March 2025

CECA NEC4 Bulletin

CECA Member Briefing:

Bulletin Nr 51: Assessing Compensation Events - Forecast or Actual Costs?

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 52 - NEC4 ECC High Level User Guide

Please respond to Lucy Hudson should you require any further information on the CECA NEC4 Bulletins via e-mail: lucyhudson@cecasouth.co.uk.

For further advice or guidance on the NEC details please visit www.gmhplanning.co.uk where you will find a wealth of free NEC Guidance Notes, NEC FAQs, and other helpful measures.

NEC Bulletin 51: Assessing Compensation Events - Forecast or Actual Cost?

For any project there will inevitably be numerous compensation events that will need to be agreed in terms of both cost and time. We have produced several other Bulletins that already cover the general principles and aspects of the compensation event process, such as:

- assumptions within compensation event quotations (bulletin 4)
- notifying compensation events (bulletin 13)
- getting compensation events accepted (bulletin 15)
- assessing a compensation event against the last Accepted Programme (bulletin 18)

This Bulletin will focus specifically on whether actual cost or forecast cost should be used when assessing the associated cost.

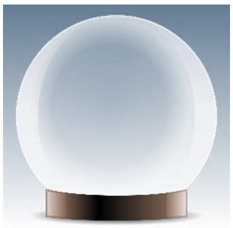
Clause 63.1 is a very important clause in understanding actual / forecast defined cost. This clause states that:

"The change to the Prices is assessed as the effect of the compensation event upon

- the actual Defined Cost of the work done by the dividing date,
- the forecast Defined Cost of the work not yet done and
- the resulting Fee."

The same clause then goes onto say:

"For a compensation event that arises from the Project Manager or Supervisor giving an instruction or notification, issuing a certificate or changing a decision, the dividing date is the date of that communication. For other compensation events, the dividing date is the date of the notification of the compensation event. "



What therefore is the "dividing date"? This is a new phrase introduced into NEC4 to identify the switch point between actual and forecast defined cost. Probably the most common compensation event that occurs on a project would be a Project Manager instruction to change the Scope. Clause 63.1 now clearly states that the dividing date would be the date of that instruction. Given that the Contractor should not have commenced any works to change the Scope without a written instruction to do so, that can only mean that this compensation event should be based on forecast Defined Cost.

Why would actual Defined Cost not come into play if costs are known before the quotation is agreed? The rule in clause 63.1 is clear that it is to be based upon forecast Defined Cost at the point the instruction was given. The fact a Contractor can prove that works associated with a particular event took ten days is immaterial. If the Project Manager can determine that a reasonable estimate with a sensible allocation for risk would have been only six days, then that is what they should base their assessment upon. The rule is intended to prevent a Client having to pay for ten days work if the Contractor has not acted expediently in reacting to the written instruction. It is intended that Contractors would therefore be incentivised to work efficiently and competently for compensation event works, to mitigate losing out financially if the actual cost incurred might end up more than what was a reasonable forecast.

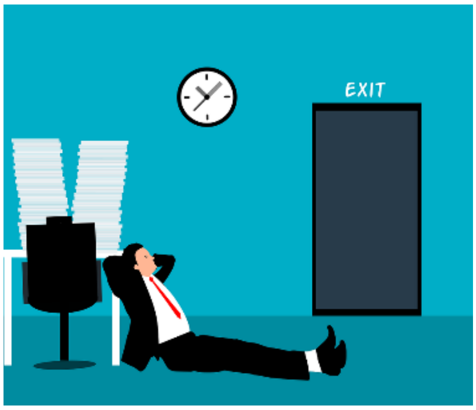
Can the Project Manager use actual Defined Cost when it suits them? No, the Project Manager does not get to pick and choose when they do or do not apply actual/forecast Defined Cost. Even if the Project Manager with the benefit of hindsight can see that the works are complete before the quotation has been agreed, they cannot ignore risk that hasn't happened if it was reasonable for the Contractor to have allowed for. If a forecasted £5,000 risk item has not occurred, the Project Manager can not just delete that risk item with the benefit of hindsight stating 'it did not happen'.

Hindsight is hard to ignore on a practical level. Obviously either party would like to use the benefit of hindsight when it suits them, but it would be very difficult to set such a different contractual rule that would be fairer to both Parties. That is why the contract sets a constant rule to be applied with each situation.

Isn't there legal precedent that suggests actual costs would be used in court? There is a well-known case of 'Northern Irish Housing Executive' versus 'Healthy Building'. In this case, the judge in summing up stated "why should I shut my eyes and grope in the dark when the material is available to show what work they actually did and how much it cost them". This was a very specific case where firstly there was significant amendments to the standard NEC contract wording, and secondly neither party had been disciplined at following the contractual rules during the project. This does not therefore set a precedent that all cases that end up in the court will come to the same conclusion that actuals will be used. The contractual rules that both Parties signed up to will be the first thing to be considered by both an adjudication, and then by the courts (if it goes that far).

When would actual Defined Cost ever be contractually relevant? One of the most obvious situations would be a weather event in excess of a 1-in-10 year event under clause 60.1(13). It would only be ascertained in the following month if the weather exceeded such values. In this situation at the point the compensation event is notified, the actual programme and its impact will already be known and therefore form the basis of that quotation.

Could a Contractor deliberately delay notifying a compensation event to try and get it assessed using actual Defined Cost? In theory yes, although questionable whether this would actually be a benefit to the Contractor. Firstly, the quicker a compensation event is notified, the quicker that it will be agreed that it is one, and the quicker the quotation can be issued and subsequently accepted. Delaying the notification of a compensation event will slow down the agreement of the quote and for ECC options A/B, delay the payment of any money associated with this event (as there is no mechanism for interim payment until they are implemented).



The Contractor must notify compensation events within eight weeks of becoming aware of the event, for events they are obliged to notify (such as lack of access or unforeseen ground conditions). If they delayed notifying to say seven weeks after they become aware, the 'dividing date' would be the date of the notification of the compensation event.

Whilst any subsequent quotation might be based on actual costs incurred during those seven weeks, Clause 63.9 states that the assessment of the compensation event is based upon the assumption that the Contractor reacts competently and promptly to the event and that Defined Cost is properly incurred. Therefore any "actuals" could still be subject to Project Manager assessment if they felt some "actual cost" was avoidable. There are also other things that will have gone on during that seven weeks that may cloud a decision (whether contractually relevant or not).

Summary: To ensure smooth management of the project, the NEC family of contracts are written to encourage the parties to address issues as they arise, rather than storing up disputes which can then lead to a big dispute at conclusion of the project. Key to this ethos is the contractual principle of prospective assessment of compensation events. Whilst some compensation events would be based on actual Defined cost, a vast majority are likely to need to be based upon forecast Defined Cost.

For more information, contact CECA Southern Director David Allen on 07741 543468 or davidallen@cecasouth.co.uk
CECA (Southern) Ltd, 2nd Floor, East Wing, Metro House, Northgate, Chichester, West Sussex, PO19 1BE