

Should Overheads in all Variations be Deducted from Loss & Expense Claims?

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This is a question which I am being constantly asked.

Take a simple example - during the course of the works the Architect/Engineer issues two variation orders.

- The first variation ("the Non Delaying V.O") order is to amend the specification of the doors from softwood to hardwood. This variation does not cause any delay but when valued results in an addition of HK\$1 million of which it is agreed that HK\$100,000.00 (10%) represents an allowance for site and head office overheads.
- The second variation order ("the Delaying V.O") is to add additional drainage works. This variation causes a delay of one month for which an extension of time is given, and when valued results in an addition of HK\$100,000.00 of which it is agreed that HK\$10,000.00 (10%) represents an allowance for site and head office overheads.
- The Contractor then submits a claim for the costs of prolongation, i.e. a claim based on the requirement to remain on site for an additional month as a result of the Delaying V.O. The quantum under claim is calculated as the actual cost of site overheads, and head office overheads for the additional month (which it should be noted is the month in which the additional works were carried out and not the month of the extended period), amounting to HK\$2 million.

The prevailing question is then how much should be deducted from the HK\$2 million claimed for prolongation costs? Should it be the value of the overheads in both the

Delaying V.O. and the Non Delaying V.O, i.e. HK\$110,000.00, or should it just be the value of the overheads in the Delaying V.O, i.e. HK\$10,000.00.

Many Architects and Engineers would argue the former is correct and that they are entitled to set offset overheads recovered through all variations. They argue this on the basis that the contractor has included in the Contract Sum all the overheads necessary to remain on the site for the contract period. Therefore any additional overheads which it receives as a result of variation orders are a windfall which need to be deducted if an assessment of the actual costs of prolongation are to be assessed. Further, on the wording of clauses such as Clause 63 of the Government Conditions of Contract which provides that the Contractor is entitled to payment of expenditure "*for which the Contractor will not be reimbursed by a payment made under any other provision in the Contract*" it is argued that the Contractor should only be entitled to reimbursement of overheads additional to those for which the Contractor is being reimbursed by means of the valuation of variations.

Whilst these arguments on the face of it seem logical, I believe that they are in fact incorrect. The only deduction which should be made from the loss and expense claim for prolongation is the value of those overheads included in the valuation of the variations which caused the delay to the works for which the loss and expense claim is being made - the Delaying VO. In our example this means that only the sum of HK\$10,000 should be deducted from the HK\$2 million being claimed.

The reasoning behind such an approach stems from the basic principles upon which such claims are made.

It is generally accepted that under standard forms of contract claims for loss and expense (to use RIBA/RICS contract terminology) or Costs (to use Hong Kong Government/ICE terminology) are to be calculated on the same basis as claims for breach of contract. Therefore the intention is that they shall be compensatory in nature aiming to place the claimant in the position (in so far as money can do) that he would have been in had the contract been performed. *Robinson v. Harmon*.

Put simply, in cases such as our example, this means that the contractor is entitled to be put in the position it would have been in had the delay not occurred. Had the works been completed on time the Contractor would have been paid the full amount of the valued variations including any allowance included for overheads, with no deductions.

Where there is delay the contractor should be reimbursed the additional expenditure which it incurs by being on site for an additional period as a result of the variation causing the delay. In our example, it would

therefore be entitled to the HK\$2 million actual costs less only the HK\$10,000.00 for overheads already included in the valuation of the works which have caused the delay - the Delaying V.O.

However if the value of overheads in the Non Delaying V.O. - the amendment to hardwood doors, is also deducted from the HK\$2 million, then the Contractor is in effect put in a worse position than in would have been in had the delaying event not occurred. This contravenes the intention of the Contract and the principles upon which a damages claim are assessed.

Accordingly quantity surveyors would be advised to ensure that, when claims for prolongation costs, or loss and expense are being prepared or assessed, to avoid a double recovery of overheads the value of overheads in the valuation of those variations causing the delays are deducted from the amount claimed. However they should also note that this does not extend to the value of overheads in non delaying Variations.

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