RECOVERY OF HEAD OFFICE OVERHEADS DUE TO PROLONGATION OF TIME

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A project report submitted in partial fulfilment of the requirements for the award of the degree of Master of Science (Construction Contract Management)

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Specially dedicated to my beloved parents, my wife Aida and all my children...
Thank you for all the infinite prays, support, understanding and encouragement.
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In the name of Allah, the Most Gracious, the Most Merciful. My praise goes to Allah s.w.t who gave me a chance and ability to complete this project report.

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ABSTRACT

It is a contractor’s obligations to execute the works in accordance with the contract and entitled to be paid for works done including all variations instructed by the employer. The entitlement to claim for other additional payment caused by the employer is generally covered under ‘direct loss and/or expense’ claim. The heads of claim to be included under this claim are on-site overheads, loss of productivity, interest and finance charges, etc. The other heads that the contractor usually includes is head office overheads. The objectives of the research are firstly, to determine the requirements to be provided when claiming for head office overheads, and secondly, to determine the most preferable method to be applied when calculating the head office overheads. The approach adopted in this research is by way of case laws analysis collected from countries specifically Malaysia and the United Kingdom. The research shows that the main requirements that the contractor needs to provide when claiming for head office overheads are: to show that because of the resources being locked on the current delayed project, they are unable to tender; to show that a drop in company’s turnover due to the prolongation of time; and to show that ‘an act of prevention’ by the employer has resulted in a delay. The research also shows that there are three common methods when ascertaining the head office overheads namely the Tender Allowance Method, the Formulae Method and the Actual Cost Method. The research suggests that the most preferable method to adopt when calculating the head office overheads due to prolongation of time is using the Actual Cost Method based on actual cost incurred on affected delay period. The other methods are not preferred because they are solely based on approximation or projection i.e. Formula Method and Tender Allowance Method respectively.
ABSTRAK

Adalah menjadi tanggungjawab pihak kontraktor untuk menjalankan kerja-kerja seperti yang terkandung didalam kontrak dan mendapat bayaran bagi kerja-kerja yang telah disiapkan termasuklah bayaran bagi kerja-kerja perubahan seperti yang diarahkan oleh majikan. Selain daripada kelayakan ini, kontraktor juga layak untuk membuat tuntutan bagi segala bayaran tambahan yang disebabkan oleh lanjutan masa oleh pihak majikan. Ini dipanggil sebagai tuntutan 'loss and expense'. Perkara-perkara yang biasanya termasuk dibawah tuntutan ini ialah seperti kos perbelanjaan tapak, kehilangan produktiviti, caj faedah dan lain-lain. Antara lain yang dituntut ialah termasuk perbelanjaan ibu pejabat. Tujuan penyelidikan ini ialah untuk memberi pemahaman yang jelas kepada pihak kontraktor tentang keperluan dan bukti yang perlu dipenuhi apabila membuat sebarang tuntutan; dan juga menentukan apakah kaedah yang paling sesuai bagi mengira kos perbelanjaan ibu pejabat ini. Pendekatan yang diguna pakai didalam kajian ini ialah melalui analisa kes berdasarkan kepada kes-kes yang diambil daripada negara seperti Malaysia dan United Kingdom. Kajian ini mendapati pihak kontraktor perlu membuktikan bahawa mereka tidak dapat menender untuk projek lain disebabkan oleh sumber-sumbernya terikat dengan projek yang telah lewat; perlu membuktikan bahawa perolehan syarikat telah berkurangan akibat daripada lanjutan masa; dan perlu membuktikan terdapatnya 'act of prevention' oleh pihak majikan. Kajian ini juga menunjukkan bahawa kaedah yang sesuai bagi mengira perbelanjaan ibu pejabat ialah Actual Cost Method iaitu berdasarkan kepada kos sebenar yang terlibat. Kaedah-kaedah lain seperti Formula Method dan Tender Allowance Method adalah kaedah yang kurang sesuai digunakan kerana ianya berupa anggaran atau jangkaan sahaja.
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CHAPTER 1

INTRODUCTION

1.1 Background of Research

Contractor’s obligations accrued on the date that the acceptance of the tender.¹ This is achieved once the letter of acceptance is issued to the contractor.² As soon as consensus ad idem is reached, then the contractor has to commence the works in accordance to the provision of contract.³ The fundamental obligation of the contractor is to undertake and complete the works specified under the contract.⁴

Generally, the contractor is obliged to take over possession of site from the employer, start with his scheduling work, mobilise his resources, commence with the relevant submissions to the authorities and utility providers, obtain the necessary

² Ibid. Note 1
³ Ibid. Note 1
⁴ Ibid. Note 1, p.243
permits and approvals, procure the labour and materials, make the relevant submissions to the contract administrator and commence operations at site.\(^5\)

Progressively, the contractor is entitled to be paid for works done including any appropriate variations ordered by the employer as stated in the contract.\(^6\) It is the employer’s obligation to pay the contractor based on the contract administrator’s certification.\(^7\) Other than this entitlement, the contractor may also be able to make other claims against the employer under the contract.\(^8\) One of the most common claims made by the contractor is for additional payment because of delays.\(^9\)

Usually, the contractor is required to complete the works ‘on or before’ the completion date stated in the contract.\(^10\) However, some works are delayed due to some natural events or due to some act of prevention by the employer or its authorized agents.\(^11\) At the same time, some delays are also caused by the contractor or his workmen themselves.\(^12\) Any prolongation of time under the contract may lead


\(^8\) Ibid. Note1, p.243


2. Trollope & Colls Lid v North West Metropolitan Regional Hospital Board [1973] 9 BLR 60


the contractor to incur administrative costs, such as the contribution of head office personnel to involve in the delayed project.¹³

Most standard forms of construction contracts contain provisions that entitled the contractor to claim from the employer for any direct loss and expense due to prolongation of time caused by certain events. The major standard forms of contract used in Malaysia such as Public Works Department (P.W.D) Form 203A (Rev. 1/2010) and Pertubuhan Akitek Malaysia (PAM) Contract 2006 also contain such provision as specified in Clause 44¹⁴ and Clause 24¹⁵ respectively.

Notwithstanding the unclear requirement in the standard forms of contract of what consist of direct loss and expense claims, there are common head of claims that usually submitted by the contractor when claiming for additional payment.¹⁶ These may include the on-site overheads such as site staff salary, site expenses, site offices, transport, plant and equipment, maintenance, etc.¹⁷ The other areas that may be included in the claim are loss of profits, interest and financing charges, loss of productivity, inflationary cost increase of materials and labour, and cost of preparing the claim.¹⁹

¹⁴ Clause 44 [Claims For Loss And Expense] of P.W.D 203A Form (Rev. 1/2010)
². Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board [1973] 9 BLR 60
¹⁷ Ibid. Note 16
¹⁹ Ibid. Note 16
One of the most common head of claims that often claimed by the contractor is the recovery of head office overheads.\(^{20}\) The essence of this claim is that, in principle, income from any project contributes not only to the costs of running the project itself, but also to the costs of running the head offices.\(^{21}\) Having resources such as staffs locked into the project during the prolongation of time, the contractor has lost the opportunity of using those resources on other projects where they would have earned a contribution to the cost of running the head offices.\(^{22}\)

As such, when recovering for head office overheads, the contractor may claim based on additional overheads which are actually expended as a result of time prolongation, or claiming as lost opportunity for unabsorbed overheads\(^{23}\) where the contractor has lost the contribution of head office overheads because of the delayed projects.\(^{24}\)

### 1.2 Problem Statement

Despite any delays and prolongation of time, the contractor has to maintain its head offices in order to support the ongoing projects and this is obviously expensive

\(^{21}\) Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board [1973] 9 BLR 60
\(^{22}\) Percy Bilton v Greater London Council [1982] 20 BLR 1
\(^{24}\) MBAM, “Construction Contract & Management Issues”. (Master Builder, 4\(^{th}\) Quarter 2010), p.61
Generally, the contractor’s business depends solely on the projects for its turnover and profit which in turn pay the head office overheads. Therefore, if the project completion date is prolonged, it will incur additional costs and resulting in a reduced contribution to the head office overheads.

Because of this situation, most contractors seek compensation of the reduced contribution under a so-called ‘direct loss and/or expense’ claim. This type of claim is usually allowable in most standard forms of contract internationally as well as in Malaysia i.e. P.W.D 203A Form (Rev.1/2010) and PAM Contract 2006. However, the clauses in these forms of contract only refer to ‘direct loss and/or expense’ and do not specify what includes in the provision.

However, a difficulty may arise when recovering the head office overheads as one of the head of claim covered under the provision of direct and/or loss expense clause. As such, the claim for these expenses is not easy to justify and substantiate. Some evidences or requirements may need to be provided by the contractor before this claim can be successfully recovered. Furthermore, the method to be applied when calculating or recovering the head office overheads is also crucial for the contractor to establish.

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27 Ibid. Note 26
1.3 Previous Research

A previous research on the heads of claim that may be recovered under the direct loss and expense claim was conducted.\textsuperscript{31} The research suggested that the head office overheads, the on-site overheads and financing charges are recoverable. However, loss of profit, loss of productivity and cost of preparing a claim are not recoverable.

1.4 Research Objective

The objectives of this research are listed hereunder:

1. To determine the requirements to be provided by the contractor before claiming for head office overheads due to prolongation of time; and

2. To determine the most preferable method when calculating the head office overheads.

1.5 Scope of Research

The approach adopted in this research is based on literature review from books, articles, journals and relevant case laws analysis. The research covers the following:

1. The relevant case laws under the English common law jurisdiction specifically Malaysia and the United Kingdom are referred to.
2. The relevant case laws up to year 2012 are referred to.
3. This research is based on the following standard forms of contract:
   a. Public Works Department (P.W.D) Form 203A (Rev. 1/2010); and

1.6 Significance of the Research

Most contractors usually take things for granted when submitting a claim for head office overheads under a direct loss and expense claim to the employer. The ‘no-harm-trying’ mind set as to include every single thing in the claim is not beneficial when assessing for the entitlement. It would be more fruitful if the contractor can submit a comprehensive claim which can be accepted by the employer or the court in case the claim is disputed. To successfully recover the claim, certain requirements are required to be provided by the contractor, and method to be applied when calculating the additional head office overheads due to prolongation of time is also crucial to be established.
Having in-depth understanding on how the additional head office overheads may be successfully recovered using proper substantiation, the contractor at the first place would be ready to gather necessary records and relevant information to facilitate in proving that they have indeed lost the opportunity to work for other projects that may contribute to the head office overheads, as well as incurred additional head office overheads due to prolongation of time occurs on current project caused by employer’s fault.

1.7 Research Methodology

The methodology of this research is by way of case laws analysis and comprehensive literature review. The relevant case laws pertaining to recovery of head office overheads form an important source of the primary data which was searched and obtained through the access of *Lexis Nexis* online database.

Secondary data were obtained through comprehensive reading from text books, journals, newsletters, articles, conference papers, newspaper articles and internet articles regarding head office overheads, delay, extension of time and loss and expense claim.

All primary and secondary data were analysed accordingly. Documentary analysis was made on these data as to provide an answer for the objective of this research. All relevant information and findings were written and summarized. The flow chart of the research methodology is shown in Figure 1.1.
Figure 1.1: Research Methodology Flow Chart

**STAGE 1**
- Research proposal and initial study.
- Literature review and discussion with research supervisor.
- Identify the research issue, objective and scope.

**STAGE 2**
- Development of theoretical framework.

**STAGE 3**
- Data collection and reading of law journals, standard forms of contract, books, articles, journals, website.
- Data recording.

**STAGE 4**
- Data analysis.
- Data observatory and interpretation.
- Data arrangement.

**STAGE 5**
- Writing up a report.
- Summary formation, conclusions and recommendations.
1.8 Organisation of the Chapters

This research covers six (6) chapters as follow:

2. Chapter 2: Delays and Extension of Time.
3. Chapter 3: Loss and Expense.
4. Chapter 4: Head Office Overheads Claim.
5. Chapter 5: Methods of Calculating the Head Office Overheads.
6. Chapter 6: Conclusion and Recommendation.

1.8.1 Chapter 1: Introduction

This chapter introduces the focus area of the research. It does contain the background of the research and the problem statement. The objective, scope and significance of the research are also discussed in this chapter. This chapter also covers the research methodology and the organisation of the chapters.

1.8.2 Chapter 2: Delays and Extension of Time

This chapter explains the terms of delays, extension of time and prolongation of time. It also examines the clauses as provided in P.W.D 203A (Rev. 1/2010) and
PAM 2006 forms of contract particularly to the event that allows the extension of time to be granted. It also reviews the definition and relationship between delays and extension of time, the effect for late completion and the general principle of damages. The relevant case laws relating to these matters are also examined and explained.

1.8.3 Chapter 3: Loss and Expense

This chapter examines the clauses provided in P.W.D 203A (Rev. 1/2010) and PAM 2006 forms of contract particularly to the loss and/or expense provision. The review on what relevant events that such claim may be allowed under the contract is also included in this chapter. The differences between direct and indirect loss is also examined. This chapter also examines the common head of claims that the contractor usually included in the submission to the employer. The relevant case laws relating to these matters are examined and explained.

1.8.4 Chapter 4: Head Office Overheads Claim

The definition of overheads is explained in this chapter. The relationship between overheads and turnover is also discussed. It also reviews the different between on-site overheads and head office overheads, and what items contain in those overheads category. The items included in the head office overhead claim are
also discussed in this chapter. It examines the requirements to be fulfilled by the contractor when submitting the claims.

1.8.5 Chapter 5: Methods of Calculating the Head Office Overheads

This chapter discusses the common method of recovery the head office overheads and review each method in detail. The pertinent case laws are also reviewed and analysed. The most preferable method is determined.

1.8.6 Chapter 6: Conclusion and Recommendation

This chapter consolidating the summary and findings infers conclusions from this research. It also contains the problems encountered during the research as well as the recommendations and suggestions for future research.
LIST OF REFERENCES AND BIBLIOGRAPHY


