

Compensation events under NEC3: Prospective vs Retrospective Assessment

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The NEC3 suite of contracts contemplates compensation events being assessed at around the time they occur or are instructed, based on the forecasted impact of the event. But if the actual cost or delay arising from an event is different from the forecast, should this have an impact on the assessment? A recent case highlights a ‘common sense’ approach to this issue.

Prospective assessment under NEC3

The New Engineering Contract 3 (**NEC3**) suite prescribes a regimented step-by-step process for an employer and contractor or consultant to initiate, price and deliver a compensation event (for variations and other matters entitling the contractor or consultant to make a claim). NEC3 contains a requirement for the contractor or consultant to provide a quotation, and stipulates associated time limits for the employer to accept or substitute such quotation.

The NEC3 conditions clearly envisage that the process for implementing a compensation event is carried out prior to the works being completed, and is thus thought to be a prospective regime.

Retrospective assessment in circumstances of disagreement

There has, however, been some uncertainty over whether the same prospective approach to assessing compensation events applies “after the event”, i.e. when the full effects of an event (from a cost and time perspective) are known. Should later-acquired information trump any earlier made prospective assessment? Furthermore, is an adjudicator, arbitration tribunal or court required to engage in an exercise of retrospectively assessing the prospective impact of an event, where the impact is already known?

This controversial issue was considered in the case of Northern Ireland Housing Executive v Healthy Buildings (Ireland) Limited [2017] NIQB 42. In that case:

- The contracting parties using the NEC3 form became embroiled in a dispute as to the assessment of a compensation event.
- The employer issued an instruction changing the scope of the works, however it did not follow the normal course prescribed by NEC3 and failed to request a quotation.
- The consultant later informed the employer of the compensation event, proffered a quotation and proceeded to carry out the works.
- After the consultant completed the works, the employer rejected the consultant’s quotation.

The court was left to determine whether the assessment of the compensation event should have regard to:

- the forecast costs initially submitted by the consultant (thus applying a prospective analysis); or
- the actual known costs of the consultant (thus applying a retrospective analysis).

The employer sought to rely upon evidence of the consultant's actual time and cost incurred, because this yielded a lower overall cost to the employer. The consultant, by contrast, contended that only a prospective assessment was called for by NEC3, meaning that its time sheets and other evidence of work actually performed were irrelevant to the determination of its contractual entitlements.

Applying 'business common sense'

The court made clear that evidence from the consultant's time sheets as to the costs actually incurred was not only relevant evidence, but the best evidence, to determine the effect of the compensation event. The question before the court became whether, within the confines of the NEC3 conditions, it could have regard to such information.

In considering this issue, the court referred to the *cardinal principle of contractual interpretation*, that the agreement should be considered "overall". It was noted that the parties were under an obligation to act "in a spirit of mutual trust and co-operation". The refusal of the consultant to allow the utilisation of its time sheets and records of work completed was found to be at odds with such spirit of mutual trust and co-operation.

The court went even further to state that an "efficacious and business-like" interpretation of the NEC3 conditions was called for. Notwithstanding that the NEC3 regime included the word "forecast" (suggesting a prospective assessment of the compensation event), the court found that the assessment of the compensation event should be informed by the best information available. In applying such business-like approach, it was found that the best information available was the time sheets and other materials documenting the actual cost incurred by the consultant.

Conclusion

Whilst NEC3 has often been thought to adopt a more 'prospective' approach to the assessment of compensation events, the Northern Ireland Housing Executive case offers a different perspective. In circumstances where the parties disagree as to the assessment of a compensation event, both an employer and a contractor or consultant should be prepared for a tribunal to look to the best evidence available to support the assessment of the compensation event, which may well be evidence of "what happened". Thus, contracting parties driving an NEC vehicle will, so to speak, need to look both out the windscreen and in the rear-view mirror as the project proceeds.

NEC3 is soon to be replaced by NEC4, but it is not expected that this basis of approach to compensation events will change under the new suite.

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