

TARGET COST CONTRACTING AND JOINT VENTURE AGREEMENTS

By Victoria Peckett, Phillip Ashley, Mark Breslin & Kate Jones

A recent TCC decision has considered the target cost provisions of the NEC3 Option C contract in the context of a joint venture agreement between two contractors. The decision considers the ability of the parties to make pain/gain share adjustments for interim payments both at main contract and joint venture agreement level. Joint venture disputes are rarely before the courts and the decision provides valuable insights as to the implications of joint venture contracting under target cost arrangements.

Target Cost contracts in brief

Target Cost contracts are a form of cost reimbursable contract under which the contractor is paid the "Total Cost" it incurs in carrying out the works plus a fee, subject to a "Target Cost" agreed by the parties at the beginning of the project. Upon completion, the parties ascertain whether savings were made and the project delivered for less than the Target Cost; or whether costs overran and the cost of delivery was above the Target Cost. Any saving or overrun is then allocated according to a predetermined formula commonly known as a "pain/gain share" mechanism. If the costs of the project exceed the Target Cost the excess, or "pain", is allocated between the employer and the contractor, and if the project comes in under cost then the "gain" is allocated. The philosophy behind such contracts is to actively encourage both parties to work together to manage the costs of the works.

Doosan Enpure Limited v Interserve Construction Limited

Doosan and Interserve entered into a Joint Venture Agreement ("JVA") for the purpose of carrying out upgrade works at the Horsley Water Treatment works in Northumberland for Northumbrian Water

Limited ("NWL"). The JV parties and NWL entered into a contract based on the NEC3 Option C form (Target contract with activity schedule).

The progress of the works was delayed with an increase in cost. The JV parties fell into dispute over whether interim payments under the JVA should be made on an actual cost basis or whether they should reflect the anticipated pain-share likely to result upon completion of the works. The JV parties also disagreed over whether the NEC3 contract with NWL allowed the pain-share mechanism to be applied at an interim payment stage, although in practice it appears that NWL's Project Manager did not seek to deduct any amount for pain-share from interim payments applied for by the JV parties.

TCC proceedings were commenced for various declarations to resolve the impasse between the JV parties and to determine entitlement to sums held in the JV bank account. Those sums had been received from NWL in relation to the most recent interim payment application made by the JV parties.

Pain/gain share under the NEC3

Before considering the position under the JVA the court considered whether interim payments under

the NEC3 contract with NWL could include pain/gain share adjustments. The court concluded that such adjustments could not be made at an interim stage, emphasising the terms of clause 53.3 of the contract as follows (unamended from the standard form):

"The Project Manager makes a preliminary assessment of the Contractor's share at Completion of the whole of the works using his forecasts of the final Price for Work Done to Date and the final total of the Prices. This share is included in the amount due following Completion of the whole of the works."

The court rejected the suggestion that this provision left open the ability of NWL to apply the pain/gain share mechanism at an earlier stage.

Pain/gain share under the Joint Venture Agreement

In relation to interim payments, clause 8.6 of the JVA provided that:

"The parties shall receive interim payments from the

JV in reimbursement of the Works Part Costs incurred by each party as shown on the parties' Interim Cost Statements. Works Part Costs shall be reimbursed in accordance with the principles set out in Schedule 4."

The "Interim Cost Statements" were simply those applications submitted by each of the JV parties which combined together to form the joint application for payment submitted to NWL. Schedule 4 contained reference to the pain/gain share mechanism to be applied on completion but made no specific reference to interim payments.

The only clauses which dealt with the issue directly provided that where costs were likely to exceed the relevant target or where delay to completion was likely to result in the deduction of delay damages, the JV Committee could be requested to, "suspend or reduce the level of interim payments to the other Party to take account of the anticipated damages. Where the JV Committee is unable to reach agreement, the matter may be referred to resolution under Clause 21."



The JV Committee had been requested to suspend payments, but had been unable to reach agreement. Accordingly, the position remained as per clause 8.6 quoted above. The court considered that the first sentence of that clause required the full amount of the payment from NWL to be distributed to the parties without adjustment or suspension for anticipated pain-share.

Conclusion and implications

This is an interesting decision in relation to target cost contracting in a joint venture context. The court's finding that the standard NEC target cost provisions do not permit pain/gain share adjustments for interim payments underscores the desirability for employers of negotiating such contracts to build in the ability to make pain-share adjustments at an interim stage where the target cost has already been exceeded. This avoids the need to recover overpayments upon completion of the works, although brings added complexity to the interim payment process and raises other issues such as whether the target cost figure should be updated on a rolling basis.

Such cashflow considerations can also, as here, be seen at the joint venture level; which may lead to the inclusion of provisions preventing the release of funds to JV parties where pain-share adjustments are at risk, although that will force the issue to be dealt with at an earlier stage by the JV parties during the course of the works.

The judgment also highlights the governance issues which can arise in JV structures where decisions are often required to be taken on a unanimous basis. Parties negotiating JVA's should consider carefully what options are available for the breaking of any deadlock which arises if JV relations are tested. The JVA in the present case permitted deadlock over the suspension or reduction of interim payments to be referred to dispute resolution, but did not indicate any specific criteria to be applied in resolving the deadlock.

References

Doosan Enpire Ltd v Interserve Construction Ltd [2019] EWHC 2497.

ABOUT THE AUTHORS



Victoria Peckett
Partner, London



Phillip Ashley
Partner, London



Mark Breslin
Senior Associate



Kate Jones
Associate

Infrastructure, Construction and Energy

