



**NEC3 PROFESSIONAL SERVICES  
CONTRACT (PSC3): THE  
CONSULTANTS' PERSPECTIVE**

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# **NEC3 PROFESSIONAL SERVICES CONTRACT (PSC3): THE CONSULTANTS' PERSPECTIVE**

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## **Introduction – the principles of the PSC3 contract**

NEC contracts are developed by the Institution of Civil Engineers (ICE) and are now in their third edition (known as 'NEC3').<sup>1</sup> It needs to be remembered that they are a 'family' of contracts and each is consistent with the others. As a result, the third edition of the consultant's NEC3 Professional Services Contract (PSC3) is consistent with the NEC3 Engineering Construction Contract (ECC), which is a contract between an employer and a contractor.

PSC3 is therefore very different from the other standard forms of contract, for example those produced by the Association for Consultancy and Engineering (ACE), the Royal Institute of British Architects (RIBA) or the Construction Industry Council (CIC). It is much more like a contract with the contractor: there is a detailed programme which has to be accepted, a Completion Date and an Option for Sectional Completion. If the Consultant is to obtain a change to the Completion Date, he has to have a ground for doing so – a compensation event – and there is a procedure for ascertaining the extension to be given. There is an Option whereby the Consultant is obliged to pay delay damages if the services are completed late. If the Consultant is to receive any addition to his fee the same basis applies. The Consultant has to comply with the same procedures concerning the Risk Register, key dates and early warning notices as does a contractor under the ECC. There can be Key Performance Indicators. There is a Defects liability period and an obligation to put right Defects. The fee basis can be Option A: 'Priced contract with activity schedule', Option C: 'Target contract', Option E: 'Time based contract' or Option G: 'Term contract'. (There are no Options B, D or F, which are confined to ECC contracts.)

PSC3 is divided into core clauses, which set out the clauses that will apply to all PSC3 contracts, and then there are the main Option clauses. These set out the four types of pricing mechanism (from which one is selected); two dispute resolution options (known as W1 and W2); and then secondary Options clauses comprising X clauses (including provisions such as key performance indicators, a bonus for early completion and limitation of liability); two Y clauses (the first brings in the Construction Act payment provisions, the other the option to give a third party the right to enforce any term(s) under the Contracts (Rights of Third Parties) Act). Finally, there is provision for additional Z clauses.

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<sup>1</sup> See generally, [www.neccontract.com](http://www.neccontract.com).

NEC3 contracts each come with Guidance Notes – lengthy documents with many flow charts illustrating each contract’s processes. They provide a commentary on all the provisions in the contracts, so it is advisable to refer to the Guidance Notes first when clarification of the underlying contract is needed, although they do not, as you will see, always provide an answer.

The PSC3 contract is created by the Employer completing the data in Contract Data Part one and the Consultant the data in Contract Data Part two, although the Guidance Notes accompanying PSC3 also contemplates a letter of offer from the Consultant, a letter of acceptance from the Employer and possibly a form of agreement.

Together, the two Parts of the Contract Data provide the specifics for the contract and state which Options are to apply. It is the Employer who designates the services and ‘the Scope’ and it is ‘the Scope’ which specifies and describes the services or states any constraint on how the Consultant is to provide the services. There is no definition of ‘services’ as such. This can give rise to some confusion, as the services are often no more than a brief description of the work – unlike other forms of appointment where there can be extensive services schedules – while the Scope contains everything else.

There is also the option for the Employer to add its own specific additional clauses (the Z clauses referred to above). These can be used to alter significantly the basis of the contract and so need special consideration.

PSC3 is an entire contract and no change to the contract has effect unless it has been agreed, confirmed in writing and signed by the parties, unless provided otherwise.

The main feature of the PSC3 and other NEC3 contracts is that they are heavily procedural. Notices have to be given within certain timescales, and likewise responses; meetings have to be held and decisions made: all within certain timescales. Acting promptly is a condition precedent to many of the rights that the parties enjoy under the NEC3 family of contracts. Consultants should not under-estimate the resources that will be needed simply to comply with these procedures.<sup>2</sup>

The objective is to make the parties deal with delays, compensation events, risks and other matters that may affect the provision of the services or the project at an early stage and to resolve these. This is different from other traditional contractor contracts, where contractors are inclined to leave claims for additional time and/or money to the end.

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2 Subsequent to giving the talk in London in March, I received extensive comments from Rob Gerrard (who is an NEC Consultant) and I am most grateful to him for correcting a couple of comments I made regarding the operation of the contract, and for helping with other aspects by explaining NEC thinking. A number of his comments are included here as footnotes. He makes the point generally that one of the key characteristics of NEC is to provide a stimulus to good management. The expectation is that there should be no surprises at the end of the commission and that the parties deal with matters on a real-time basis, which is simply good management.

In my view, these contracts work best where the work to be performed has been fully detailed before the works or services start, where only relatively few ‘compensation events’ should arise. The PSC3 Guidance Notes state in relation to the clause 23.2 provisions concerning the holding of meetings (page 31): ‘It is important that planning and programming of the work of the various consultants and Others are carried out before the start of the contract’.

Where projects have started before the works have been fully detailed, so that virtually every piece of design is a change to the original scope, the parties can struggle to keep up with and operate the machinery of the contract.

The contract also envisages co-operation between the parties: there is an express obligation to act in a spirit of mutual trust and co-operation (clause 10.1).

NEC3 contracts are different from the standard forms produced by the ACE and RIBA and the contractors’ contracts produced by the Joint Contracts Tribunal Ltd (JCT) and ICE, in that they use the present tense (as does the Royal Institution of Chartered Surveyors (RICS) contract). There are therefore no obligations expressed as such in the traditional sense. It can as a result sometimes be difficult to work out when something is to be done. To date, there have been no court cases which have considered the language of the NEC3 contracts (although one case in relation to the notice provisions suggested the language was mandatory but found a way round it).<sup>3</sup> So it is not yet known how the courts will interpret NEC language. For the purposes of this paper, however, the provisions in PSC3 will be referred to as if they are obligations.

Finally, before turning to the detail, I would like to say something about the role of the designer under ECC contracts: which is none. The ECC only refers to the Employer, the Contractor, the supervisor and project manager. The ‘designer’ does not appear – many consultants do not appreciate that they have no role other than that of producing a design for the Employer. If consultants do get involved in ECC contracts, then it is not as a designer or even as engineer, but only as supervisor and/or project manager. It should be noted that if consultants take on *both* of the last two roles then Chinese walls will have to be set up. PSC3 may also be used in both cases. PSC3 is not solely confined to design work.

In this paper I am going to look at four particular areas introduced in PSC3 and say something about the concept of Defects, which has been around from the beginning but is still problematic.

1. The Key Date provisions and consider how these fit or do not fit with the other provisions in PSC3 concerning the Accepted Programme etc.
2. The status of the matters on the Risk Register.
3. A brief word on the new provision concerning ‘prevention’.

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3 *Anglian Water Services Ltd v Laing O’Rourke Utilities Ltd* [2010] EWHC 1529 (TCC), 131 ConLR 94.

4. The bases for limiting liability and how these compare with most consultants' professional indemnity insurance. The PSC3 has moved from the simple limit of liability for matters resulting from a failure to Provide the Services in the NEC2 Professional Services Contract (PSC2) to something much more complex and where there is a real possibility that consultant's professional indemnity insurance will not cover some of the matters.
5. The concept of 'Defects' and the obligation to put them right.

## Key Dates

A Key Date is defined in clause 11.2(6) (page 3) as:

'... the date by which work is to meet the Condition stated. The Key Date is the *key date* stated in the Contract Data and the Condition is the *condition* stated in the Contract Data unless later changed in accordance with this contract.'

It is assumed therefore that all Key Dates will be identified before the contract is entered into and the Employer will put them in the Contract Data part one (page 44) by setting out where provided the stated condition that is to be met and then the key date. There is no provision for adding Key Dates at a later date. Presumably at that point during the tender process, if the Consultant thinks he cannot meet the key date and/or condition he must refuse to agree the contract.

Then there are the requirements concerning Key Dates in relation to the programme set out in clause 31.2 (page 9). They have to be set out in relation to the overall dates in the programme and the Consultant has to include in his programme 'the dates when the *Consultant* plans to meet each Condition stated for the Key Dates ...'. This seems curious – surely he will plan to meet the Condition by the Key Date? In some circumstances, however, it might be that he plans to meet it earlier than the Key Date.

Key Dates are different from the dates by which sections of the work are to be completed. So what sort of thing could constitute a Key Date? Clause 31.2 (page 9) already covers: 'the order and timing of the operations which the *Consultant* plans to do in order to Provide the Services', and 'the order and timing of the work of the *Employer* and Others ...'

The Guidance Notes say (page 28) that Key Dates are 'dates by which the services are required to reach a stated Condition'. (The definition of Key Date in PSC3 uses the word 'work', not 'services', but PSC3 seems to use 'work' and 'services' interchangeably.) Are they to be milestones, for example completion of various stages of the design – design brief and concept approval, detailed design approval etc? But this could be covered by some of the other matters in the programme. However, I think the reason for having

Key Dates is because of the strict obligation to meet them and the remedies the Employer has if the Consultant misses them.<sup>4</sup>

There is no strict obligation to meet the various other dates in the programme. All clause 30.1 says (page 9) is that the Consultant, like a contractor, ‘... does the work so that Completion is on or before the Completion Date’. How he gets to the Completion Date is therefore a matter for him. If he is to have any delay to the Completion Date then he will need to bring himself within one of the stated compensation events. So by introducing Key Dates the Employer will be able to fix some interim dates which the Consultant is also to meet.

The obligation to meet a Key Date is in clause 30.3 (page 9): ‘The *Consultant* does the work so that the Condition stated for each Key Date is met by the Key Date’. It is therefore a strict obligation. The Consultant will, in my view, be entitled to additional time and a resultant change in the Key Date if the event preventing him from achieving a Key Date is a stated compensation event, even if the change to the Key Date is the only change required. The compensation events also include the Employer changing a Key Date. The Consultant has to notify the event within the timetable prescribed.

An early warning notice also has to be given if either party becomes aware of any matter which could ‘delay meeting a Key Date’ (clause 15.1, page 5). This could result in a change to the Scope. The Employer is entitled to give an instruction to change the Scope which would be a compensation event (clause 20.2, page 7) and so could reduce the Scope so that the original Key Date is met. If a change in Scope makes the description of the Condition for a Key Date incorrect, the Employer can correct that description and that is to be taken into account in the assessment of the effect of the compensation event (clause 63.9, page 16). The Employer also has the authority to change a Key Date (clause 20.2, page 7) and this is a compensation event (clause 60.1(4), page 13).

The question for the Consultant will be: will the agreed compensation events for any project cover all the likely events that ought to relieve the Consultant of the strict obligation to meet the specified Condition by the specified Key Date, in circumstances where he has not been negligent or where he has been prevented for reasons beyond his control? Such events could be difficult to predict. If not, further events will need to be added. The ACE Agreements deal with this more generally by qualifying an obligation to meet the programme with ‘Subject always to conditions beyond the Consultant’s control ...’<sup>5</sup>

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4 Rob Gerrard comments that Key Dates are not necessarily included in all PSC3 contracts and clients need to appreciate when to use them, and/or constraints in the Scope, and/or Sectional Completion, or simply require all of the services to be provided by the Completion Date. They are not just milestones to check on progress for example, they are an important stage in the consultancy process, often used in connection with third party interfaces. On many projects, the Consultant will have to do certain things at certain times to keep the project going: Key Dates offer a route to achieve this other than simply stating constraints or using Sectional Completion.

5 For example, the Association for Consultancy and Engineering Agreement 1, 2009 edition, clause F2.5.

The effect of compensation events on Key Dates is to be brought into the quotations/assessments for the costs and time consequences of all compensation events: which is why I think a Consultant can use the compensation event procedure if a Key Date cannot be met as a result of a compensation event (clauses 62.2 and 63.3, pages 14 and 15). The latter clause says the delay is assessed as the length of time that, due to the compensation event, the planned date when the Condition stated for a Key Date will be met is later than the date shown on the Accepted Programme.

There are consequences if the Consultant does not meet the Condition stated for a Key Date. Clause 23.3 (page 7) says that:

‘If the *Employer* decides that the work does not meet the Condition stated for a Key Date by the date stated and, as a result, the *Employer* incurs additional cost either

- in carrying out work or
- by paying an additional amount to Others in carrying out work

on the same project, the additional cost the *Employer* has paid or will incur is paid by the *Consultant*. The *Employer* assesses the additional cost within four weeks of the date when the Condition stated for that Key Date is met. The *Employer’s* right to recover the additional cost which is his only right in these circumstances.’<sup>6</sup>

Taking the various parts of this clause: first, the Employer ‘decides’ if the Condition for a Key Date has not been met by the date stated. What if the Employer’s decision is wrong? There is nothing in PSC3 about the parties acting reasonably. Yes, they have to work in a spirit of mutual trust and co-operation,<sup>7</sup> but this does not really cover it. I do not think there is any basis on which the decision could be challenged. The same applies to the assessment the Employer is to make. Again, it is not thought the Consultant would be able to challenge this assessment – the Employer has been given a right to do this – there appears to be no objective test and therefore no basis on which to found a challenge. If a challenge is possible, then it would be through the relevant dispute resolution procedure.

There is also the question this clause raises of whether the Employer will in fact be able to make an accurate assessment within the four week period. Presumably if the Employer fails to make the assessment within the four weeks he loses his right to the additional cost, but again that is not clear.

What is the cost he is to assess? This is the additional cost he incurs in carrying out work or additional cost he incurs by paying an additional amount to Others ‘in carrying out work on the same project’. There is some uncertainty about this. Is the ‘work’ that is to be carried out only that necessary to meet the Condition? It is implied, but not stated, that only the minimum is necessary but it will depend on the nature of the Condition itself. It is also implied that either the Employer or Others will carry out *work*. Is it anticipated that Others, say, will complete the relevant part of the Consultant’s

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6 It is thought the ‘which’ in the last sentence has been included in error.

7 Clause 10.1 (page 3).

design which, for example, he has failed to complete by a Key Date? Will 'work' always be what is required? Do 'costs' cover the consequential costs of carrying out other work (eg additional work) the Employer and Others incur because of delay? Yes, probably, because the clause refers to 'costs', but the Employer clearly is not entitled to any recovery for any other types of losses.

What if the Consultant does the work but does it after the Key Date? This might be a better and cheaper solution than the Employer employing Others to do so. What about any delay to the project as a result? Will the Employer be able to collect damages or LADs if the Consultant fails to meet the Completion Date as a result? It is arguable that the Employer may not be able to do so – as clause 23.3 (page 7) provides this is the Employer's only remedy. There could therefore be some advantages in terms of the loss/damages payable to the Employer if a Key Date is missed: the remedy could be more restricted than if it were treated as a straight breach of contract.

So in respect of the Key Date provisions, a Consultant will need to consider whether he is prepared to agree that the Employer should assess any additional costs if the Conditions for Key Dates are not met. This will depend on his view of how the Employer may act in these circumstances.

## **The Risk Register**

PSC3 introduced the concept of the 'Risk Register'. It is understood from the definition in clause 11.2(10) (page 4) that this is to be compiled at the beginning of the project. The definition says 'The Risk Register is a register of the risks which are listed in the Contract Data ...'. Both parties have sections in the Contract Data (pages 42 and 49) where the matters to be included in the Risk Register are to be listed – in two or four lines respectively. The definition continues:

*'... and the risks which the Employer or the Consultant has notified as an early warning matter [ie all early warning matters are now risks to go on the Risk Register]. It [presumably the Risk Register] includes a description of the risk and a description of the actions which are to be taken to avoid or reduce the risk.'*

Nothing is said about who sets up the Risk Register and records what is to be done in order to avoid or reduce the risks listed in the Contract Data. It is assumed that these are the Employer's duties for reasons I explain below.

Once there has been an early warning notice, PSC3 provides that the new procedure for dealing with matters on the Risk Register takes the place of the procedure which under PSC2 followed the giving of early warning notices.

Clause 15.1 (page 5) requires either party to give an early warning notice to the other as soon as either becomes aware of any matter which could:

- increase the total of the Prices (ie the lump sum or target cost fee),
- delay Completion (ie of the services),
- change the Accepted Programme,
- delay meeting a Key Date,

- impair the usefulness of the services to the *Employer*, or
- affect the work of the *Employer*, an *Employer's* contractor or another consultant.

These are all compulsory for both parties. The Consultant ‘may’ – but presumably is not obliged to – give an early warning of any matters which could increase ‘the ‘total cost’.

All these early warning matters are to be entered by the Employer in the Risk Register, presumably in addition to those which are in the Contract Data. If the Employer has this obligation and the later obligation to revise it, I assume it is implied that he is to be responsible for the setting up of the Risk Register and recording of actions from the beginning.

Finally, clause 15.1 (page 5) says the parties do not have to give early warning of a matter for which a compensation event has previously been notified. It should be noted that failure to give an early warning notice can have an effect on the assessment of a compensation event.

Clause 61.5 (page 14) says:

‘If the *Employer* decides that the *Consultant* did not give an early warning of the event which an experienced consultant could have given, he notifies this decision to the *Consultant* when he instructs him to submit quotations [for compensation events].’

Then clause 63.5 (page 15) says that in such circumstances, ‘the event is assessed as if the *Consultant* had given early warning’. It is thought that this means that if extra time and/or cost has been incurred by the Consultant because of the failure to give an early warning notice, then that extra time or extra cost will not be recoverable in any compensation event, even if the Consultant has complied with the requirement to notify a compensation event within eight weeks of becoming aware of the event.

It seems to be intended that all matters on the Risk Register, whether originally stated or added to by later early warning notices, are to be dealt with by risk reduction meetings, but these are not compulsory nor is any timetable set for them. Clause 15.2 (page 5) says either the Employer or the Consultant may instruct (presumably at any time) the other and other people (if the other party agrees) to attend a risk reduction meeting and then, pursuant to clause 15.3, everyone attending co-operates in:

- ‘making and considering proposals for how the effect of the registered risk can be avoided or reduced,
- seeking solutions that will bring advantage to all those who will be affected,
- deciding on the actions which will be taken and who, in accordance with this contract, will take them and
- deciding which risks have now been avoided or have passed and can be removed from the Risk Register’.

It is unclear what the status is of the matters on the Risk Register and of the decisions made at the risk reduction meetings under clause 15.3. Do the parties have to take the action decided upon, ie is it a contractual obligation? What does 'in accordance with this contract' add? There are no specific obligations relating to who has to do what in relation to the Risk Register – although the Consultant does have to obey instructions given by the Employer (clause 25.3, page 8) but the Employer's right to give instructions is limited to changing the Scope or a Key Date (and after Completion an instruction is given only if it is necessary to Provide the Services) (clause 20.3, page 7).

Some other provisions in the contract also allow the Employer to give instructions in certain circumstances but not in relation to the Risk Register. Also, nothing is said as to what is to happen if there is any failure to take the action decided upon. Additional costs incurred as a result of complying will only be recoverable if they are also compensation events.

After the meeting it is the Employer who revises the Risk Register to record the decisions made at such meetings and who issues the revised Risk Register to the Consultant. If a decision needs a change to the Scope, the Employer is to instruct the change at the same time as he issues the revised Risk Register (clause 15.4, page 5). The parties then move into the compensation event procedure.

It is possible that some of the actions decided upon as being needed to reduce or avoid the risk could also qualify as compensation events if they were not complied with even if they do not require a change to the Scope. For example, if it was essential to reduce a risk that the Employer provided relevant information to the Consultant by a certain time and then failed to do so because he has been unable to obtain it from a third party, that would qualify as a compensation event.

This is all the contract says about the Risk Register and so this gives us no idea as to the sort of risks it is anticipated will go on the Register. All the Guidance Notes say (page 28) in relation to the definition is that the Risk Register provides a means of identifying the risks and managing them by eliminating them or reducing them or otherwise deciding how they are to be dealt with, and that sub-clause 15.4 provides a procedure for revising the Risk Register following a risk reduction meeting. The first part echoes the language of the Construction Design and Management Regulations but I do not think the Register can be intended to cover health and safety aspects of the Consultant's design and/or the matters that need to go in the construction phase plan for which the Regulations already provide procedures.<sup>8</sup>

It is unclear whether Employers will include in the original Risk Register matters that are different from and more extensive than those which are stated in clause 15 (page 5) to be the subject of early warning notices, which are

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8 The Construction Design and Management Regulations are not mentioned in PSC3 at all and in my view quite rightly. The obligations are imposed by statute and should not also be a matter of contractual obligation.

fairly comprehensive. Perhaps they are simply to be specific risks for that particular project which the parties foresee at the outset.<sup>9</sup>

Consultants will need to consider any risks in the Contract Data which the Employer provides or which the Consultant considers should be included with these points in mind and their interaction with compensation events. Should there be included in the Contract Data all the matters which could give rise to additional cost/time if they are not dealt with or which could not be dealt with as originally anticipated and should these all be included as compensation events? It seems possible that they should.<sup>10</sup>

Some consultants have commented to me that the status of the Risk Register is so unclear and the contract is so uncertain as to what should be included on the Register that it is little used.

## Prevention

There is a new provision in PSC3 clause 18 (page 6) headed ‘Prevention’. This is essentially a *force majeure* provision, and it is intended to be so. The Guidance Notes comment on this clause (page 30):

‘This subclause is designed to deal with what is commonly referred to as “force majeure” events, that is the kind of events which neither Party can prevent or control.’

It is not, however, drafted in the traditional manner.

Clause 18.1 says (page 6):

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- 9 Rob Gerrard comments that the matters to be listed in the Contract Data should reflect the residual risks that the parties consider have not been avoided or reduced at the point of entering into the contract. The whole early warning process is concerned with simple risk management, not the contractual allocation of risk. What risks have the parties not been able to reduce or avoid? Whatever they are, be they CDM related, stakeholder or otherwise, could have a detrimental effect on the project/parties if the parties do not capture them and give them appropriate consideration post-contract. They are particular to the project and the parties, they are not a generic list of any or all risks that might happen. The whole process of risk management commences on a particular project generally way before any PSC3 contract is finally entered into. The matters in the Contract Data reflect a snap shot of residual risk at a point in time. The whole concept is about trying to ensure there are minimal surprises and where problems do arise, that there is an efficient process for dealing with such matters in a timely way. It is left to the parties to judge what amount of effort/consideration goes into each risk reduction meeting.
- 10 Rob Gerrard comments that the matters to be stated in the Contract Data are not to be an ‘everything and anything’ possible list or just those confined to matters which are compensation events. They are particular to the project/parties and must be completed with careful thought at tender stage. On occasion, the matters may cause the tender process to be delayed as the matters are so numerous or potentially so problematic, the project could be nowhere near the stage of eg securing a lump sum fee from any consultant. That would be a good outcome compared with the unrealistic and sadly common approach of both parties sticking their head in a bucket of sand, entering into a lump sum contract, then being beset with an untold amount of risk that both parties sort of had in the back of their head but failed to communicate to the other party, or do anything about. The risk management approach in PSC3 is simple yet best practice, and gives our industry a chance to manage risk on a practical basis.

‘If an event occurs which

- stops the *Consultant* Providing the Service or
- stops the *Consultant* from Providing the Service by the date shown on the Accepted Programme

and which

- neither Party could prevent and
- an experienced consultant 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

the *Employer* gives an instruction to the *Consultant* stating how the Consultant is to deal with the event.’

If he does so, this could be (but not necessarily will be) a compensation event (clause 60.1(11), page 13). The test is different for a compensation event. In clause 60 the reference is to an event which stops the Consultant ‘completing the services’, *or* stops the Consultant completing the services by the date shown on the Accepted Programme, whereas in clause 18 it is to stopping the Consultant ‘Providing the Service’ or stopping ‘the Consultant Providing the Service by the date shown on the Accepted Programme’. No explanation for this discrepancy is given. An event could of course have both effects. But it is also possible that an act of *force majeure* could temporarily stop the Consultant from providing the service but not ultimately from completing the services. It is not clear whether in this case he is to have no adjustment to his fee/time for completion. Does the difference in wording mean the Consultant is to take the risk of an event if it does not stop him completing the services but only stops him from providing them temporarily?

What about the description of the prevention event? The wording in clauses 18 and 60.1(11) is the same. Not only could neither party prevent it, but the Consultant has to establish that the event was something which had such a small chance of occurring that it would have been unreasonable for him to allow for it. This could be difficult. Are strikes, acts of terrorism, a catastrophic fire on a neighbouring site, or an interruption of power supplies all things that have a ‘small chance of occurring’? If the Consultant is to take the risks of foreseeable but likely events which are not stated as compensation events, then he will need to include some time for them in his programme and in agreeing the Completion Date for his services.<sup>11</sup>

The usual wording for an objective test in a traditional *force majeure* clause is ‘beyond the control of either party’ and it might have been clearer if this wording had been used, as it is in the Guidance Notes.

As has been said, once there is an event that comes within clause 18 (page 6) ‘the *Employer* gives an instruction to the *Consultant* stating how he is to deal with the event’. The Consultant also has to obey any instruction given under

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11 Rob Gerrard comments that Consultants get time/cost relief for stated compensation events; they are not carrying all foreseeable/likely risk or even unforeseeable/unlikely risk however or wherever it comes from.

this clause (clause 25.3, page 8): ‘The *Consultant* obeys an instruction which is in accordance with this contract and is given to him by the *Employer*’. There is no provision for him to challenge it if he disagrees with the solution.

Consultants will have to consider the risks of accepting this clause unamended for any particular project, particularly for overseas projects where *force majeure* clauses are probably more important.

## **Limiting liability**

I turn now to consider the provisions in clause 82 concerning limiting liability with the professional indemnity insurance requirements in clause 81.

Starting with insurance: clause 81.1 (page 18) requires the Consultant to provide the insurances stated in the ‘Insurance Table’ unless the Contract Data says the Employer is to provide them. The periods for which the insurances are to be maintained are from the Contract Date until the end of the period specified in the Contract Data – all of this is in the Employer’s part of the Contract Data.

The first insurance in the table under clause 81.1 (page 18) refers to the Consultant’s professional indemnity insurance – expressed as against:

‘Liability ... for claims made against him arising out of his failure to use the skill and care normally used by professionals providing services similar to the services.’

The minimum amount to be provided is to be stated in the Contract Data. The insurance requirement refers only to the Consultant’s failure to use reasonable skill and care and thus it would be satisfied if the Consultant were to have a negligence-only policy. However, there are obligations in PSC3 which are not negligence based: for example, the strict obligations in relation to Completion, Key Dates, notices etc, breach of which could be outside a negligence-only policy. Also, the obligations in respect of ‘Defects’ might not be covered by such a policy.

The Guidance Notes (page 50) contemplate something wider in that it refers to insurance for sums for which the Consultant could become liable ‘as a result of any neglect, error or omission’ in carrying out his professional activities.

As to the cover expected in the Contract Data (page 43) this is ‘in respect of each claim, without limit to the number of claims’. This does not reflect many standard professional indemnity policies where cover for claims such as pollution and contamination and asbestos are often on an aggregate basis and that for terrorism on a very limited basis or excluded altogether. The Guidance Notes appreciate this (page 50): ‘In some circumstances, some insurers insist on a maximum sum for any one claim and in the aggregate in the period of insurance’. The Consultant who has these restrictions on his professional indemnity insurance will have to ask the Employer to amend these requirements.

As to a limit of liability, PSC3 provides for limits of liability for certain matters but unlimited liability for others; this is a change from PSC2 which had an overall limit. PSC2 provided that the Consultant's liability to the Employer 'resulting from a failure to Provide the Services is limited to the amount stated in the Contract Data'. Although there could be doubts as to whether this clause would cover all claims that could be made against the Consultant, particularly those brought in tort for negligence, at least it was clear. It could not in any event apply to claims for personal injury or death because of the Unfair Contract Terms Act 1977.

Clause 82.1 (page 18) in PSC3 provides:

'The *Consultant's* total liability to the *Employer* for all matters arising under or in connection with this contract, other than the excluded matters, is limited to the amount stated in the Contract Data and applies in contract, tort or delict and otherwise to the extent allowed under the *law of the contract*.'

First, this is an aggregate limit, which is good but can lead to problems in fixing the amount. The Guidance Notes say (page 51) that 'this total amount will be the amount stated in the Contract Data'. This aggregate approach will match those elements of the Consultant's professional indemnity insurance which are on an aggregate basis. If, say, the Consultant has £5 million professional indemnity insurance per claim for most types of claim, and £5 million in aggregate for other types of claim, and the amount to be stated as a total aggregate limit is £5 million, that would be fine. If the amount stated were higher, say £7 million – to reflect the fact that there may be more than one claim – and the first claim was for £6 million, this would be more than the £5 million professional indemnity cover he has per claim, and would thus be beyond his professional indemnity insurance but within the aggregate cap in the contract. Generally, the parties do just put £5 million as the aggregate limit of liability if that is the Consultant's professional indemnity insurance limit with, if necessary, lesser aggregate caps where this is the cover provided by their professional indemnity insurance.

Secondly, there is also a doubt whether this limitation could cover claims in negligence because this is not specifically referred to.<sup>12</sup>

What is the purpose of 'to the extent allowed under the law of the contract'? Does this mean that if the law of the contract was a law which allowed no limitation at all or reduced or different limitations of liability, that would apply despite anything inserted in the contract itself? Where would this leave the excluded items? Would not it be better for limitations of liability in contracts not governed by English law to be dealt with separately? If this wording applies to a contract under English law, its effect is not clear. Is it a reference to the Unfair Contract Terms Act 1977 and what is or is not allowed under that Act and the test of 'reasonableness'? If so, what does that add? The wording regrettably does not meet one of the criteria for limitation clauses: that they must be clearly expressed.

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12 *Canada Steamship Lines Ltd v The King* [1952] AC 192 (on appeal from Supreme Crt of Canada).

Of most concern, however is that this clause provides that the total aggregate amount in clause 82.1 (page 18) will only apply to non-excluded matters. It will therefore not apply to the excluded matters which are:

- ‘delay damages if Option X7 applies [ie LADs],
- *Consultant’s* share if Option C applies [ie the target contract basis],
- an infringement by the *Consultant* of the rights of Others [presumably this is a reference to the indemnity in clause 80.1 which appears to cover copyright infringement but it could be construed more widely],
- loss or damage to third party property and
- death of or bodily injury to a person other than an employee of the *Consultant*.’

The amounts payable in respect of the excluded matters will, as has been said, be unlimited but will also be payable *in addition* to any aggregate amount agreed under clause 82.1. As I have said, the Guidance Notes say (page 51) that the amount in clause 82.1 will normally be the amount of the *Consultant’s* professional indemnity insurance. If that is the intention, then there would be no professional indemnity insurance for any of the excluded matters. Further, this basis for limiting liability ignores the fact that for some claims the insurance is on an each and every claim basis and for others on an aggregate basis, that the amount and basis of the *Consultant’s* professional indemnity insurance could be very different by the time the claim is made, and that the same insurance may have to cover this liability and liability for the excluded matters.

Let us look at these exclusions:

***Exclusion 1 – delay damages:*** this is the fixed amount of LADs per day that is to apply if Option X7 (page 36) is chosen. Some *Consultants* accept this as a commercial risk. However, most *Consultants’* professional indemnity insurance excludes LADs entirely, or the amount by which the LADs exceed the damages for delay assessed on the usual common law principles. Careful consideration will therefore be needed before the *Consultant* accepts Option X7, as the firm will be responsible for these amounts. However, if there is professional indemnity insurance cover for some or all of delay damages, this is not covered by the limit of liability in PSC3. Indeed, if there is a claim which, say, results in £3 million damages for additional costs and £3 million in LADs under Option X7, and there is a £5 million aggregate limit for clause 82.1, then the *Consultant* will find he is paying the £6 million regardless of his insurance limit and the aggregate limit in the appointment.

***Exclusions 2 and 3*** may not be of particular concern – the *Consultant’s* share of any loss when a target contract is agreed is generally a commercial risk not underwritten by insurance. And an indemnity for copyright infringement (if that is what it is) is also something *Consultants* might accept as a commercial risk when this is within their control.

***Exclusion 5 – death or bodily injury:*** liability for this cannot be limited in any event under the Unfair Contract Terms Act 1977.

***Exclusion 4 – loss or damage to third party property*** – this is a concern. A claim for loss or damage to third party property can arise under a Consultant’s professional indemnity insurance or his public liability insurance, depending on the cause. It is not clear whether this reference to loss or damage to third party property is meant to refer to the sort of damages covered by public liability insurance and not such losses caused by the professional when carrying out his services. So, as presently worded, there is a real risk that loss or damage to property claims covered by professional indemnity insurance and not public liability insurance will be excluded from the cap in clause 82.1. Such claims can be very substantial. No explanation is given in the Guidance Notes.

A new Option X18 (page 39) has been added to PSC3 which allows the parties to agree some other limitations. These are stated as a limit of liability for indirect or consequential losses, and a limit of liability for Defects not found until after the defects date. These are to be put in the Contract Data.

Again, it is not clear how these two additional limitations if used with clause 82.1 (page 18) would fit into the overall limit in that clause. Option X18 does not deal with this. Are they to be calculated as part of the aggregate limit in clause 82.1 or are they to be paid in addition like the excluded matters? Indirect or consequential losses and liability for Defects would (subject to a *caveat* about the way PSC3 describes Defects) normally be covered by the Consultant’s professional indemnity insurance and subject to the same limit of indemnity. Are the limitations to be attached to these types of losses meant to be in addition to anything paid as a result of a claim that comes within the aggregate cover under clause 82.1, or are these limitations to provide for a lesser limitation for those particular losses? Again, there is no comment on this in the Guidance Notes.

Consequential losses have been held to be other than ‘normal’ losses – that is the ‘normal’ loss which every claimant in a like situation would suffer – and ‘consequential loss’ is loss that is special to the circumstances of a particular claimant. Thus, the consequential losses would cover indirect damages and therefore might not cover loss of profits or loss of rent, for example. Loss of profits and wasted overheads have been found in one case to be direct and not indirect or consequential losses.<sup>13</sup>

It can be difficult to say in advance what special losses could be incurred by a client if there has been a breach of contract and thus whether there will be indirect/consequential losses. It follows from this that when capping indirect and consequential losses a Consultant may not know exactly what he has capped. And in any event, the aggregate cap without this Option would include such losses. If it is clear what the indirect or consequential losses could be, then it could well make sense for a Consultant to seek a lower cap for those than the overall cap provided under clause 82.1.

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13 *Deepak Fertilisers and Petrochemical Corporation v Davy McKee (London) Ltd* [1998] All ER (D) 577 (CA).

As to fixing a cap for ‘Defects that are not found until after the defects date’, the question arises as to what is the liability of the Consultant in respect of ‘Defects’ as defined in the PSC3 at the defects date. As is explained later in this paper, the Consultant may or may not be liable under common law principles for services which are not in accordance with the Scope. He is made so liable under clause 41 (page 11) until the defects date insofar as he has an obligation to correct them until that date. Nothing in PSC3 says that he is to be liable as if clause 41 applied after the defects date and thus obliged to correct Defects or pay for others to do so and a Consultant should be wary of any additional Z clauses which might seek to provide for this. If he is not liable in respect of Defects after the defects date, then this limitation is meaningless. If it does mean something, then a cap on this liability should only be used to bring in a lesser cap from that in clause 82.1 because such a claim would be within the overall cap. The Employer will not be without a remedy. The Consultant could still be liable after the defects date, for example if he has failed ‘to use the skill and care normally used by professionals providing services similar to the *services*’ (clause 21.2, page 7), but this limitation would not apply in that case, although the general aggregate limit would.

The parties can also, as a result of Option X18.3 (page 39) fix a time limit for claims, by agreeing ‘the *Consultant* is not liable to the *Employer* for a matter unless it is notified to the *Consultant* before the end of liability date’, ie a date also to be put in the Contract Data by reference to a number of years ‘after Completion of the whole of the services’. This again might not put a time limit on claims in tort for negligence or claims other than for breach of contract as they have not been specifically referred to. And Completion of the whole services may never happen; there could be early termination, for example.

Clause 82.2 (page 18) is meant to be a net contribution clause. This is clear from the Guidance Notes (page 51). However, what clause 82.2 says is that:

‘The *Consultant’s* liability to the *Employer* is limited to that proportion of the *Employer’s* losses for which the *Consultant* is responsible under this contract.’

The principle which applies when two or more parties are liable in respect of the same damage is that each is 100% liable to the client. Thus, the proportion for which the Consultant ‘is responsible’ would be 100%. In order to be able to limit that to a lesser percentage when another party with whom the Consultant is jointly liable has gone bankrupt or is unable to pay his share in full (the only circumstances in which a net contribution clause is needed), you have to have the assumptions set out in the traditional type of net contribution clause (such as in the ACE, CIC or RIBA appointments).

There is a real danger, therefore, that this clause is ineffective.

## Defects

Unlike any of the standard forms such as ACE, CIC or RIBA, PSC3 has an express provision requiring the Consultant to correct Defects up to the ‘defects date’ (clause 41, page 11). In this respect, as in others in this form of contract, the Consultant is being treated as a contractor. However, it is important to recognise that the Defects being referred to are defects in the services and the Scope of work that the Consultant has undertaken for the Employer. The Defects referred to are not defects resulting from faulty construction work undertaken by a contractor.<sup>14</sup>

First there are provisions concerning notification. Until ‘the defects date’ (which is a period fixed by the Employer in the Contract Data part one (page 43), being a number of weeks after the Completion of the whole of the services, ie equivalent to the usual defects liability period), both the Employer and the Consultant (and not just the Employer) have to notify the other as soon as they find a Defect. At Completion, when the Consultant completes his services, the Consultant has to notify the Employer of any Defect that has not been corrected. After Completion and until the defects date, the Consultant (only) notifies the Employer of any Defect as soon as he finds it. These are overlapping provisions. Why does one need the final provision if both parties have to notify the other until the defects date? Was the first period meant to be only until Completion? After the defects date there is no obligation to notify.

There is a statement in clause 41.1 (page 11) that the Employer’s rights in respect of any Defect which the Employer has not found or notified by the defects date are not affected. This is I assume a reference to latent defects which could appear after the defects date; but why does it only refer to those the Employer has not found? Surely this should also refer to those the Consultant has not found – or just apply to defects generally. The Guidance Notes say (page 36), ‘The final sentence preserves the Employer’s rights in relation to Defects which are not discovered until after the defects date.’ This would have been a simpler way to put it.

A ‘Defect’ is defined as ‘a part of the *services* which is not in accordance with the Scope or the applicable law’ (clause 11.2(5), page 3). The first part of this definition is understandable, if misguided in my view, as I will explain. You can see the logic, however: if the Consultant has not provided the services described then that is to be a breach of contract, unless the Employer has waived that requirement or changed the Scope to match. I will come back to the ‘applicable law’.

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14 Rob Gerrard comments that this is basically something that the Consultant has done wrong, it has nothing to do with the construction contract. It is a practical and necessary basis for getting defects corrected by the Consultant in a timely manner. RB: My point, however, is that ‘putting right defective design’ (i) is not necessarily required by law and (ii) it would often not be enough simply to correct the Consultant’s design. Other consultants and the contractor may well have to do things as a result, which would be covered if this was treated on the normal breach basis and not on a ‘put right’ basis. The client could lose out.

Clause 41.2 (page 11) then provides that the Consultant corrects a Defect (ie those that appear before the defects date) whether or not the Employer notifies him of it, within a period which minimises the adverse effect on the Employer and Others. However, if he does not so correct it within that timescale, the Employer can assess the cost of having this Defect corrected by Others and the Consultant has to pay this amount. This implies the Employer can get Others to correct the Defect but it is not stated expressly. The wording could encompass not just errors in design discovered before the relevant part of the project is built but also a defect in the Consultant's design which has now become incorporated in the construction – say in a retaining wall built early on – and could only be 'corrected' as such by pulling the relevant part down and rebuilding it to a corrected design. How can the Consultant correct this defect? He can correct the design but the contractor would have to do the demolishing and rebuilding. Would this fall into the part of the clause which says he has not corrected the 'Defect'? But the Defect is the negligent design, not the building works.

The whole concept of treating Defects in this manner is the wrong way round and does not reflect the proper basis on which the Consultant should be held liable (ie for a failure to use reasonable skill and care, not on the strict test of whether the services were in accordance with the Scope). Compliance may have been outside the Consultant's control and/or where he has not been negligent. Also, the Scope might have been expressed in such a way that it contains a warranty or warranties for fitness for purpose and, as will be appreciated, this could take the Consultant outside his professional indemnity insurance.<sup>15</sup>

A Consultant is not necessarily required by law to remedy or correct defects for which he is responsible (for example damages may be an adequate remedy), nor is the timescale within which he has to do this necessarily that which 'minimises the adverse effect on the Employer'. He is certainly not required to remedy defects for which he is not responsible. PSC3 recognises this to some extent by providing for the Consultant to notify as a compensation event the correcting of any Defect for which he is not liable. However, this reverses the burden of proof. This results in the Consultant

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15 Rob Gerrard comments: do Employer's think this is the wrong way round, or even Consultants? The Consultant has done something wrong, whether it is reasonable skill and care or not is irrelevant. RB: In my experience, Consultants think this is wrong, as do their insurers. The point is that the Consultant should *only* be liable if he has been negligent; if he has, there is a remedy at common law and the Employer could well recover much more than he is given by clause 41. The Consultant should not be liable on a strict liability basis, as provided in PSC3, and then have to prove he was not negligent in order to get paid for something he has had to put right when he was not negligent. RG: The consultant needs to put right defects in a timely manner. The suggested 'right way round' could result in the Consultant submitting defective design, for example, but never putting it right as he used reasonable skill and care. Can that really be fair to the Employer? RB: it may not be fair but it is the common law basis for the liability of a professional and thus the basis on which professional indemnity insurance is predominantly written. PSC3 recognises this to some extent by providing as a compensation event the notifying of a defect for which the consultant is not liable – clause 60.1(12).

having to prove he was not negligent, when the Employer should prove that he is.

The Guidance Notes state in relation to this compensation event (page 44) that ‘Not all Defects are the Consultant’s liability ... Those Defects that arise notwithstanding the fact that the Consultant has exercised the skill and care in clause 21.2 are the Employer’s responsibility’.

It is not thought, as I have said, that the provisions in clause 41 (page 11) achieve this, as the definition of Defect does not include a reference to skill and care.

There could also be a problem if the Employer is allowed to assess the cost of correcting any Defects. He may not do so on the common law basis of damages. Does this provision apply equally where the Consultant rectified the Defect but not within the timetable required? If so, why should the basis be the cost of Others correcting the Defect? What about the situation where it might no longer be possible to rectify a Defect, or where it is technically a Defect but the Defect has no significant effect on the services? What if the assessment is simply wrong?

As to that part of the definition that says a ‘Defect’ is something that is not in accordance with the applicable law, there is no obligation in PSC3 (and indeed there should not be) that the design is to be in accordance with the applicable law. A change in the law which affects the design is not a compensation event (although ‘a change in the law of the project’ can be added as a compensation event by option X2.1 – if that is the same thing). A change in the applicable law could also have consequences which do give rise to a compensation event.

The Consultant could therefore notify as a compensation event under clause 60.1(12) (page 13) a change in the law after preparing his design as ‘a Defect for which he is not liable’ if he has amended or ‘corrected’ his design as a result. It is unclear whether this means he can also notify any other failure to comply with the law which results in corrective work having to be carried out, whether or not he is responsible for it. If there is no obligation to comply with the applicable law, however, there is a question as to whether he is ‘liable’ if he does not.

It has to be said, though, that many consultants regard the question of correcting Defects under PSC3 of little significance. The biggest risk arises from the cost of re-design from some fundamental assumption of the Consultant’s being wrong, but such a risk arises whatever the form of contract being used.<sup>16</sup>

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16 Rob Gerrard comments: surely a clear process to be followed in the event of a Consultant’s Defect is far better than saying nothing in a contract and forcing the parties down a lengthy/expensive legal route in the event a Defect arises? RB: My reply is that I do not think so because of the basis on which this is to be done. Most Consultants (as professionals) would want to put things right if a problem is discovered during construction. Also, this clause does not cover problems that arise post-completion, as many do.

## Conclusion

I am conscious that this paper has raised more questions than it has answered. I must also stress these are my views and the courts may not agree if or when they come to consider these provisions.

Some of the procedural and other uncertainties produced by the new provisions for Key Dates and the Risk Register have been caused, I believe, by grafting them on to the earlier clauses. Until the courts consider these clauses, Consultants and Employers will at least be able to argue about what they mean and how they are to be applied, which may be helpful, as an interpretation unfavourable to Consultants cannot yet be pointed to.<sup>17</sup>

The prevention clause deficiencies could be remedied by some limited drafting amendments but the problems with the limitation clauses and options are so great that I would recommend a wholesale deletion and a reversion to the position under PSC2 (provided you include ‘negligence’) with, if appropriate, a proper net contribution clause.

As to Defects, I would remove these provisions altogether and let the common law rules apply. However, this concept has been part of the NEC contracts for so long there is probably little likelihood of that happening. There is though no need in law to provide somewhat convoluted machinery for putting defects right: the common law does not leave Employers without an adequate remedy.

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17 Rob Gerrard comments: ‘Key Dates’ is an entirely new provision designed to ensure the Consultant knows what services need to be provided by a certain date: surely that is a good tool to have? The Risk Register is a replacement for an early warning register which the parties generally put together in PSC2; the added feature is about collecting residual risk that exists at tender stage which the parties will need to put their mind to post-contract.

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