

April 2021

# CECA NEC4 Bulletin

CECA Member Briefing:

## Bulletin No.4: Pricing Compensation Events & The Use of Assumptions

### Introduction

Training and development support is a key part of CECA's core offer for its membership and working in conjunction with GMH Planning it has delivered a programme of training events around the NEC Form of Contract across several CECA UK regions.

In addition to this training, a series of monthly NEC Contract Bulletins are being produced for both Contractors and Subcontractors to improve practical awareness on key topics within the NEC. The coverage, whilst not exhaustive, is intended as a general overview on some of the contractual principles to increase a wider understanding in support of more sustainable outcomes.

For the purposes of these bulletins a contractual relationship between a "Client" and "Contractor" is assumed. The same rules/principles also apply if the contractual relationship is between a "Contractor" and a "Subcontractor" and so the term "Contractor" will be used to describe both parties.

These bulletins are based on the latest NEC4 family of contracts, but the same principles and rules would apply where parties are engaged under an NEC3 form of contract.

### Coming next month:

Bulletin Nr 5: Liability for not notifying early warnings

Please respond to Leone Donnelly should you require any further information on the CECA NEC4 Bulletins via e-mail: [leonedonnelly@cecasouth.co.uk](mailto:leonedonnelly@cecasouth.co.uk).

For further advice or guidance on the NEC details please visit [www.gmhplanning.co.uk](http://www.gmhplanning.co.uk) or contact GMH Planning Ltd by e-mail [glenn@gmhplanning.co.uk](mailto:glenn@gmhplanning.co.uk).

# NEC4 Contract Bulletin Nr 4 - Pricing Compensation Events & The Use of Assumptions

It is worth noting that compensation events are rarely that straightforward which can reduce the likelihood that they will be agreed quickly. They are also generally the only mechanism for the Contractor to recover liability for an event that they had not considered within their tender. It is therefore imperative that every aspect or likely consequence of the compensation event and its impact on the Contract are fully understood and represented within the quotation to recover due entitlement. Once agreed there will be no recourse to add to this at a later date for issues that should have been identified at the time, it is a one stop shop for that CE.

Equally, the Project Manager is required to mitigate the Client's liability under the Contract and will seek to challenge the quotation to ensure that it realistically represents the impact of the event on the Contract. It is therefore incumbent on the Contractor that they can appropriately substantiate the case they put forward. Reducing the degree of subjectivity will make the path to getting agreement more straightforward, but is not always a guarantee that this will happen, particularly where there may be other commercial pressures impacting on the Contract or where relationships have broken down. There is always likely to be a challenge over what the level of the contractor's legitimate contractual entitlement is, given the nature of the process, so it is important to recognise the need to maintain good working relationships between the parties engaged in the process. Timely, consistent, and open engagement will help develop an environment that supports constructive resolutions.

**First, get the Client to agree that it is a compensation event.** The Contractor cannot submit a quote until the matter has been agreed as a compensation event. Unless the Project Manager has already notified that this is a compensation event, the Contractor will have to notify what the event is and why specifically it is a compensation event and under which contractual clause. The reasons for justifiable compensation events are mostly found listed in clause 60.1, but there are a few additional ones within the option specific clauses, the secondary options, and/or within Z clauses. Once the Project Manager agrees that it is a compensation event, this should be confirmed in writing to the Contractor along with a request to provide a quotation.

**How can a quotation be submitted without the Contractor having to price for excessive risk?** One way this would be possible is with the use of Project Manager assumptions. Where an element of the quotation is difficult to assess, the Project Manager under clause 61.6 can state assumptions for which the Contractor should assume. One such example would be ground conditions that the Contractor would otherwise have to price risk for, where no Site Information is available. If the Project Manager, for example, stated that the Contractor should assume good solid clay at formation level (and therefore not have to do any over dig down to a suitable formation and back fill with type 2), the quotation from the Contractor will correspondingly reduce in price accordingly. If the quote is agreed and implemented based on that assumption, and it turns out to be worse than stated, it would be recoverable as an additional cost. This would be a new compensation event under 60.1(17) where a Project Manager assumption has turned out to be incorrect. The original quote cannot be reopened and reassessed in full, as it is only the change in assumption that can be considered under a new compensation event.

**Can a Contractor include their own assumptions within a quote?** Not contractually. If a quotation is accepted by the Project Manager with any such Contractor assumptions, there is nowhere in the contract that says these can be revisited. Whilst this might be done with good intent to try to reduce the quote down to a level that would be more satisfactory for the Client it only serves to increase the liability on the Contractor. The way round this is for the Contractor to suggest assumptions for the Project Manager to agree, and if the Project Manager confirms them in writing before the quote is submitted, these would now become Project Manager assumptions which can be contractually revisited after the event. The only other alternative would be for the Contractor to price the risk. If as a result the quote is viewed as too high, it will at least lead to further discussions between the Parties about mitigating any such risk within a revised quotation.



**How should a Contractor present their quotation?** It makes sense to lay the quotation out in line with the sections of the schedule of cost components headings, i.e. People, Equipment, Plant and Materials, Subcontractors, Charges, Manufacture and Fabrication and Design (the last section Insurances not normally being anything that can be claimed for).

**Can/should a Contractor include risk within their quotation?**

Yes, as clause 63.8 states that the Contractor should assess the effect of a compensation event to include "risk allowances that have a significant chance of occurring" and are the Contractors risk under the contract. Whilst this will be subjective in terms of what is a "significant chance of occurring", it is for the Contractor to demonstrate as clearly as possible it is sensible risk that has been allocated. The Contractor should not add a "blanket 10/15% for risk" which is unlikely to be agreed. They should demonstrate specifically which elements of risk have been applied. If you take pipework installation – it will depend upon depth of excavation, size of pipe, type of ground, time of year, etc. A standard percentage of risk across the board is not really the correct approach that is likely to be accepted.



**Should the quotation include a programme and an assessment of time?** Clause 62.2 states that where a quotation for a compensation event affects the Completion Date or Key Dates, the Contractor includes alterations to the Accepted Programme within the quotation. We will explore this topic in a more detailed bulletin later in the year but in simple terms if the remaining works have been affected then this should be demonstrated in a programme that goes with the quotation. This should visually help the Client understand the time that is being claimed and would perhaps speed up the assessment response.

**What if the Project Manager does not respond to the quotation within the timescale of the contract?** In this situation the Contractor should notify the Project Manager that they have not responded to the quotation. If they fail to respond to this written reminder within a further period (two weeks in the ECC contract), the quotation would then be treated as having been accepted (i.e. deemed accepted). This should ensure the quotation process is moved along so both Parties know where they stand.



**If the quotation has not been agreed and the works in the meantime have been done – does that mean the assessment should revert to actual cost?** No, as Clause 63.1 sets the rules as to how it should be assessed. It states it is the "actual Defined Cost of the work already done, and the forecast Defined Cost of the work not yet done" (plus the fee). The clause goes on to confirm that the "switch point" (named the "dividing date" under NEC4) is the point when the instruction was issued, or for all other events not resulting from an instruction, when the compensation event was notified. This means that a vast majority of compensation event quotations should only ever be based on forecast which does look to protect both Parties. The Client is not left with having to pay for excessive cost if they feel the Contractor could/should have done it quicker, but equally confirms why the Contractor should also be paid for risk that the Client with hindsight can see has not happened (providing it was a risk that was reasonable to have been expected).

**Can the Project Manager make their own assessment of a Contractors quote?** Yes, if they do not believe it has been assessed correctly, they can make their own assessment. Their assessment would still have to follow the rules of the contract.

**What if the Project Manager makes their own assessment and it is implemented at an amount the Contractor does not agree with?** Well in the first instance just talk. If you can convince them they have assessed it wrong then they could change their decision as a new compensation event under 60.1(8), but this can only increase the Prices rather than reduce them. If you cannot convince them their assessment is too low, then you would need to follow the dispute process within the contract. Under NEC4 this would be to first go to senior representatives that each Party names in contract data to see if they can resolve it. If it cannot be resolved at that level, then ultimately the next contractual step would be adjudication. Hopefully, sense would be seen along the way to prevent adjudication, but it is the ultimate sanction/remedy under the contract if both Parties are adamant that they are correct in their respective assessments.

**Summary:** Follow the contractual processes along the way to move a compensation event through notification, quotation, assessment and implementation. Project Management assumptions are the only elements of an implemented compensation event quotation that can be revisited. A contractor should not put their own assumptions within a quote – they should suggest them for the Project Manager to agree before issuing the quotation, or alternatively price the risk.

For further advice or guidance on the NEC details please visit [www.gmhplanning.co.uk](http://www.gmhplanning.co.uk) or contact GMH Planning Ltd by e-mail [glenn@gmhplanning.co.uk](mailto:glenn@gmhplanning.co.uk).