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# THE NEC4 OPTION F

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**The NEC4 Engineering and Construction Contract (ECC) Option F is a cost reimbursable management contract where the contractor is managing a series of subcontract packages on behalf of the employer. The contractor is responsible for the procurement, coordination, and implementation of works in exchange for a fee and remains responsible for the works throughout the project while the employer takes on the financial risk.**

Unlike in the other NEC4 options, where a Schedule of Cost Components are utilised to set out the specifics which should be included in the assessment of Defined Costs, in Option F, the Defined Costs are restricted to payments due to Subcontractors and the agreed fee percentage applied for work done by the Contractor as no such Schedule is applicable in this option. There is therefore significantly less risk to the contractor resulting from this payment mechanism adopted in this contract in comparison to other ECC options.

Defined Costs are the actual cost the contractor can prove has already been incurred as well as a forecast of their spend up until the end of the following payment period. Following the payment application, a contractor typically only gets paid 4 weeks later, this method allows for a more accurate payment for what has actually been spent and enabling a sensible cashflow for the contractor. Any errors in the forecast amounts are of course corrected in subsequent payments, in line with what was actually spent.

In short, the payment mechanism is used to recover the actual costs plus an agreed fee percentage minus any disallowed costs. Despite this Option appearing less risky to the contractor, this type of rigid payment mechanism does not provide an opportunity to improve on margins and does not leave room for errors in respect of disallowed costs which could quickly result in the Contractor losing money.

Disallowed Costs apply to the ECC options where costs are paid on an "open book" basis like in the case of Option F. The contractor should pay careful attention to not include disallowed costs in the payments to subcontractors. These costs are incurred by the contractor itself and are not payable by the employer. These costs are the contractors responsibility in their entirety.

The disallowed costs are deducted from Defined Cost and include costs which:

- The Contractor cannot justify having incurred through its accounts and records, it is therefore pertinent for the contractor to understand the employer's requirements to prove actual costs;
- should not have been paid in terms of the relevant subcontract;
- were incurred as a result of the Contractor's failures to follow the contractual acceptance and procurements processes;
- were incurred as a result of the contractor's failure to issue an early warning when it was necessary to do so and the costs can therefore be seen as avoidable costs;
- arose as a result of correcting Defects after Completion;
- arose as a result of the Contractor's failure to follow constraints identified in the contract;
- arose from wastage of Plant and Materials or unused resources (after allowing for reasonable wastage) unless resulting from a change to the Scope. The contractor would be able to demonstrate through its records that it has not been unnecessarily wasteful and that the project was efficiently managed.

To prove 'disallowed costs' would require regular audits to assess if any of these potential disallowed costs have been incurred.

If the contractors works are affected by a compensation event, the project manager and the contractor may jointly agree to change the price as well as extend the completion date or any relevant key dates. Failure to mutually agree would result in the project manager making the final decision.

The subcontracts govern the works, procedures and remedies for the respective subcontractors.

Option F is the least commonly used NEC Option but as will be shown below, its use should be more common to allow for certain standards and requirements imposed on contractors to promote previously disadvantaged contractors and contract participation goals (CPG).

**The Construction Industry Development Board**

The Construction Industry Development Board ("CIDB") was developed by the Construction Industry Development Board Act 38 of 2000 which promotes a regulatory and developmental framework. The CIDB intends to assist the construction industry by implementing strategies, facilitating and promoting the industry and advocating the contribution of the industry to the local economy and society. In doing so, the CIDB established the Standard for Contract Participation Goals for Targeting Enterprises and Labour through Construction Works as gazetted on 10 November 2017 under Gazette No. 41237 ("CIDB Standard").

CPG requires the contractor to engage a certain percentage of the contract value to targeted enterprises, to employ people from the local community "local labour"; and purchase materials/hire plant from local suppliers in the identified development areas. The contractor is responsible and liable for the conduct of the CPG Subcontractors and local labour and failure to achieve the CPGs would result in penalties.

The objectives of CPG's is compliance with Constitutional Obligations of economic upliftment; skills and leadership development and promote economic growth and transformation. The CPG's attempt to mitigate the risks caused by the construction mafia and promote smaller business to ensure that small, emerging contractors are engaged with on certain projects.
The employer is required to undertake a process of community engagement and to conduct a feasibility study within the targeted area in order to achieve the CPG objectives.

**Preferential Procurement Policy Framework Act**

PPPFA was established by Section 217 of the Constitution and is aimed to redress the inequalities inherited by the previously disadvantaged South African community and requires organs of state to procure preferential policies when allocating contracts. The policies enable the previously disadvantaged to participate in the South African economy and provides for schemes aimed to protect and advance people currently disadvantaged as a result of unfair discrimination. As has been discussed above, CPG is one of those schemes.

The PPPFA empowers the Minister of Finance to introduce Preferential Procurement Regulations, several were introduced, including the 2017 and 2023 Regulations.

In 2017, the Minister introduced a criteria for pre-qualification to exclude bidders who did not meet the criteria, regardless of price. The Regulations permitted Organs of State to implement pre-qualification standards "to advance certain designated groups" encompassing black individuals, women, individuals with disabilities, and small enterprises.

Qualifying tenderers were required to subcontract 30% of the value of the contract and failure to do so would result in the contractor being disqualified for failing to meet the conditions of tender.

These regulations were declared unconstitutional by the Constitutional Court as the introduction of the pre-qualification criteria for tenderers was not in line with Section 217 of the Constitution. The 2017 Regulations were repealed bringing the 2023 Regulations in to act which allows the Organ of State wider discretion to prescribe conditions.

The most significant changes from the 2017 and the new regulations is that the 2023 Regulations preclude the pre-qualification criteria for tendering and does away with the requirement that certain subcontractors were required to subcontract a minimum of 30% of the contract value.

**Conclusion**

NEC4 Option F is very rarely used in practice but in fact, it fits in well with Constitutional requirements of promoting and including smaller, previously disadvantaged and local businesses as the entire project is subcontracted. An employer, following its duty to conduct a feasibility study, would be able to select a number of suitable subcontractors to take on the works and leave the rest to the managing contractor. This is particularly suitable for Government projects where there is a specific focus on promoting and furthering previously disadvantaged contractors.

Utilising this option would allow for easy integration of various targeted local community subcontractors for defined portions of the works, to perform commercially useful functions in the performance of the contract in line with the CIBD requirements and for purposes of achieving the CPGs.