CHARTERED INSTITUTE OF ARBITRATORS
NEC compensation events
A process for all eventualities?

April 21st 2016
NEC3 ENGINEERING AND CONSTRUCTION CONTRACT

Dealing with Compensation Events
Part 1 – Unpacking the Contract
Prologue

- Any contract requires ‘complete and precise performance’ by its parties.

- The ECC is far more than [sic] “a stimulus to good management”:

- It should be administered on a ‘Page Turn’.

The success of the contract turns on doing exactly what it says.
Introduction

- Compensation events are given at Clause 60.1

- 19 causation issues listed (of which 17 are treated as if breach by the Employer)

- Compensation events can either be:
  - notified or instructed by the Project Manager; or
  - notified by the Contractor

- If the Contractor fails to notify within 8 weeks of becoming aware, entitlement to time and money relief is forfeited
Understand, comply and plan for dealing with compensation events in the contract timescales
A word about Communications

Clause 13.1:

“Each instruction, certificate, submission, proposal, record, acceptance, notification, reply and other communication which this contract requires is communicated in a form which can be read, copied and recorded...."

Clause 13.2:

“A communication has effect when it is received at the last address notified by the recipient for receiving communications or, if none is notified, at the address of the recipient stated in the Contract Data”

Clause 13.7:

"A notification which this contract requires is communicated separately from other communications".

Minutes of meetings do not constitute valid notification, nor will it be sufficient to include a notification within a communication addressing other, unrelated matters.
Where does early warning fit in (1)?

**Clause 16.1:**

“The Contractor and the Project Manager give an early warning by notifying the other as soon as either becomes aware of any matter which could:

- Increase the total of the Prices
- Delay Completion
- Delay meeting a Key Date
- Impair the performance of the works in use

The Contractor may give an early warning by notifying the Project Manager of any other matter which could increase his total cost...."

The obligation is **not** confined to notifying matters which are/or may be compensation events.
Where does early warning fit in (2)?

- Early warning notifications do not constitute notifications of compensation events. The two require separate notifications.

- Both the Project Manager and the Contractor are under an obligation to notify. (61.1 and 61.3 respectively)

**Clause 61.5:**

"If the Project Manager decides that the Contractor did not give an early warning of the event which an experienced contractor could have given, he notifies this decision to the Contractor when he instructs him to submit quotations."

**Clause 63.5:**

"If the Project Manager has notified the Contractor of his decision that the Contractor did not give an early warning of a compensation event which an experienced contractor could have given, the event is assessed as if the Contractor had given early warning."

The intention of 63.5 is to ensure that the Contractor does not benefit from his own breach – i.e. by failing to give early warning, in circumstances where early warning would have had a mitigating effect on the consequences of a compensation event.
Notifying Compensation Events (1)

- **Clause 61.1:**

  "For compensation events which arise from the Project Manager or the Supervisor giving an instruction or changing an earlier decision, the Project Manager notifies the Contractor of the compensation event **at the time of giving the instruction or changing the earlier decision.** He also instructs the Contractor to submit quotations,...."

- **Clause 61.3:**

  "The Contractor notifies the Project Manager of an event which has happened or which he expects to happen as a compensation event if

  - the Contractor **believes that the event is a compensation event** and
  
  - the Project Manager has not notified the event to the Contractor....."

The requirement to instruct the submission of quotations is mandatory (see also 10.1).
Notifying Compensation Events (2)

Clause 61.4:

"If the Project Manager decides that an event notified by the Contractor
• arises from a fault of the Contractor,
• has not happened and is not expected to happen,
• has no effect upon Defined Cost, Completion or meeting a Key Date or
• is not one of the compensation events stated in this contract
he notifies the Contractor of his decision that the Prices, the Completion Date and the Key Dates are not to be changed...."

The above four reasons are the only reasons upon which the PM can base his decision that there will be no changes.
Clause 61.4 also provides:

"...If the Project Manager does not notify his decision to the Contractor within either

- one week of the Contractor's notification or
- a longer period to which the Contractor has agreed,

the Contractor may notify the Project Manager to this effect. A failure by the Project Manager to reply within two weeks of this notification is treated as acceptance by the Project Manager that the event is a compensation event and an instruction to submit quotations.”
Notifying Compensation Events (4)

Assumptions

- **Clause 61.6:**

  "If the Project Manager decides that the effects of a compensation event are too uncertain to be forecast reasonably, he states assumptions about the event in his instruction to the Contractor to submit quotations. Assessment of the event is based on these assumptions. If any of them is later found to have been wrong, the Project Manager notifies a correction."

- **Clause 65.2:**

  "The assessment of a compensation event is not revised if a forecast upon which it is based is shown by later recorded information to have been wrong."

A compensation event/quotiation based originally on incorrect assumptions is not reassessed, but a new compensation event is assessed in accordance with the provisions of Clause 63.
Clause 61.7:

"A compensation event is not notified after the defects date."

(The defects date is stated in Contract Data Part One.)

This provision is on all fours with the proposition that the ECC does not permit retrospective claims.
Quotations/Assessment (1)

- Clause 62.2:

"Quotations for compensation events comprise proposed changes to the Prices and any delay to the Completion Date and Key Dates assessed by the Contractor...."

- If a quotation does not deal with all the relief sought and is accepted (or treated as accepted) by the Project Manager, the Contractor will have lost his right to that part of the relief not dealt with by the quotation.

The Contractor’s quotation must deal with the relief sought in terms of both time and money.
Quotations/Assessment (2)

- **Clause 62.2** further provides:

  "...The Contractor submits details of his assessment with each quotation."
Quotations/Assessment (3)

Clause 63.1:

"The changes to the Prices are assessed as the effect of the compensation event upon

- the actual Defined Cost of the work already done,
- the forecast Defined Cost of the work not yet done and
- the resulting Fee.

The date when the Project Manager instructed or should have instructed the Contractor to submit quotations divides the work already done from the work not yet done."

The actual physical progress of the work at the time the assessment/quotation is made, is not the criteria for deciding work done or not done. The line in the sand is the date of the instruction or, if that instruction is late, the date it ought to have been given.
Quotations/Assessment (4)

- **Clause 63.3:**
  
  "A delay to the Completion Date is assessed as the length of time that, due to the compensation event, planned Completion is later than **planned Completion** as shown on the Accepted Programme....“

- The ECC envisages that the Contractor may plan to complete the works earlier than the contractual Completion Date, hence the reference to 'planned Completion'.

- Accordingly any delay to planned Completion will result in an equivalent delay to Completion Date.

- Any float between planned Completion and the contractual Completion Date is owned entirely by the Contractor.

Activity float before planned Completion is available to either party to mitigate delay, (unless the Contractor has ‘ring-fenced’ as “risk” on the Accepted Programme).
Quotations/Assessment (5)

Assessments are made on the basis of 'Defined Cost'.
(It is important to note that the definition of Defined Cost varies between the Main Options):

- For Options C, D, E & F, ‘Defined Cost’ is:
  
  "the amount of payments due to Subcontractors for work which is subcontracted........And the cost of the components in the Schedule of Cost Components for other work......."

- For Options A and B, ‘Defined Cost’ is:
  
  "...the cost of the components in the Shorter Schedule of Cost Components whether work is subcontracted or not excluding the cost of preparing quotations for compensation events"

For Options A and B, the Contractor is not entitled to recover amounts charged by subcontractors (ie. the subcontractor's invoice amount) in quotations/assessments of compensation events.
Clause 62.3:

"The Contractor submits quotations within **three weeks** of being instructed to do so by the Project Manager. The Project Manager replies within **two weeks** of the submission. His reply is

- an instruction to submit a revised quotation,
- an acceptance of a quotation,
- a notification that a proposed instruction will not be given or a proposed changed decision will not be made or
- a notification that he will be making his own assessment."

Acceptance or deemed acceptance of a quotation automatically implements the compensation event.
Clause 62.6:

“If the Project Manager does not reply to a quotation within the time allowed [two weeks], the Contractor may notify Project Manager to this effect. If the Contractor submitted more than one quotation for the compensation event, he states in his notification which quotation he proposes is to be accepted. If the Project Manager does not reply to the notification within two weeks, and unless the quotation is for a proposed instruction or a proposed changed decision, the Contractor's notification is treated as acceptance of the quotation by the Project Manager.”

This “deemed acceptance” provision is clearly contingent upon the Contractor giving the 'reminder notice'. It is only from the date of the reminder that the 2 week period can be calculated.
**Project Manager’s Assessment (1)**

- **Clause 64.1:**

  "The Project Manager assesses a compensation event

  - if the Contractor has not submitted a quotation and details of his assessment within the time allowed,

  - if the Project Manager decides that the Contractor has not assessed the compensation event correctly in a quotation and he does not instruct the Contractor to submit a revised quotation,

  - if, when the Contractor submits quotations for a compensation event, he has not submitted a programme or alterations to a programme which this contract requires him to submit or

  - if, when the Contractor submits quotations for a compensation event, the Project Manager has not accepted the Contractor's latest programme for one of the reasons stated in this contract."

These are the only circumstances under which the Project Manager can make his own assessment of the effect of a compensation event.
Project Manager’s Assessment (2)

Clause 64.2:

"The Project Manager assesses a compensation event using his own assessment of the programme for the remaining work if

- there is no Accepted Programme or

- the Contractor has not submitted a programme or alterations to a programme for acceptance as required by this contract."

Allowing the process of programme submission and acceptance to slip can have disastrous consequences under the ECC.
Clause 64.3:

"The Project Manager notifies the Contractor of his assessment of a compensation event and gives him details of it within the period allowed for the Contractor's submission of his quotation for the same event. This period starts when the need for the Project Manager's assessment becomes apparent."

The period is three weeks. The need for the PM's assessment arises when one or more of the conditions set out in clause 64.1 arises.
Clause 64.4:

"If the Project Manager does not assess a compensation event within the time allowed, the Contractor may notify the Project Manager to this effect. If the Contractor submitted more than one quotation for the compensation event, he states in his notification which quotation he proposes is to be accepted. If the Project Manager does not reply within two weeks of this notification the notification is treated as acceptance of the Contractor's quotation by the Project Manager."

This provision is clearly contingent on the giving of the reminder notice. It is only from the date of the reminder that the two week period can be calculated.
Implementation

Clause 65.1:

"Compensation events are implemented when:

• the Project Manager notifies his acceptance of the Contactor's quotation,
• the Project Manager notifies the Contractor of his own assessment or
• a Contractor's quotation is treated as having been accepted by the Project Manager”
In Summary…

- Do not be taken in by the easily-read “simple language” style of drafting

- The compensation event process is complex and assumes parties will keep up with the process

- The word “quotation” has a special meaning under the ECC.

- Once implemented, that compensation event is finished with there is no going back.
Part 2 – Case Studies
Case Study 1 – Using the contract

Relatively complex contract in where the work was contained inside an existing operational plant. Option A design and build - there were significant interfaces with existing works, so the contract documents were set up to assist with the co-ordination needed with the Employer and Others.

The Project Manager who was working with us throughout the procurement process and the development of the contract, started on site.

He said:

….. “If we have to resort to the contract, then we’ve all failed” ……

Read – and use - the contract!
Early Warnings

16.1 The contract intends that early warnings are raised by the Contractor or the Project Manager, for events that will

- Increase the total of the Prices
- Delay Completion
- Delay meeting a Key Date
- Impair the performance of the works in use

*The Contractor may give an early warning by notifying the Project Manager of any other matter which could increase his total cost....”*

- Some examples in practice:
  - Project Manager not accepting early warnings - did not wish to worry the Employer!
  - Employer saying that raising early warnings is “too contractual”
  - Employer saying that if early warnings are raised, then he will give no more work to the contractor/consultant
- None of these practices will enable the Project Manager to manage risk and reduce it
- And therefore, the Employer cannot benefit from the process

Raise early warnings, use the risk reduction process
Case Study 2 – Raising early warnings

The project was a civil engineering structure which included M&E equipment which was included in the Works Information with a Plant data sheet.

There were two pieces of information in the data, which could not work together – either one was correct or the other was correct, both couldn’t be correct.

It should have been notified as an ambiguity or discrepancy under clause 17 as to which variable was correct, along with an early warning.

Instead, the Contractor chose one of the two variables but unfortunately, this was the wrong one.

The Contractor was entitled to a compensation event but because he had not followed either clause 17 raising the ambiguity or clause 16 for an early warning, his compensation event was valued as if he had given an early warning. At considerably less expense than it would have cost if he had raised the early warning.

Issue went to adjudication
Case Study 3 – Delegating duties

The project was a civil engineering project which involved the construction of some land drainage across a field that was needed for an event after Completion.

The design acceptance process was an advisory service to the Project Manager.

A subcontractor proposed a different drainage system.

The proposal was sent to the designer who responded in the “if x, y and z were included, then it may be acceptable”.

No compensation event or instruction was issued.

The subcontractor constructed the alternative proposal and introduced a delay into the project which ultimately affected the availability of the field for the event.

There had to be some remedial and additional works implemented so that the event could go ahead on time.

The contract needed a clear line of authority for issuing instructions by the Project Manager

Make sure there is supervision of the works

Ensure that the lines of communication are set out clearly and that instructions and compensation events are raised when needed
Case Study 4 – an altered compensation event process

<table>
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<th>Ref No:</th>
<th>Date Notified</th>
<th>By Who</th>
<th>Detail</th>
<th>EW Meeting Required</th>
<th>Date</th>
<th>Quotation Requested</th>
<th>Agreed As Requested</th>
<th>Date</th>
<th>Agreed As CE</th>
<th>Date</th>
<th>Contractor Price</th>
<th>Agreed Price</th>
</tr>
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This was a NEC Option C project, with some amendments – no amendments to the compensation event process

- The Contractor or the Project Manager raised an early warning
- They were entered into one register
- Those the Contractor raised were generally items that he considered to be a compensation event – some of those were rejected
- Quotations were submitted and qualified re: time effects, then negotiated for costs, some of which took months to agree, even without considering the time

It is difficult to deal with an alternative process, especially one that becomes disputed
Case Study 4 – an altered compensation event process

Cumulative Early Warnings and Compensation Events

Graphs are what might be expected but note that PM only notified events in first 3 months of a 2.5 year programme.
Case Study 4 Completion and the programme

- Programmes were not accepted generally, so at Completion, the latest Accepted Programme was ~ 18 months old in a contract period of ~ 24 months
- The Contractor had been awarded one delay to the Completion Date and an Accepted Programme had been in place at that date
- The works had been Taken Over before Completion
- The Contractor had been reporting progress >90% complete at Take Over
- Several months after Take Over, the Contractor was still on site, unfinished.
- No Completion certificate had been issued
- The Contractor asked for the Project Manager to determine the revised Completion Date
- This now needed assessment, when there had been both Employer and Contractor culpable delay
Case Study 4 Completion and the programme

- What to do?
- The Accepted Programme had long since expired and had not been kept up to date and had no information relating to work carried out after the Completion Date
- First task carried out was a review of the available programmes, including the Accepted Programme and the dates of implementation of compensation events to see what effect there had been on the Planned Completion
- We found that the Contractor had reported on occasion a decrease in the Planned Completion after compensation events had been implemented.
- We took the approach here and assumed that any reduction in Planned Completion had not been the result of the compensation events.
- A delay to Completion Date was calculated using the differences between programmes, even though this would have included all delay, not just delays for which the Employer was responsible

The lack of a current Accepted Programme causes difficulty in assessing delay effects; it also means that responsibilities for delay can be obscured
Case Study 4 Completion and the programme

- Things we found:
  - There was insufficient as-built information to see what any compensation event effects had actually been
  - There was a lack of a programme in native form to undertake any detailed programme assessment.
  - The delay to Planned Completion was calculated using the Contractor’s own but unaccepted programmes
  - Completion was certified at an earlier date than the current date
  - It had been recognised that the retrospective review on programme changes between compensation events implemented after the programme submissions had ended, so there was an approximation and it was “high level”
  - A Project Manager’s assessment was issued

One effect of not following the process is that it is hard to apply the process into what has happened
Case Study 4 – Compensation events…or not

A global claim was subsequently submitted 2 days before the defects date.
This global claim was based on 60.1(18)

(18) A breach of contract by the Employer which is not one of the other compensation events in this contract.

- The alleged breach was the failure by the Project Manager to implement the compensation event process.
- The Contractor claimed that no compensation events existed because there had only been early warnings notified by the Contractor – [note the requirement for a separate notification]
- This was even though the Contractor had updated, submitted and used the “Early Warning and Compensation Event Schedule”
- The dispute finally went to adjudication and the decision did give some further time – principally because there had been compensation events issued after the Completion and the Completion Date and no programme went as far as the latest compensation event

Inevitably, where there the processes are not followed, there is no standard solution or recognised method of resolving disagreements.
Delay – prospective or retrospective?

- Mostly, compensation events ought to be notified, quoted, assessed and implemented in a short period, so this will mean that where the compensation event is going to happen in the future, it will be a prospective analysis.

- Forward, advance assessment of compensation events fits in with the intention of the NEC contract.

- This principle is that change is assessed early, the effects are implemented and then the matter is closed and the team gets on with completing the works.

- But for work that has been completed, compensation events that are notified within the prescribed period but after the event, then there will be a decision to make on how the delay ought to be calculated.

- There is some debate over whether a “prospective” or “retrospective” method of delay analysis ought to be used to determine the delay to the Completion Date.

- Prospective techniques need to be used to determine the impact of a compensation event when the event occurs and this is the intention of the NEC.
Delay – prospective or retrospective

- **Clause 63.3**
  - A delay to the Completion Date is assessed as the length of time that, due to the compensation event, planned Completion is later than planned Completion as shown on the Accepted Programme. A delay to a Key Date is assessed as the length of time that, due to the compensation event, the planned date when the Condition stated for a Key Date will be met is later than the date shown on the Accepted Programme.

- However, it makes sense, when working in hindsight - to see what did actually happen because this means that there is no need to use estimates when facts are available

- In Case Study 4, the Project Manager's assessment was based on issued programmes, and so had an element of what the Contractor considered that the effects of the compensation events would be but this was not necessarily how he would have seen the potential effect at the time

- In the global claim (it couldn’t be described as a compensation event really), the Contractor had used a prospective method which over-estimated the delays and then made a deduction to the actual.

- This clearly did not demonstrate that the compensation events had any particular effect as the delay that didn’t happen was mitigated in one step for “acceleration” back to the actual date of finishing on site

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Make sure that compensation event assessments include time!
Case Study 5 - Not following the SCC

We worked on a contract during which both parties had effectively ignored the contract document for approximately 2 years. It is difficult to determine Defined Cost for compensation events when the SCC has not been used for the calculation of Defined Cost for the entire contract duration.

Case Study 6 - in a spirit of mutual trust and co-operation?

An Employer decided to use the number of compensation events issued as a KPI for the performance of his framework consultants.

Some consultants issued compensation events as intended;

Others, issued instructions, which were then grouped by the 100 into compensation events.

It may have been a good strategy for gaining KPIs but a Contractor cannot realistically prepare quotations for 100 instructions within 3 weeks
This is a profile which looks reasonable.
Case Study 7 – profile of compensation events

Look out for warnings:

- Low target cost
- Defined Cost reaching the Target Cost
- Lack of progress
- Disruption
- Delays

All this information is likely to be available

Look out for signs of an under-performing project

>>>Early warnings >>> risk reduction

Can see an increased rate of notifications as the target is reached and exceeded
And finally….

A NEC target contract commenced on site and the Contractor raised a compensation event notice, on average one every hour of working time.

The learning from this – **make sure the contract documents and especially the Works Information are comprehensive and correct**
Compensation events – 60.1

1. **Changes to the Works Information** except changes to accept a defect or change to WI provided by the *Contractor* for his design at his request or to comply with the *Employer’s WI*

2. The *Employer* **does not allow access** or use of a part of the Site either by the *access date* or the date shown on the Accepted Programme

3. The *Employer* **does not provide something** he is to provide by the date for providing it shown on the Accepted Programme

4. The *Project Manager* gives an **instruction to stop or not to start any work** or to change a Key date

5. The *Employer* or Others - **do not work within times on the Accepted Programme**, - **not within conditions stated in the Works Information** or **carry out works on the Site** that is **not stated in the Works Information**

6. The *Project Manager* or the *Supervisor* **does not reply to a communication** from the *Contractor* within the period required by this contract.

**Note that the Employer’s WI takes precedence over the Contractor’s WI**
Compensation events – 60.1

(7) The *Project Manager* gives an instruction for **dealing with an object of value or of historical or other interest** found within the Site.

(8) The *Project Manager* or the *Supervisor* **changes a decision** which he has previously communicated to the *Contractor*.

(9) The *Project Manager* **withholds an acceptance** (other than acceptance of a quotation for acceleration or for not correcting a Defect) for a reason not stated in this contract.

(10) The *Supervisor* instructs to **search for a Defect and no Defect is found** unless the search is needed only because the *Contractor* gave insufficient notice of doing work obstructing a required test or inspection.

(11) A **test or inspection done by the Supervisor** causes **unnecessary delay**.

(12) The *Contractor* encounters **physical conditions** which are: within the Site; not weather conditions: …would have such a small chance of occurring it would have been unreasonable to have allowed for them. Difference to be taken into account in assessing the event.

**Note that withholding acceptances need to be for reasons stated in the Contract.**
Compensation events – 60.1

(13) A weather measurement is recorded….occurs on average less frequently than once in ten years.

(14) An event which is an Employer’s risk stated in this contract

(15) The Project Manager certifies take-over before Completion and the Completion Date

(16) The Employer does not provide materials, facilities and samples for tests and inspections as WI.

(17) The Project Manager notifies a correction to an assumption re: a compensation event.

(18) A breach of contract by the Employer which is not one of the other compensation events….

(19) An event which stops the completing the works or stops the Contractor completing the works by the date on the Accepted Programme: which neither party could prevent, small chance of occurring that it would be unreasonable to have allowed for it;

Note that 60.1(19) is similar to a force majeure clause but potentially much wider application