NEC3 compensation events

a practical guide

What is a compensation event?

Compensation events are NEC3 terminology for variations, loss and expense and extensions of time; a single assessment that deals with the entire effect of an event on time and money

Whilst the name suggests this always results in something more for the Contractor (a compensation), this is not always the case, as the saying goes, 'Prices can go down as well as up'.

Which events?

Of course, not all events are compensation events. Without exception, compensation events are those which are not the fault of the Contractor, but that does not necessarily mean they are the fault of anyone else; they could be fault neutral such as weather conditions or site conditions. In those cases, compensation events are used to allocate risk between the Parties.

Events that are compensation events are set out in the Contract.

There are 19 events listed in clause 60.1 of the core clauses, a further 3 in main options B and D (the bills of quantities options) and more scattered through the secondary options.

In addition, the Employer has the option to add further events in the Contract Data part 1 and some could be added in the Z clauses.

Is there a procedure to follow?

It is NEC3, of course there is a procedure. Simply put, it is:

- Notification;
- Quotation;
- Assessment;
- Implementation.

Taking each in turn:

Notification

For a compensation event that arises from an instruction of the Project Manager or the Supervisor, for instance to change the Works Information or to search for a Defect, the Project Manager notifies the Contractor of the compensation event and instructs him to provide a quotation.

For all other compensation events, the Contractor notifies the Project Manager.

On receipt of a notification from the Project Manager and an instruction to provide a quotation, the Contractor provides that quotation within 3 weeks.

That period can be extended by agreement with the Project Manager, such extension only being effective on receipt of a notification from the Project Manager of an agreement to extend.

On receipt of a notification from the Contractor, the Project Manager responds with a 'no' if:

- The event is the Contractor's fault;
- It has not occurred or is not going to occur;
- It has no effect on the Defined Cost and the Completion Date;
- It is not one of the listed events.

In all other cases, the reply is 'yes' along with an instruction to the Contractor to provide a quotation.

When instructing the Contractor to provide a quotation, the Project Manager may, after discussion with the Contractor, instruct him to provide other quotations for alternative methods of dealing with the event.

In any case, if the effect of the event is unclear, the Project Manager states assumptions on which the Contractor is to base his quotation. If those assumptions turn out to be incorrect, it is another compensation event.

Quotation

Under NEC3, a quotation has a special meaning. It must deal with all the effects of a compensation event on both time and money.

The quote must be assessed using the procedures in the contract and, when providing his quote to the Project Manager, the Contractor must include details of his assessment and, if the compensation event affects the Completion Date or the Key Dates, a revised programme for acceptance.

On receipt of a quotation, the Project Manager must respond within 2 weeks (or an agreed and notified extended period). His reply must be one of the following four permitted responses:

- An acceptance of the quotation;
- A confirmation that a proposed compensation event will not be instructed;
- A notification that the quotation has not been prepared properly (with reasons) and an instruction to resubmit;
- Ditto, with a notification that the Project Manager will instead assess the compensation event.

Assessment

A compensation event is assessed as the effect of the event on:

- The actual Defined Cost for work already done plus the Fee;and
- The forecast Defined Cost for work not yet done plus the Fee;and
- Planned Completion as shown on the latest accepted programme.

The cut off point between work done and work not already done is the date of the instruction to provide the quotation.

So, what does this mean? In simple terms, the NEC3 philosophy is that neither Party should be disadvantaged or should unfairly gain from the happening of a compensation event.

For those of you who are familiar with more traditional forms of contracts with bills of quantities, a contractor would ordinarily be reimbursed for additional work based on an existing bill rate. In that case, if the bill rate is too low or too high, the Contractor could unfairly gain an advantage or suffer a loss.

Under NEC3, neither the rates and prices in the Activity Schedule nor the Bill of Quantities are considered in assessing a compensation event.

Rather, the assessment is based on the effect of the event on the Contractor's cost; i.e. it either increases the cost or decreases it.

One final point, it is not actual cost which is considered, rather it is Defined Cost. These are costs the Contractor incurs in Providing the Works which fall into the particular definition of Defined Cost applicable to the relevant main option.

More on this in a later article.

Implementation

When a compensation event is 'implemented' it means it is finalised and cannot be changed by the parties, only by an adjudicator.

A compensation event becomes 'implemented' when:

- The Project Manager accepts the Contractor's quotation;
- The Project Manager notifies the Contractor of his assessment;
- The Contractor's quotation is treated as having been accepted by the Project Manager.

Sanctions

If the Contractor fails to notify the Project Manager of a compensation event within 8 weeks of him becoming aware of the event, he loses his right to claim any additional time or money (unless it is an event which the Project Manager should have notified to the Contractor).

If the Project Manager fails to reply to a notification of an event by the Contractor within 1 week, the Contractor may notify the Project Manager of that failure. If the failure continues for a further 2 weeks after the reminder, it is deemed that the Project Manager has accepted that the event notified is a compensation event and an instruction issued to provide a quotation.

If the Project Manager fails to reply to a quotation or to assess a quotation within the allowed time, the Contractor may notify the Project Manager of that failure. If the failure continues for a further 2 weeks, the Contractor's quotation is treated as being accepted.

There is no express sanction for a situation in which both the Project Manager and the Contractor entirely fail to notify an event which the Project Manager should have notified save that only notified events are compensation events and that no event can be notified beyond the Defects Date.

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When is a compensation event not a compensation event?

When it is time barred.

Clause 61 contains a procedure by which the Project Manager and the Contractor must notify the other of a compensation event. In the case of the Contractor, clause 61.3 requires notification within 8 weeks of becoming aware of the event; if he fails to do so, he loses his right to claim a change in the Prices or the Completion Date.

This clause provides opportunity for many to claim a Contractor's entitlement is 'time barred'.

However, the Contractor would not be time barred if he failed to notify an event which the Project Manager should have notified to the Contractor, but did not.

Clause 61.1 describes such events as those arising from the Project Manager or the Supervisor issuing an instruction or changing a decision.

In those events, clause 61.1 requires the Project Manager notify the Contractor "at the time", but if he does not, clause 61.3 requires the Contractor to notify the Project Manager but, as above, without falling foul of the time bar if he fails to do so.

That appears reasonably straightforward, but closer inspection of the applicable clauses reveals that NEC3, out of character, uses words such as "believes", i.e. "the Contractor believes that the event is a compensation event" and "becoming aware", i.e. "if the Contractor does not notify an event within 8 weeks of becoming aware of the event....".

These words are difficult to define in a corporate context.

A final consideration; under clause 61.3 the obligation on the contractor to notify an event does not arise until the contractor believes that event is a compensation event.

However, that same clause prescribes that the 8 week time bar runs from awareness of the event. It is possible that by the time an event becomes a compensation event (i.e. one that effects the Prices and the Completion Date), the 8 weeks may have expired.

For more information, please contact us.

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