



**New South Wales Government
Procurement System for Construction**

Procurement Practice Guide

**Handling prolongation and disruption
claims**

December 2008

Important notices

Current version

The current version of this Procurement Practice Guide is maintained on the Internet at:

<http://www.nswprocurement.com.au/Procurement-System-for-Construction/Reference-material/Procurement-practice-guides.aspx>

Amendments

Refer to the Procurement Practice Guide Amendments Log which is available on the Internet at:

<http://www.nswprocurement.com.au/psc/ppg/amendments.aspx>

Copyright

This work is copyright. Apart from any use as permitted under the Copyright Act 1968 (Cwlth), no part may be reproduced by any process without written permission.

© NSW Government 2008

Requests and enquiries concerning reproduction and rights should be addressed to:

NSW Procurement Client Support Centre:

Telephone: 1800 NSW BUY (1800 679 289)

Email: nswp_support@commerce.nsw.gov.au

Using hyperlinks in this document

This Procurement Practice Guide contains embedded hyperlinks and Uniform Resource Locators (URL).

To follow a hyperlink or URL:

- Right mouse click; and
 - Select "Open in web browser" in the drop-down box.
-

Handling prolongation and disruption claims

Contents

1	Introduction.....	1
2	Prolongation claims	1
	2.1 Definition.....	1
	2.2 Establishing an entitlement.....	1
3	Evaluating prolongation costs.....	2
	3.1 For contracts with specified rates for delay costs.....	2
	3.2 For contracts without specified rates for delay costs.....	3
	3.3 On-site overheads.....	3
	3.4 Off-site overheads.....	7
	3.5 Subcontractors' prolongation costs.....	10
	3.6 Financing costs.....	10
	3.7 Claim preparation costs.....	11
	3.8 Loss of profit claims.....	11
4	Disruption claims.....	12
	4.1 Definition.....	12
	4.2 Establishing an entitlement.....	12
5	Evaluating disruption costs.....	13
	5.1 For events with applicable specified rates for delay costs.....	13
	5.2 For events without applicable specified rates for delay costs.....	13

Handling prolongation and disruption claims

1 Introduction

If claims for delay costs resulting from prolongation or disruption by the Principal are not handled appropriately, there are risks that excessive costs will be incurred or contract disputes will occur.

The purpose of this Procurement Practice Guide is to assist agencies and their representatives to respond appropriately to claims from construction contractors for additional costs for prolongation or disruption.

2 Prolongation claims

2.1 Definition

Prolongation claims are claims for additional time-related costs associated with delays caused by the Principal. A prolongation claim is a claim for 'delay costs'.

2.2 Establishing an entitlement

Contractors sometimes attempt to establish prolongation claims in a variety of ways which are without basis in law or logic (e.g. it took 'x' weeks longer than planned, therefore it is the Principal's fault and the Principal is liable for the extra costs that resulted). Such approaches are not to be accepted. A contractor must show that the cause of the delay is one that entitles the contractor to payment for the extra costs incurred.

To establish an entitlement to prolongation costs, a contractor must demonstrate that:

- a delay to completion of the contract has occurred; and
- the cause of the delay is either:
 - an action or inaction of the Principal (or its agents) which amounts to a breach of contract; or
 - an event for which the contract specifically provides an entitlement for the contractor.

The claim must be supported by evidence of the facts on which it is based.

Evidence of a delay

To warrant the payment of prolongation costs, a delay must affect the critical path and delay completion of the whole of the Works or a Milestone.

The Procurement Practice Guide *Managing extension of time claims* provides guidance for determining whether a delay has occurred, whether the contractor has an entitlement for completion to be extended on account of the delay and what extension of time should be granted. Any delay claim, including prolongation or disruption claims, can be assessed using the principles given in the Procurement Practice Guide *Managing extension of time claims*. Note in particular:

- the principle of concurrent delays, which means that a contractor is not entitled to delay costs when there is a concurrent delay that is within the contractor's control; and
- the 'but for' test, which examines whether the contract work would have been completed earlier 'but for' an event not within the contractor's control.

The cause of the delay

A contractor must show that the cause of the delay is one that provides the contractor with an entitlement to extra payment, either under a term of the contract or for breach of contract by the Principal.

Clause 55 of the **GC21** Contract provides an entitlement to compensation for delays caused by the Principal, including prolongation costs, at specified rates. The preamble to that clause 55 states:

Where prescribed in the Contract, the Contractor may be entitled to payment of delay costs which are caused by a specified delaying event. Otherwise, the Contractor is not entitled to extra payment for delay, disruption or interference of any nature whatsoever caused by the Principal (including for a breach of the Contract by the Principal).

Under a **GC21** Contract (clause 55.1.1), a contractor is entitled to delay costs on account of delays caused by the Principal:

for the number of days by which the time for Completion is extended because of a delay caused by:

- .1 a Variation, other than one for which, under clauses 41.6, 42.4 and 44.3, there is no payment for delays; or*
- .2 a breach of Contract by the Principal ...*

That is, in a **GC21** Contract, the entitlement to be paid delay costs at the specified rate depends on whether there is an entitlement to an extension of time for a breach of contract or a Variation, with the exception that no entitlement exists where a Variation is instructed:

- as a result of Site conditions, but the Contractor did not give the Principal the *Further Site Information* within the time provided in clause 41.5;
- to resolve ambiguities, inconsistencies or discrepancies in the *Contract Documents*, but the contractor did not notify the Principal of the ambiguities etc at least 21 days before the Contractor proposed to use them, as required by clause 42.1; or
- when the Contractor is required to accept full responsibility for design carried out by the Principal before the Date of Contract, but did not notify the Principal of details of any *Fault* in the *Principal's Documents*, as required by clause 44.1.1.

In a **GC21** Contract, an extension of time claim must be valid before an entitlement to compensation for delays caused by the Principal arises under clause 55. The entitlement to delay costs will be determined when assessing the applicable extension of time. The Procurement Practice Guide [Managing extension of time claims](#) provides guidance on determining these entitlements.

Where the contract does not specify a delay costs rate (for example the NSW Government *Procurement System for Construction Minor Works* standard form contract), claims for extensions of time and claims for prolongation costs can be made independently. A delay may be caused by the Principal and a contractor may not claim an extension of time, but this is no basis for refusing payment of the prolongation claim. A breach of contract by the Principal which resulted in a delay to the work could be a valid ground for a prolongation claim.

3 Evaluating prolongation costs

3.1 For contracts with specified rates for delay costs

Where a contract specifies rates for delay costs that are applicable to the events causing the delay, calculating prolongation costs is straightforward once the appropriate extension of time has been determined. The contractor is entitled to be reimbursed at the specified delay costs rate for the period by which the contract time was extended, subject to any exclusions stated in the contract.

In a **GC21** Contract, the Principal specifies a rate per day for delay costs (Contract Information item 51A). Delay costs can be specified either for the whole of the

Works, or for each individual Milestone. This allows the delay costs to be set at rates appropriate to the amount of work in the Milestone, and hence to reflect the likely site establishment and other time related costs incurred by the contractor at the time of a delay.

In a **GC21** Contract, delay costs reimbursed under clause 55 are calculated using the number of calendar days by which the date for Completion has been extended (not the number of “working” days by which the extension of time has been determined).

3.2 For contracts without specified rates for delay costs

Where there is no specified rate for delay costs, as in a NSW Government *Procurement System for Construction Minor Works* standard form contract, calculating a contractor’s entitlements can be complex and time-consuming.

At times, contractors may claim it is difficult to assess the full impact of directions or alleged breaches on the overall contract time and may resist quantifying the delay-cost element at the time of the event. Contractors often prefer to wait until the end of the contract when, they argue, the full cost impact is known. This argument should not be accepted because:

- it is much more difficult to accurately assess the delay-cost element many weeks or months after the event that gave rise to prolongation costs; and
- it is much more difficult to accurately predict the final value of the contract.

Furthermore, by valuing the delay component of each claim when it is first submitted, the opportunity of exaggerating the quantum of such a claim is significantly reduced. In an overall delay costs claim at the end of a contract, there is more scope for including delays for which the contractor is not entitled to make a claim. It is often difficult to separate and identify different causes of overall delay.

Quantification of prolongation costs

To quantify a prolongation claim, a contractor must demonstrate that the delay caused damages (in the case of a breach of contract) or extra cost (in the case of a specific contract provision). The onus is on the contractor to prove that the costs claimed have been incurred and that every effort has been taken by the contractor to minimise these costs.

If a contract does not include a prescribed delay cost rate, then it is necessary to assess what delay costs are legitimate and to evaluate those costs. Determining delay costs is time consuming and expensive, and can often lead to contractual disputes. Whether the Principal is able to accurately evaluate the claims depends on whether the site records are adequate.

Contractors may include a range of items in delay costs claims, for example:

- on-site overheads;
- off-site overheads;
- Subcontractors' delay costs;
- nominated/designated/selected subcontract delay costs;
- financing costs;
- claim preparation costs; and
- loss of profit opportunity.

These elements of prolongation claims are discussed in detail in the following sections.

3.3 On-site overheads

Make-up of on-site overheads

Each construction project entails certain indirect expenses that are charged directly to the job. These costs are sometimes known as ‘Preliminaries’ costs, but are most

often referred to as ‘on-site overhead’ costs. They must be distinguished from the direct costs of construction activities.

On-site overheads cover the cost of the items a contractor must provide during construction, including:

1. salaries of site supervisory staff, including accommodation and travelling expenses;
2. general wages employees employed in providing general services and activities, including:
 - labourers engaged part-time on these activities;
 - chainmen, storemen, cleaners;
 - spare drivers, dogmen, crane operators;
 - maintenance scaffolders and carpenters (who maintain site access, platforms and other safety requirements); and
 - clean-up gangs, attendance labourers.
3. general construction plant, including:
 - cranes, hoists, climbing scaffolds, compressors, generators, site vehicles; and
 - any major temporary works which cannot be readily allocated directly to work items, such as de-watering equipment, ventilation fans, water supply etc;
4. small tools and consumables;
5. site services including power, water, air and telephones;
6. site offices, amenities, workshops and stores;
7. site office expenses including couriers, postage, copying; and
8. insurances and security charges, WorkCover charges, long service levy charges.

The test for inclusion of labour in the ‘general labour’ category is whether or not the employee was present on the site for a longer time due to the delay; or whether the employee is one who is engaged on a specific work activity and whose time on site is governed by the rate of progress of that activity. For example, a carpenter engaged on formwork is not on site for a longer period than anticipated at tender time unless the formwork activity is prolonged. On the other hand, a scaffolder responsible for modifying and adjusting the climbing scaffold as work progresses could be on site for longer if there is any delay at all which affects the critical path. Some of the personnel claimed in the delay costs claim may have carried out productive work for part of the delay period and their full cost may thus not be a legitimate claim.

To establish whether a claim is justified, it may be necessary to sight subcontract agreements defining what services the contractor has agreed to provide to subcontractors.

Similar principles apply to general construction plant. The cost of on-site overhead increases as a result of delays. When these costs are incurred as a result of delays for which a contractor is entitled to reimbursement, the contractor is usually entitled to recover an amount to cover these costs.

On projects where the level of construction activity varies significantly between various stages of construction, the appropriate costs will be those which relate to the period(s) in which delay has occurred. To adopt average daily or weekly on-site overhead rates over the whole contract duration is not necessarily appropriate.

The weekly cost of on-site overheads is related to the total work activity being undertaken on a construction site at any time and not only to work on the critical path. Although a delay to critical work may occur at a period of maximum site activity, the effect may be to prolong only relatively few activities for additional time. The appropriate rate for calculation of site overheads is that related to the sequence of activities which were delayed, together with any consequential effects attributable to the delay.

Some non-critical activities will be delayed by a delay to critical activities on which they were dependent. They may still be non-critical, but they will be undertaken at a later time. This shift in time may not result in additional site overheads overall. It may merely cause the overhead costs to be incurred at a later time.

Actual costs

One method of assessing on-site delay costs is to evaluate the actual costs incurred. If cost information is provided by a contractor to justify a claim, then this must be audited to eliminate all costs that should be included in the direct costs of construction activities.

Generally, there will be very few material costs in on-site overheads. An exception could be time-related items essential for the maintenance of the overhead staff or amenities.

Costs that are not time-related would be deducted. For example, mobilisation and removal costs will be incurred irrespective of contract duration. The exception could be where equipment or staff may be demobilised temporarily at the beginning of a long delay and remobilised at the end of the delay period in order to save the cost of retaining these resources on the site for the duration of the delay period.

The actual cost of staff and labour will generally be provided by wages or salary sheets and the cost of all external plant and services will be substantiated by invoices. These invoices should be inspected to ensure that no operating charges such as repairs or replacement parts, fuel or other incidentals are included. The delay cost is the equipment rental charge only. In some cases, there will be reduced hire rates or even no charge for standby or non-operational periods. Where contractor owned plant is involved, invoices are not likely to be available, so an analysis of the costs claimed will have to be made separately.

Where the Principal has maintained good site records, the checking of the actual times claimed against a contractor's records is the ideal way of establishing costs and the best way of accurately assessing the costs.

A contractor is required to mitigate costs in the event of delay. Excessive expenditure due to poor management or inefficiency, if proven, is not recoverable. Specific instances of obvious waste or mismanagement would need to be identified in the costs or noted from site observations.

Examples of actions that could be taken by contractors to mitigate losses include:

- terminating hire of plant not being used or 'hire out' plant;
- putting off workers who are not productive when this is possible;
- putting on additional workers or subcontractors, with a nett benefit of a reduced delay impact;
- working overtime; and
- re-organising work programs and order of works.

The importance of site records to assist in recognising excessive costs cannot be overstated.

Estimated costs

To minimise the administrative effort required to provide actual cost information in support of on-site overhead costs in a delay claim, a contractor will often provide estimated daily or weekly costs for the staff, plant and facilities involved.

If good site records exist, it is usually possible to check such claims in broad terms and highlight inconsistencies in a contractor's claims. The onus is on the contractor to prove the amount of such claims. An examination by both parties of cost records may become essential.

Evaluating claims for on-site overheads

On-site overheads are broadly related to the direct cost of the work to be undertaken. For projects with a high labour content, the cost of supervision will be greater than for projects with a high plant or material content. Less supervision is required for work where subcontractors are used compared with work requiring unskilled labour or using the contractor's employees. The cost of engineering staff on civil engineering or complex multi-disciplinary projects may be higher than on building contracts.

The following guidance may assist in evaluating claims for on-site overheads:

1. Site Staff Costs

For site staff engaged on supervision, administration or maintenance, names and responsibilities should be supplied for the personnel included in the claim. Where there has been turnover of staff, the dates of commencement and departure from the project should also be provided. The rate being charged for site staff should be the actual incurred cost and it should be checked against actual pay records or reasonable salary rates for that category of employment.

Where vehicles form part of the salary package of senior staff, additional allowance should be included if those costs are not separately identified. Accommodation costs should be separately identified.

Recruitment, training and any other costs which are not time-related should not be included.

2. Labour and plant

Labour should be included at the 'labour costing rate' which includes all payments made to the employee, and all entitlements and statutory charges, but not overheads, profit or contingent allowances. It is not appropriate to use labour 'nett rates'.

The charges for hired constructional plant can readily be checked against the current market hire rates for similar plant. In many cases, a reduced rate will apply for standby conditions when plant is idle. Where a contractor owns plant and charges for hire, particular note should be taken of the use of that plant in determining an appropriate rate for reimbursement. For example:

- on a tunnel contract where the ventilation fans are in continuous use whether the work is delayed or not, the operating rate is the appropriate cost. On the other hand, if a shotcreting machine is on site and only used intermittently, the appropriate charge during a delay period would be the standby cost.
- where the contractor's own earth-moving equipment is idle, the rate charged should be exclusive of the costs of operation or wear and tear.

- beware of using internal ‘sell rates’ for plant for plant which, over the duration of the delay, could buy the plant several times over.

General plant is the most variable on-site overhead cost and may form a high percentage of the total in some cases. The test for inclusion is whether the use of that plant item is time-related or specific to a particular work activity. If specific to a particular activity, it will only form part of a delay claim if that activity was delayed. The cost of site establishment is not claimable as a delay cost unless, because of the duration of the delay, plant and facilities were disestablished and re-established to save costs.

Small tools and consumables generally represent from 2% to 6% of the cost of labour, being greatest for bridge and wharf work and least for building work where workers provide their own hand tools and power tools are generally provided by subcontractors.

3. **Site services including power, water, air and telephone**

The cost of installation and removal of services such as power, water and telephone is not time-related and therefore is not included. On-going costs such as rental of telephones and electricity charges would be eligible for inclusion in delay costs. These are generally not a major cost and should reflect lesser on-site activity due to the delay.

4. **Site offices, amenities, workshops & stores**

Here again, installation and removal costs are not a legitimate delay cost, but weekly rental costs for a site office, being additional time-related costs, would be considered. In assessing such costs care must be taken that only costs which are reasonably incurred due to the delay are justified. For example, while the delay to a critical activity may occur during a peak work period, the effect may be to only prolong relatively few activities and site establishment related to these may be relatively small.

5. **Site office expenses - postage, copying, etc**

Extreme care must be taken, in admitting expenses such as postage or photocopying as delay costs, that they are in fact due to the proven delay. For example, why would additional copying costs be incurred just because of a delay caused by the Principal?

6. **Testing, procurement, inspection and consulting fees**

A contractor must establish, as for site office expenses, that testing, inspection or consulting costs were incurred as a result of the delay and wouldn't have been incurred (over a shorter frame) if the delay had not occurred. A consultant testing service provided on an ‘on-call’ basis that would have been required anyway (irrespective of when), would not be admissible.

7. **Insurance and security costs**

The fees associated with maintaining insurance and security (unconditional undertakings) for a longer period are a legitimate cost.

3.4 Off-site overheads

Make-up of off-site overheads

Within the administrative structure of many contracting organisations, there is not a clearly defined separation between ‘on-site overheads’ and ‘off-site overheads’.

Costs claimed as off-site overheads may in reality be contract-related services which are performed away from the site.

The test of whether a particular cost or service should be classified as an on-site or off-site overhead is simple. If the service or cost would have been incurred in the operation or maintenance of the contractor's organisation irrespective of any specific contract the contractor may have been awarded, then it is an off-site overhead. If, on the other hand, the service was required to be performed as part of the work done by the contractor under a specific contract, then it is an on-site overhead and should be included in the total cost of the execution of that contract.

For example, contract managers, estimators, marketing personnel, safety and industrial officers are normally off-site overheads, although their time may occasionally be charged to a particular project for specific services. It is common to include these personnel because of the additional time required in claims preparation and assessment.

Off-site overhead expenses include the general administrative and indirect costs of a contractor not attributable to a particular contract. The following types of cost may be considered in the category of off-site overheads:

- Executive and clerical salaries;
- Office occupancy costs (rent, mortgage, services etc.);
- Advertising, marketing, general administrative;
- Professional fees, books and periodicals;
- Off-site vehicle expenses, office supplies, taxes; and
- Other business operating expenses.

In the case of engineering contractors, the off-site overhead may also include other activities associated with construction work, but not attributable to any single contract. Costs in this category may include:

- design office overheads, testing facilities;
- plant workshops, yards, storage areas; and
- general maintenance and depreciation of plant.

All these categories of costs are usually identified in a contractor's accounts as overheads, and may be funded by the income-producing elements of the organisation, namely, the contracts. Care must be taken to ensure that only overheads relating to the construction operations are taken into account.

Evaluating off-site overheads

It is often asserted that when a contractor has several contracts in progress simultaneously, each contract contributes a proportionate amount to this total off-site overhead based on the individual contract amounts and the durations of each contract. This is rarely, if ever, true. One contract may contribute much more than another contract and some contracts may contribute nothing and may cause a loss to a contractor.

When one contract is suspended or extended due to a delay, the overall off-site overhead continues to be incurred. It is usually not increased or decreased as a consequence of the delay. It is often argued that the contribution towards the overheads anticipated to be earned from that particular contract is reduced. This is easily demonstrated to be untrue. Notwithstanding that the contract is delayed, the amount of money earned by the contract is ultimately the same (or even greater) and hence the contribution towards the total off-site overhead cost will not be less. The result is that there is no loss of recovery of off-site overhead which can be attributed directly to the delay.

Exactly the same false logic is often used by contractors to claim alleged loss of profits. Provided a contractor recovers the direct cost of the delay, the profit earned from a contract will not be diminished by the delay.

If the delay occurs as a result of additional work for which payment is made (e.g. variations) then part of these payments will usually include a proportion for off-site overheads. Care must be taken in evaluation to ensure 'double counting' does not occur.

There are two formulas commonly put forward by contractors for the purpose of calculating the alleged loss of off-site overheads due to delay: the **Hudson** formula which is widely used in most Commonwealth countries and the **Eichleay** formula which is commonly used in the United States. Both formulas are similar in application, although neither formula has any basis in Australian law or logic. These formulas must not be used as a basis for calculating loss.

The accurate assessment of head office overheads on any particular contract claim is very difficult. It is highly dependent on the structure of the particular organisation, the corporate overhead of the organisation, the degree of authority given by senior management to the on-site personnel, the nature of the delay and the nature of the direct cost of the delay.

If there are direct costs, including payment of workers, extended hire of plant and increased insurance, there will usually be some additional off-site overheads. These may include additional computer time for the processing of payment claims, extra hours for head office clerical staff, an extended period of bank overdraft and even costs for extra site visits by the Managing Director. The salary of the Managing Director will not be affected by the delay, but transport costs to pay extra site visits could be an extra cost.

The difficulty of exactly measuring the extra costs which are part of off-site overheads was the reason for including prescribed delay costs in **GC21** contracts and Clause 42 in **AS2124**. The AS2124 clause provides that 'the valuation shall include a reasonable amount for overheads' and does not distinguish between off-site and on-site overheads. Calculation of a reasonable amount is less difficult than calculation of the exact amount.

It is in the area of off-site overheads that there is a real distinction between **damages claims** and **Clause 40.2 claims** under **AS2124**. In respect of Clause 40.2 claims, a contractor does not have to prove actual overheads, but only what is a reasonable amount for overheads.

Under a **damages claim**, a contractor must prove actual costs incurred for overheads. Also, in respect of damages claims only, a contractor may be able to recover extra by way of common law damages if the contractor can prove that, if the delay had not occurred, the contractor would not have suffered some loss that is not included in direct cost.

There are difficulties in establishing such a claim, including principles of mitigation and foreseeability. The contractor most likely to succeed is the very small contractor who, because of the delay, is prevented from undertaking other works and hence incurs a loss of income. Larger contractors will usually be able to recruit other staff or subcontractors to perform the other works and will, therefore, not be prevented from undertaking the other work.

The Department of Commerce's experience is that after ensuring that all quantifiable overhead costs which are related to 'on-site' activities have been taken into account, additional head office overheads (off-site overheads) of some 3% are usually reasonable, e.g. for a \$1,000,000 contract over 50 weeks, a head office overhead rate of \$600 per week would apply.

3.5 Subcontractors' prolongation costs

Subcontractors may well have an entitlement to delay costs from a contractor. In turn the contractor may consider that such delays were caused by the Principal and 'pass-on' these claims to the Principal.

Subcontractors' delay claims may include delay costs due to actions of the contractor and the Principal. The Principal must ensure that these claims are separated and must insist that the contractor's claim does so. Contractors are often reluctant to provide such a 'break-up' and endeavour to recoup all of a subcontractor's delay costs from the Principal.

It often happens that in the subcontract there is no specified program and the subcontractor has agreed to carry out the subcontract work in accordance with the requirements of the progress of work under the head contract. In that event it may be extremely difficult to prove that a particular act caused delay, since there would be nothing by which to measure delay.

To evaluate such claims, it is necessary to:

- have the contractor establish the justification and amount of any claim in the same manner that would be required for the contractor's own claims;
- have a copy of the subcontracts between the contractor and the subcontractors, to check what claims are justified; and
- have the contractor certify that the subcontractor has been paid the entitlement due or give a direction for the Principal to pay the subcontractor. Note that there is nothing the Principal can do if the contractor falsely certifies that a subcontractor has been paid.

Subcontractor site overhead costs are generally less than those of a head contractor, which is generally responsible for most site services and facilities.

Damages claims from subcontractors are likely when the delayed subcontract was a substantial part of the subcontractor's earnings for that time period and the subcontractor was prevented by the delay from undertaking other profitable work during the delay.

As for any claim, a contractor has to establish that reasonable steps have been taken to mitigate losses. Subcontractor claims can often be avoided by the subcontractor undertaking other works. This is the nature of the operations of many subcontractors in that they have many clients at the one time and proper planning by them can both significantly mitigate losses and maintain their projected turnover to recoup what small head office overheads they may have.

Whether a subcontractor is nominated, designated or selected by the Principal does not change the fact that there is a contractual arrangement direct between the contractor and the subcontractor. The same principles apply as for any subcontract claim.

3.6 Financing costs

This is an area where claims have little or no justification. Sometimes, however, a contractor can genuinely incur an extra cost for financing charges.

An example demonstrates where financing charges could be payable. Assume that in the first week in April a Contractor is delayed for one week and incurs a cost of \$1,000 for labour which is idle. This is a direct extra cost which would not have been incurred, but for the delay. The \$1,000 is paid by the contractor by, say, 7th April. If it is claimed in the payment claim on 30th April (assuming that the Principal is liable to pay the extra costs as a result of the delay) the Principal will pay the contractor not later than 28th May. The contractor will have been out of pocket by \$1,000 for just over 7 weeks and may have paid interest at overdraft rates

on \$1,000 for those 7 weeks. This is a direct cost resulting from the delay. If the Principal does not pay the \$1,000 on 28th May, then interest start to accrue on late payments. Overdraft interest is no longer applicable after 28th May because of the interest accruing under the late payments provision of the contract. On 30th April, the contractor could only claim overdraft interest from 8th April. On 31st May, in the next progress claim, the contractor could claim overdraft interest from 30th April to the date of payment of the \$1,000 or 28th May, whichever is the later.

If the contractor does not include the \$1,000 claim in the next progress claim (30th April), the contractor cannot recover financing charges (overdraft interest) after the date when the \$1,000 would have been payable had it been claimed on time.

Note that some prolongation costs (for example payments to subcontractors) may not have been paid out by the head contractor at the date of a payment claim, and hence overdraft interest could not be properly included in the claim.

If financing charges are claimed, the contractor should be required to provide proof of the dates upon which amounts were allegedly paid out. Bank statements with payments identified may assist. Proof of payment of interest by the contractor should also be requested. The account may be in overdraft and it may only be necessary to have proof of the overdraft rate. Interest from the date when the money was paid out until the next date thereafter for a payment claim is then calculated.

3.7 Claim preparation costs

The cost of preparation of a prolongation claim is not payable as a separate head of damage. The cost is part of overheads. A contractor is not entitled to additional payment because the contractor chooses to make a separate claim or to use a claims consultant.

Just as a contractor is not entitled to extra for preparing claims, the Principal is not entitled to recover from the contractor the additional cost of reviewing claims, even if they are totally without substance.

3.8 Loss of profit claims

In respect of claims arising from breach of contract, profit is never payable. The law permits an award of the actual loss arising from a breach of contract, but not profit on the loss. Loss of profit may be recoverable in rare instances, as part of a claim for loss of income. The loss of income is income, not from the contract breached by the Principal, but from other sources. The breach by the Principal must be shown to have prevented the contractor from earning income which the contractor would have earned if the breach had not occurred.

For example, a small plumbing contractor may only have the resources to take on one contract at a time. If the contractor has contracts lined up, one after the other, so that there is no time in between, it may be that one week's delay by the Principal on one contract will mean a permanent loss of income equivalent to one week's income of the contractor.

Provided that the contractor has mitigated the loss, by utilising the manpower and resources as much as is reasonably possible during the delay, by putting off staff where reasonable, terminating hire where possible, etc., there may be a permanent loss in income which is recoverable from the Principal as damages. It is irrelevant whether the income lost is profit or overheads or categorised in any other way. It only has to be shown to be income lost.

In such instances, the real cause of the loss of income is that the contractor is tied up by the delay. The delay prevents the contractor from earning income. If, however, the Principal pays for the contractor's resources during the delay period, the lost income is reimbursed through those payments and there is no basis for a claim.

A contractor's income will vary from time to time and although the delay on one contract may reduce the income from that contract in one financial year, the income

from that contract will be received in the next financial year, and there is no permanent loss of income.

Various devices have been invented to show that if a contractor is delayed on a contract, there is a loss of profit and overheads which, if the delay had not occurred, would have been earned from other contracts. The **Hudson** and **Eichleay** formulas are two such devices. These formulas and other similar formulas have never been accepted in Australian courts as methods of proving damages and should not be used to assess claims.

4 Disruption claims

4.1 Definition

A disruption claim is a claim for alleged disruption or loss of productivity resulting from the acts or omissions of the Principal or the Principal's agents. Disruption claims are sometimes included with delay claims but are fundamentally different. Disruption may not result in delay. Contractors claim that they could not achieve their planned output because of the Principal's actions and hence that the damages or extra costs are payable.

Disruption (loss of productivity) results in a delay to the work being carried out and not necessarily to completion of the Works. The work produced is not changed, it simply takes longer to complete.

4.2 Establishing an entitlement

To justify a disruption claim, a contractor must establish that:

- actual progress of the work has been interrupted; **and**
- the cause of the disruption was either a breach of contract by the Principal or an action for which the contract provides for the reimbursement of extra cost.

A contractor may claim disruption costs independently of an extension of time claim, where the contract makes provision for this.

Evidence of a delay

To warrant the payment of disruption costs, a contractor must identify the particular work activities that were affected by the disruption or loss of productivity and demonstrate that the disruption caused the contractor to incur additional costs.

The fact that there are many variations, no matter how many, does not give rise to an entitlement to a claim for loss of productivity.

For a disruption claim to be valid, a contractor must demonstrate disruption to *actual* progress, not *planned* progress as is often claimed. A 'work-as-executed' program can be the starting point for any demonstration of reduced productivity.

The cause of the delay

There are many factors that can lead to a loss of productivity but provide no basis whatsoever for claims. Examples of this would be union activity, low morale, working to rule and introduced work practices. Such factors are usually not related to acts or omissions of the Principal.

A disruption claim must identify specific events that are breaches of contract by the Principal or events for which the contract specifically provides for extra costs.

Even if the Principal does cause disruption, this may not result in an entitlement to additional payment. It may be that the contractor failed to comply with certain contractual requirements and is therefore not entitled to reimbursement of the disruption costs. For example the contractor may have failed to give reasonable notice of information required.

An example of where a loss of productivity claim could be justified would be where the Principal ordered a contractor to cease work on a particular activity for frequent

short periods (for example to provide for some necessary operating function of a plant or building) and the need for such stoppages was not specified in the tender documents. Another example would be where the Principal ordered urgent variations and groups of workers had to continually move from one activity to another at short notice, being unable to develop optimum productivity on a particular work activity.

5 Evaluating disruption costs

5.1 For events with applicable specified rates for delay costs

A GC21 Contract includes specified delay costs rates that are clearly stated to include disruption, when that disruption amounts to a delay caused by the Principal (clause 55). The calculation of disruption costs flows from the extensions of time granted on account of delays caused by the disruption. The contractor is entitled to be paid at the daily delay costs rate for the number of days by which the contract period was extended, unless the cause of the extension of time is one that is excluded under clause 55.1.1.

5.2 For events without applicable specified rates for delay costs

Where a contract does not prescribe a method for evaluating disruption costs, a contractor might make an ambit claim for the difference between the amount allegedly allowed in the tender and the actual cost of the work performed. Such an approach falsely assumes that the amount allowed for the work at the time of tender was totally correct and there were no inefficiencies in the contractor's management of the construction operations.

A contractor must quantify the disruption costs once it has established that loss of productivity has occurred and caused a delay. This involves comparing the actual cost with what the cost would have been were it not for the disruption. The contractor must demonstrate that the latter hypothetical cost is reasonable.

In making such claims, a contractor must also establish that everything reasonable has been done to minimise the cost of the disruption, for example that hired machines were not left idle on the site when the hire could have been terminated.