
Fundamentals of Construction Contract & Contractual Risks

belden

Risks Associated with Variations (Build-Only Projects)



Build-Only Projects

- **Lump Sum**
- **Re-measured (Based on BQ)**

Variation

Original
Scope of
Work

Variation

- “Extras” or “Changes” or “Alterations” from original scope
- Can be additions or omissions
- Not expressly or impliedly included in the work
- Indispensably necessary works (lump sum)
 - not variation

Variation

- **Alterations to:-**
 - **Scope of work arising from design changes**
 - **Quantity changes?**
 - **Quality changes?**
 - **Sequence of Work/ working method?**

Identifying the Scope of Work

- Ought to be done as early as possible to prevent ambiguities/discrepancies to minimize risk of arguments on scope of work which may lead to potential disputed variations
- How early is early? – at the pre-tender stage (pre-tender clarifications)

Identifying the Scope of Work

- How to identify and clarify? – usually by comparing tender drawings & specifications followed by seeking of clarification

Avoiding Ambiguities/Discrepancies

- **Contract usually deems it to be checked. Failure to check is not an excuse**
- **What needs to be done?**
 - **Check (drawings, specs, BQ)**
 - **Early notification/clarification.**

Avoiding Ambiguities/Discrepancies

- Early notification will result in clarification on the scope of work and clear discrepancies/ambiguities
- Reduce risk of variation dispute

Avoiding Ambiguities/Discrepancies

- Are there any discrepancies between the tender drawings and specifications?
- Are there any ambiguities?
- Are there lacking information?

Avoiding Ambiguities/Discrepancies

- If the answer is yes, seek clarification at pre-tender stage
- Answers to the clarification would remove doubt, affect pricing and costing for the Project

Avoiding Ambiguities/Discrepancies

- It is important to document the clarifications (pre-tender clarifications, minutes of meetings etc) to form part of tender and contract documents

Rise of Variation Disputes

- Chances of a potential variation dispute increases when clarification on discrepancies/ambiguities are not sought before contract entered

Rise of Variation Disputes

- Why?
 - When there are discrepancies between the tender drawings and specifications
 - When the scope of work identified in the tender drawings and specifications clashes with the construction drawings

Rise of Variation Disputes

- If ambiguities/clarification are discovered and sought after the commencement of the works – potentially lead to a variation dispute
- How? Can be done by issuance of RFIs

Rise of Variation Disputes

- RFI's may return with:-
 - Instructions
 - Sketches
 - Revisions/amendments
- If they are clarification/amplification of existing scope of work – no variation
- If they are different from contractor's understanding/ alter the scope of work – potentially constructive variation

Temporary Work/ Method of Works

- What about temporary work/work method?
 - Usually under prerogative of the contractor
 - However there may be issues which will give rise to variation disputes

Temporary Work/ Method of Works

- Contractor's build-ability responsibility (approved or otherwise)
- Contractor has full control – unless sure to fail
- Min std : sound principles/current practices in industry
 - safety, technology, environmental

Temporary Work/ Method of Works

- Otherwise Owner's interference or Owner dictating post-contract = variation?
- Owner's assistance not on a without prejudice basis = variation?

Potential dispute on variation - How do they arise?

- Shop drawings approved with comments – requires contractor to change method of work
- Shop drawings not approved – forcing contractor to adopt method of work demanded
- Other interference with the temporary work/work method with the effect of changing the scope and method of work

Instructed Variation

- Instructed by Owner or S.O?
- What are the contractual requirements?
- If Owner instructed?
 - Is the instruction documented? Written instruction
 - If no, e.g. Oral instruction, contractor to confirm in writing
 - Potential Risk e.g. arguments on non-conformance with the contractual clause/mechanism

Instructed Variation

- If instructed by S.O?
 - Is the instruction documented? **Written instruction**
 - If no, e.g. **Oral instruction, contractor to confirm in writing**

Constructive Variation

- Occurs where one party refutes that there is a variation
- Dispute whether an instruction amounts to variation when the consultants refuse to acknowledge that it is so (constructive variation):-

Constructive Variation

- Procedure for variation not followed.
- Contractor is best advised to record his objections and proceed with the works
- Contractor does not face danger of refusing to carry out the works as a repudiation of the contract (risk limited to additional cost)

Constructive Variation

- If contractor refuse to carry out the work – risk of termination and backcharges
- Contractor to protect its right by risk management
- Any stipulated time frame for claiming variation: to be strictly followed regardless of refusal to accept:
Syarikat Binaan Utara Jaya v Koperasi Serbaguna Sungai Glugor Bhd [2009] 1 CLJ 786

Formal Procedures for Variation

- What happens if not formally instructed in writing but is a change in owner's requirement?
- Through other modes when review & liaison on construction drawings
- Requires contractor to make decision not to proceed. High risk. Proceed with notice.

Formal Procedures for Variation

- Seeking to hide/refute from variation purely on non-compliance with formal procedures are not effective. Why?
 - Bad Faith conduct
 - Project beneficial changes
 - Owner encouraged

Formal Procedures for Variation

- Owner cannot rely on own breach/failure to issue formal written instruction
- Fundamental breach/repugnant
- Arbitrator/Court can review

Variation by way of Omission

- Bad faith transfer of scope of works to 3rd parties by way of omission
- Unless allowed specifically in contract
- Not in the case of contractor default
- Right to claim loss of profit for such omissions
- Financial risk increases if there is rate-loading

Documenting the cause

- 5 stages:-
 - Pre-tender
 - Pre-award
 - At contract execution
 - During contract administration
 - Post-completion

Documenting the cause

- Pre-tender – clarifications, minutes of meeting etc
- Pre-award – tabulate changes negotiated and agreed, beware rate-loading, check rates, give all necessary information
- Contract execution – capture all changes, use special conditions
- Contract administration – keep good record of obligations and update changes, monitor deadlines
- Post-completion – no more variations!

Valuation

- **Pre-Contract Agreed Prices or Rates : Schedule of Rates or BQ Rates**
- **Pre-Performance Agreed Price or Rates : Depends on Contract & Parties – Uncertainty but applicable if fallback mechanism exist (i.e. determined by Arbitrator)**

Valuation

- **Prescribed Method of Measurement & Valuation**
- **Daywork rates – only if instructed, can be used to proof the reasonableness of market rates?**
- **Valuation by SO : Is it Final? Is it reviewable by Arbitrator? Is it in bad faith?**

Valuation

- **Similar nature or character done in similar conditions – extrapolation from existing rates**
- **Otherwise, reasonable rates or star rates or market rates**

Valuation

- Rationalisation of BOQ rates/Schedule of Rates
= indirect cost to cover claims of under recovered loss and expense due to variations
- Extrapolation should be allowed + extra for different conditions

Excessive variations

- **Cardinal Change Principle**
 - Not accepted in common law jurisdictions
 - The “non-vitiating” clause
 - May be a repudiation of the contract, or
 - Misrepresentation that allows rescission

Excessive variations

- Reasonableness of using BQ/Schedule of Rates rather than the rate itself – no longer similar
- **Henry Boot Construction v Alstom Combined Cycles [2000] 69 Con LR 27 :**
can't question the rate itself

Protocols on Valuation

- Encourages Pre-Performance Agreement on Price & EOT
- Extrapolation from Contract Rates for similar character and carried out in similar conditions
- Adjustments to contract rates for not of similar character or not carried out in similar conditions

Protocols on Valuation

- Extensively dissimilar, then fair and reasonable rates + reasonable direct cost + reasonable allowance for overhead and profit
- Value + prolongation or disruption effect

THANK YOU