



Technical

An Introduction to NEC Compensation Events

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NEC Background

1. The NEC3 Engineering and Construction Contract (“ECC”) has been used increasingly, not just in the UK but also in over twenty other countries for over twenty years. It is now widely used for all sizes of projects. It has been used on projects such as Heathrow Terminal 5 and the London 2012 Olympics.
2. The NEC contracts are different from the traditional forms of contract (such as JCT) in a number of ways:
3. The contract is drafted with the following objectives:
 - Flexibility.
 - Clarity and simplicity.
 - Stimulus to good management.
 - Assessment of change is radically different.
 - Encourage trust, collaboration and early risk identification.
 - Written in present tense.
 - Requires a change of culture.
4. The general ethos of the contract is set out in the first clause:

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“10.1 The Employer, the Contractor, the Project Manager and the Supervisor shall act as stated in this contract and in the spirit of mutual trust and co-operation.” (NEC3)

5. One of the ways that NEC tries to achieve this is through short direct clauses. The simplicity of language aims to reduce the occurrence of disputes. This seems to have occurred as there is limited case law on NEC.
6. Support for NEC should not lead to myopia about its implementation, as NEC3 does have its fair share of problems. The following extract from Eggleston (2006) sums up the issues well:

“One of the major surprises which comes out of analysis of the compensation procedures is that far from excelling as schemes which are fair to the contractor as the promoters of NEC3 suggest, they place more risks on the contractor than other standard forms of construction contracts.”

(Eggleston, B. 2006, p.218)

7. The contract is not universally loved amongst lawyers and its detractors criticise the lack of judicial cases, as well as the use of present tense in the contract terms and simplicity of language.
8. HH Humphrey Lloyd QC comments on the NEC use of language as follows:

“The use of ‘plain English’ in the ECC and the absence of terminology found elsewhere requires one to focus on what is truly intended and not what is to be presumed.”

9. Questions are raised regarding various elements of the Compensation Event mechanism that have not been resolved in the Courts and have not been clarified by the NEC in sufficient detail resulting in continued debate and argument by those who use NEC day to day and those who represent them in dispute resolution processes.

Compensation Events

What is a Compensation Event?

10. A Compensation Event (“CE”) is not an “*identified and defined term*” under Clause 11 of the contract. The NEC3 Guidance Note states that they are:

“Compensation events are events which, if they occur, and do not arise from the Contractor’s fault, entitle the Contractor to be compensated for any effect the event has on the Prices and the Completion Date or a Key Date. The assessment of a compensation event is always of its effect on the Prices, the Completion Date, and any Key Date affected by the event.”

(NEC Guidance Note, p.68)

11. Compensation Events are the events which are the Employer’s risk under the contract and for which the Contractor requires compensating. NEC3 makes any risk that is not specifically identified as being the Employer’s, to be the Contractor’s (Clause 81.1).
12. Compensation Events can be found in three places:
- Clause 60.1 list.
 - Main Options B and D include additional CE’s in Clauses 60.4, 60.5 and 60.6.
 - Secondary Options X2, X14, X15 and Y(UK)2.
13. The principle behind CE’s is that they should be valued prospectively before the work is carried out, which should ensure that the Parties know early on the time and cost implications, allowing for effective planning and reduction in disputes.
14. The various elements of the Compensation Event mechanism are as follows:
- Early Warnings Notices.
 - Notification of Compensation Events.
 - Quotations for Compensation Events.
 - Assessing Compensation Events (including Defined Cost).
 - The Project Manager’s assessment of Compensation Events.

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Summary

15. This article has given a brief introduction into NEC3 and what the Compensation Event mechanism is. The Compensation Event mechanism has had little specifically written about it. I will therefore be taking the 5 key elements of the mechanism and discussing these in 5 separate articles and sharing my own qualitative and quantitative research.

Note: This article is based on the author's own research.

Bibliography

16. Eggleston, B. 2006. The NEC3 Engineering and Construction Contract: A Commentary. Oxford: Blackwell Publishing.
17. HH Humphrey Lloyd QC, (2009), "Some thoughts on NEC3", NEC Users' Group Newsletter, Special Issue, January 2009; article first published in International Construction Law Review, October 2008.

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