

## PRACTICE

# Survey reveals that risk pricing is one of the key challenges for NEC users



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## KEY POINTS

- Most NEC users believe more discussion on risk pricing is required by NEC parties prior to assessing compensation event quotations.
- NEC users should invest in collaborative compensation event meetings where instructions and compensation events are discussed prior to issuing quotations.
- In preparing quotations, emphasis should be placed on productivity, impact on other works and impact upon the programme and critical works items.

Last year my consultancy conducted an industry-wide survey amongst NEC users to determine how the compensation event procedure works in practice. Of the 123 users who completed an online questionnaire between May and September 24% were clients, 50% contractors, 15% subcontractors and 12% consultants and advisers.

The results of the survey overwhelmingly showed that respondents were most concerned about pricing risk and disruption within quotations, and about the effects of time barring. The findings are significant as a failure to address these issues may lead to financial loss. This article looks at the issue of risk pricing and future

articles will examine disruption and time barring.

Almost all of those surveyed (98%) agreed that more discussion on risk pricing is required by NEC parties and participants prior to assessing compensation event quotations. Furthermore, 95% of respondents said the higher party (project manager in the NEC3 Engineering and Construction Contract (ECC) or contractor in the NEC3 Engineering and Construction Subcontract) only rarely add risk allowances and assess and implement higher than the quotation value.

A large majority (79%) also agreed that whenever risk pricing is included in quotations it is nearly always amended by the higher party to a lower value. Nearly three quarters (73%) said higher parties generally remove most, if not all, of the assessed risk allowances while (72%) agreed higher parties should increase risk allowances in their assessments in instances where the supplier did not appropriately value the risk.

## Pricing risk in NEC

Clause 63.6 in the NEC3 ECC and clause 63.8 in the NEC4 ECC are quite succinct. They say, 'Assessment of the effect of a compensation event includes risk allowances for cost and time for matters which have a significant chance of occurring and are at the *Contractor's* risk under this contract' and 'The assessment of the effect of a compensation event includes risk allowances for cost and time for matters which have a significant chance of occurring and are not compensation events', respectively.

Furthermore the NEC3 ECC Guidance Notes

state, 'Allowances for risk must be included in forecasts of Defined Cost and Completion in the same way that the *Contractor* allows for risk when pricing his tender. The value of the allowance is greater when the work is uncertain and there is a high chance of a *Contractor's* risk happening. It is least when the uncertainties are small and when the work is to be done by resources already on site whose output rates can be predicted relatively accurately.'

They continue, 'If there is considerable uncertainty over the effects of a compensation event the *Project Manager* can decide, in

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consultation with the *Contractor* where appropriate, to limit this uncertainty by stating the assumptions the *Contractor* is to base his quotation on (clause 61.6). In effect, he is limiting the *Contractor's* risk, but not necessarily removing it. Risk allowances for cost and time are still permitted in the assessment'.

It seems clear from the survey that parties and participants in NEC contracts need to talk more, both prior to and at the time of the issue of instructions and the accompanying compensation event notice and instruction to quote. In particular, there needs to be a far better

understanding of the many contractor (and subcontractor) risks. For example, is the weather bad, but not bad enough to be a compensation event? Could the poor ground conditions have been foreseen? Are outputs going to be affected by multiple trades working next to one another due to disruption? And so on.

## Advice for NEC users

To ensure correct use of the compensation event process and avoid disputes, NEC users need fully to understand the interplay between risks and assumptions in quotations. In particular they should invest in collaborative compensation event meetings, where instructions and

compensation events are discussed prior to issuing quotations.

In preparing quotations, emphasis should be placed on productivity, impact on other works and impact upon the programme and critical works items. When assembling a quotation users need to ensure they are fully informed by their own project teams and, before issuing the quotation, get it reviewed by management. Finally, compensation event quotations and assessments should be holistic; they are effectively the only opportunity to price and assess potential risks, disruption and delay caused by a change to the works information