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Payment of head office overheads in a loss and expense situation

Loss and expense is a means by which a contract can cater for payment of monetary damages. Where a contract permits a claim for loss and expense, the contract administrator or architect or engineer is normally authorised to award money in that respect. Without such authority, payment of these monetary damages would only be made with the approval of the employer or following an award of court or of an arbitrator (or through an adjudicator's decision).

What is meant by 'overheads'?

Although similar to preliminaries, in that they constitute expenditure on support services and general running costs, overheads refer to the costs of running the contractor's general business as distinct from the site costs of any particular contract. Overheads include, for example, the rental of the contractor's buildings and general support staff and, if they are proved to have been increased by a contract's delay, there is no doubt that, in principle, they can be claimed (*Finnegan -v- Sheffield City Council* 1988). In that case, Sir William Stabb QC in delivering his judgement said:

> 'It is generally accepted that, on principle, a contractor who is delayed in completing a contract due to the fault of his employer, may properly have a claim for head office or off-site overheads during the period of delay, on the basis that the workforce, but for the delay, might have had the opportunity of being employed on another contract which would have had the effect of funding the overheads during the overrun period.'

A contractor's overheads are normally covered by the income of the business as a whole and, where the completion of one contract is delayed, the contractor may claim to have suffered a loss arising from the diminution of the income from the contract and hence, the turnover of the business; but the general running costs of his business continue to be expended. Were it not for the delay, the contractor's workforce would have had the opportunity of being employed on another contract or contracts, with the result that it would have

contributed towards the overhead costs during the overrun period. Also, if he can show that staff, who would otherwise have been gainfully employed, had to devote time to dealing with the disruption or delay, he may have a claim for that too.

A claim for overheads is often accompanied by a claim for loss of profit. It is common for a contractor to claim a loss of profit arising out of a diminution in turnover but, as with the overheads, in order to establish such a claim, he must show that at the time of the delay he could have used the lost turnover profitably. *Keating on Construction Contracts* (eighth edition) states that:

> 'A claim for loss of profit does not... fail merely because the contract in question was unprofitable. The question is what the contractor would have done with the money if he had received it at the proper time. Even if, at that time, the contractor's business was making a loss, a sum analogous to loss of profit is... recoverable if the loss of turnover increased the loss of the business.'

The main difficulty contractors face is in establishing these lost opportunities in fact. What a contractor has to do is to demonstrate that he would have been able to undertake other work, or that his staff would have been otherwise profitably employed, over the period of overrun. If the contractor cannot overcome this initial hurdle, he may have to address an argument along the lines that the overhead and lost profit costs would have been incurred in any event and that they are therefore not 'losses' and for larger contracting organisations, undertaking many projects at any one time, it may be difficult, or even impossible, for him to convince a dispute resolver that delay on any one project has actually affected his ability to take up other opportunities. When a contractor makes a claim for his overheads and profit, he would normally do so under one of two different forms.

Firstly, the contractor may be able to demonstrate that time and cost of specific, identified, resources at its head office had been incurred during an overrun period.

In *Euro Pools and Clydeside Steel Fabrications*, a Scottish case from 2003, the pursuers were able to demonstrate the lost opportunity of their employees, who were diverted from other contracts, for the purpose of addressing defects in the defender's work. They were also able to demonstrate management time spent by their director, and other engineers, relating to the attendance at meetings and the preparation thereof, and investigating the problem that had arisen through the defect. The court held that such a claim is based on the second limb in *Hadley -v- Baxendale*, i.e. that the losses claimed were such as might reasonably be supposed to have been in the contemplation of both parties at the time they made the contract as the probable results of the breach of it.

The other form is where the contractor argues that, in having resources locked into a site during the prolongation period, he has lost the opportunity of using those resources on other sites where they would have earned a contribution to the costs of running their head office. For this argument to be successful, a contractor must show that work was reasonably plentiful, and that, on a balance of probabilities, other work was, or would have been, available. This is sometimes referred to as unabsorbed head office overheads, in that the level of head office cost continues but the revenue stream from the particular the contact in question suffering the delay, shows a shortfall.

This loss of opportunity method of claiming for unabsorbed overheads has been converted into three alternative formulae; *Hudson*, *Emden* and *Eichleay*. An analysis of the peculiarities of each of these formulae is beyond the scope of this paper but suffice to say that each of them, to a greater or lesser extent, rely on particular assumptions and are approximations of the contractor's losses.

Authority for the use of formulae derives from a number of cases including *Whittal Builders and Chester-le-Street District Council* in which Mr Recorder Percival QC said:

> 'Lastly, I come to overheads and profit. What has to be calculated here is the contribution to off-site overheads and profit which the contractor might reasonably have expected to earn with these resources if not deprived of them. The percentage to be taken for overheads and profits for this purpose is not therefore the percentage allowed by the contractor in compiling the price for this particular contract,
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> which may have been larger or smaller than his usual percentage and may or may not have been realised. It is not that percentage that one has to take for this purpose, but the average percentage earned by the contractor on his turnover as shown by the contractor's accounts.'

These formulae are all approximations rather than assessments of actual costs, and they are all over-simplistic when compared with more accurate alternatives. In *Tate & Lyle -v- Greater London Council* 1981, a claim, based simply on adding a percentage of the overall cost, which is of course even more simplistic than the three formulae mentioned above, was rejected on the basis that there must have been more accurate methods of assessment open to the claimant of which he had not availed himself. Each formula relies on assumptions, which may not always be appropriate, and the inclusion for an allowance for profits in some of the formulae must be separately justified.

In conclusion, whereas a contractor may choose to present a claim on the basis of a recognised formula in order to cut through the difficulties associated with proving actual losses, the use of any formula should always be subject to proof that the contractor has in fact suffered loss as a result of the delay or disruption. In order to prove such losses, he might produce invitations to tender which he declined to price, with supporting evidence that the reason for declining was that the delay in question left him with insufficient capacity to undertake that work, or he might show from his accounts a drop in turnover and establish that this resulted from the particular day rather than from other causes. If he cannot establish a loss of turnover from the delay, the effect of that delay is that the receipt of the money is delayed; it is not lost.

With modern management accounting and electronic diaries, etc. company managers ought to be able to demonstrate exactly what time they spend doing any particular activity. This should be more apparent in the contractor organisations where claims of this sort are more likely than in others. Where overhead losses can be proved, they should be, and allowance made against any calculation produced through a formula.

The use of formula is only appropriate:

a) Where there is no more accurate method of proving the loss; and

b) Where the assumptions underline the formula are shown to be correct in each particular case.

Unless of course the parties have agreed to use one of the formula (such as might be the case where they employ use of the Society of Construction Law's protocol for delay and disruption).

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