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Construction Law Update

Assessing Compensation Events

NEC3 contracts, with their emphasis on proactive contract management, require compensation events to be valued using forecasts of the cost of the additional work. However, it is often the case that the compensation event procedure is not operated properly and the parties can find themselves in a situation where they are trying to assess the cost of compensation events after the extra work in question has already been done. In that situation, is it permissible to ignore the requirement for a forecast and look at the actual cost incurred? This question was considered by the courts in the recent case of *Northern Ireland Housing Executive v Healthy Buildings (Ireland) Ltd* (2017).

Background

Healthy Buildings (Ireland) Ltd ("HB") was engaged by Northern Ireland Housing Executive ("NIHE") under two largely identical NEC3 Professional Services Contracts (June 2005 edition) to provide asbestos management services at housing association properties.

The scope of HB's work under both contracts was changed in January 2013, but at that time NIHE did not instruct HB to submit compensation event quotations (which it should have done). Instead, HB notified the changed scope of work as a compensation event in May 2013. HB then submitted compensation event quotations, but they were rejected by NIHE. NIHE made its own assessment of the compensation events and found that HB was not entitled to any additional cost.

HB adjudicated against NIHE and the adjudicator awarded sums to HB. NIHE later commenced court proceedings challenging the adjudicator's decisions. As part of the court proceedings, NIHE asked HB to disclose its time sheets and cost records relating to the period after the compensation event occurred. HB refused to do so, arguing that information about its actual costs was irrelevant because clause 63.1 of the contracts required assessment by a forecast.

Clause 63.1 stated:

"*The changes to the Prices are assessed as the effect of the compensation event upon*

- *the actual Time Charge for the work already done and*
- *the forecast Time Charge for the work not yet done.*

The date when the Employer instructed or should have instructed the Consultant to submit quotations divides the work already done from the work not yet done."

HB's position was that NIHE should have instructed them to submit quotations back in January 2013 (when the scope of work was changed) and consequently all work done after that date was to be assessed based on a forecast, notwithstanding that they had already done the work.

The court was asked to decide whether the assessment of the compensation event should be calculated by reference to the forecast Time Charge or the actual cost incurred by HB.

The decision of the court

The court rejected HB's argument for a number of reasons:

1. **The need to consider relevant evidence.**

   The court noted that if the dispute went to a full trial, it would have to assess the fair and reasonable additional cost due to HB. The court would only be able to properly review the adjudicator's decisions with the benefit of knowing the actual cost incurred by HB due to the compensation events. This evidence of actual cost incurred would be "*clearly the best evidence to assist the court*" in finally determining the dispute.

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2. **Common sense interpretation.**

   The court interpreted clause 63 of the contracts as clearly contemplating a situation where the employer had complied with the contract and instructed the consultant to submit a compensation event quotation at the appropriate time. However, in reality, HB was making a claim for the cost of additional work already carried out. In order to give an efficacious and business-like interpretation to the contract, assessment of the compensation event in that situation "*ought to be informed by the best information available as to the actual cost and time incurred by the consultant as a result of the instruction*". The court found that it was a "*strained and unnatural interpretation*" to rely on the use of the word "forecast" in clause 63.1 to prevent access to the best evidence of the cost incurred, stating "*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?*".

3. **Spirit of mutual trust and co-operation.**

   The court found that a refusal by HB to hand over time sheets and records relating to work done was "*entirely antipathetic to a spirit of mutual trust and co-operation*" which was required by clause 10.1 of the contracts.

Consequently, the court ordered HB to disclose all relevant time sheets and other cost records dating back to January 2013.

Analysis

This case provides useful clarification that in certain situations, there is no need to adhere rigidly to the requirement for a forecasted assessment where it would be artificial to do so because the compensation event is already in the past. This seems to be a common sense approach and is no doubt welcome news for many employers and contractors who are struggling with the often significant administrative burden of dealing with compensation events promptly when they arise.

However, it is interesting that the court has decided that some of the express terms of the NEC compensation event procedure can essentially be abandoned where the parties have failed to comply. Could this encourage non-compliance with the compensation event procedure, whether due to laziness on the part of contracting parties or a deliberate attempt on the part of employers to save money by looking at actual costs incurred? It may be that the courts would not come to the same decision if an employer was found to have deliberately failed to follow the compensation event process in order to avoid making payment based on forecasts.

It certainly remains the case that it is best practice to operate the NEC forms of contract as intended by trying to deal with compensation events as they arise.

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