The NEC Contract – Key Concepts and the Proper Approach to Assessment

The proper basis of assessment of Compensation Events

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Overriding principles in NEC3: ECC

• Flexibility
  – Usable for construction and engineering works involving all disciplines;
  – Covers contractor’s design, partial design or no design responsibility;
  – Intended for use in 6 types of payment mechanism – the main Options;
  – Can be used in UK or internationally.
Overriding principles in NEC3: ECC

• Clarity and Simplicity
  – Designed to be user friendly;
  – Written in ordinary language;
  – Options clauses add to Core Clauses not altering or deleting them;
  – No cross referencing between clauses.
Overriding principles in NEC3: ECC

• Stimulus to good management
  – Key proposition
    • “foresighted, co-operative management of the interactions between the parties can reduce the risks inherent in construction and engineering work.” NEC Guidance Notes, June 2005.
  – Foresight applied collaboratively reduces problems and risks;
  – Clearly defined functions and responsibilities assists accountability and motivates the parties.
NEC PHILOSOPHY

• ...managing events is most successful if, before a solution is implemented, all parties contribute their expertise and devise methods of overcoming problems.

• This is the principle governing the early warnings provisions, compensation events, forecasts...: NECP/08/032
COMPENSATION EVENTS

• Events which do not arise from any fault on the part of the Contractor and which entitle the Contractor to be compensated for any change the event has on the Prices and the Completion Date or a Key Date under the contract.

• Compensation Events are listed in the Core Clauses, the Options and the Contract Data.
Section 6: Compensation Events

• Core Clauses 60-65
  – 60 Defines Compensation Event (19 events listed)
  – 61 Obligations to notify Compensation Events;
  – 62 Quotations (including impact on time as well as money) for Compensation Events;
  – 63 Assessing Compensation Events;
  – 64 The Project Manager’s Assessments;
  – 65 Implementing Compensation Events.
Key Contractual provisions

• CLAUSE 60 – a Compensation Event is defined under 19 different sub-clauses, the most important of which is clause 60.1(1) where the Project Manager gives an instruction changing the Works Information.

• Clause 60.1(19) is a generic Compensation Event which covers events which neither party could prevent and an event which is so unlikely that it would be unreasonable to expect an experienced contractor to have allowed for it.
Key Contractual provisions

• CLAUSE 61: Notification of Compensation Events

• Clause 61.1: Actual Compensation Events arising from instructions of the Project Manager, are notified to the Contractor at the time the instruction is given; quotations are requested unless the event is the fault of the Contractor or a quotation has already been provided; the Contractor puts the instruction into effect.
Key Contractual provisions

• Clause 61.2: the Project Manager instructs the Contractor to submit quotations for a proposed Compensation Event.

• Proposed instructions or changed decisions are not put into effect at this stage.
Key Contractual provisions

• Clause 61.3

• The Contractor notifies the Project Manager of an event which has happened and which he expects to be a Compensation Event;

• If the Contractor does not notify such an event within 8 weeks of becoming aware of it, he is not entitled to any change in the Prices, Completion Date or Key Date[s], unless the Project Manager should have notified the Contractor of the event but failed to do so.
Key Contractual provisions

- Clause 61.4: provides for the notification by the Project Manager of his decision whether the Contractor’s notice of an event is a Compensation Event, if it is not, the Prices and Completion Date are not affected, if he decides it is, he instructs the Contractor to submit quotations.

- A failure by the Project Manager to respond to the Contractor’s notification within a week or any longer period agreed, or within two weeks, is treated as an acceptance of the Contractor’s notice and an invitation to the Contractor to submit quotations.
**Key Contractual provisions**

- **Clause 61.5 & 61.6**
  - **Clause 61.5** – The Project Manager gives a decision of the Contractor’s failure to give early warning of event:
    - test – warning which an experienced contractor could have given.
    - Effect – limits Contractor’s entitlement to increase in time or money.
  - **Clause 61.6** – Project Manager’s decision that effects are too uncertain to forecast reasonably, the Contractor is then instructed as to assumptions on which quotations are to be based. May be revised later.
Key Contractual provisions

• CLAUSE 62 – Quotations – comprise proposed changes to the Prices, Completion Dates or Key Dates, each one to be supported by details of the Contractor’s assessment including any alterations to the Accepted Programme.

• After discussing ways to deal with the Compensation Event, Quotations can be for the works requested; for alternative quotations as requested by the Project Manager, or for the consequences of other methods of dealing with the Event considered practicable by the Contractor.
Key Contractual provisions

- Clause 62.2, 62.3 & 62.4
- Clause 62.2 - Quotations must be submitted within 3 weeks of the instruction to submit quotations;
- Clause 62.3 - the Project Manager must reply within 2 weeks:
  - Instructing a revised quotation (must give reasons, quote to be submitted within a further 3 week period: 62.4)
  - Accepting a quotation
  - Notifying that the proposed instruction will not be given;
  - Notifying that he will make his own assessment.
Key Contractual provisions

• Clause 62.5 & 62.6

• Clause 62.5 – the Project Manager extends time either for the Contractor to submit a quotation or for his reply if agreed with the Contractor before it is due. The Project Manager must notify any agreed extension of time to the Contractor.

• Clause 62.6 – If the Project Manager fails to reply to quotations, the Contractor may notify to this effect and the quotations submitted will be deemed to be accepted unless they are for a proposed instruction or change.

• Where alternative quotations or quotations for other methods have been submitted, the Contractor’s notification states which quotation he proposes to be accepted.
Clause 63

• Assessing Compensation Events
  – In essence – for compensation events under all NEC contract main options, details of the proposed cost, based on detailed cost schedules prepared by the Contractor, must be given to the Project Manager and substantiated as necessary in order for the Project Manager to respond effectively to the quotation: see Clause 62.3 [ibid.] for possible responses.
ASSESSMENT: Money

• Clause 63.1 Changes to the Prices
• The effect of the Compensation Event on:
  – The Actual Defined Cost of work already done,
  – The Forecast Defined Cost of the work not yet done and
  – The resulting Fee
• No reduction of the total Defined Cost save as stated in the Contract.
ASSESSMENT: Time

• Clause 63.3 – The Completion Date – delay is assessed by finding the difference between the planned Completion date due to the Compensation Event, and the planned Completion as shown on the Accepted Programme. A similar exercise is undertaken in relation to impacts on Key Dates in the Accepted Programme.
ASSESSMENT: Restrictions

• Clause 63.4 – the parties rights to alter Prices; the Completion Date and Key Dates are their only rights arising from a Compensation Event;

• Clause 63.5 – If the Project Manager has notified the Contractor of a failure to give an early warning of a Compensation Event the event is assessed as if the Contractor had given early warning.
ASSESSMENT: Matters included; Assumptions.

- Clause 63.6 – risk allowances for cost and time for matters which have a significant chance of occurring and are at the Contractor’s risk under the contract.

- Clause 63.7 – it is assumed that the Contractor reacted promptly and competently to the Compensation Event and any Defined Cost or time resulting are/were reasonably incurred and the Accepted Programme can be changed.
ASSESSMENT: Changes to Works Information

• Clause 63.8 – it is assumed that changes to resolve an ambiguity or inconsistency will be interpreted in the way most favourable to the party which did not provide the relevant Work Information.

• Clause 63.9 - If a change to Work Information changes the description of a Key Date, the description will be changed and taken into account when assessing the Compensation Event.
PROJECT MANAGER’S ASSESSMENTS

• Clause 64

• Undertaken if:
  – No Contractor’s quotations provided;
  – Contractor’s quotation is incorrect and no revised quotation has been requested;
  – Contractor’s quotations failed to include time impacts of Compensation Event;
  – The Project Manager has not accepted the Contractor’s latest programme for one of the reasons given in the contract.
PROJECT MANAGER’S ASSESSMENT: TIME

• Clause 64.2

• The time impacts are assessed by the Project Manager if:
  – There is no Accepted Programme; or
  – The Contractor has failed to submit a programme or alterations to a programme for acceptance as required by the contract.
PROJECT MANAGER’S ASSESSMENT: Timeframe

• Clause 64.3 & 64.4

• Clause 64.3: within the period allowed for the Contractor’s submission of his quotation, beginning on the date when the need for the Project Manager’s assessment becomes apparent.

• Clause 64.4 - If the Project Manager fails to assess a Compensation Event in the time allowed, the Contractor may notify to this effect, and state which of his quotations, if he has submitted more than one, he proposes to be accepted. If the Project Manager does not reply within 2 weeks, the Contractor’s quotation is treated as accepted.
ASSESSMENT: Difficulties

• Complex and lengthy set of rules;
• Substantial administrative burden;
• Expensive to resource;
• Draftsmen clearly underestimated use;
  – All changes to time and money included;
  – All changes to Works Information (60.1(1)) included;
• Prospective assessment – the emphasis is on
  the forecast cost of works still to be done –
  includes programming and cost assessments.
ASSESSMENT: Dealing with difficulties

• Steps taken to reduce the workload associated with assessment of Compensation Events:
  – Grouping events – bringing small claims together; batching kinds of claim (time bar issues to watch); grouping time impacts (monthly programme submissions);
  – Setting Schedules of Rates;
  – Excluding low value, minimal time impact events from the regime.
  – Streamlined administrative processes, to avoid time bars/”deemed” acceptances etc.
ASSESSMENT: back to first principles

- Process heavily dependent on principles of transparency and co-operation.
- Collaborative working is key to success;
- Effective risk management (from tender onwards) before and at the time of occurrence of events is critical;
- Sensible management of Compensation Events when they occur also essential.
ASSESSMENT: tensions

• Fault-based liability for consequences of Compensation Events;
• NEC requirements to predict outcomes in time and money – subjective assessments by Contractor and Project Manager may not agree;
• How to assess impacts when the predictions are wrong –
  – Should it be assessed on the basis of what the quote would have been if correctly predicted outcomes; or
  – What the actual outcomes are / actual costs.
ASSESSMENT: speculating on consequences of non-compliance

• Project Manager default/errors – if the contractual process is not followed – deemed acceptances of Contractor’s quotes as to time and money; potential for common law claims for damages for breach of contract: Employer pays;

• Contractor Defaults: likely time bars to claims; imposition of Project Manager’s assessments on time and/or money.

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9 July 2010