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# Compensation Events in NEC & Practical Issues Arising from Managing NEC Projects

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# Today's roadmap

- Introduction – KK
- Compensation Events – Joseph
- Administering Compensation Events – Joseph
- Impact of Early Warning Procedure – Joseph
- NEC Cases of Interest – Joseph
- Practical issues arising from managing NEC projects – Allen

# Introduction (1)

- Under traditional standard form contracts, which talks of extensions of time and variations, NEC 3 does not use such terminologies. Instead, it talks of “changes” and “compensation event”
- The main provisions relating to compensation events are set out in Section 6 of the Engineering & Construction Contract (ECC)
- Under ECC, changes is a package of time and money i.e. for every compensation event, the effects on the programme and contract sum (Prices) are considered at the same time

# Introduction (2)

- The set up of the compensation event mechanism is that the earlier a compensation event is identified, the more likely its effect can be reduced or better still, avoided
  - Early Warning Procedure
- The compensation event mechanism also tries to prevent the *Contractor* from being out of pocket for events that are outside its control

# Introduction (3)

- Section 6 sets out:
  - list of compensation events
  - procedure for notifying, assessing and implementing the compensation event
- The above will be looked at in turns

# Compensation Events (1)

- Compensation event is not defined in the ECC. However, compensation event can simply be referred to as an event which triggers the reassessment of Prices, Completion Date and Key Dates
  - typically, they will be events which are at the *Employer's* risk
  - Core Clause 81.1: risks that are not specifically identified as being the *Employer's* risks are at the *Contractor's* risk
- Today's talk will focus on the compensation events set out in Core Clause 60.1

# Compensation Events (2)

- The *Project Manager* gives an instruction changing the Works Information (Core Clause 60.1(1)) e.g. addition or deletion of work, change to specifications, issue of revised drawings
  - triggering event is instruction that changes the Works Information
  - the instruction must come from the *Project Manager* not the *Employer* or else the *Contractor* is not entitled to claim
  - frequent dispute is whether the instruction provides for interpretation of the Works Information or changes to the Works Information
  - exceptions:-
    - change made in order to accept a Defect. By Core Clause 44.1, the *Contractor* and the *Project Manager* may propose to the other that the Works Information should be changed so that a Defect does not have to be corrected. This may occur where the time and costs for rectifying a defect may be disproportionate with the benefit to be obtained from the rectification
    - changes by the *Contractor* to its part of the Works Information

# Compensation Events (3)

- The *Project Manager* or the *Supervisor* does not reply to a communication from the *Contractor* within the period required by the Contract (Core Clause 60.1(6))
  - various clauses in the ECC will stipulate the period within which the *Project Manager* is to respond. Such timeframe may be extended by agreement between the *Project Manager* (as opposed to the *Supervisor*) and the *Contractor*. The *Project Manager's* failure to reply within the stipulated period will amount to a compensation event
  - if timeframe is not stated, the default timeframe will be that stated in “*period for reply*” in the Contract Data. Note that this default provision only applies where the Contract requires the *Project Manager* or the *Supervisor* to reply
  - in practice, this event is difficult to rely upon as it would be difficult for the *Contractor* to show that the delay by the *Project Manager* in replying resulted in the *Contractor* incurring delay and extra cost

# Compensation Events (4)

- The *Project Manager* or the *Supervisor* changes a decision which he has previously communicated to the *Contractor* (Core Clause 60.1(8))
  - the rationale for this is that a change in decision is likely to result in extra work for the *Contractor* and thus a compensation event
  - decision is not defined under the ECC but should be confined to decisions which the *Project Manager* or the *Supervisor* is required to make under the Contract

# Compensation Events (5)

- 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 the Contract (Core Clause 60(9))
  - various clauses in the ECC requires the *Contractor* to submit proposals to the *Project Manager*. Each of those clauses would also set out the reasons for which the *Project Manager* can refuse acceptance
  - Core Clause 60(9) will trigger where the *Project Manager* withholds an acceptance for reasons not specified in the Contract
  - what if *Project Manager* does not respond? – compensation event under Core Clause 60(6)
  - what if the *Project Manager* withholds an acceptance for an invalid reason but there was existing valid reason to withhold acceptance – arguably a compensation event

# Compensation Events (6)

- The *Contractor* encounters physical conditions which:
  - are within the Site
  - are not weather conditions; and
  - an experienced contractor (objective test) would have judged at the Contract Date to have a small chance of occurring that it would have been unreasonable for him to have allowed for them (Core Clause 60.1(12))
    - under this clause, the risk for physical conditions is upon the *Employer*
    - the clause is not simply confined to ground conditions. Physical conditions could be natural or man made
    - the usual disclaimer in the instructions to tenderers will not relieve the *Employer* of his responsibilities?
    - the *Employer* could of course delete this compensation event using Option Z in which case, all risks for physical conditions would be upon the *Contractor*

# Compensation Events (7)

- Core Clause 60.1(12) needs to be read in conjunction with Core Clauses 60.2 and 60.3
  - by Core Clause 60.2, when assessing this compensation event, the *Contractor* is assumed to have taken into account:-
    - the Site Information
    - publicly available information referred to in the Site Information
    - information obtainable from a visual inspection of the Site
    - other information which an experienced contractor could reasonably expected to have or to obtain

# Compensation Events (8)

- by Core Clause 60.3, any ambiguities or inconsistencies in the Site Information on physical conditions would be interpreted in favour of the *Contractor*
  - it is therefore important for the *Employer* to provide as much information as possible on the physical conditions

# Compensation Events (9)

- An event which is *Employer's* risk stated in the Contract (Core Clause 60.1(14))
  - need also to cross-refer to Core Clause 80.1 and part 1 of the Contract Data to identify matters which are at the *Employer's* risk
  - Core Clause 80.1 includes fault of the *Employer* or a fault in the design, loss of or damage to Plant and Materials supplied to the *Contractor* by the *Employer*

# Compensation Events (10)

- Breach of contract by the *Employer* which is not one of the compensation events listed (Core Clause 60.1(18))
  - sweep up provision
  - note Core Clause 63.4 which provides that the rights of the *Employer* and the *Contractor* to changes to the Prices, the Completion Date and the Key Dates are their only rights of a compensation event
    - does Core Clause 63.4 read in conjunction with Core Clause 60.1(18) exclude the *Contractor's* remedies for the Employer's breach of the Contract? - unlikely. Need clear words to give that effect.

# Administering Compensation Events (1)

- 3 stages:
  - notification
  - quotation
  - implementation

# Administering Compensation Events – Notification by *Project Manager* (2)

- Either the *Project Manager* or the *Contractor* can notify a compensation event
- For compensation events which arise from the *Project Manager* or the *Supervisor* giving an instruction, issuing a certificate, changing an earlier decision or correcting an assumption, the *Project Manager* notifies the *Contractor* of the compensation event at the time of that communication. He also instructs the *Contractor* to submit quotations (Core Clause 61.1)
  - the compensation events include
    - the *Project Manager's* instructions to change the Works Information
    - the *Project Manager* gives an instruction to stop or not to start work or to change a Key Date
    - the *Project Manager* or the *Supervisor* changes a decision that he had previously communicated to the *Contractor*
  - two elements:
    - notify at the same time as giving the relevant communication
    - on notification, the *Project Manager* must also invite the *Contractor* to submit quotations

# Administering Compensation Events – Notification by *Project Manager* (3)

- The *Project Manager* may also instruct the *Contractor* to submit a quotation for a proposed instruction or a proposed changed decision (Core Clause 61.2)
- What if the *Project Manager* does not notify a compensation event? - the *Contractor* may do so. The *Employer/Project Manager* may find themselves in breach of the fundamental provision to act in a “spirit of mutual trust and co-operation” (Core Clause 10.1)

# Administering Compensation Events – Notification by *Contractor* (4)

- The *Contractor* may notify the *Project Manager* of a compensation event where (Core Clause 61.3)
  - the *Contractor* believes that the event is a compensation event; and
  - the *Project Manager* has not notified the event to the *Contractor*
- The *Contractor* must within 8 weeks of becoming aware of the event give that notification. There is however no time limit where the *Project Manager* should have given the notification

# Administering Compensation Events – Notification by *Contractor* (5)

- What if the *Contractor* fails to comply with the 8 weeks time limit?
  - he is not entitled to a change in the Prices, the Completion Date or a Key Date unless the *Project Manager* should have notified the event to the *Contractor* but did not
  - however, and arguably, Core Clause 61.3 is not sufficiently plain enough to exclude the *Contractor's* rights to claim common law damages if the compensation event also amounts to a breach of the Contract by the *Employer*
  - to get round this, some employers have amended Core Clause 61 (via Option Z) to make the 8 weeks limitation a condition precedent
- What if the *Contractor* deliberately avoids forming a belief? - arguably, this is a breach of Core Clause 10 and thus the *Contractor* would not be entitled to rely on its own wrong to deny that it had formed the requisite belief
- Practical tip is that the *Contractor* should notify all events that he considers to be a compensation event

# Administering Compensation Events – Notification by *Contractor* (6)

- Once notified by the *Contractor* of a compensation event, the *Project Manager* has to consider whether the event (Core Clause 61.4):
  - arises from a fault of the *Contractor* (this would probably include the *Contractor's* failure to give early warning)
  - 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 the Contract
- If the above tests are “passed”, the *Project Manager* would instruct the *Contractor* to submit quotations
  - if the *Project Manager* decides otherwise, the *Contractor* may refer the matter to adjudication
- The *Project Manager* has one week (of the *Contractor's* notification) to notify the *Contractor* of his decision. Failing which, the *Contractor* may notify the *Project Manager* of this. Failure to respond within a further two weeks, it is treated that the *Project Manager* has accepted that the event is a compensation event and instruction to submit quotations

# Administering Compensation Events – Quotations (7)

- Four situations where the *Project Manager* may instruct the *Contractor* to submit quotations:
  - the *Project Manager* instructs the *Contractor* to submit quotations for a compensation event at the same time as he notifies the compensation event
  - the *Project Manager* instructs the *Contractor* to submit quotations for compensation event when he has decided that the event notified by the *Contractor* is a compensation event
  - the *Project Manager* instructs the *Contractor* to submit a revised quotation for a compensation event
  - the *Project Manager* instructs the *Contractor* to submit quotations for a proposed instruction or changed decision

# Administering Compensation Events – Quotations (8)

- The Contractor has 3 weeks to submit the quotations (Core Clauses 62.3 & 62.4)
  - the 3 weeks limitation may be extended by agreement between the parties before the 3 weeks is due to expire (Core Clause 62.5)
  - if the *Contractor* does not submit its quotations within the required time, the *Project Manager* would still be required to assess the compensation event (Core Clause 64.1). The basis of the assessment is set out in Core Clause 63

# Administering Compensation Events – Quotations (9)

- Quotations should include the following (Core Clause 62.2):
  - details of assessment of the changes to the Prices and the delay to the Completion Date or Key Date
  - alterations to the Accepted Programme showing the effect of the compensation event
  - costs and time risk allowances for matters which have a significant chance of occurring and are at the *Contractor's* risk under the Contract
  - alternative quotations where instructed by the *Project Manager*
  - alternative quotations for other methods of dealing with the compensation event which the *Contractor* considers practicable
- The *Contractor's* assessment should follow Core Clause 63 failing which, the *Project Manager* can make his own assessment (Core Clause 64.1)

# Administering Compensation Events – Quotations (10)

- The *Project Manager* has 2 weeks to respond to the quotations which could be one of the following (Core Clause 62.3):
  - an instruction to submit a revised quotation. This could occur where the *Project Manager* is of the view that the *Contractor* has assessed the event incorrectly. In this case, the *Project Manager* has to give reasons for such instructions and the *Contractor* has a further 3 weeks to submit the revised quotations
  - acceptance of the quotation in which case, the compensation event is implemented
  - a notification that a proposed instruction or a proposed changed decision will not be given
  - a notification that he will do his own assessment. Of course, Core Clause 64.1 needs to be satisfied

# Administering Compensation Events – *Project Manager's* own assessment (11)

- The *Project Manager* may make his own assessment of the compensation event in the following circumstances (Core Clause 64.1):
  - the *Contractor* did not submit his quotations and accompanying details in time (3 week limitation)
  - the *Project Manager* decides that the *Contractor* has not assessed the event correctly and he does not instruct a revised quotation
  - the *Contractor* has failed to submit a programme or alterations to a programme with his quotations
  - the *Project Manager* does not accept the *Contractor's* latest programme

# Impact of Early Warning Procedure (1)

- By Core Clause 16.1, the *Contractor* and the *Project Manager* may give an early warning by notifying the other as soon as it becomes aware of events which could:-
  - increase the total of the Prices;
  - delay Completion;
  - delay meeting a Key Date; or
  - impair the performance of the works in use

# Impact of Early Warning Procedure (2)

- If the *Project Manager* decides that the *Contractor* did not give an early warning that an experienced contractor could have notified and the relevant event becomes a compensation event, the *Project Manager* is required to inform the *Contractor* of such decision when he instructs the *Contractor* to submit quotations (Core Clause 61.5)
  - the implications of this are that the *Contractor* will not be entitled to compensation for the effects of the compensation event which could have been mitigated by the early warning

# NEC Cases of Interest (1)

## Costain Limited and others v Bechtel Limited and another (2005)

### Facts:

- ❑ Channel Tunnel High-Speed Rail Link Project
- ❑ The employer was Union Rails (North) Limited (“URN”)
- ❑ The consortium contractor was CORBER
- ❑ The project manager was a consortium called Rail Link Engineering (“RLE”) with Bechtel being the leader
- ❑ In 2002, CORBER entered into an NEC engineering and construction contract with URN for the extension and refurbishment of St Pancras Station
- ❑ Target cost contract

# NEC Cases of Interest (2)

- ❑ CORBER alleged that Bechtel in certifying payments, Bechtel had failed to act impartially. CORBER sought interim injunctions against Bechtel
- ❑ The issue for the Court was whether in assessing payments to CORBER, the project manager was under a duty to act impartially as between the employer and the contractor or to act in the interests of the employer

## Held

- ❑ It was arguable that when assessing payment, the project manager is under a duty to act impartially

# NEC Cases of Interest (3)

## Anglian Water Services Ltd v Laing O'Rourke Utilities Ltd (2010)

*“I have to confess that the task of construing the provisions in this form of contract [NEC Engineering and Construction Contract] is not made any easier by the widespread use of the present tense in its operative provisions. No doubt this approach to drafting has its adherents within the industry, but, speaking for myself and from the point of view of a lawyer, it seems to represent a triumph of form over substance.”*

- The fact that a contract may be NEC in nature, does not affect the applicability of the general principles of interpretation of a contract (RWE Npower Renewables Ltd v JN Bentley Ltd (2013))

# Thank you for your participation

- Any Questions?

