



**NEC 3: How to claim as the main contractor for compensation events arising from subcontracted work under main options A (Priced Contract with Activity Schedule) and B (Priced Contract with Bill of Quantities)**

+ Author: Caroline Jachs

### Introduction

In this edition we look at the main contractor's entitlement to claim costs in relation to compensation events where the work was performed by a subcontractor in terms of the contract and the correct way in which the cost and fee entitlement should be calculated for main options A [Priced Contract with Activity Schedule] and B [Priced Contract with Bill of Quantities]. This article applies only to options A and B, as whilst entitlement for these two options is essentially the same, the calculation of entitlement that arises under options C, D, E, F is to be handled entirely differently.



### Contractual Provisions

In terms of clause 63.1 a compensation event claiming a change to the price / additional cost is to be assessed as the effect of the compensation event on the actual Defined Cost of the work already done, the forecast Defined Cost of the work not yet done, and the resulting Fee.

Thus, the first step is to ascertain what the Defined Cost is. The definition of Defined Cost is the same for both options A and B and is described at clause 11.2(22) as:

*“the cost of the cost components in the Shorter Schedule of Cost Components whether work is subcontracted or not excluding the cost of preparing quotations for compensation events.”*

It is clear from the above that regardless of whether the work for which a compensation event has been submitted was done by the main contractor or by his subcontractor, the Defined Cost is to be calculated through the use of the Shorter Schedule of Cost Components.

This position is further affirmed in clause 26.1 of the contract which deals with subcontracting and states that:

*“If the Contractor subcontracts work, he is responsible for Providing the Work as if he had not subcontracted. This contract applies as if a Sub-contractors employees and equipment were the Contractor’s.”*

In particular, the second sentence of the above provision makes it clear that the subcontracted work is to be treated as though it were undertaken by the main contractor.

Based on clauses 11.2(22) and 26.1 in order to ascertain the Defined Cost for compensation events regardless of whether the work was performed by the main contractor or the subcontractor one simply needs to calculate the costs as allowed by the Shorter Schedule of Cost Components (the costs for preparing quotations for compensation events to be excluded).

The Shorter Schedule of Cost Components sets out the costs that can be claimed in respect of people, equipment, plant and materials, charges, manufacture and fabrication, design and insurance.

Having used the Shorter Schedule of Cost Components to calculate the Defined Cost, the next step is to work out the fee allowable on such Defined Cost, as clause 63.1 clearly indicates that not only is cost allowable, but so too is the fee thereon.

Clause 11.2(8) of the contract defines the Fee as:

*“the sum of the amounts calculated by applying the subcontracted fee percentage to the Defined Cost of subcontracted work and the direct fee percentage to the Defined Cost of other work.”*

Thus, whilst for the purposes of calculating the Defined Cost, the work performed by the main contractor and the work performed by the sub-contractor are treated as one and the same, the opposite applies for the purposes of calculating the Fee. For the purposes of calculating the Fee one must be able to show which costs arose from work executed by the main contractor and which costs arose from work executed by the subcontractor. Then the direct fee percentage is to be applied to the Defined Cost

of work executed by the main contractor, and the subcontracted fee percentage is to be applied to the Defined Cost of the work executed by the subcontractor.

#### Submitting a quotation for the compensation event

The main contractor should accordingly ensure that when submitting a quotation for the compensation event he clearly sets out the following:

- a) The Defined Cost of the main contractor's work and the Defined Cost of the subcontracted work are to be set out separately (for the purpose of later applying the Fee).
- b) The cost items claimed which in total comprise the Defined Cost for both the main contractor and the subcontractor's work are cost components allowed by the Shorter Schedule of Cost Components.
- c) That the direct fee percentage, as indicated in the Contract Data, has been applied to the Defined Cost of the main contractor's work and that the subcontracted fee percentage has been applied to the Defined Cost of the subcontractor's work.

In accordance with clause 11.2(22) the cost of preparing the quotation for the compensation event is not to be included in the quotation.

#### So where does the risk arise?

In relation to both the cost and the fee to be applied, the main contractor's risk does not lie in his contract with the employer, but rather it lies in his contract with the subcontractor.

In respect of costs, due to the fact that the Defined Cost of work is calculated through the use of the Shorter Schedule of Cost Components (and such Defined Cost is treated as one and the same whether the work is executed by the main contractor or the subcontractor), the main contractor must ensure that the Shorter Schedule of Cost Components and related information in the Contract Data set out in the subcontract is identical to the Shorter Schedule of Cost Components and related information in the Contract Data set out in the main contract as, if not identical, it may result in loss to the main contractor.

By way of example we shall look at a claim for equipment. In the Shorter Schedule of Cost Components, it states that one can claim:

*“Amounts for equipment which is in the published list stated in the Contract Data”*

The main contractor must ensure that the published list stated in the Contract Data for the main contract, and the published list stated in the Contract Data for the subcontract are the same published list. If the main contract and the subcontract indicate two different lists, and the published list indicated in the subcontract allows greater amounts for equipment whilst the published list in the main contract allows lesser amounts for equipment, the main contractor may suffer loss. The subcontractor will be able to claim the (greater) published list amount from the main contractor, but the main contractor will only be able to claim the (lesser) published list amount from the employer.

So too, it follows that if the parties intend amending the items stated in the Shorter Schedule of Cost Components the main contractor must be especially careful that the Shorter Schedule of Cost Components forming part of the subcontract be amended to identically match the Shorter Schedule of Cost Components in the main contract. One doesn't want a situation to arise where one of the items has been deleted from the Shorter Schedule of Cost Components (and is accordingly not claimable) in the main contract, but this same item has not been deleted from the Shorter Schedule of Cost Components in the subcontract. Were such a situation to arise, the main contractor would have to swallow the cost of this item.

In respect of the fee to be applied, and in a similar vein, the main contractor must be careful to ensure that the fee percentage to be applied and paid to his subcontractor does not exceed the fee percentage to be applied and paid to him by the employer.

The employer and the main contractor will have agreed the subcontracted fee percentage to be applied to the Defined Cost. Such subcontracted fee percentage will have been specified in the Contract Data of the main contract.

So too, the main contractor and the subcontractor will have agreed the fee percentage to be applied to the Defined Cost for the subcontracted work. Such fee percentage will have been specified in the Contract Data of the subcontract (for the purpose of the subcontract it will be the subcontractor's direct fee percentage).

The main contractor must take care when entering into the subcontract by ensuring that the direct fee percentage to be paid to the subcontractor per the subcontract is equal to or lower than the subcontracted fee percentage specified in the main contract. If the direct fee percentage in the subcontract is higher than the subcontracted fee percentage in the main contract, then the main contractor will have to absorb this difference in fee percentages, which will result in loss to the main contractor every time he submits a compensation event for subcontracted work.

However, the above risks in respect of both cost and fee percentage can be managed. When the main contractor calls for tenders from potential subcontractors it would be advisable for the main contractor to do the following:

- a) Provide a copy of the Shorter Schedule of Cost Components (as amended) and the Contract Data information relating thereto, as is applicable to the main contract; and
- b) Stipulate what the maximum subcontract direct fee percentage is (this percentage should of course be equal to or lower than the subcontracted fee percentage stipulated in the main contract).

In this way the main contractor can ensure that the subcontractor is appraised as to how the Defined Cost is to be calculated, and will ensure that tenders received from potential subcontractor's do not include direct fee percentages that are higher than the subcontracted fee percentage stipulated in the main contract with the employer.