forms of JCT, but they cannot cover all eventualities could happen [3].

The following forms are included in the JCT suite of contracts includes [3]:

- Standard Building Contract
- Intermediate Building Contract
- Minor Works Building Contract
- Major Project Construction Contract
- Design & Build Contract
- Management Building Contract
- Construction Management Contract
- Lump-Sum Contracts
- Measured Term Contract
- Prime Cost-plus Building Contract
- Repair & Maintenance Contract
- Home Owner Contract

1.2. The NEC Forms of Contracts

According to Gould, the New Engineering Contracts (NEC) were published with new simple and direct drafting approach which was adapted to address strong project management standards, considering the following three main objectives [4]:

1. The NEC scope should be more flexible than the standard forms of contracts
2. Greater stimulus should be given by the NEC than other existing forms
3. The NEC expressions should be more simple and clearer than the standard contract forms.
Therefore, the NEC style and content is different than other existing forms of contract [5].

Figure 1 represents the NEC suite of contracts and how this family of contracts can be used to procure a wide range of different types of projects starting from the initial idea through build and post-build management steps [6].

According to the Institute of Civil Engineers (ICE), the third edition of the New Engineering Contract (NEC3) is suitable for procuring a wide range of works, services and supply, purchasing of products and supplies, and spanning major projects’ structure through to minor works [7].

In addition to the forms of contracts mentioned in Figure 1, NEC3 comes with several main contract options which they are as following [8]:

- **Option A: Lump Sum priced contract with activity schedule:** In this contract option, the Contractor carries the greatest risk because he will be responsible for estimating quantities and resources, assessing and pricing risks.

- **Option B: Measurement priced contract with bill of quantities:** This option is not suitable for Design and Build contracts, and it is usually used where the risk of change in quantities is relatively high.

- **Option C: Target Cost contract with activity schedule:** In this contract option, risks are shared between the contract parties in order to reduce the possible disputes.

- **Option D: Target Cost contract with bill of quantities:** This is similar to option C except that the price is calculated by means of a bill of quantities. In this option, more risk is taken by the employer.

- **Option E: Cost Reimbursable contract:** Under this option, a very small risk is taken by the Contractor. It is used where the risk is high, and may also be used for emergency work.
Option F: Management Contract: This option is used for management contracts, in which the procurement work is carried out by the sub-contractors, and the Contractor manages this work. Under this option, most of the risk is taken by the employer, and the contractor receives the payment for the sub-contracts’ cost plus a management fee.

In order to find its contractual liabilities, the above mentioned case (Hunt Demolition Ltd v ASME Engineering Ltd [2007]) will be firstly discussed and analysed under the JCT contracts to find the mode of failure. Then, it will be considered to be undertaken under the NEC3 form of contract, which is the latest edition of the NEC provisions that was used according to Gould as a contract choice for the construction of the Olympic Games 2012 in London [4]. The ECC3 (the NEC 3 Engineering Construction Contract) will be considered as the Main Contract which was made between the employer, Whitehall, and the main contractor, Build. Then, the sub-contract, which was made between Build and the sub-contractor, Hunt, will be carried out under the ECS 3 (the NEC3 Engineering Construction Subcontract).

2. The Case Factual Background

As stated in the report of John F Hunt Demolition Ltd v ASME Engineering Ltd [2007] which is retrieved from the Nationwide Academy for Dispute Resolution UK Ltd website [1]:

In June 2002, Whitehall Place Ltd made a main contract with Build Ltd to design and build commercial office premises at 3-8A Whitehall Place, London, SW1. In order to start the work, a demolition of the existing buildings is required. Therefore, Build made a sub-contract with John F Hunt Demolition Ltd to do the demolition work. Hunt made a sub-subcontract with ASME Engineering Ltd in December 2002 to build the steel structure that supports the existing facades during the demolition works. During work on the steel structure, fire accident occurred, and caused damage to the retained facades.

Whitehall and Build indicated a joint claim against Hunt to recover their losses that caused by the fire. In 2006, Hunt settled that claim, and then he claimed against ASME to recover these sums. ASME resisted this claim by conceding that Hunt has no liability to Whitehall under the main contract’s terms.

3. The Mode of Failure

As stated in John F Hunt Demolition Ltd v ASME Engineering Ltd [2007] report [1]:

On 22 April 2003, during work on the steel structure, which was being carried out by ASME, sparks from the arc welding work set light on the weather proofing of the retained facades and caught fire lasted for about 45 minutes, which caused damage to the retained facades. As a result of what happened, Whitehall and Build claimed against Hunt. This claim entirely focused on the effects of the damage that occurred due to the fire, which seems to be ASME’s default. Whitehall and Build claimed together against Hunt for £248,145 to repair the damaged facades. Hunt and ASME appointed Haleys
Ltd in 2005 to evaluate the value of the claim. Haleys’ result indicated that the claim’s value was around £151,545 plus interest.

In 2006, Hunt made an agreement with Whitehall and Build to settle their claim for £152,500 (£108,988 to recover Whitehall’s losses and £43,513 was considered as Build’s losses). As a result of this settlement, Hunt claimed against ASME to recover theses sums. ASME admitted that Hunt has no liability to Whitehall under the main contract’s terms, and the maximum amount that Hunt should pay is only £43,513, which represents Build’s losses.

This paper will provide a critical discussion to find out whether Hunt is liable to Whitehall in respect of the damage that occurred or not.

4. The Case Terms under the JCT Contracts

4.1. The Main Contract

The main contract, which was made between Whitehall and Build to design and construct commercial office premises in London, incorporated the JCT Standard Form of Building Contract with Contractor’s Design 1998 Edition. The contract terms that relevant to this failure as stated in the report of John F Hunt Demolition Ltd v ASME Engineering Ltd [2007] at pp. 2-3, were as follows [1]:

Clause 20.2, as amended, provided the following [1]:

"The Contractor shall be liable for and shall indemnify the Employer against any expense, liability, loss, claim or proceedings in respect of any loss, injury or damage whatsoever to or in respect of any property, real or personal (including any expense, liability, loss or claim arising from but not limited to obstruction, trespass, nuisance or interference with any rights of way, light, air or water) in so far as such loss injury or arises out of or by reason of the carrying out of the Works and to the extent the same is due to any negligence, breach of statutory duty, omission, breach of contract or default of the Contractor his servants or agents or out of the presence on Site of any person or persons for any reason whatsoever apart from the Employer or any person employed, engaged or authorised by him to be on the Site or by any local authority or statutory undertaker executing work solely in pursuance of its statutory rights or obligations. The liability and indemnity hereunder is subject to Clause 20.3 and where Clause 22C.1 is applicable excludes loss or damage to any property required to be insured there under caused by a Specified Peril”.

Clause 20.2, as amended, provided the following [1]:

"The Contractor shall be liable for and shall indemnify the Employer against any expense, liability, loss, claim or proceedings in respect of any loss, injury or damage whatsoever to or in respect of any property, real or personal (including any expense, liability, loss or claim arising from but not limited to obstruction, trespass, nuisance or interference with any rights of way, light, air or water) in so far as such loss injury or arises out of or by reason of the carrying out of the Works and to the extent the same is due to any negligence, breach of statutory duty, omission, breach of contract or default of the Contractor his servants or agents or out of the presence on Site of any person or
persons for any reason whatsoever apart from the Employer or any person employed, engaged or authorised by him to be on the Site or by any local authority or statutory undertaker executing work solely in pursuance of its statutory rights or obligations. The liability and indemnity hereunder is subject to Clause 20.3 and where Clause 22C.1 is applicable excludes loss or damage to any property required to be insured there under caused by a Specified Peril".

Clause 1.3 provided a definition of the Specified Perils which they include: "fire, lightning, explosion, storm, tempest, flood...and related perils" [1].

The relevant parts of Clause 22C.1 were as follows [1]:

"The Employer shall take out and maintain a Joint Names Policy in respect of the existing structures … together with the contents thereof owned by him or for which he is responsible, for the full cost of reinstatement, repair or replacement of loss or damage due to one or more of the Specified Perils …"

Clause 22.2 provided a definition of the Joint Names Policy [1]:

"A policy of insurance which includes the employer and the Contractor and such other persons as the employer may reasonably require including (but without limitation) the Commissioners and DEFRA and the Fund as the insured and under which the insurers have no right of recourse against any person named as an insured, or, pursuant to Clause 22.3, recognized as an insured there under."

4.2. The Sub-contract

The sub-contract was made between Build and Hunt by incorporating the JCT Domestic Sub-Contract DOM/2 1981 Edition (reprinted in 1998) to carry out the demolition work.

As stated in the report of John F Hunt Demolition Ltd v ASME Engineering Ltd [2007] at p. 3 [1], the contract terms that relevant to this failure were as follows: Clauses 6.3 and 6.4 of the DOM/2 conditions [1]:

Clause 6.3 "The Sub-Contractor shall be liable for, and shall indemnify the Contractor against any expense, liability, loss, claim or proceedings in respect of any loss, injury or damage whatsoever to any property real or personal insofar as such loss, injury or damage arises out of or in the course or by reason of the carrying out of the Sub-Contract Works and to the extent that the same is due to any negligence, breach of statutory duty, omission or default of the Sub-Contractor or any person for whom the Sub-Contractor is responsible. This liability and indemnity is subject to Clause 6.4".

Clause 6.4 "The liability and indemnity to the Contractor referred to in 6.3 shall not include any liability or indemnity in respect of injury or damage to the Works and/or Site Materials by one or more of the Specified Perils, whether or not caused by the negligence, breach of statutory duty, omission or default of the Sub-Contractor or any person for whom the Sub-Contractor is responsible, for the period up to and including whichever is the earlier of the Terminal Dates".

Clause 8C, which is connected to Clause 22C in the main contract, provided the following conditions [1]:
"The Contractor shall, prior to the commencement of the Sub-Contract Works, ensure that the Employer arranges that the Joint Names Policy referred to in Clause 22C.2 of the Main Contract Conditions shall be so issued or so endorsed that in respect of loss or damage by the Specified Perils to the Works and Site Materials insured there under, the Sub-Contractor is either recognised as an insured under the Joint Names Policy or the insurers waive any rights of subrogation they may have against the Sub-Contractor, and that this recognition or waiver shall continue up to and including whichever is the earlier of the Terminal Dates"

5. The Case Contractual Liabilities Under The JCT

Despite the fact that the normal contractual structure (the contractual chain) does not provide for direct claim made by an employer against a sub-contractor, a potential claim in the tort of negligence arises due to physical detriment caused by the sub-contractor [9].

In order to analyse the contractual liabilities in the above mentioned case (Hunt Demolition Ltd v ASME Engineering Ltd [2007]), and find whether the sub-contractor, Hunt, is liable to the employer, Whitehall, or not, it is important to note that the main contractor, Build, has no liability to Whitehall, because the damage to the retained facades was caused by fire, and Clause 20.2 in the main contract excluded the contractor’s liability of any damage or loss to the property caused by "Specified Peril" which is defined in Clause 1.3 of the main contract as "fire, lightning, explosion, storm, tempest, flood…and related perils".

On the other hand, Hunt’s liability in respect of the damage to the existing facades seems to be not excluded under the sub-contract, because Clause 8C.1 mentioned that only damage in respect of "Works and Site Materials" is insured under the Joint Names Policy which has been defined in Clause 22.2 of the main contract. Therefore, Hunt seems to be liable under the sub-contract to the main contractor, Build, in respect of any damage happens to the existing facades.

In addition, Clauses 20.2 and 22C.1 in the main contract considered the contractor’s and sub-contractor’s liabilities for any damage or loss occurring to the existing structures, except that caused by a "Peril" which is in this case the fire. Therefore, Hunt would owe no liability to Whitehall in respect of the damage to the existing structure according to the main and sub-contract conditions. On the other hand, he would be liable under the sub-contract to the main contractor, Build, of any damage or loss occurs to the existing structures, namely the retained facades, according to Clauses 8C.1, 6.3 and 6.4.

As a result, Hunt seems to be liable for only £43,513, which represents Build’s losses.

6. The Case Contractual Liabilities Under The NEC3 Contracts

6.1. The ECC 3 Form of Contract (the Main Contract)
The ECC3, which is the latest edition of the Engineering and Construction Contract (ECC), has considerable changes from the last edition (ECC 2). Most of these changes simply enrich the clarity of documents. However, the significant changes that presented in this edition have influence upon project time management, risk management, the evaluation of compensation events and work pricing; especially the fee percentage [10].

Eggleston mentioned that the Option X18 of the ECC3 form of contract, which is a new secondary option of significant importance, presents diverse limitations of the contractor’s liabilities to the employer [5]. Weddell also stated that it should be some limits to the contractor’s liability, and this option sets financial limits to those liabilities which the contractor may have under the contract to the employer [11]. Clause X18.1 of this option states that "the Contractor’s liability to the Employer for the Employer’s indirect or consequential loss is limited to the amount stated in the Contract Data" [12]. Clause X18.2 declares that the contractor’s liability for the loss of or damage to the employer’s property is limited to the amount stated in the contract data. This limitation requires to be taken together with the provisions of insurance in the NEC3, especially Clauses 84.1 and 84.2, in which the contractor is required to insure for the damage that could occur to property. Both insurances covers are set in the contract data. The contractor would usually try to come with liability limit that within the insurance cover, rather than above it [5].

Furthermore, Clause X18.4 in the NEC 3 Engineering and Construction Contract mentions that the contractor’s total liability to the employer for all the matters that associated with the contract is limited to the amount stated in the contract data and applies in contract, tort or defect, otherwise to the amount allowed under the law of the contract, except the following matters that stated as payable amounts by the contractor [12):

- Loss of or damage to the employer’s property.
- Liquidated delay damages.
- Liquidated low performance damages.

Eggleston also mentioned that Clause X18.4 has a great potential significance, because wording the Option X18 indicates titles to claim damages in contract and in tort, if the contractor tries to use those rights, which could make the employer has no benefit gained from the limitation of liability [5].

According to the Guidance Notes for the NEC 3 Engineering and Construction Contract, section 8 of the ECC 3 deals with the insurances that covering the risks of loss, damage, injury or death which are allocated to either the employer or the contractor. Clause 84.2 of this section states that the insurances in the joint names of the employer and the contractor should include the policies and certificates that cover the contractor’s risks that mentioned in the insurance table [13]. According to this table, insurance should be applied against the liability for loss of or damage to property with the amount of cover that stated in the contract data for any one event with cross liability [12].

As a result of what has been mentioned above, the contractor, Build, seems to be liable under Clause X18.4 of the ECC 3 (the main contract) to the employer, Whitehall,
for the damage occurred to the property, namely in this case the retained facades, but at the same time he is covered under the Clause 84.2 against this liability.

6.2. The ECS Form of Contract (the Sub-contract)

Before start talking about the sub-contractor’s liabilities to the employer and the contractor under the NEC3 sub-contract, it is important to mention that Clause 26.1 of the ECS3, which is the third edition of the Engineering and Construction Subcontract, states that if the sub-contractor sub-subcontracted works, he would provide the subcontract works as he had not sub-subcontracted [14]. As a result, the sub-contractor would be responsible to the employer and the contractor for his sub-subcontractors’ works.

According to Weddell, the need for limiting the sub-contractor’s liability might be more substantial than in the contractor’s liability case. Therefore, there should be some financial limits to the sub-contractor’s legal liability [11].

Clause X18.1 in the NEC3 Engineering and Construction Subcontract states that “the Subcontractor’s liability to the Contractor for the Contractor’s indirect or consequential loss is limited to the amount stated in the Subcontract Data”. Clause X18.2 states that the sub-contractor’s liability to the contractor for loss of or damage to the employer’s or contractor’s property is limited to the amount stated in the sub-contract data. In addition, Clause X18.4 mentions that the sub-contractor’s total liability to the contractor for all the matters that associated with the sub-contract is limited to the amount stated in the sub-contract data and applies in contract, tort or defect, otherwise to the amount allowed under the law of the contract, except the following matters that stated as payable amounts by the sub-contractor [14]:

- Loss of or damage to the employer’s or the contractor’s property.
- Liquidated delay damages.
- Liquidated low performance damages.
- Sub-contractor’s share under main options C and D.

Clause 83.1 states that each party indemnifies the other against claims resulted from an event caused by him. In addition, the contractor indemnifies his sub-contractor against all the claims that the employer indemnifies the contractor under the main contract. Furthermore, Clause 83.2 mentions that the sub-contractor’s indemnity to the contractor is reduced, if the event is caused by the contractor or employer, taking into account each party’s responsibilities under the sub-contract [14].

Clauses 84.1 and 84.2 in the ECS3 form of contract state that the insurances in the joint names of the Parties should include the policies and certificates that cover the sub-contractor’s risks that mentioned in the insurance table, except any insurance provided by the employer or the contractor as stated in the sub-contract Data. According to the insurance table, insurance should be applied against the liability for loss of or damage to property with the amount of cover that stated in the sub-contract data for any one event with cross liability [14].
Clauses 85, 86 and 87 provide conditions for the insurance policies and certificates that should be provided by the contractor or employer to the sub-contractor as required in the sub-contract [14].

According to what has been mentioned above, the sub-contractor, Hunt seems to be liable under Clauses X18.1 and X18.4 of the ECS3 (the sub-contract) to the contractor, Build, for the loss that happened to the employer’s property, and he should indemnify him according to Clause 83.1 for this event, which is considered as his risk. However, Hunt’s liability to Whitehall seems to be covered under the insurance that provided by Build under Clause 84 and managed under Clause 87.

7. Conclusions

To sum up, the above mentioned case’s contractual liabilities arising under the JCT and NEC3 provisions seem to be similar. However, several differences between both forms of contract have been indicated.

First of all, the terminology and language used in NEC options and clauses is clearer than the JCT document’s language.

Secondly, risk carriers under the NEC could be allocated easily, while, without amending the contract conditions, risk allocation under the JCT contracts is fixed and cannot be changed. Whereas, the allocation of risks under the NEC is more flexible and can be well fitted to the contract party best able to carry and control them. This can be managed by choosing the secondary options under each main option thoroughly.

Thirdly, the sub-contractor’s responsibility of his sub-subcontractors’ works is stated clearly under Clause 26 of the NEC3 Engineering and Construction Subcontract. On the other hand, there is no clause under the JCT considers this responsibility.

Finally, there is no impeccable form of building contract for a specific project, but an understanding should be balanced against the knowledge with completely tailor-made forms of contract, not generally been favourable, so that it is recommended to select a building contract form that is the most suitable for the project profile. Therefore, if the above mentioned case was undertaken under the NEC3 provisions, the legal liabilities arising from its contractual failure would be considered and evaluated properly.

8. References

6. What is the NEC. (2010). Website: www.ice.org.uk/Information-resources/Downloads/NEC-Contracts