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Pricing compensation events under the NEC[®]: When you don't know what you don't know...

Estimating uncertainty in construction is nothing new. It is common practice within the industry for assumptions, clarifications, exclusions and the like to be incorporated into submitted quotations; whether as part of a tender or when pricing changes. These assumptions are intended to redefine the risk allocation under the contract and attempt to allocate the risk or uncertainty to the client.

However, when it comes to pricing compensation events under the NEC3 contracts, things work a little differently and contracting parties should be aware of the risks they are taking in using assumptions when pricing compensation event quotations.

The NEC[®] actively promotes the use of prospective quotation assessments with a view of providing the Employer with time and cost certainty, often before the actual costs may be known or before the changed works have been carried out. Effectively, pricing change under this form of contract is to be treated like a 'mini tender'.

The Contractor is required to price the event as if it had been incorporated within the scope of work at tender stage. Although mainly relevant to Options A and B in terms of financial risk or reward for the Contractor, this is acknowledged by the NEC3 contracts Guidance Notes;

"The Contractor carries the potential risk or reward if his forecast of the cost impact is wrong, and the Employer has a firm commitment. The Contractor's risk or reward is conceptually similar to the risk he takes when pricing a tender". This enables "the Employer to make rational decisions about changes to the work with reasonable certainty of their cost and time implications".

Under all Main Options, the compensation event assessment mechanism is the same and as part of these 'mini-tenders', the Contractor can make an assessment of risks that are at his risk under the contract and have a significant chance of occurring, in the same way he would when tendering.

However, the inclusion of risk allowances within a quotation and the pricing of 'uncertainty' is often a topic of contention, where the parties may struggle to determine what a realistic allowance is for the time and cost of events that may or may not occur.

Accordingly, in this cost conscious world a common strategy by the Contractor is to bring out our old friend the assumption, whereby the Contractor will state the assumptions upon which his quotation is based and if the assumptions turn out to have been wrong, he will hope to recover the actual time and costs of the compensation event based on a retrospective adjustment. Surely this seems a fair and reasonable way forward and in the spirit of the contract?



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Not quite. The use of generic assumptions by the Contractor and retrospective adjustments goes against the ethos of the NEC® and its use of prospective assessments of quotations. The more traditional approach by its very nature tends to be retrospective and does not permit events to be effectively risk managed as they have already occurred and the costs expended.

If events are priced fully, incorporating Contractor risks, the Employer can achieve time and cost certainty as “the assessment of a compensation event is not revised even if a forecast upon which it is based on is shown by later recorded information to have been wrong” (clause 65.2).

Consequentially, there is no contractual mechanism for time or cost to be adjusted should Contractor assumptions included within quotations prove to be incorrect or not eventuate. Outside of the specific Main Option payment mechanisms, for the Contractor to be entitled to additional cost and time an event must occur which triggers one of the stated compensation events under the contract (clause 60.1). A Contractor assumption does not constitute such an event.

Notwithstanding the above, if the Project Manager believes that “the effects of a compensation event are too uncertain to be forecast reasonably”, the contract allows for the incorporation of Project Manager’s assumptions (clause 61.6).

Critically, it is the Project Manager who must decide whether an assumption should be included and it is he who decides whether the effects of a compensation event are too uncertain to be forecast reasonably.

However, the Contractor may suggest that the Project Manager includes certain assumptions, which may lead to the Project Manager re-issuing his instruction to submit a quotation, should he be in agreement that the assumptions are to be included.

If the Project Manager decides assumptions are required to best enable the progression of a quotation, these should be stated in an unambiguous manner and clearly outline the elements of the quotation which are based on Project Manager’s assumption in order to prevent any disputes arising after the fact.

Project Manager’s assumptions should not prevent the Contractor from incorporating risk allowances within quotations for those elements that could and should reasonably be expected and allowed for within the event price (such as weather, ground conditions, equipment breakdowns, etc.), unless the uncertainties associated with the event render it impractical to forecast with reasonable certainty.

At this point the quotation for the event can be assessed with the inclusion of the Project Manager’s assumption(s), which, if later established by recorded information to be incorrect are adjusted via a separate compensation event clause (60.1(17)). This clause states “the Project Manager notifies a correction to an assumption which he has stated about a compensation event”, reaffirming that the contract makes no provision for assumptions incorporated within quotations by the Contractor.

It is inevitable that situations will arise where the outcome of a compensation event is too uncertain to reasonably and accurately forecast and the inclusion of assumptions will allow the event to be progressed.

This allows the Employer reasonable foreseeability of time and cost based on sensible assumptions from the Project Manager and prevents a situation where both parties become reliant on a retrospective assessment.



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This article does not look to detract from the advantages of using assumptions in these circumstances; however, both parties should be aware of the risks and requirements of the contract when implementing assumptions.

There is no mechanism for the Contractor to make pricing assumptions in the same way he may under other forms of contract, he must either price the risk or request the Project Manager include an assumption in his instruction to submit a quotation.

Only those assumptions made by the Project Manager will give the Contractor that all important second bite at the compensation event cherry should they later prove to have been wrong.

The moral of the story is, follow the contract. Make the Project Manager aware of what you don't know and discuss!

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