

NEC101: Compensation Events, an introduction

Q&A

1. Clause 63.1 identifies the point when either actual or forecast cost should be used in a compensation event. However, what is not clear is how this should be calculated in the compensation event and then subsequently changes the Prices. For example, where actual costs are identified in a compensation event (pre-dividing date) which are abortive costs due to the effect of the compensation event, should this be a + or - cost in the assessment, especially in a target price contract as the outcome will have an influence on final pain/gain share assessment. Further, where actual costs are not abortive but are works done (pre-dividing date) as part of the compensation event, should this be + or - cost. Can the panel provide any clarity on this?

You are trying to calculate the 'effect of the compensation event upon...Defined Cost'. The Prices are whatever they are at the time. You need to determine what you genuinely believe the actual Defined Cost is that has been incurred as a result of the compensation event, and what the forecast Defined Cost will be going forward as a result of the compensation event. You are standing on the dividing date and looking back and forecasting forward. That is the basis. Abortive costs would likely be actual Defined Cost, in effect a positive cost to the existing Prices. Same for actual Defined Cost – how much of that is due to the compensation event. If Option C, this adjustment to the Prices should be reflected in a similar adjustment to Defined Cost + Fee for the purposes of calculating the Price for Work Done to Date.

2. We have recently been on a scheme where the ground risk was a Client risk. We as the Subcontractor notified this to the Contractor but the said client has a Z clause that removed this as a compensation event, leaving us at loggerheads. We then proceeded at risk after 5 weeks as it was a large compensation event the time lost (5 weeks) was not agreed but the cost to deal with the ground was. Where do you stand with such a Client risk?

Whatever risk is transferred to the Contractor in the main contract is immaterial for purposes of managing the subcontract. If you are using the NEC4 Engineering and Construction Subcontract and clause 60.1(12) is left intact, you may well have a compensation event occurring in your subcontract irrespective of the Contractor's rights in their main contract. There are too few facts here to give a definitive answer.

3. Who might be responsible for a compensation event caused by delays on the part of the Building Safety Regulator completing inspections under the Building Safety Act?

The Regulator would likely be classified as an 'Other' and therefore clause 60.1(5) would be relevant. Much depends on what the Scope/Accepted Programme say for this.

4. If the Contractor doesn't notify the Project Manager that he hasn't responded for say 2 weeks, is that the point where the project manager then has 2 weeks to respond?

That is correct, according to i.e. clause 62.6.

5. What should a Contractor do if the Project Manager notifies a compensation event but does not instruct the submission of quotations, although should have?

Notify the compensation event yourself under clause 61.3.

6. When you descope contracted works under NEC4 ECC Option A, how do you do this without it being labelled as a "commercial benefit of the project manager"? This seems to be the default response.

There is no such thing if it is the Scope provided by the Client that is being descope. You assess the saving just the same as if it were an extra.

7. If the Contractor wants to get paid in the next interim payment application for an implemented compensation event, can it propose asap a revision of the pricing document (Activity Schedule or Bill of Quantities)?

The proposed revision is a part of the quotation submitted by the Contractor. So when it is accepted and therefore implemented, it goes onto that pricing document.

8. Please can you explain further what is the dividing date?

It is just a point in time according to clause 63.1 and it will frequently be the point at which the Project Manager issues an instruction to change the Scope under clause 14.3. That is the point the contract basically says whoever assess the compensation event, the Contractor, the Project Manager or even an Adjudicator, they should stand on that date and look back and forwards in assessing time and money associated with the compensation event.

9. Should not the compensation event be accepted and implemented before including it in the programme?

No. Clause 32.1 requires all 'remaining work' to be shown on revised programmes.

10. What is the default position where contracts have been amended, so that the failure to respond to a quotation or notification within the period of reply, is treated as "unaccepted" instead of "accepted"? Does the compensation event just remain open until a response is formally given?

We cannot comment on changes to the standard ECC but the obligation upon the Project Manager to respond to i.e. a notified compensation event under clause 61.3 or to a quotation under 62.3 is a continuing one until they respond. A further compensation event occurs under clause 60.1(6) after the initial period has elapsed.

11. If you are using a Bill of Quantities and a Standard Method of Measurement (SMM) and you do not measure the Bill of Quantities fully in accordance with the SMM e.g. using pre-hung doors rather than measuring the door fully in accordance with the SMM - is this a compensation event – or can you qualify the description and measure to negate the compensation event?

Assuming Option B or D is used, this looks to be a mistake in the Bill of Quantities as it is a departure from the rules in the SMM. Therefore, a compensation event occurs under clause 60.6.

12. What if the Contractor fails to notify the Project Manager that they have not replied in the two-week period? Does the two-week period to reply until treated as accepted still apply?

It is not a failure of the Contractor, it is a right they have and if the right is not exercised, then the Project Manager still needs to reply. A compensation event occurs for not replying within the original time period.

13. Is there a contract mechanism/arbitration process in the event protracted liaison between parties does not bring about acceptance of compensation event/quotation?

The Project Manager is obliged to make an assessment due to certain eventualities, you cannot go around in circles indefinitely. At that point, or even if the Project Manager refuses to assess the compensation event, the Contractor may dispute this and, depending on whether W1, W2 or W3 is used, the next step will be taken away from the Project Manager.

14. If the Project Manager has accepted a quotation, but only refers to the costs and extension of time and not to the latest revision of the programme, would the latest revision of the programme be deemed accepted as part of the compensation event?

When a quotation is submitted, a part of the Accepted Programme will be used to show the changes the compensation event causes. This is not a revised programme, and it will not lead to a (new) Accepted Programme.

15. What happens when the project manager changes the Scope and knows 100% that this will result in a compensation event - but neither him or the Contractor notifies each other of the compensation event?

As long as it is notified by either before the defects date, it will still validly be assessed and not time barred.

16. At what point the compensation event should be included in the programme? Shouldn't be only once it is accepted and implemented?

No. Clause 32.1 requires all 'remaining work' to be shown on revised programmes.

17. Can you review and change a compensation event after it has been agreed?

Clause 66.3 says you cannot. That is unless you have used Project Manager assumptions under clause 61.6.

18. In 62.6, pretty sure the Contractor "may" notify the project manager, but there's no requirement that they do so - no "shall"?

That is correct. The obligation still sits with the Project Manager to act.

19. If the Contractor does not submit a quotation, can the Project Manager then assess the compensation event themselves?

Yes, the Project Manager is obligated to do this under clause 64.1.

20. If the Project Manager has done their own assessment, and notifies the Contractor, upon which the Contractors disagrees with the Project Manager assessment, could the Project Manager then issue an instruction to the Contractor to submit a revised quotation?

No. Once the assessment is done then under clause 66.1 this becomes implemented and according to clause 66.3 cannot later be changed. The only recourse for the Contractor is to formally dispute this.

21. How does early warning notification tie into the compensation event?

It does not, they are completely separate processes. Only the failure to notify an early warning can be an issue in assessing compensation events.

22. Can a compensation event only be paid when implemented under 66.3?

For Option A and B, yes, that is correct. It is not the case in Option C to F as that has an entirely different way of assessing Price for Work Done to Date.

23. Can you revisit compensation events if you have made Project Manager assumptions? Rather than not implementing a compensation event is it not better to make assumptions and then correct the assumption in a further compensation event should you be having difficulty agreeing the quantum of the compensation event?

Yes, agreed. If the effects of the compensation event are too uncertain to be forecast reasonably, use Project Manager assumptions and agree the quotation on this basis. Then if the assumptions prove to be incorrect, another compensation is notified and the difference is then assessed as a further compensation event, but you do not alter the original quotation if perhaps you got this wrong in the first place.

24. Aware of clause 66.3 but can it be under W1 the Senior Representatives suggest a change and that the Parties agrees, can we re-open assessment and change the valuation of the compensation event?

The Parties are free to change any such assessment under clause 12.3 anyway, with or without the Senior Representative's later involvement. Yes is the answer.

25. If Contractor does not send a reminder to the Project Manager for failing to assess the quotation, re the deemed accepted provisions not applicable?

Correct. Read clause 62.6 for example.

26. If you notify the compensation event under Clause 61.3 do you need to state under which clause of 60.1 is this considered to be a compensation event? For example 60.1.6. or any other.

The contract doesn't actually stipulate this, but we think this is sensible as otherwise could cause uncertainty.

27. If there's an implemented compensation event but things significantly change down the line i.e. part of those compensation event works are to be omitted, can you issue a further compensation event which may effectively reduce a previously accepted compensation event?

Yes, but you don't issue a compensation event, you notify one. You presumably have a clause 14.3 instruction to change the Scope, the compensation event is implemented. Then, for whatever reason, it is necessary to change part of the Scope already changed, that's fine and will be done with a further Project Manager's instruction which causes a separate compensation event to occur. The Prices may increase or decrease as a result, but you do not alter the original quotation or bring forward i.e. the Completion Date.

28. Can the time spent/cost of preparing the quotation be included within the compensation event quotation?

It depends if Defined Cost increases i.e. resources brought from head office to deal with the quotation.

29. As a Project Manager if I want the Contractor to provide a quote to survey a certain area to possibly include into the contract, is the survey quote a compensation event? Will the results of the survey be considered a secondary compensation event or should it be included all in one?

The requirement to carry out a survey should be via a Project Manager's instruction under clause 14.3 to change the Scope. This causes a compensation event under clause 60.1(1) to occur. If you require further works after considering the results of the survey, these should be given via a separate Project Manager's instruction under clause 14.3 again to change the Scope. This causes a separate compensation event to occur under clause 60.1(1).

30. If a Contractor prices a "piece of furniture" within their lump sum quotation and a compensation event comes in to change that item. If at tender a higher margin was priced into this item in particular, should this be given back to the Client or are you as the Contractor entitled to keep this margin and just charge the extra over incurred for the item.

It seems this is an Option A contract. If you change the item via a Project Manager's instruction under clause 14.3 then the effect of this compensation event upon Defined Cost is to be assessed, leaving the higher (or lower) margin intact. We are not undoing good or bad tender allowances in clause 63.1, only looking at the difference caused by the compensation event.

31. In relation to clause 62.2 if a compensation event changes the Completion Date etc, the Contractor submits the Accepted Programme showing the delay and then this programme must be accepted by the Project Manager separately, Is that correct?

No, that is not correct. The programme gets revised through section 3 of the contract, in particular clauses 31/32. The compensation event process just uses the version of the Accepted Programme in place at the dividing date and only extracts of the programme will be necessary to show the effects of the compensation event. The acceptance of the

quotation includes proposed changes to planned Completion will not cause this to become the Accepted Programme.

32. How should the matters entered in the Contract Data to be included in the first Early Warning Register during the tender/ negotiations and entered into the Contract Data prior to signing be best dealt with?

You include these as matters to go onto the first Early Warning Register, which will happen post contract. At early warning meetings you may discuss any of these matters as you so wish to, together with other notified early warnings post contract.

33. Are compensation events always created using Defined Cost, rather than Bill of Quantities for Options B/D?

The default is to assess compensation events using Defined Cost, as required by clause 63.1. If the Project Manager and Contractor agree, rates and lump sums (from the Bill of Quantities) may be used as the basis instead.

34. Other question I had was when does the 8-week time bar for Contractor compensation event notification start?

Clause 61.3 states that this time bar starts from 'the Contractor...becoming aware that the event has happened'.

35. What happens if a compensation event is notified after Completion of the whole of the works?

Assuming it is not caught by the clause 61.3 time bar, then it is processed as any other compensation event would be.

36. If the Project Manager has a wait and see approach and tells that the compensation events have to be assessed retrospectively, should the Contractor still assess the quotation base on the forecast?

Best advice is to follow the contract, which does not offer a wait and see approach. Use the dividing rule in clause 61.3 and follow that properly.

37. It is sensible to me to add any compensation events through the Contract Data, Z clauses or even to remove some of those included in the clause 60.1 etc. but to change the wording of the already included in the NEC4 ECC that is quite against the clause 10.1 and 10.2. Can I have your view please?

Take care in changing standard forms of contract. That said, you can simply add in a compensation event in the Contract Data. You can delete or modify existing compensation events through Z clauses – the drafters permit this to happen, we would say it is ok as long as this ties up with your sensible risk allocation determined in your project risk register and you understand the implications of this.

38. Is the Subcontractor fee within a compensation event is disallowable under Options A and B in a Contractor quotation?

It is not 'disallowable', such term is not used in Option A/B. The new provisions in the Short Schedule of Cost Components allows for the whole price from a Subcontractor to be included in a compensation event quotation, but must be at open market rates etc as required in clause 52.1.

39. If the Contractor includes 5 days of a crane as a risk provision in forecast Defined Cost for a compensation event quotation that is then accepted but then carries out the entire works under the compensation event without using crane (and no crane used on Site) clause 66.3 does not allow the cost of the crane to be deducted when later making payment for the compensation event. This is what NEC says but is also similarly quite annoying.

Would it be annoying the other way around? You do not say what the main Option is but both Project Manager and Contractor at the time of the quotation seemed to be happy with the allowance and it seems the Contractor then found a different/better/cheaper way of carrying out the works. That is their right at tender stage, and you wouldn't deny them that so why is it wrong here?

40. Does a compensation event lead to a reduced total time period i.e. use more productive plant?

It could do, it depends, but may cost more money. But you will not bring forward the Completion Date.

41. Can a Contractor notify a compensation event without a prior early warning?

Yes, there is no direct linkage.

42. What is the time bar triggered by?

The Contractor becoming aware that the event has happened, see clause 61.3.

43. We currently have a live job (Short term). Last year we received additional funds through a side agreement to cover the impact of the inflation rises. However, compensation events that have been notified due to additional Project Manager requests or missing information in the original documents (or information we had at the time of the side agreement) have been denied. Their response does not refer to the contract, so they are using the side agreement as some sort of fixed price agreement - which was not the case or worded to that effect. What are our options? Adjudication?

This seems very messy and scenario-specific rather than a generic query. Work things through one at a time, in the order in which they occurred – what exactly was the side agreement deemed to cover? Was it all compensation events notified at the time, or something else? And how did the Project Manager change the Scope, and was this before or after the side agreement. Seems like you need some professional help here to untangle this as it's impossible for us to comment sensibly. You always have a right to dispute things, just be sure it's the right thing to do and i.e. you have not inadvertently tied all such things up in this side agreement.

44. NEC3 includes Risk Register 11.2(14) / NEC4 includes Early Warning Register 11.2(8) - do we need both to manage project risks?

The Early Warning Register has replaced (in name) the Risk Register. Yes, you need to manage the matters on these Registers.

45. If a compensation event has time implications, do the cost of the time implications (preliminaries) need to be included in the compensation event quote? My understanding of this is yes.

Your understanding is correct, as required in clause 63.1/63.5.

46. Does the first bullet point in clause 80.1 (NEC3 ECC) cover damage caused by the Contractor's delivery vehicles to a road adjoining the Site and therefore any repair works by the Contractor is also a compensation event?

Was it an unavoidable result of the works? Was there no other way but to damage this road outside of the Site? If the answer is it was unavoidable, this would seem to be an Employer's risk under clause 80.1 and further a compensation event under 60.1(14). This will be fact-specific though.

47. The Project Manager can issue a negative compensation event?

There is no such thing as a negative compensation event, but you can i.e. issue a Project Manager's instruction which has a negative effect on the Prices. But this does not bring the Completion Date forward. Further, you do not issue compensation events, you notify them.

48. If the Contractor does not notify the Project Manager of a failure to reply to a notified compensation event after one week under 61.4, does the Project Manager still have another 2 weeks to reply or do they have longer?

The Project Manager still should reply as soon as they can, there is no end period but a compensation event under clause 60.1(6) occurs because of the initial failure. The Contractor is not compelled to notify the Project Manager of the failure, it is optional, but the Project Manager still has to reply to the original notification.

49. If the Contractor gives an early warning on a matter and based on the early warning meeting the project manager later gives an instruction to change the Scope and the matter is a compensation event, then what date should be the dividing date? The date of instruction or the date of giving early warning?

The early warning and compensation event processes are completely separate. A notification of early warning is not sufficient to double up as a notification of a compensation event. According to 63.1, second paragraph, the dividing date is the date the instruction to change the Scope.

50. If you have an NEC4 ECC Option E contact for a design team lead and the same Contractor is going to provide additional work from another part of their business - is this a compensation event?

No, this event does not seem to be covered by any of the stated compensation events in the contract.

51. How does a Client raise NCEP against the Contractor for damaging their existing assets during the phase of work to recover repair cost?

Sorry, not sure what 'NCEP' means. This seems to be a Contractor's liability under the 3rd bullet of clause 81.1, covered by insurance 3rd row in clause 83.3 of the Insurance Table. This is fact-specific though.

52. Can the Project Manager require the Contractor to provide a fixed quotation when the impact continues over time in order to accept the compensation event?

If the compensation event is too uncertain to be forecast reasonably, under clause 61.6 the Project Manager can give some assumptions for the quotation to be based on. Otherwise, allow for such impact within the quotation if it is not too uncertain to be forecast reasonably.

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