

## **NEC3 & 4 - Disallowed Cost Explained**

If you're working under NEC Option C, D, E or F then you need to know about "disallowed cost". Unlike "defined cost", this is cost which cannot be recovered from the employer/ client. As you can imagine, this results in an area of dispute.

Within this document we will establish the defined terms for "disallowed cost" and explore the differences between NEC3 and NEC4, in addition to highlighting some key areas of confusion. Firstly we will investigate what the contract says and then talk about ways you can avoid disallowed cost.

### **Disallowed Cost Under NEC3:**

The defined term for "disallowed cost" can be found in the "main option clauses" Clause 11.2 (25):

(25) Disallowed Cost is cost which the Project Manager decides

- is not justified by the *Contractor's* accounts and records,
- should not have been paid to a Subcontractor or supplier in accordance with his contract,
- was incurred only because the *Contractor* did not
  - follow an acceptance or procurement procedure stated in the Works Information or
  - give an early warning which this contract required him to give

and the cost of

- correcting Defects after Completion,
- correcting Defects caused by the Contractor not complying with a constraint on how he is to Provide the Works stated in the Works Information,
- Plant and Materials not used to Provide the Works (after allowing for reasonable wastage) unless resulting from a change to the Works Information,
- resources not used to Provide the Works (after allowing for reasonable availability and utilisation) or not taken away from the Working Areas when the Project Manager requested and
- preparation for and conduct of an adjudication or proceedings of the tribunal.

### **Disallowed Cost Under NEC4:**

There is some slight variation for what constitutes “disallowed cost” under NEC4, the definition can be found in the “main option clauses” Clause 11.2 (26):

(26) Disallowed Cost is cost which

- is not justified by the Contractor’s accounts and records,
- should not have been paid to a Subcontractor or supplier in accordance with its contract,
- was incurred only because the Contractor did not
  - follow an acceptance or procurement procedure stated in the Scope,
  - give an early warning which the contract required it to give or
  - give notification to the Project Manager of the preparation for and conduct of an adjudication or proceedings of a tribunal between the Contractor and a Subcontractor or supplier

and the cost of

- correcting Defects after Completion,
- correcting Defects caused by the Contractor not complying with a constraint on how it is to Provide the Works stated in the Scope,
- Plant and Materials not used to Provide the Works (after allowing for reasonable wastage) unless resulting from a change to the Scope,
- resources not used to Provide the Works (after allowing for reasonable availability and utilisation) or not taken away from the Working Areas when the Project Manager requested and
- preparation for and conduct of an adjudication, payments to a member of the Dispute Avoidance Board or proceedings of the tribunal between the Parties.

### **Difference between “pain” and “disallowed cost”**

It should be noted that just because a cost isn’t claimable as a Compensation Event, doesn’t mean the cost is “disallowed”. If a target cost contract is being used, it’s often the case that some cost which can be attributed to the fault of the contractor may just increase the “defined cost”, reducing likelihood of potential “gain” and increasing likelihood of potential “pain”.

The project manager decides if a cost is to be disallowable. This should be done in accordance with the contract, the reasons must be provided in the form of certification, issued to the contractor.

### **Avoiding “disallowed cost”**

Here are some key tips to avoiding disallowed cost as a contractor:

- Ensure you have detailed daily site records. These records should include: start and finish time, location of works, direct and subcontract resource on site, works carried out, remaining works to complete and any events which could cause a change to cost or time.
- Ensuring Early Warnings are submitted on time and according to the contract
- Ensuring good Quality Management Systems (QMS) are in place to ensure any defects are corrected before completion of works
- Ensuring a clean and organised site with wastage removed promptly and/or as requested by the project manager
- Ensuring the works information is fully understood and all project stakeholders know which elements of the works information they are responsible for