

Embracing a Modern Contract – Progression since Latham?

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Abstract

Sir Michael Latham and Sir John Egan in their reports “Constructing the Team”, “Rethinking Construction” and “Accelerating Change” identified substantial changes in the culture and structure of UK construction being required. These also included changes in the relationships between companies. The choice and form of contract can play a significant role in the governance of such relationships.

Sir Michael Latham suggested that contract writing bodies could amend existing standard forms to meet some of the concerns further urging the industry to embrace a Modern Contract. The forms of contract, and the changes to them over time, can influence culture change. This paper compares and contrasts the principal provisions of the contracts published by the Joint Contracts Tribunal (“JCT”), Institution of Civil Engineers (“ICE”) and the New Engineering Contract (“NEC”) against Sir Michael Latham’s 13 requirements for a Modern Contract. Where relevant, subcontract and consultant forms are also considered within the contractual matrix.

The JCT and ICE forms of contract were found to have retained the principle features more conducive to promoting an adversarial relationship as opposed to the modern requirements for a collaborative and trusting relationship. Some attempts have been made by the JCT and ICE to promote collaborative working and to incorporate the features of a Modern Contract but this relies heavily on overarching documents which, in the main, are non binding on the parties and simply exhort collaborative behaviour. The single, most notable, exception to this was the JCT Constructing Excellence Contract. On the other hand, the NEC family of contracts were found to have embraced virtually all the requirements for a Modern Contract in an integrated way and, could be argued, were the most conducive to assisting with implementation of the various drivers for change.

Keywords: contracts, collaboration, team working, culture

1. Introduction

The first major broad based report into construction in the UK was in 1944. The Simon Report (Min. of Works, 1944), looked into the placing and management of contracts focusing mainly on procurement routes and labour. The Emmerson Report reported a lack of cohesion between all parties to a construction contract (Min. of Works, 1962:8). The Emmerson Report also urged that consideration should be given to “the possibility of adopting a common form of contract for both civil and building engineering work” (Min. of Works, 1962:12). Further suggestion was made that the standardization should also apply to subcontracts.

Sir H Banwell iterated that the most urgent problem with the construction industry was the “necessity of thinking and acting as a whole” with attitudes and procedures needing to change but also suggesting that such changes would be “of no avail until those engaged in the industry themselves think and act together” (Banwell, 1964:5). The changes to practice and procedure included a limited aim “first step”, towards a common form of contract for building and a common form for civil engineering (Banwell, 1964:18). Once this first step had been achieved which, the Banwell Report also argued required goodwill to do so, a final step should be taken to “agree a joint form for building and civil engineering conditions of contract.” (Banwell, 1964:18).

The interim report by Sir Michael Latham focused on the relationship between “Trust and Money” and was largely concerned with the interaction between the main contractor and the subcontractor also calling for agreed subcontract terms amongst the contract writing bodies and calls from specialist subcontractors for mandatory use of them unamended (Latham, 1993:29).

The final report by Sir Michael Latham expressed continuing concern at the proliferation of standard forms being used in the industry and the problems associated with them (Latham, 1994). The Latham Report went on to suggest that one of the options of dealing with the associated problems could be to “try to define what a modern construction contract ought to contain” and then either amend the standard forms to include the requirements or to introduce a new contract (Latham, 1994:35). The Latham Report listed 13 requirements for a “most effective form of contract in modern conditions” – A Modern Contract (Latham, 1994:37). The Latham Report also went on to suggest that the recently produced 1st Edition of the New Engineering Contract (ICE, 1993) was the closest standard form of contract “containing virtually all these assumptions of best practice” (Latham, 1994:39).

Sir John Egan (Egan, 1998) identified five key drivers for change including “integrated processes and teams”. Substantial changes in the culture and structure of UK construction were required to improve the “relationships between companies”. Sir John Egan (Egan, 2003) reporting on progress since 1998,

stated that the UK Office of Government Commerce (“OGC”) recommended integration of the project team as an enabler of change with the proposal from the OGC of the adoption of forms of contract that encourage such team integration. Sir John Egan also indicated the delivery of the vision for integration required collaboration between the various players in the construction industry including the legal profession and contract writing bodies in order to prevent an adversarial approach (Egan, 2003).

2. Requirements for a Modern Contract

This paper sets out the requirements for a Modern Contract (Latham, 1994:37) and compares them with the findings of the author’s review of the NEC, JCT and ICE standard forms of contract.

2.1 Requirement 1 – *duty of fair dealing with all parties*

“A specific duty for all parties to deal fairly with each other, and with their subcontractors, specialists and suppliers, in an atmosphere of mutual co-operation” (Latham, 1994:37).

The ECC contract obliges the Employer, Contractor, Project Manager and Supervisor to act "in a spirit of mutual trust and co-operation." (NEC, 2005a). This obligation is also integrated into the rest of the contract documents forming the NEC suite including the Subcontract (NEC, 2005c) and the Professional Services Contract (NEC, 2005d).

In general, the JCT and ICE standard forms do not include such a specific obligation throughout their suite of contracts. Nevertheless, JCT and ICE attempt to deal with this particular requirement in a different way.

The JCT Partnering Charter arguably goes further than required by introducing the obligation to act “in good faith” in addition to acting fairly and in an open and trusting manner (JCT, 2005b:3). Whilst this charter is suitable for use with almost any standard form of construction contract, it is specifically not a legally binding agreement but simply conducive to creating a collaborative working environment (JCT, 2005b:inside cover). Similar provisions appear in the Framework Agreement where this document provides a mechanism for the parties to “work with each other in an open co-operative and collaborative manner and in a spirit of mutual trust and respect” (JCT, 2007:3). It is doubtful whether this is more than a desire because, in the event of conflict or discrepancy between the Framework Agreement and any Underlying Contracts, the Underlying Contracts “will prevail over the conflicting/discrepant provisions of this Framework Agreement and the Parties will be excused compliance with the conflicting/discrepant provisions of the Framework Agreement” (JCT, 2007:4).

The strongest obligation can be found in the Constructing Excellence Contract which includes in the Overriding Principle an “intention to work together with each other ... in a co-operative manner in good faith and in the spirit of mutual trust and respect” (ICT, 2006a:37).

The ICE versions rely upon the traditional arrangement with the obligations of each of the parties clearly set out. The ICE have made some attempts with the Partnering Addendum whereby the parties could sign up to a Partnering Objective to deal fairly with each other and in an atmosphere of mutual cooperation, but no express provision is made. These Partnering Objective’s could then be distributed throughout the supply chain by including the subcontractors/subconsultants/suppliers as Partners (ICE, 2003:1).

2.2 *Requirement 2 – teamwork and win-win solutions*

“Firm duties of teamwork, with shared financial motivation to pursue those objectives. These should involve a general presumption to achieve "win- win" solutions to problems which may arise during the course of the project Latham (1994:37)”.

The introduction of a Risk Register in the NEC Contract comprising a list of the risks identified and set out in the Contract Data before tender and those added to the Register by notification during the contract as early warning matters assists the parties to share in problem solving (NEC 2005a:4). The Risk Register is reviewed at risk reduction meetings where, amongst others, the parties who attend will cooperate in "seeking solutions that will bring advantage to all those who will be affected" (NEC 2005a:6).

The ICE have however, introduced a requirement for the Partners to the Partnering Addendum to “work together as a team in accordance with the Partnering Objective and in the best interests of project" (ICE, 2003:1). Partners are also urged to find solutions to problems as they arise (ICE, 2003:1)

The Constructing Excellence Contract urges the project team to work together to "support collaborative behaviour and address behaviour that does not apply with the Overriding Principle" (JCT, 2006a:37).

The JCT Partnering Charter (albeit non binding) sets out a number of objectives in relation to Teamwork: focus on the customer; engender a working environment that is conducive to shared problem solving; provide mutual support and; involve all members of the supply chain in the partnering concept (JCT, 2005b: 3).

2.3 *Requirement 3 – integrated package of documents*

“A wholly interrelated package of documents which clearly defines the roles and duties of all involved, and which is suitable for all types of project and for any procurement route.” (Latham, 1994:37). Standard tender documents and bonds would also be desirable, (Latham, 1994:40).

The NEC suite of contracts comprises 22 documents of which 16 are directly related to main contracts, with 2 documents each aimed at subcontractors, consultants and the adjudicator. Each document is in a similar style, wording and format to the others. Sample forms of Tender and Agreement are provided (NEC, 2005b:140-142). The most notable absence from the NEC suite are sample forms of bonds or guarantees with the parties remaining free to negotiate their own terms.

Different types of project and procurement routes are catered for with NEC. In addition to simply providing the Works, the Employer can specify the extent of the Contractor’s design responsibility (NEC, 2005a:7). Further flexibility is introduced by selection from one of 6 Main Option Clauses (A to F) covering: lump sum pricing through either activity schedules or a traditional bill of quantities; target cost pricing again through the use of either activity schedules or bill of quantities; cost reimbursement or; under a management contract. The roles and responsibilities of all parties to the contract are also clearly set out within the NEC contracts including those of the Project Manager and the Supervisor.

The full range of types of contract, Design and Construct, Measurement, Target Cost, Term Contracts, Minor Works are catered for by the ICE. The ICE’s 17 documents are main contracts with the exception of the Partnering Addendum.

The JCT suite comprises some 56 documents in all, with 30 documents being directly linked with main contracts, 24 being aimed at subcontracts and the remaining balance of 2 documents being aimed at appointing the adjudicator. The JCT is unique in being the only one of the three sets of documents to include standard forms of collateral warranties. Whilst none of the JCT forms are drafted specifically to engage a consultant, provision is made within the Constructing Excellence Contract to do so (JCT, 2006a:4).

Both JCT and NEC include standard forms of contract interrelated with the main contracts as between the Employer and the Contractor with only NEC incorporating a standard appointment document for a consultant in the form of the Professional Services Contract (NEC, 2005d).

However, the ICE rely, by virtue of the Partnering Addendum, upon the ACE forms of agreement to engage civil/structural, mechanical/electrical and/or the Planning Supervisor (as was) as consultants

and upon the CECA forms of subcontract to engage subcontractors (albeit the latter only presently being compatible with out of date versions of the relevant ICE contracts) (ICE, 2003:iii).

2.4 *Requirement 4 – simple language and guidance notes*

“Easily comprehensible language and with Guidance Notes attached.” (Latham, 1994:37).

One of the original drafting aims of the NEC contract was that it should be in ordinary language thereby being a model of “clarity and simplicity”. This would have the benefit of making it easier to understand by people who are not used to formal contracts and by people whose first language is not English. The Engineering and Construction Contract, Guidance Notes indicate that its use of ordinary language would also make it easier to translate into other languages, NEC (2005b). It is understood the 2nd Edition of the Engineering and Construction Contract and the Professional Services Contract (ICE, 1995) have been translated into Mandarin with plans in hand to do so with the latest edition.

Guidance Notes and Flowcharts have been produced for all the documents in the NEC3 package apart from the Subcontract and the Short Subcontract.

Both JCT and ICE have retained their traditional styles of wording which, arguably by familiarity within the industry, are readily understood by users of the contracts. Guidance Notes have been released by the two contract writing bodies to help explain how they are envisaged to work in practice for practically all the contract documents in their extensive suites. The ICE guidance notes have been produced with the specific aim of representing what the Conditions of Contract Standing Joint Committee (“CSJC”) considers constitutes good practice in the conduct of civil engineering projects (ICE, 1999b:1).

2.5 *Requirement 5 – role separation*

“Separation of the roles of contract administrator, project or lead manager and adjudicator. The Project or lead Manager should be clearly defined as client's representative.” (Latham, 1994:37).

The roles of the Project Manager and Adjudicator are clearly separated within the NEC. The Project Manager is appointed by the Employer and becomes the principal point of contact with the Contractor under the contract, being able to give instructions, acceptances, issue certificates, assess amounts due for work done to date including assessment of Compensation Events amongst others. Brian Eggleston notes the Project Manager has no express requirement to act impartially nor to act in the interests of the Employer citing the English case of *Costain Ltd and Others v Bechtel Ltd* 2005 (Eggleston, 2006:89). The Adjudicator is clearly intended to be independent as the Adjudicator has jurisdiction to

resolve disputes under the contract which may involve an action or inaction of the Project Manager (NEC, 2005a:45,46).

The ICE conditions retain the definition of the Engineer/Engineers Representative as the agent of the Employer. The ICE role also envisages determination of matters of dissatisfaction as a precursor to determination by an independent adjudicator (ICE, 1999:48).

The Employers Agent's role is also largely retained within the JCT contracts as having "full authority to receive and issue applications and otherwise to act for the Employer" (JCT, 2005a:3). The role is redefined within the Constructing Excellence Contract as the Purchasers Representative with full authority to "act on the Purchasers behalf in relation to the Project and who shall be the point of first contact for the Supplier" (JCT, 2006a:39).

2.6 *Requirement 6 – risk allocation*

"A choice of allocation of risks, to be decided as appropriate to each project but then allocated to the party best able to manage, estimate and carry the risk.", Latham (1994:37).

Within the NEC, the Employer's base risks are clearly set out with all other risks being carried by the Contractor by exception (NEC, 2005a:21). Additional risks to be borne by the Employer can be set out in the Contract Data (NEC, 2005a:64) with other risks to be borne by the Contractor being allocated using amended or additional clauses under Option Z (NEC, 2005a:69).

The Risk Register in the NEC Contract comprising a list of the risks identified and set out in the Contract Data before tender and those added to the Register by notification during the contract as early warning matters (NEC, 2005a:4). The Risk Register is reviewed at risk reduction meetings (NEC 2005a:6). There are three objectives to the Risk Register: the first is to identify the generic or specific risks inherent in the project; the second is to set out how the risks will be managed i.e. who will take what action to manage or minimise them; the third is to identify the time and cost consequences of doing so (NEC, 2005b:32)

The JCT and ICE forms of contract generally leave the risk and solution of problems occurring on site up to the Contractor with a certain amount of control or direction from the agent of the employer or the contract administrator.

The ICE have introduced a Schedule setting out Partner Risk Managing Arrangements (ICE, 2003:5) with the express intention that it should be used to identify risks and the Partners who are able to control that risk (ICE, 2003:vii).

JCT's introduction of a Risk Register within the Constructing Excellence Contract together with completion of a Risk Allocation Schedule (JCT, 2006a:43,44) appeared to implement the express intention to encourage the identification and management of the project risksand to enable the parties to allocate responsibility for the consequences of identified risks to the party best able to manage those consequences." (JCT, 2006b:13)

2.7 *Requirement 7 – variations*

“Taking all reasonable steps to avoid changes to pre-planned works information. But, where variations do occur, they should be priced in advance, with provision for independent adjudication if agreement cannot be reached.”, Latham (1994:37).

The NEC contract envisages the pre-planned Works Information being as complete as possible. Nevertheless the contract also envisages changes being made to the Works Information by instruction from or a change in an earlier decision by the Project Manager (NEC, 2005a:15) with further provision for quotations being submitted before the varied work starts (NEC, 2005a:15). The NEC treats any changes to the pre-planned Works Information as Compensation Events rather than claims for extensions of time and/or money (NEC, 2005a:15-19).

The ICE make provision for agreeing “wherever possible the value and delay consequences ... of each variation ... before work starts” (ICE, 1999a:31).

Within the JCT contracts, the parties are urged to agree the cost of variations without necessarily setting out a procedure for agreeing them before work starts (JCT, 2005a:53 and JCT, 2006a:50)

All disagreements on the pricing of variations to the pre-planned works information can be resolved by an independent adjudicator (see Requirement 11 below)

2.8 *Requirement 8 – mechanisms for assessing interim payments*

“Express provision for assessing interim payments by methods other than monthly valuation i.e. milestones, activity schedules or payment schedules. Such arrangements must also be reflected in the related subcontract documentation. The eventual aim should be to phase out the traditional system of monthly measurement or re-measurement but meanwhile provision should still be made for it.”, Latham (1994:37).

The NEC mechanism for assessing interim payments are based on the assessment of the Price for Work Done to Date (NEC, 2005a:13). Depending upon which of the Main Options are used, the

assessment can be against a bill of quantities (NEC, 205a:29) or against an activity schedule (NEC, 2005a:27). These assessments are carried out at regular intervals of no more than five weeks (NEC, 2005a:62). The NEC contract appears to be yet to embrace payment by milestones or payment schedules.

The ICE do not appear to have departed from traditional monthly valuation routes within the Measurement Contract (ICE, 1999a:40) nor within the Design and Construct Contract (ICE, 2001b:35).

Apart from the Constructing Excellence Contract, the JCT documents appear to rely upon traditional monthly valuation methods whether they be by measurement or by reference to an activity schedule. Some provision is made within the Design and Build contract for payment by stages (JCT, 2005a:9). In any event, the Constructing Excellence Contract appears to be the only form of contract fully compliant with this Latham requirement setting out clear mechanisms for payment against monthly valuations whether assessed on a cost basis or by admeasurement with further provision for a payment schedule (JCT, 2006a:19-22). The Guidance also explains that the Payment Schedule can show payments “by reference to completed activities or milestones or progress against the project programme or any other method of assessing and paying by instalments” (JCT, 2006a:16).

2.9 Requirement 9 – payments

“Clearly setting out the period within which interim payments must be made to all participants in the process, failing which they will have an automatic right to compensation, involving payment of interest at a sufficiently heavy rate to deter slow payment.”, Latham (1994:37).

Since publication of the Latham Report, statutory intervention has taken place in relation to instalments, stage and periodic payments Construction Act 1996: ss109-113). The NEC (NEC, 2005a:13), JCT Design and Build (JCT, 2005a:45,46) and the ICE Measurement version (ICE, 1999a:40) payment provisions have been drafted to comply with the legislative provisions of the Construction Act. In default, the provisions set out in the Scheme would apply anyway (Construction Act 1996: s110 ss3).

If payments are late, each of the standard forms incorporate a contractual right to interest on behalf of the payee (NEC, 2005a:13), JCT, 2005a:46) and (ICE, 1999a: 42). The parties are free to agree the contractual interest rate although they are usually fixed by the client or employer, it remains arguable whether the rates fixed are sufficiently heavy to deter slow payment when compared to the default statutory rate (Commercial Debts (Interest) Act).

2.10 Requirement 10 – trust funds

“Providing for secure trust fund routes of payment.” (Latham, 1994:37).

The second edition of the NEC Contract permitted the setting up of a trust fund to meet the needs of this requirement if Secondary Option Clause V was invoked (ICE, 1995:46). Sample Trust Fund documentation and a sample Trust Deed were also included in the Guidance Notes (ICE, 1995b:131-138). This option disappeared following the drafting of NEC3 in 2005.

With the enactment and implementation of the Office of Government Commerce Model “Fair Payment Charter” in 2007, the NEC drafting committee responded by producing an Option Z clause to allow users to implement the fair payment practices into NEC contracts with included the creation of a Project Bank Account with beneficiaries of the Account being designated by execution of a Trust Deed and subsequently a Joining Deed, NEC (2008).

Provisions for a Trust Fund and/or a Project Bank Account are currently absent from the ICE and JCT documents.

2.11 Requirement 11 – speedy dispute resolution

“While taking all possible steps to avoid conflict on site, providing for speedy dispute resolution if any conflict arises, by a pre-determined impartial adjudicator/referee/expert.”, Latham (1994:37).

Steps have been taken within all the forms of contract, to varying degrees, in attempts to try and avoid conflict on site by the introduction of Risk Registers/ Risk Allocation Schedules and regular meetings to discuss risks. Nevertheless, adjudication procedures are introduced: in the NEC contract by invoking Main Option Clause W2 within the UK (NEC, 2005a); in the JCT contract by slightly modifying the statutory Scheme for Construction Contracts; and in the ICE contract by use of the ICE’s Adjudication Procedure (ICE, 1997).

A decision on the dispute from the adjudicator is normally expected within 4 weeks but may be extended to give the adjudicator further time to receive information and/or to come to his decision on the dispute.

2.12 Requirement 12 – incentives

“Providing for incentives for exceptional performance.”, Latham (1994:37)

In the absence of use of the Partnering Secondary Option, users of the NEC contract may be incentivised by the use of Key Performance Indicators (“KPI”) contained in a pre-agreed Incentive Schedule setting out payments to be made if a particular KPI is achieved or exceeded (NEC, 2005a:54). KPI’s are an integral part of the Partnering Secondary Option with the incentives set out in the Schedule of Partners (NEC, 2005a:50)

Bonuses can also be won under NEC for early completion of the works (NEC, 2005a:50).

The ICE generally do not provide incentives for exceptional performance. However, the Partnering Addendum suggests that "financial adjustments shall be under the Bi Party Contracts” (ICE, 2003:2). Whilst details of the Partner KPI/Incentive arrangements can be set out in the Partnering Addendum (ICE, 2003:5) it appears to be left to the Parties to agree how the underlying contracts should be amended.

The JCT again do not generally provide incentives nor do they set down provisions for measuring performance. Only the Framework Agreement and the Constructing Excellent Contract provide mechanisms for Performance Indicators assessed against the Framework Objectives (JCT, 2007:9) and performance monitoring against Key Performance Indicators (JCT, 2006a:47).

2.13 Requirement 13 – advanced mobilisation

“Making provision where appropriate for advance mobilisation payments (if necessary, bonded) to contractors and subcontractors, including in respect of offsite prefabricated materials provided by part of the construction team.”, Latham (1994:37)

NEC provide a mechanism agreeing to make an advanced payment, for unspecified purposes, by invoking Secondary Option X14 (NEC, 2005a:52). The advanced payment is then repaid by preagreed instalments as set out in the Contract Data from amounts assessed as due to the Contractor from time to time (NEC, 2005a:52). The Employer can also elect for the Contractor to deliver an advanced payment bond by an appropriate entry in the Contract Data (NEC, 2005a:68). No sample form of bond is provided.

JCT also make provision for an advanced payment being made to the Contractor, for unspecified purposes, which are reimbursed to the Employer on the terms stated in the Contract Particulars (JCT 2005a:45). Subject to certain conditions being met, the Contractor can also be paid for off site materials (the Listed Items) in advance of incorporation into the works (JCT, 2005a:50). In both cases, the Employer has the right to call for a bond from a Surety approved by the Employer.

Bonds can be required with an appropriate entry within the Contract Particulars. Forms of bond are helpfully provided for both general advanced payments and for offsite prefabricated materials (the Listed Items) for most of the main contracts (JCT, 2008)

The ICE's provision for advanced payment relates only to the vesting of materials off site (ICE, 1999a: 33). No form of bond is provided or asked for.

3. Conclusion

As expected the NEC family of contracts were found to have embraced virtually all the principles of a Modern Contract. The NEC does lack suggested forms of bond and guarantees. Furthermore even though there are provisions for a Risk Register, this Register could help the parties by being in a form conducive to setting out precisely how each risk has been allocated to the party best able to manage it.

In general, the ICE and JCT contracts were found to be less compliant with the requirements for a Modern Contract. They have some good features particularly the ICE Partnering Addendum, JCT Partnering Charter and the JCT Framework Agreement. The documents fell short in that they allowed the underlying contracts to take priority in the event of discrepancy or dispute. It would be helpful to step down or incorporate the Modern Contract compliant provisions of the overarching agreements into the underlying contracts.

The most notable exception within the ICE and JCT contracts as found by the review was the JCT Constructing Excellence Contract. This particular contract was found to be highly compliant with the Latham requirements of a Modern Contract with particular reference to the form of Risk Allocation Schedule taken together with the completed examples within its Guidance Notes. Further work is required to the Constructing Excellence Contract to ensure that is fully compliant with the requirements for a Modern Contract.

In closing, it would also appear the industry still has some way to go before it is ready to take the "final step" towards agreeing a joint form of contract for building and civil engineering.

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