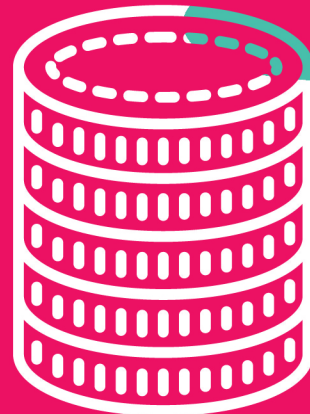




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OMISSIONS AND LOSS OF PROFIT

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The Situation

I'm working on an unamended JCT 2016 Building Contract with a £3m lump sum Contract Sum. The Employer is looking to amend an element of the works and has issued an instruction to omit a relatively large portion (approximately 10% in financial terms) of our scope of works.

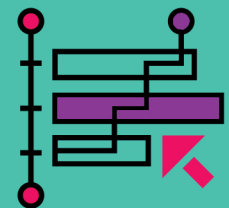
These works are now to be varied and completed by Another company. The works are valued at approximately £300,000 including circa £30,000 of profit, my question is:

1. Can the Employer simply omit this element of the works and then place an order with Another contractor or can I reject the instruction?
2. Am I entitled to claim for the Loss of Profit of approximately £30,000 in the Employer omitting this?
3. If I can claim for Loss of Profit, what do I have to reasonably provide to recover the monies?
4. When can I claim loss of profit for omissions to contract works?
5. Does the amount of variations affect if I can claim for loss of overhead and profit?

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Response 1:

Can the Employer simply omit this element of the works and then place an order with Another contractor or can I reject the instruction?



On the basis of the scenario as set out then firstly, the Employer, acting through the CA/Architect can order the omission of work for which an appropriate adjustment of the Contract Sum to reflect the reduced work scope will need to be made.

However, the Employer cannot simply omit the works and ask another company to carry out the omitted work because say it is commercially advantageous to it – this would be a breach of contract. An omission means that the work will not be done at all, not that it will be done by someone else.

You say that 'these works are now to be varied and completed by Another company'. The general position outlined above will apply only where the work to be awarded to the alternative contractor is the same, or substantially the same as the omitted work. For example:

- ✓ the omission of new external drainage works, which is then to be carried out by the alternative, presumably cheaper contractor would be a breach of contract – same work being given to Another. Whereas,
- ✓ the grubbing up of existing drainage and replacement with new drains, being substituted with 'reline of existing drains with specialist proprietary sleeves ref. XYZ' would be a legitimate variation omission as the substituted work is different from the original. Equally this substitution could be instructed under the contract with the original contractor.

The grounds for refusing to accept an instruction under the JCT 2016 Contract are limited and relate to access or use of the site, working space, working hours and the sequence of execution.

So, put simply, if the employer intends to issue an instruction to omit works there will be little, contractually, that the contractor can do to stop them from issuing the instruction.

If the motive for the omission is to pass the work to Another contractor in the circumstances outlined then it is unlikely that the relationships will be such that the original contractor is able to dissuade the employer from this course of action; however, as I outline below – you will be able to recover the lost profit.

2 Response 2:

Am I entitled to claim for the Loss of Profit of approximately £30,000 in the Employer omitting this?



Where there has been a breach of contract, then the injured party is entitled to be put back in the same position as it would have been before the breach occurred. If the breach has caused the original contractor to make less profit than it otherwise would have done, then it would be entitled to make a recovery.

But, and it is a big but, the recovery for this class of breach is not one to which the contractual remedies apply.

Let me explain: the JCT contract is a lump sum contract with the facility to make reparations for changes which would otherwise be considered to be breaches of contract – e.g. a delay caused by the Employer is a breach of contract but there is a remedy within the contract itself which repairs the breach (i.e. an extension of time).

There is a provision for variations for both additions and omissions with appropriate adjustments to the Contract Sum. There is no mechanism to enable the Employer to omit the contract work scope and ask another company to carry it out – for this type of breach the remedy would be legal or quasi-legal under the dispute resolution provisions whereby you will be able to recover the lost profit.

3 Response 3:

If I can claim for Loss of Profit, what do I have to reasonably provide to recover the monies?



To successfully demonstrate you're entitled to recover loss of profit, a contractor would need to demonstrate that it had had a reasonable expectation of actually making the profit in the first place.

Depending on the structure of the Contract Sum, it may be sufficient to rely on declared mark-ups (for example in the dayworks section of the contract); otherwise a full substantiation would be required. This might entail you disclosing the detailed build up to the tender, distribution of profit through the Contract Sum Analysis or pricing document, internal financial reports and board minutes as well as published financial results.

The responsibility for demonstrating that the profit could have been earned and that the opportunity to earn it has been lost will rest with the contractor and it will need to do everything that it reasonably can to substantiate its claim.

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Response 4:

When can I claim loss of profit for omissions to contract works?



My advice would be to begin to register the entitlement with the Employer as soon as it becomes known that it is the intention to have the omitted work carried out by the alternative contractor and then to claim the loss of profit in the next application for payment after the omission instruction has been issued and to keep updating the value in subsequent applications.

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Response 5:

Does the amount of variations affect if I can claim for loss of overhead and profit? For example, if the £300k is omitted above and I lose £30k of profit but my other variations on the project total £300k, could the Employer argue that I've not lost any profit because I've made it elsewhere?



In short, yes. Where the value of profit lost through omissions is balanced by a gain through additions & substitutions, then a loss of profit argument will not be sustainable.

A contractor should be able to determine the amount of profit and contribution to overhead it expects to earn from a given project and how this fits into its business plan for the financial year(s) in which the particular project is 'live'.

Where a project is significantly delayed then this may mean that the overhead and profit allowances in a particular project are collected over a longer period leading to shortfalls in the financial year – this is how management accounting works. In this case overheads may be recovered as a head of loss & expense where entitlement can be demonstrated.

J P Farnell

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