

CONSTRUCTION CONTRACTS CLAIMS

(Preparation, Evaluation, Negotiation and Settlement)

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1.0 Basis of Claims

1.1. Construction contract claim- A legitimate request for additional compensation (cost and or time) on basis of a change in the terms of contract.

This may take form of two types of requests:-

- i) Contractual entitlement - an application for reimbursement of direct loss and/or expenses arising from a clause in the conditions of contract.
- ii) Damages – a claim of damages arising from a breach or series of breaches of contract conditions.
 - Most Contractors claims arise from the provisions of the conditions, but they can also have a concurrent right at common law to claim damages for breach of contract.
 - Claims arising from provisions of contract are usually more advantageous to the contractor than claims arising from common law for the following two reasons:-
 - Claims arising from contract provisions require only to be certified by the Architect or Engineer and then included in interim certificate for payment.

1.2 The JBC and the FIDIC standard forms of contract have detailed provisions for the reimbursement of a contractor's direct loss and/or expenses and provision for Employers recovery of damages for delay in completion and they both set out the specific procedures which must be followed.

The provisions that may give rise to claims by the contractor and employers claim for damages for delay are:-

The JBC Standard Form

- Clause 37 (1) which deals with loss and expense caused by matters materially affecting regular progress of works.
- Clause 30.8 which deals with loss and expense arising from carrying out of variation works by contractor.

- Clause 44.2 dealing with loss and expenses which may be incurred by contractor while dealing with finding of fossils and antiquities and objects of value found on site.
- Clause 43.1. Dealing with claim for damages by Employer, if the contractor fails to complete the works by the date of practical completion stated in the agreement.

The FIDIC Form

- Clauses 53 - Dealing with procedure for claims for additional payments.
- Clause 51- Dealing with claims arising out of carrying out variation works.
- Clause 47.1 – Dealing with claim for damages due to delay in completion.
- Clause 27.1 – Dealing with claim for reimbursements of costs which may be incurred by contractor while dealing with fossils, coins, antiquities or articles of value.

2.0 The meaning of Direct Loss and /or Expenses

2.1 Clause 37.1 provides for “direct loss and/or expenses caused by disturbance of regular progress of works”. This means that what is recoverable is the financial loss and expenses which directly and naturally results in the ordinary course of occurrence of events specified in the contract:-

- The FIDIC form under clause 53.1 uses the terms additional payment to cover costs arising from any event prescribed in any of provisions of contract.

Therefore a contractor who claims direct loss and /or expenses (or additional payment in case of FIDIC) must establish by use of oral or documentary evidence the following:-

- That he has suffered loss or incurred additional costs caused by occurrence of events specified in the provisions of Contract.
- Demonstrate that the loss or expenses or additional costs are sufficiently linked to the events set out in the contract.
- The loss or expense or costs must be actual financial and not merely notional loss. The contractor must prove his case “on the balance of probabilities.”
- Must be able to prove the loss or expense or additional costs, reasonably to establish the probability that it has been incurred.

2.2 Nature of direct loss and/or expenses:-

- Actual losses of money (which ought to have been received) as a result of the circumstances giving rise to entitlement.
- Actual expenditure of money which ought not to have been made occasioned as a direct result of the same circumstances. “The primary meaning of the word expense is actual disbursements.”
- Note that in all cases of loss and expense the contractor is under a duty in law to “mitigate his loss” so far as it may be reasonable for him to do so. For example if a contractor is issued with a variation order which necessitates plant lying idle for some days, he (the contractor) would not be entitled simply to accept the situation, but would be bound to make reasonable endeavours to use the plant productively elsewhere or to persuade the plant owner to accept an early return.

3.0 Contractor’s Claim under the JBC form:-

3.1 The events affecting regular progress must be those that the Employer or his agents is responsible e.g.

- Delay in receipt of instructions, drawing details or levels from Architect.
 - Opening for inspection and testing where materials are found to be in accordance with contract.
 - Delay in appointment of Architect or Quantity Surveyor
 - Discrepancy or divergence in conditions, drawings specifications or bills
 - Delays arising from nomination of subcontractors
 - Delay in receiving possession or access
 - Contractor suspending work in accordance with provisions of contract.
 - Not all grounds entitling Contractor to extension of time lead to automatic recovery of loss and expense.
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- Loss and expenses claims arising out of clause 37 (1) are the most common and usually more substantial in practice. The provisions of this clause confer on the contractor a legally enforceable right to financial reimbursement for direct loss and/or expense suffered or incurred as a result of specified matters provided that he observes and follows the procedures laid down by the provisions.
 - In practice under the JBC standard forms the following situations may generate contractor’s claims.

- A delay in completion of the contract works beyond the date when they otherwise would have been completed often known as a prolongation claim.
- The effect of an event upon the contract works themselves often referred to as disruption claim, may not necessarily involve delays in completion of the contract works.

3.2 Potential Head of Contractor's claims:-

- Preliminaries or site establishment costs
- Head office overhead costs
- Profits
- Inflation
- Loss of productivity or acceleration costs
- Finance charges and interest
- Cost of preparation of claim
- General
- Variations

3.2.1 Preliminaries (on site establishment)

- Preliminaries costs are usually of three types:-
 - Set up costs
 - Running costs and
 - Demolition or clearing costs
- Items constituting this cost head:
 - Site management expenses e.g. staff expenses and incidental traveling expenses.
 - Plant equipment and scaffolding.
 - Power for lighting and use in works
 - Temporary hoarding site offices and storage sheds
 - Local authority charges for the temporary hoarding and other costs
 - Water for the works
 - Telephone services
 - Insurances for works and third party
 - Performance bond and guarantee
 - Attendance on nominated subcontractors
 - Site security watching lighting
 - Site safety sanitation, and welfare measures
 - Programme and progress schedule
 - Site clearance and maintenance of temporary roads

- The losses and or expenses under these cost heads are usually broken into three categories:
 - Occurrence related – those cost that depend on occurrence
 - Time related – costs that are related to the time on site
 - Value related – those costs that depend on value of work

3.2.2 Head office overheads

- The Head office for a Contractor exists to support the site operations. Therefore any delay or any disruption on site will lead inevitably to some increase in direct head office administrative expenses relating to period of delay and also relating to involvement of head office staff in dealing with disruptions.

Head office administrative expenses will include:-

- Contract managers and other head office staff's time spent organizing labour, recasting programmes, ordering materials, arranging plant hire etc.
- Cost of such general items as rents, rates, lights, power, cleaning, clerical staff, telephone bills, stationery, office equipment etc.
- For most Contractors the overhead costs are usually budgeted as a percentage of planned turn over.
- However normally the contractor must first prove that had his resources not been engaged on the overrun of the project in question he would infact have deployed his resources elsewhere to fund his overheads. However case law shows that courts show certain tolerance towards contractors' duty to prove this.
- In claiming loss of office overheads the contractor must be prepared to provide documentary evidence. This is usually in form of recording of the time spent by managerial staff on particular project.

3.2.2.1 The formula approach

- There is an accepted practice in the industry to use a mathematical formula. The argument: put forward in support of use of formula is that at time of tender a percentage has been added to the net estimated costs as a contribution to the costs of running the head office. This being the case the total sum for overheads included in the tender if divided by the contract period results in a weekly rate.

This theory has been converted into a formula popularly known as Hudson's formula:-

i) The Hudson's Formula

$$\frac{\text{H.O/Profit}}{\text{Contract period (in weeks)}} = \frac{\text{Contract sum} \times \text{head office/overheads (profit) as a \% \text{ of turnover} \times \text{Period of delay (weeks)}}{\text{Contract period (in weeks)}}$$

The percentage of turn over income used is what the contractor has allowed for in his tender for general overheads and profits.

3.2.3 Loss of Profits which contractor would have earned

- Loss of profit which the contractor would otherwise have earned but for the delay or disruption. This is based on the argument that a contractor has lost the opportunity to earn additional profit as a result of being delayed on another project. Perhaps he had to turn down a lucrative contract because this project continued to absorb his staff and labour. If such losses have really been incurred, then very persuasive evidence will be required before any judge or arbitrator will consider making an award.
- "These claims are often made but are rarely awarded even by arbitrators or judges.
- However where the contractor's employment has been determined in accordance with conditions of contract as a result of default by the employer the contractor is entitled to be reimbursed the profit that he can prove that he would have made on that particular contract had he been allowed to complete the works, less the amount saved because of disappearance of his contractual obligations.

Example:

Annual cost of all projects	=	60,000,000.00
Overheads and profit	=	4,500,000.00
Annual turn over	=	64,500,000.00
Overheads and profit	=	7.5% of annual cost or 6.977% of annual turnover.
Contract sum	=	160,000,000.00
Less overhead/profit 6.977%	=	11,163,200.00
Cost of delayed project	=	148,836,800.00
Original contract period	=	52 weeks
Delayed period	=	13 weeks

$$\begin{aligned} \text{Overheads and profit during delayed period} &= \frac{148,836,800 \times 7.5\% \times 13}{52} \\ &= 2,790,690.00 \end{aligned}$$

3.2.4 Fluctuations of Prices or Inflation

- For fixed price contract the contractor is usually entitled to some compensation for variation in cost of materials due to fluctuation. The value of this claim should be the excess the contractor has had to incur as a direct result of the prolongation.
- The correct measure of this loss would be the difference between what the contractor would have spent on labour materials and plant and what he has actually spent over the whole period of the work as a result of the delay and disruption concerned.
- Evidence is important and records must be kept showing how labour and material prices varied when the work was actually carried out compared to the prices prevailing at the time when the work was programmed to be carried out.

A common solution to this is to introduce JBC fluctuations clause provisions into the delayed contract.

3.2.5 Loss of, Productivity and Acceleration costs

- Delay and disruption can lead to increased expenditure on labour and plant in two ways.
 - i) It may be necessary to employ additional labour and plant.
 - ii) The existing labour and plant may stand idle or under – employed. This is usually referred to as “loss of productivity”.
 - The Contractor is entitled to be reimbursed for delays as well as for disturbance to planned progress of his work.
- However this claim head is usually very difficult to prove the onus is usually on the contractor to prove as a matter of fact what the costs would NOT have been had the delay or disruption not occurred.
- The evidence advanced to support disruption claims is often presented in the form of bar charts or critical path analyses, sometimes supported by resource histograms. Ideally the contractor should demonstrate using an updated programme, how the disruption affected the programme and the workforce.

- Many claims for loss of productivity fail because good contemporaneous records do not exist and the contractor can only guess who was to blame for which loss. Others claims fail because contractors will not acknowledge that they have been at fault in anyway.

Evaluation of loss of productivity

Methods of evaluating loss of productivity

- Comparison of actual costs with allowances in the tender
- Comparison of actual expenditure on man power according to labour records with manpower allowed in tender.
- Assessed percentage addition on disrupted work – i.e. adding % on the direct costs of labour or plant
- Comparison of output or productivity with previous or other projects or industry statistics
- Comparison of output or productivity during known disruption with output or productivity when little or no disruption occurred.

3.2.6 Idle Plant, Equipment and Tools

- For this claim head the contractor must show that due to time over run he has had to employ additional plant and equipment or that his plant and equipment has had to stand idle or underemployed on site.
- For claims on plant and equipment, there are usually two types of plant and equipment.

Plant and equipment hired-in:-

- Amount claimable is the loss actually incurred which is the sums payable to the plant owner under terms of hire contract.

Contractor's own plant and equipment:-

- Where contractor uses his own plant and equipment thus: There are four possible heads of costs or expenses:-
 - Depreciation costs
 - Interest of money invested
 - Cost of maintenance
 - Wages for staff operating in the plant or equipment.
- In case of Contractor's own plant unless the contractor can prove special damages case law supports the view that Contractor can only recover nominal damages based upon mathematical calculation of the rate of depreciation of the machine.

3.2.7 Finance Charges and Interest

- Under the “direct loss/or expenses” provisions of standard forms, finance charges by way of interest on money expended are allowable as a head of claim. Indeed the loss of the interest that might have been earned on the money diverted from investment is also recoverable.
- When ascertaining the cost of financing, the following should be taken into account:
 - Rate of interest actually paid by the contractor provided it is not unreasonable. Where the contractor claims to pay paying well above or well below prevailing market rates appropriate rates are those at which (contractors) in general borrow money.
 - The cost of finance shall be calculated on the basis that it is charged by the contractor’s bank i.e using same rates as compounding accrued interest at same intervals.
 - In the case where the contractor is self-financed from within its co-operate group the appropriate rate of interest is that earned by the contractor on monies it has placed deposit.
 - Account should be taken of actual negative cash flows by way of primary expenses.

3.2.8 Interest on under-certification

- Contractors frequently allege that architects or engineers deliberately undervalue work in interim certificates. Contractors often claim interest on the late or delayed certification but they rarely receive payment.
- A certificate which bona-fide assess the value of the work done at a lower figure than is due to the Contractor which does not involve a contractual error or misconduct of the architect will not rank for interest under loss and expenses claim.

3.2.9 Delayed release of retention

- Delays in issuance of certificate which releases retention held by employer will give rise to claim for finance charges on retention for the period of delays.

3.3 Cost of preparing claim

- There is very little, if any, evidence in practice where costs of preparing a claim have been certified and paid. It is generally accepted that the contractor is not entitled to reimbursement, for any costs he has incurred in preparing a claim

3.4 Variations

- The JBC standard forms of contract provides the following universal principles in the valuation of additional or omitted work (variations):-
 - Contract rates are used where work instructed is similar and does not significantly change quantity.
 - Contract rates to be adjusted to allow for difference where work is similar but not executed under similar conditions or quantity differs.
 - Fair rates to be used where work differs in character. In those cases, where the instructed work is to be valued by measurement using one of the three principles it is the onus of the contractor to prove any difference in characteristic of work. This will then leave the contractor free to use rates than those in the contract bills.

4.0 Employer's claims for damages for delays in completion:

- Clause 43.1 provides for Employer to recover liquidated and ascertained damages if Contractor fails to complete the works by contract date for completion.
- Liquidated damages are subject to exception that employer is not entitled to liquidate damages if he has prevented contractor from completing by his acts or omissions
- Liquidated and ascertained damages payable are usually expressed on weekly or daily basis at rates stated in the appendix as liquidated damages. The damages are calculated and agreed at the time of contracting.
- When liquidated damages are not pre-estimated and agreed the Employer must prove the loss suffered.
- The liquidated damages are not meant to be punitive but to be compensation for likely loss.
- Liquidated damages are enforceable- whereas a penalty is not.

- Liquidated damages are reasonable pre-estimate of the loss the employer anticipates he will suffer if contractor completes late.

4.1 Calculation of liquidated damages

- For commercial projects or housing damages are estimated on basis of loss of rest income due to delay
- Certain projects e.g. roads, schools, hospital church etc, damages may be based on a formula

5.0 Claims preparation

5.1 Application Requirements:-

- The contractor must submit a written notice of application as a condition precedent to any reimbursement of direct loss and/or expenses as per the opening words to clause 37.1
- The application must be made within a reasonable time. It must not be made so late that the Architect can no longer form an opinion or satisfy himself that the Contractor has suffered the loss or expenses claimed
- The application should be sufficiently detailed so as to persuade the Architect that “the regular progress of work or any part thereof has been or was likely to be affected.”
- The details of application will depend on the circumstances, including time available, contractors experience and the quality of the records.
- The application must be sufficiently particularized to enable the architect to form an opinion as to whether or not the contractor had incurred or was likely to incur any direct loss and/or expense to be ascertained under the contract. The Architect under the contract may ask for further information to be provided so that he may form an opinion on the merits of contractor’s application.
- Contractor must to co-operate with the Architect in the ascertainment of direct loss/or expense.

The contractor must act promptly in advising the architect that direct loss and/or expense has arisen or is likely to arise.

5.2 Correct procedure for claims:-

- The Contractor must show that he has followed the administrative machinery provided by the contract itself.
- Claims must be founded on facts and these facts must be substantiated by the Contractor. Contractor must keep full and accurate records.
- The Contractor must establish each and every head of claim by means of supporting documentation and other evidence.

5.3 Claims Substantiation

A contractor claiming must be able to:

- Establish the direct link between cause and effect with regard to delays.
- Provide sufficient particulars of the resulting loss and/or expense.
- Provide the architect and/or quantity surveyor with all the information necessary for them to ascertain the direct loss and/or expense.
 - This will include costs records, charts showing actual progress measured against programme, original tendering calculations showing level of anticipated profit, possibly even profit-and-loss accounts and balance sheets (particularly when head-office overheads are to be examined.)

5.4 Format of a claim

Although there is no requirement as to the format in which claim must be presented

- The claim should be prepared in such a form that it can be readily used for purpose of formal pleading in arbitration.
- Must be prepared in a tidy and workman like manner.
- The sections that are to be commonly found in well presented claims are:
 - Introduction
 - Contractual basis of claim
 - The details of the claim
 - Appendices

5.5 Documentation and Supporting Records

- Claims must be adequately documented with appropriate records kept at the time the relevant work was executed or event occurred.
- Good set of contemporaneous supporting records and document to be kept may include the following:
 - i. Tender and bid documents and any pre-contractual agreements, representations and understandings.
 - ii. All fully signed written agreements relating to the project. While oral agreements are generally enforceable, written ones are easier to prove.
 - iii. Project correspondence- organized according to each key party and whether the correspondence is incoming or outgoing.
 - iv. Record of all the notifications of potential claims.
 - v. Record of all relevant conversations and follow up correspondence.
 - vi. Progress photos or videos at all stages of the project.
 - vii. All plans and drawings including amendments and addendums
 - viii. Project diary together with diaries for key personnel. Diaries should record: 1) the weather; 2) (manpower, visitors and contractors on site; 3) key deliveries; and 4) any notable event such as problematic or hidden site conditions or events that may cause or affect productivity.
 - ix. Maintain an as-planned schedule and regularly update it with an as-built schedule
 - x. Record of all key events, especially ones that may lead to a claim, and specifically record: 1) when the event occurred; 2) what it was; 3) who noticed it; 4) the projected impact it may have on cost and time; 5) whether notice was given and to whom; and 6) response to notice.
 - xi. Record of all variation orders and claims for extras and when they were submitted for approval, and separate those that are approved from those that are not.
 - xii. Document the additional costs caused by an event – including proper accounting and employee payroll records pertaining to additional overhead and employee costs.

5.6 Presentation of a claim

- The claim document must be of good quality produced with top quality print graphics, well reproduced and a cover which invites the potential reader to look inside.
- The claim can be read and understood without reference to other documents, correspondence, site minutes, and records are usually essential to corroborate the facts referred to in the text of the claim.
- Claim must be of high quality of presentation: concise and clear; and properly evidenced arguments and contentions.
- Use plain English and avoid use of jargon and specialist terminology. Technical words should be explained in full.

5.7 Some commercial factors influencing contractor's claims

The following factors have an influence on Contractor's claims.

Over all total losses incurred on project

The severity and complexity of events experienced both on and/or off the construction site

The parties involved and their respective responsibilities each to the other

The incidence of inflation, labour material or plant shortages

Requirement to pay third parties i.e. suppliers and subcontractors

Liquidated and ascertained damages liability

Has Employer budgeted for the problem and has he the resources to pay the claim

Current market place, interest/funding rates foreign exchange rates etc

Contractors or subcontractors loss of opportunity to use resource on other work or pursue other work

Cashflow situation and overdraft facilities

There are a number of reasons why parties are better of negotiating claim settlement.

Someone may be in the wrong and wrongdoers pay heavily in court or arbitration.

It may be necessary manpower to support litigation or arbitration may be lacking.

The required manpower to support litigation or arbitration may be lacking.

Insufficient money may be available to finance litigation or arbitration.

There may be delay in matters getting to trial for final hearing.
Negotiation can give better results in a short time.

Negotiation can also be done for a fraction of the cost.

6.0 The Role of Architect in dealing with Claims

- Under both clause 37, 30 and 44 the written application for claims must be made in the first instant to the Architect. It is the architect's responsibility to form an opinion as to whether or not "the contractor has incurred or is likely to incur direct loss and/ or expense."
- The architects may request for any additional information required to form the opinion. Architects are under obligation to ascertain the contractors "direct loss and/or expense" which can be delegated to the quantity surveyor.
- The Architects obligation to operate clauses 37.1 30.2 and 44.2 of the contract is absolute and the employer may be liable in damages for breach by the Architect of his duty. It is the employer's responsibility to ensure that the Architect operates provisions of the contract including the loss and expense." The Architects failure, to ascertain or instruct the Quantity Surveyor to ascertain the amount of direct loss and expense incurred by contractor was a breach of contract for which the employer was liable.
- However in claims negotiations the Architect and Quantity Surveyor should occupy neutral positions.

7.0 Conclusions

- There is now a pressing need for dealing with claims in a more professional manner.
- Construction market conditions have changed
 - Increased costs of borrowing have made building owners anxious to cut down original capital outlay and avoid extra costs.

- Conditions are inserted in standard forms intended to transfer increased liability to contractors and sub contractors.

- There is stiffer competition for work
- All these give rise to a greater possibility for dispute and claims

- The Employer and his consultant should always have in mind the need to avoid claims if possible. There is need to deal with proper claim entitlements in an efficient and business-like manner.

- The Contractors and subcontractors should avoid presentation of unmerited and exaggerated claims.

- Contractors need to adopt a more professional approach to the preparation and settlement of claim.

- The policy of claim avoidance should be adopted by all concerned and should apply from the day on which the Employer takes the decision to build the final account is agreed.