



Contracting Strategy Procedure

Client Advisory

NJE QUANTITY SURVEYING LTD

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1.0 PURPOSE

The purpose of this procedure is to assist in the development the appropriate contracting strategy for high value contracts, or those identified as presenting significant safety, environmental or business risks to the Company. The criteria considered for strategy selection will include value, technical complexity and operational criticality.

The Contract Owner shall be responsible for developing individual contract strategies to ensure that:

- (i) contracts are tendered, evaluated and awarded in accordance with the Company's Business Ethics Policy and Tendering Procedures
- (ii) contracts comply with the tax, currency, data protection, and the laws in which the contracts are performed.
- (iii) works, services and goods are acquired on the most favourable terms and conditions

This procedure also offers guidance on contracting options, type of contracts, methods of compensation and assessment of contractual risk.

2.0 CONTRACT TYPES

The type of contract shall be determined by Contract Owner. In selecting the appropriate contract type, the Contract Owner shall consider a range of factors including:

- (i) value and duration of the work
- (ii) complexity and type of work being undertaken
- (iii) business and safety risks associated with the work
- (iv) current contracting arrangements.

Where practicable, approved model contract templates should be used. If no model contracts are considered suitable for the work, guidance should be sought from a qualified professional prior to commencing the contracting process. Model contracts available include: *[Purchase Orders, Service Orders, Service Contracts, Design, Construction, Drilling Services, Major Plant and Equipment, Short Form Contracts, Framework Agreements, Proforma Contracts and Specialist Services Contracts.]*

3.0 CONTRACTING OPTIONS

Contracts covered by this procedure shall generally be awarded through a competitive tender process conducted among approved suppliers. However, alternatives may be considered.

Alternative Contracting Approaches:

(i) Competitive Tendering

Invitation to Tender documentation is issued to an approved list of tenderers seeking formal competitive offers to contract with the Company.

(ii) Single Sourcing

This approach is used when Company chooses to contract with a particular Contractor, even though there are alternative providers of that particular service available. It should only be adopted in exceptional circumstances such as operational emergencies, for specialist skills or where the number of prospective tenderers is limited. A robust justification should be made at the time of raising if this route is to be followed. The mechanism for arriving at a contractual basis for a Single Source arrangement can be through negotiation (as described below), ensuring that a check on market competitiveness is carried out.

(iii) Sole Sourcing

This approach is used in a situation where there is realistically only one possible Contractor for Company to utilise to undertake the particular work requirement. Again, a robust justification is required and essentially the same rationale and mechanism as for Single Sourcing above should be followed.

(iv) Negotiation

Direct negotiation - where negotiation is between Company and the Contractor to formulate a contractual and commercial relationship which offers Company a market competitive deal, or

Indirect negotiation - where negotiation is between a third party acting on behalf of the Company and the Contractor(s) to formulate a contractual and commercial relationship which offers Company a market competitive deal.

(v) Partnering / Alliancing

This approach is typically used when entering a longer-term contractual arrangement where company and contractor collaborate to deliver or produce enhanced business results, typically linked to a risk and reward mechanism.

4.0 METHODS OF COMPENSATION

The method of compensation must be appropriate to the work and the selection should ensure that the Company is not unduly exposed to commercial risk.

The following methods of compensation should be considered:

5.1 Lump Sum

This method essentially entails an all-inclusive fixed price for undertaking and completing the entire scope of work. To assist the Contractor with cashflow, instalments may be paid as the work progresses. Instalment payments are normally linked to achievement of milestones or provision of key deliverables.

For higher value contracts, the Lump Sum price should be broken down into elements linked to key activities to assist in the identification of anomalies and errors during the evaluation of tenders and in the quantification of variations to the work.

Advantages	Risks
• High level of risk assumed by Contractor • Incentive on Contractor to perform • Evaluation of tenders is generally easiest (can compare "like with like") • Generally easier to administer • Ability to forecast project cashflow	• Contractor's price may include a significant premium to cover perceived risk • Possibility of Contractor cutting corners on quality • Failure to control change by Company may result in claims • Not well suited for poorly defined Scopes of Work • Requires a significant effort up-front to agree a specification

5.2 Schedule of Composite Rates/Unit Rates

Contract remuneration under a Schedule of Composite or Unit Rates involves a fixed rate per unit linked to time expended and/or quantity of materials procured or fabricated. Unit of time payments are based on hours or days expended, multiplied by the applicable rate. Cost recovery, profit and overheads are usually built into each rate. Alternatively, an additional incremental fee may be charged on overall volume to recover overheads, profit or other costs.

This method is most suitable when the technical or skills requirements of the work are known, but the volume or individual task requirements are difficult to forecast. Examples are construction/fabrication, design engineering and document control services.

Advantages	Risks
• High level of risk assumed by Contractors for estimating quantities • Work may be conducted without a fully defined scope • The quantity of work, within limits, may vary without changes in pricing or administration • Composite / Unit rate estimate of final cost offers more certainty and accuracy than reimbursable • Variations to the Scope of Work easier to quantify • Greater certainty in evaluating tenders than reimbursable • Provides a good basis for estimating costs of design alternatives	• Low opportunity for Company to influence Contractor performance. (i.e. there is little incentive for the Contractor to keep costs to a minimum as profit is increased by expending more hours) ▪ Possibility of Contractor cutting corners on quality • Failure to control change by Company may result in claims • Final out-turn cost is dependant on measured quantities. (May exceed estimate). Consequently overall contract value must be closely monitored • Requires high levels of Company administration if costs are to be optimised

5.3 Reimbursable

Contract remuneration on a Reimbursable basis refers to an arrangement whereby Company reimburses the Contractor the full net cost incurred by the Contractor in undertaking the work, plus an agreed amount to cover overhead and profit. Typically, there are three ways of addressing the overhead and profit element, namely:

- (i) Net cost plus a fixed fee
- (ii) Net cost plus a percentage uplift
- (iii) Net cost plus an hourly rate

This method is most suitable when early selection of a Contractor is needed to progress work where the Scope of Work still requires to be fully defined. It is important to note here however that under such circumstances, suitable commercial control mechanisms such as Cost, Time, Resource (CTR) mechanisms should be employed to ensure a degree of control in arriving at a final contract value and controlling expenditure against budget.

Advantages	Risks
• Allows Company to make an early selection of Contractor • Reduces the need for claims as Company pays costs to the Contractor automatically • Company can influence Contractor performance	• Company retains the majority of risk • Company pays for any inefficiency or errors of Contractor • Final out-turn cost is uncertain • Less incentive on Contractor to minimise costs • Difficult to assess tenders (may not be on a "like with like" basis)

5.4 Incentive / Risk & Reward Schemes

Many different methods exist for incentivised remuneration. Generally, they all require a degree of shared financial risk and reward for the agreed Scope of Work. This shared risk can be based on the Contractor's commercial, technical or operational performance.

Benchmarks or targets are set for measurable aspects of the work which, if completed within these thresholds, result in both the Contractor and Company sharing in the savings or gains. The basis on which these improvements are shared is usually determined by a formula that accounts for variables such as target cost, equipment performance, uptime or any other measurable outcomes. Benchmarks must be measurable, relatively simple to monitor, understand and be aligned with the Company's overall objective for the work.

For an incentive scheme to be fully effective it is essential that the Contractor has the ability to significantly influence the targets it is being measured against. As an incentivised contract generally takes more time to manage, incentives should be reserved for work that has the potential to produce significant benefit to the Company.

Advantages	Risk
• Contractor cost and profit levels are known • The Contractor has clear incentives to reduce the cost of the work if the contract is incentivised properly • Contractor has more influence over the level of performance due to the setting of benchmarks • Incentivisation is a flexible arrangement that lends itself to Contractor self-motivation and innovation	• Considerable effort may be required for contract management • Complex arrangements may be difficult and time consuming to administer • Subjectivity in measuring performance against benchmarks, may lead to Company/Contractor friction

5.5 Dayrates

Contract remuneration on a Dayrate basis covers a situation where the Contractor offers Company fixed daily rates for various categories of labour, plant or equipment. The advantages and risks to Company of Dayrates are similar to the Reimbursable arrangement, although the Dayrate element and related working parameters may have been quantified and agreed in advance.

6.0 ASSESSMENT OF CONTRACTUAL RISK

Note - Criteria parameters in Risk Assessment Model are indicative only

The level of contract risk is used to determine the degree of control and management required by Company to mitigate its exposure. In the case of medium or high-risk contracts, such action may include:

- (i) comprehensive prequalification
- (ii) implementation of bridging documents to align Company and Contractor HSE management systems
- (iii) planned audit programme
- (iv) regular site and management inspections

Contract risk assessment is a subjective appraisal of the risk inherent in the Scope of Work. It considers two parameters: the potential severity of the **IMPACT** of an incident and the **LIKELIHOOD** that the incident will occur.

IMPACT is classified as one of the following:

- (i) High
- (ii) Medium
- (iii) Low

according to the impact on People, Environment, or Business. These classifications are expanded in the model below.

LIKELIHOOD is classified as one of the following:

- (i) Likely (e.g. wireline breaking during operations)
- (ii) Possible (e.g. mast collapse during wirelining)
- (iii) Remote (e.g. blowout during wirelining)

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The decision tree in the Contract Risk Assessment model below shows how Impact and Likelihood are used to generate a contract risk ranking of Low, Medium or High.

Contract Risk Assessment Model

