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New Forms of Non-Adversarial Contracting Focusing upon the New Engineering Contract

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Abstract

The paper examines the theoretical basis in contract law for new forms of non-adversarial contracting focusing upon the New Engineering Contract ("NEC"). Most analysis of traditional forms of adversarial contracts is premised upon traditional contract theory. The paper will critically examine whether this foundation is appropriate in view of the changes standard forms are undergoing. It will be argued that for most part the new forms of contract do not lend themselves to analysis using traditional contractual models. It will be argued that most of traditional contract law theory operates at cross-purposes to the philosophy of these new forms of contract. A new theoretical contractual model will be postulated which is based upon relational contract law whose central element is co-operation.

Keywords

Relational contract, partnering, co-operation, NEC

1. The Model and Relational Contract Theory

Traditional contract law, according to Holmes and Thurmann (1987), and Macneil (1974), includes both the classical contract model and the neo-classical or realist contract model. These models dominated theoretical work during the 20th century and were developed through the work of leading American contract scholars including Karl Llewellyn (1930, 1931 and 1940), Lon Fuller (1936) and Grant Gilmore (1977 and 1995). Karl Llewellyn, who is closely associated with constructionalism and American Legal Realism, has been particularly influential because of his work on the *Uniform Commercial Code*. Their work in particular has influenced later scholars and has also usefully served as the basis of a broader regrouping of certain of the other contractual models.

For Macneil and the relational contract model it is the future that is important in theoretical terms. As suggested by one study, subcontractors were prepared to settle disputes with contractors over set-offs to avoid jeopardizing future work (Kennedy *et al.* 1997). This contrasts with the present in the classical contract model. The success of the contractual relationship depends less upon what has been agreed than upon how the parties will agree to handle events in the future. What is important in relational contract theory, and indeed what distinguishes it from neo-classical contract theory, are the values it embodies: namely, trust, mutual responsibility and connection among people (Feinman, 1992, Campbell, 2001 and Kennedy *et al.* 1997). With this understanding of relational contract theory the next step is to build upon it to create a theoretical model for the NEC.

2. Empirical Foundation

The NEC may be analyzed using a relational contract theoretical framework, emphasizing the importance of good faith, fairness and co-operation. Relational contract theory and the principles underlying the NEC are supported by empirical research. Beginning with Stewart Macaulay's seminal work (1963), there has been rising interest in empiricism. For example, the Tavistock Institute of Human Relations called for further empirical work in construction and with regard to evaluating the forms of contract (1966). This resulted in a tremendous growth in empirical research in many disciplines that touches upon law (Nottage, 1997). More importantly, the interest in empiricism can be seen in project management literature and increasingly in the legal literature (Posner, 1995) – both of which have significant implications for the NEC and contractual paradigms in general. Martin Barnes has said: "[t]he management of projects has become a science with its own set of rules, techniques and words which are not even mentioned in the existing standard forms. If the conditions of contract were redraughted from first principles, having regard to modern management methods, a much more purposeful document could be produced" (Barber, 1986).

The essence of the work done by Macaulay was to show that contract law plays a marginal role in long-term continuing business relationships. The same conclusion was reached in the leading British article by Hugh Beale and Tony Dugdale (1975), 'Contracts between Businessmen'. It would appear from Beale and Dugdale's research that people neither plan as carefully nor pay as much attention to their contractual obligations as had previously been thought. Other research that has followed theirs, notably that of Macaulay (1977) also reflects the same sentiment. While these articles are of general application, some early empirical work was also done in construction concerning tendering: (Schultz 1952, Note, 1967 and Lewis 1982).

The conclusion, which follows, is that *relations*, the cultures at play, influences if not determines the extent to which risk may be borne by either side to a contract. Further, this research shows that people will perform disadvantageous contracts in the hope of maintaining relations or storing credits for the future. That future may be understood in terms of a subsequent contract with the same party or subsequent conduct within the same contract. People were also shown to be willing to renegotiate in circumstances that had turned out badly for either or both sides of the agreement. In practice, wider ranges of circumstances were recognized as excusable than most contracts had provided for. This accords with the view that many disputes are not dealt with or recorded in any way and that only a small proportion result in any formal mode of dispute resolution (Conlin 1995 and 1996). Research has also shown the critical role played by trust in collaborative contracts (Wood and McDermott, 2001 and Myers, 2000). The Macaulay, Beale and Dugdale research has shown that people perform contracts because of the *relational* sanctions that operate. In part, it is submitted, these relational sanctions are reflected in the number of internal remedies for breach available in construction contracts but they are also reflected in various informal and relational dispute resolution mechanisms. The NEC has built upon this process of understanding and therefore more accurately reflects the true relational norms that exist in construction contracting.

3. Key Model Elements

The key elements of the model may be summarized in this fashion:

1. Construction contracts are ideal for relational analysis. They are inherently multidisciplinary and involve a wide range of stakeholders.
2. Relational contract theory is compatible with promise-centered contract scholarship. Much of this scholarship complements relational contract theory on the question of why construction contracts are binding.

3. Relational contract theory tends to support analysis of the NEC as a long-term contract that is suitable for partnering.

4. Relational contracts and the NEC are both flexible. The former allows for, and the latter manifests, open terms, grants of discretion and various adjustment mechanisms.

4. Co-operation

Co-operation is key in both relational contracting, under the NEC and in the model proposed here. The classical contractual paradigm, supported by economic analysis, predicated upon rational, utility-minded individuals maximizing self-interest in discrete transactions in competitive markets with the allocation of all relevant risks at the time of contracting, has come under serious challenge. Rather, the hypothesis, which does not depend upon the allocation of all risks at the time of contracting, has gained recognition. Two scholars, Campbell (2001) and Harris (1993) in particular, have made the point emphatically. Goetz and Scott (1983) also adopt this view in their description of the bargain model, even though their model takes on some of the criteria of the classical contractual paradigm. Gordon (1985) wrote in the 'relational view' of Macaulay and Macneil: "the object of contracting is not primarily to allocate risks, but to signify a commitment to cooperate." An economic rationale for assuming future obligations to co-operate is put forward by Goetz and Scott (1981):

> In outline, the argument is that in many cases it is simply not possible (or cost effective) for party A to specify in advance how the other party, B, should act in order to minimise certain risks, or even to identify all the relevant risks. Rather than assume the risk of an opportunistic refusal by B to act in a way that minimises the parties' joint costs, A will be prepared to pay in advance for B to assume an obligation to act in an efficient non-opportunistic way.

This brings out the dilemma that comes with increasing complexity and uncertainty and that there may be no ideal strategy for distributing risk at the time of contracting. In this view contracting parties will agree – either expressly or impliedly to adjust their initial risk allocation scheme in light of subsequent events. Regrettably though once the contract risks are distributed as agreed, each party will then have less incentive to accommodate the others' request for adjustment. Each party is thus faced with a difficult choice whether to adjust cooperatively, as they have originally agreed, or to respond to immediate self-interest and circumvent the responsibility (Goodard, 1997).

The foundation for all parties' actions in the NEC (save the adjudicator) is *co-operation*. The significance of beginning the contract with an affirmation of co-operation and imposing such an obligation upon the parties in clause 10 cannot be overstated. While some may argue that such a clause is devoid of content it is argued here to the contrary and that it has the fullest possible meaning because it underscores the necessity for action with regard to every single obligation otherwise imposed upon those named in the contract.

The classic statement of the requirement for co-operation in contracting comes from Lord Blackburn in *MacKay v Dick* (1881) 6 App Cas 251 at 263, HL:

> I think I may safely say, as a general rule, that where in a written contract it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing, though there may be no express words to that effect. What is the part of each must depend on the circumstances.

A strong argument can be made that the express obligation to co-operate in clause 10.1 of the NEC takes future cases involving the NEC out from under any narrow interpretations of *MacKay v Dick* and other cases which have implied the term effectively as one necessary only to ensure the fulfillment of preconditions to performance and no more. The importance of clause 10.1, in both its ability to make use of co-operative jurisprudence, but at the same time to circumvent any limitations inherent in an implied term approach, cannot be overstated.

5. Partnering

The theoretical co-operative and relational model advanced here for the NEC is wholly consistent with the notion of partnering and third party adjudication. In contrast to traditional paradigms and contractual structures, which focus upon arbitral dispute resolution, the NEC focuses on non-adversarial contracting and adjudication.

Numerous NEC features noted by Roe (1995); namely, the commitment to co-operation (ECC cl 10.1), early warning (ECC cl 16), and the pre-pricing of variations (ECC cl 61) all suggest partnering and the form is being used for work under partnering agreements usually under the target contract options (Nicholson, 1997). The fit between the NEC and partnering was made clear with the release of the partnering option X12 in June 2001 and the work done lately by Bennett and Baird (2001), and Broome (2002). The NEC supports adjudication in contrast to the traditional contract model of third party arbitration. The adjudication provisions in the NEC were part of an early trend toward alternative forms of dispute resolution in standard forms (eg JCT 81, cll 4.30-4.37 NSC/C, cl 24 DOM/1 and cl 59 GC/Works/1 3rd). The weakness of arbitration in the traditional forms from a relational point of view is that it often cannot be invoked until after the relationship between the parties has been brought to an end. Thus the utility in any relational sanctions that could have been brought to bear in settling the dispute during the course of the enduring relationship will have been lost (Myers, 1987). The NEC three tiered dispute resolution and avoidance procedures therefore complement rather than undermine the contractual and social controls thereby serving to promote party co-operation (Scott, 1987).

The conscious attempt by the drafters to purposefully address the avoidance and management of disputes began the distancing of the NEC from many traditional forms. This is because some commentators see disputes as more likely arising under traditional United Kingdom rather than other forms of contract. (Capper, 1994). When greater co-operation, clearer allocation of risk, simpler language, clearer communication, and management procedures were added to these goals the NEC moved well beyond them. While these were the broad contours, which the drafters pursued across the form as a whole, additional, discrete choices removed the NEC further from many other forms. These choices ranged from the introduction of the schedules of cost components through to the use of activity schedules and removal of legal content to the works information. Therefore the combination of both general and specific choices by the drafters serves to significantly diminish the role of conflict on site (Heal, 1999).

6. Conclusion

The foundation for all parties' actions in the NEC (save the adjudicator) is *co-operation*. The significance of beginning the contract with an affirmation of co-operation and imposing such an obligation upon the parties in clause 10 is great. While some may argue that such a clause is devoid of content, it has been argued here to the contrary that it has the fullest possible meaning because it underscores the necessity for action with regard to every single obligation otherwise imposed upon those named in the contract. Working back from jurisprudence that has developed the meaning of co-operation in law, it has been argued that the NEC case for recognition and inclusion of an express duty of co-operation was not only warranted but also fully justified. It was also argued that the duty in clause 10.2 to co-operate takes future cases arising under the NEC out from under narrower interpretations which have implied the term effectively as one necessary only to ensure the fulfillment of preconditions to performance. The express duty to co-operate in the form permits one to make use of co-operative jurisprudence that may be helpful to elaborate upon the meaning of the term as well circumvent those limitations inherent in the cases. The NEC has been evaluated as a tool of co-operation in particular with the aim of achieving results in accordance with the purposes of the contract, the goals of the management model it prescribes and the industry in which it is used. The NEC is a precursor to what is predicted here will be wider similar trends in the construction industry as a whole.

7. References

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