CONSTRUCTION COST CLAIMS, OR ENTITLEMENTS?

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Abstract

More often than not, cost claims which are legitimately due and entitled to the contractor for works done, or for loss and expense incurred arising from disruption, prolongation and delay, are surprising not successfully recovered, whether in whole or in part, or none at all.

One of the main reasons attributing to such scenario, is due to either the contractor, employer or the consultants and their poor understanding of and adherence to established and proper contractual rubric that is embodied in the building construction contract for the works.

This paper explores some such pitfalls that could very well spell the ultimate financial disaster for many contractors, and highlights salient and essential intimations that contractors and consultants should watch out for.

Keywords: Legitimate Cost Claims; Contractual Quantum Meruit, Disruption, Prolongation, Delay Claims; Contractual Procedure

1. Introduction

Invariably, most if not all, building construction projects will involve cost claims arising from not just valid variations and additional works, but also from other cost entitlements and compensations allowed for in the contract.

A contractor's objective in being conscientious in submitting such claims for compensation is to obtain equitable relief for such costs directly or indirectly incurred; which in reality he is entitled to under the law of contract, or otherwise under common law.

More formally, a contractor's claim is often defined as "a legitimate request for additional compensation (whether in cost or time) on account of a change in the terms of the contract".[1]

Incidentally, and for the avoidance of doubt, this paper examines only cost claims or equitable relief which the Contractor is contractually entitled to under the relevant provisions of the contract, and the difficulties encountered in recovering such entitlements.

This must preclude all other sneaky, devious or frivolous practice which most Consultants and Developers are often on guard against, and hence unduly branding or generalizing such legitimate entitlements as being "claims-conscious".

2. Standard Forms of Contract

All building construction contracts have standard forms of contract[2] containing adequate contract provisions for the contractor, under given circumstances, to be entitled to extra payment and compensation due to various kinds of circumstances, and upon seeking such entitlements by making representations to the Architect, Engineer or Superintending Officer.[3]

2.1 Valuation for Variation Orders and Official Instructions

Claims for payment due to valid variation orders and official instructions are hardly ever the contention of dispute or disagreement, as the Contractors and Quantity Surveyors usually follow the well established prescribed valuation methods (sic) embodied in the various standard forms of contract.

Over and above the simplistic addition and subtraction of remeasured quantities for the revisions, and applied against standard unit rates provided in the Bills of Quantities or the Schedule of Unit Rates, there are however, still many stumbling blocks and teething problems when contractors submit supplementary entitlements to their cost claims.

Broadly speaking, the valuation of variations for design revisions, variation and additional works regularised under the official proforma of an instruction or variation order are usually dealt with using different format and procedure.

2.1.1 Bills of Quantities and Schedule of Unit Rates

When the variations instructed at such time and locality can be readily absorbed into the regular progress of the works on the same basis of commercial profitability, the unit rates in the Bills of Quantities or Schedule of Unit Rates are traditionally used for valuation purposes.

Most contract forms also allow for adjustments when the above scenario differs, and this is when contractors usually face difficulty convincing the certifier that they are entitled to such compensation.

Circumstances warranting additional payment may be due to the substantial increased quantum of works which would necessitate an adjustment to the unit rates, or when the materials need to be procured at a much later time when costs would have differed, and which may not necessarily be due to inflation or fluctuation of costs.
Even though there is such a provision, it is usually not easy for the contractor to succeed on submitting an adjustment on unit rates for similar materials but which by reason of material increase or decrease, or its sequence of ordering or location, or postponement, or any resultant dislocation or other special physical or technical circumstance, which will in essence differ in cost or commercial profitability or working methods from the original scope of works priced at the time of tender.

And then there are additional preliminaries of expenditure which may also be adjusted where necessary in the light of the quantities or time of instruction.

As an illustration, varied works sanctioned when the original scope of works have already been completed, and all site facilities and equipment fully de-mobilised, would obviously require fresh materials to be procured under new terms, and incurring additional preliminaries to re-mobilise all resources to execute the additional quantum of works. Such intangible costs are not necessarily easy to substantiate, to produce invoices and records, but are genuine and direct costs incurred by the contractor.

Certifiers are usually under the notion that Bills of Quantities and Schedule of Unit Rates are presumably applicable and valid throughout the entire tenure of the project, with no avenue for adjustment or change, and without appreciating that there are explicit contractual provisions to the contrary.

2.1.2 Pro-Rated Unit Rates

Where the varied work is of similar character to work described in the contract, but not executed under similar conditions, or involves significant changes in the quantity of such work, the contracted rates may be used as a basis for valuation, but with a fair allowance for any differences in such conditions or quantity.

It is not always the simplistic approach of using extrapolated means to adjust the unit rates for the varied work and evaluated arithmetically proportionate to the original scope of works; since allowance must also be taken for the adjustment for the quantities, site conditions, and of course the additional preliminaries of expenditure to be accounted for as well.

2.1.3 Commercial Market Rates

Sometimes called actual prime cost rates, or star rates, these are actually for varied works where there are no contract rates available, with allowance made for material, transport and labour and a standard percentage for profit and attendance including site preliminaries. Sometimes daywork rates are used to substantiate other piecemeal work.

2.2 Loss and Expense Claims

Where the standard form of contract allows provisions for claims for loss and expense, the contractor is entitled to recover such costs sustained or incurred and for which he would not otherwise be reimbursed by any other provisions of the contract as set out earlier in this paper.

These entitlement include such loss, expense, costs or damages of whatsoever nature and howsoever arising as a result of the regular progress and completion of the works having been disrupted, prolonged or otherwise affected by the issuance of such instruction constituting as variations to the original scope of works in the contract.

The extent of claims under this category includes all direct relevant costs of labour, plant and materials, or goods actually incurred; all site overheads and costs actually and necessarily incurred; and including a standard percentage for profits, head office or other administrative overheads, financing charges and any other costs, loss or expense of whatsoever nature and howsoever arising.

Interestingly, this heading of claims seldom sees the light of the day in most, if not all, final account settlements.

This is simply because of the detailed and verified substantiation of contemporaneous records required before the Quantity Surveyors are rightfully able to justify such contractual entitlement; and of which the contractors are more often than not unable to diligently upkeep and furnish.

2.3 Constructive Instructions

In practically all projects large and small, there will inevitably be design revisions, variations and additional works which are inadvertently sanctioned and ordered by the contract administrator or his representatives, and which may or may not be regularised as official instructions under the ambit of the contract provisions which would enable the contractor to comply with the contract procedure to submit cost and time claims thereafter.

Such design revisions, modifications and instructions constituting as variations may arise from on-site adjustments to suit design intent; design revisions made on shop drawings; other additional information and design modifications which are not otherwise provided; or are necessary in order to resolve some technical discrepancies, conflicts and omissions not otherwise reasonably foreseen at the outset; or else works which are necessary in order to comply with local authorities regulations and code of practice, so on and so forth. Note all these mentioned may not be arising from any changes sanctioned or requested by the Employer.

Under the ideal contractual scenario, the contractor is obliged to notify in writing to the certifier in a timely manner of such variations in order that they may be affirmed, rescinded, modified or contradicted in writing, before the contractor is entitled to compensation, if any.

While it may be possible that the contractor's failure to comply with the requirement for the provision of notification and information might reasonably deny him the entitlement to additional costs arising, it is still deemed inequitable that the contractor could be exposed to liquidated damages as a result. This would mean that the employer was effectively being paid for delay that he had caused.[4]

In the event that the contractor duly notifies the contract administrator with due diligence; and inspite there being no official instruction to confirm the variation, proceeds to carry out and complete the additional works, such variations and additional works would be deemed to be 'constructive instructions'.

The contractor is subsequently entitled to be compensated for the works based on 'contractual quantum meruit', commercial market rates, or reasonable sum basis, since such works are carried out under the existing contract based on the acceptance and compliance of this instruction.[5]

2.4 Other Works with Cost Implications

There are numerous other classifications of claims that the contractor is contractually entitled to seek recovery and compensation under the provisions of the contract. A few salient heads of claims are highlighted as the most commonly occurring ones.

2.4.1 Cost Claims Due to Disruption, Prolongation and Delay

The repercussion of late site possession; late issuance of information or instruction or nomination of a sub-contractor or supplier; suspension of works; tests and examinations instructed by the contract administrator; or even late response on review and approval of shop drawings and submissions for material procurement; all of which are not arising from the default or breach of the contractor; is that the contractor's regular progress is unduly and adversely affected as a result. This is translated into disruption, prolongation and eventual delay.

Under contract law, and unless expressly instructed to accelerate the works, the contractor is only contractually obliged to exercise reasonable measures to mitigate any incurred delay and to prevent delay to the completion of the works. He can reschedule his programme or change his sequence of works, but not when the implementation of such measures will incur unnecessary additional costs to him.

Though theoretically and contractually entitled to the recovery of such costs, the claims are never easy to quantify, let alone substantiate.

The contractor is expected to be efficient and diligent in keeping accurate, up to date, and verified contemporaneous site records of all the time and resources which are expended independently, exclusively and directly due to such circumstances which would contractually allow his entitlement of such recovery.

The end result of such consequences is that, in the midst of the contractor's urgency to complete the remaining works, and not to mention the seemingly high attrition rate of site quantity surveyors, such tabulation and substantiation of claims are more often than not inevitably left on the back burner.

2.4.2 Constructive Acceleration Costs

The concept is that the contractor is not being granted or unjustifiably refused an extension of time that he ought reasonably to have received due to valid and excuseable delay which are not caused by his own default or breach, and due to the implied contract term, or express instruction by the contract administrator to complete the remaining works within the unadjusted completion date, and in fear of exposure to liquidated damages for any likely delay, the contractor is compelled to increase resources and work longer hours in order to mitigate and overcome such delay.[6]

It is important however, to note that in order to qualify for any equitable entitlement to compensation due to constructive acceleration, the contractor must first show that there is an express or implied obligation on the part of the Employer to ensure that the contract administrator performs his obligations in discharging his contractual duties, in order to prove a breach by the Employer on the express or implied term to accelerate the works in the absence of an extension of time.[7]

The acceleration costs can be based on a calculation using the difference between the value of work undertaken in a non-disrupted period with that undertaken in a disrupted period. This must be substantiated with detailed records to demonstrate both the planned resourcing and programming for the works as it would have been carried out but for the acceleration, and the actual resourcing and programming of the accelerated works.[8]

3 Main Obstacles and Excuses Proffered

Despite the high probability of success in the recovery of such claims, the actual nett returns of contractors to recompense inclusive of such costs are surprising not very high. Most of the time, such submissions are rightfully, and justifiably rejected due to various grounds and allegations.

3.1 Timely Notice

Upon receipt of an instruction and to the extent that the said instruction does not state that it requires a variation, but the contractor considers that it does require a variation, the contractor is contractually obliged to notify the contract administrator in writing, within a stipulated period upon receipt of such instruction, to challenge the validity of the instruction which ought to constitute a variation.

The contract administrator is then obliged to respond, within a stipulated period upon receipt of the contractor's notification in writing, to modify, rescind or contradict in writing the instruction and the contractor shall then comply forthwith.

This is usually a condition precedent to the contractor's entitlement for any cost compensation. Any failure therefore to comply with this requirement would forfeit the contractor's rights of claims.

3.2 Late Claims

Late claims are often frowned upon, as this is fundamentally already a breach of contract procedures. Ideally, and in accordance with proper contract procedures, the proper timing to submit any such claims is whenever such entitlement becomes apparent that there will be additional cost implications or consequential costs and other implications.

Sometimes, the real cause for claims may not materialize until after the events have transpired. For instance, there may be accumulative impact of a series of apparently insignificant changes, cumulating into a disruptive effect and impeding regular progress, and resulting in prolongation and loss of production and increased engineering time.

As such impacts are often difficult to quantify and back-tracked accurately to the original source, contractors are eventually compelled to inevitably abandon any hopes of seeking compensation.

An alert and prudent contractor will however, and upon sensing of any potential delay arising, notify the owner at the earliest opportune of his intent to claim and the anticipated grounds for so doing.

This is an acceptable approach, as the contractor is then able to preserve his contractual rights to claims until such time when the purported delay factor has ceased to operate and when all necessary information are available for substantiation and submission.

3.3 Breach of Contract Procedure

Contract procedures are prescribed in the agreement and meant to be followed and adhered to closely.

Either party failing to conform to this procedure will constitute a breach, and will adversely affect the rights and obligations of parties to the contract in imposing or enforcing any entitlement conferred under the contract provisions.

3.4 Contemporaneous Records

Construction and engineering projects often involve a plethora of records, correspondence, reports and a myriad of administrative paperwork.

Needless to say, proper site records must be well maintained and managed on a regular and up to date basis so as to serve as substantiation in all submissions of claims.

These may include time sheets of office personnel including those expended to prepare shop drawings for approval; dockets and invoices; daily job diaries of manpower, supervision, equipment and materials; reports, tests and investigation records; notes and minutes of meetings during resolving of technical issues like discrepancies, design deficiencies and outstanding information; weather and its effect on progress; as-built progress of site works including dated photographs; updated impacted and as-built programmes; records of all design revisions, modifications and variations received and any adverse impact on actual site works; daywork records on incidental works which cannot be evaluated under normal contract provisions such as abortive works and works outside the ambit of the contract; obstructions and obstacles encountered not otherwise foreseen; etcetera.

The extent and level of information required in collating and compiling all the legitimate claims are clearly not limited to senior management or the head office only; but very well the rank and file from the project managers to foremen and supervisors, quantity surveyors, draughtspersons and store personnel alike.

Such contemporaneous records, are extremely instrumental in facilitating and verifying actual and direct costs and delays in connection with each and every claim for entitlement for costs, especially costs associated with disruption and prolongation claims, other than loss and expense claims.

Of course, measures must be implemented to ensure that all such records are properly verified, endorsed, authenticated to ensure accuracy, reliability and credibility; since unreliable and fictitious records are not only counterproductive and a waste of resources, but can be adversely detrimental in evaluation of any entitlement of claims.

The alternative yet popular approach is to use 'global' claims and engaging of claims consultants to concoct well articulated claims and academic entitlement; which are generally disdained upon and invariably treated with skepticism. [9]

3.5 Validity of Claims

Calculation for all kinds of cost claims due to delays, prolongation, disruption, acceleration or impact costs alike, involve finite estimating, engineering evaluations, statistical analyses; theories and formulae; complete with software generated as-built programmes, as supporting documentation for such claims.

Except in fairly exceptional circumstances, where it is practically not possible to identify the specific cause and effect of each class of claims, submission of claims on a purely theoretical basis are often popular but unlikely to succeed.[10]

The contractor is expected to prove actual loss from verified records. Only where this is not possible, and as an exception rather than the rule, will calculation be allowed by reference to formulae such as the Eichleay formula, and the Hudson or Emden formulae. The formulae are applied to assess loss where certain things have been established proving that the contractor did actually suffer loss.[11] [12]

Otherwise, and unless there are evidentiary facts adduced and based on contemporaneous records to substantiate the factual sequence of events and effects on the works resulting in delay, disruption and interruption, with loss and expense incurred, any such claims are likely to be deemed as defected and subject to rejection.[13]

3.6 Budget Control

Historically, building and engineering projects were far less complex and tend to be of conventional design with few specialized sub-contract works. Overall costs were rather moderate with reasonable construction periods; profit margins were generous with even a budget for contingencies thrown in for good measure.

Under such ambience, relationships between the owner, architects, engineers and contractors, as well as between the main contractor, sub-contractors and suppliers, were less formal and more cordial. Any extra cost not contemplated in this piece of work could always be built into the next, and commercial decisions and resolutions were always geared towards dispute and litigation avoidance.

Today, with the state of economy and acute accountability, high interest rates, and the current trend of speculative development businesses, building owners are ever anxious to hold down original capital outlay, seeking to avoid budget overruns at all costs.

It is not surprising to find agreements between the owners and principal consultants containing explicit terms and conditions to take control of funds out of the consultants' jurisdiction; with the owner's liability to any costs overrun limited only to employer sanctioned design revisions, variations and additional works!

This is compounded by the fact that standard forms of contracts nowadays are amended to transfer ever increasing degree of liability to the contractors and sub-contractors, with more onerous contractual rubric and warranties.

Conversely, on the part of the contractors, with cut-throat pricing and stiff competition amongst an abundant pool of eager tenderers hungry for any project, profit margins are razor thin to the extent of barely being able to sustain the site resources.

It is not uncommon therefore, that some contractors and sub-contractors alike are driven by desperation to resort to sharp practices in order to recover costs, exploiting contractual loopholes and engaging dubious claims consultants in conniving unsubstantiated and unjustifiable claims to maximize their revenue and profit.

All these can only culminate to higher incidence of disputes and litigious claims; with one party denying or refusing to allow budget overrun, and the other desperately attempting to recoup losses and alleviating a potential company meltdown.

4 Conclusion

To be able to efficiently execute, administer and complete any project successfully and be gainfully profitable; and without any unnecessary frittering away of valuable resources, both Contractors and Consultants alike should be conscientiously and reasonably familiar with established and proper contractual protocol in each and every stage of the contract until fruition, so as to be able to preserve the respective positions, rights, remedies and interests of all parties to the contract.

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