

Insight

Insight provides practical information on topical issues affecting the building, engineering and energy sectors.

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Contractor claims for
prolongation costs:
a comprehensive guide



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Claims for prolongation costs are bread and butter for those working in construction disputes. Notwithstanding this, the basic rules governing if prolongation costs are recoverable, and how to prove the quantum of those costs, are all too often ignored.¹ Likewise, the terminology used in such claims is often used without a proper understanding of what it means.

In this *Insight*, we provide a comprehensive guide to prolongation costs looking at the basic law governing when they can be claimed, the rules under key domestic standard construction contracts and then deep diving into specific categories of prolongation costs.

So, what are prolongation costs?

Where a construction project suffers from delays, those delays cost money for all involved. The Employer does not have use of its building on the date originally intended, and the Contractor incurs time-related costs. Where critical delay to the project is the responsibility of the Contractor, the financial remedy for the Employer is liquidated (or general) damages. Where the critical delay to the Works is the Employer's risk, however, the Contractor may be entitled to prolongation costs (which are also known as loss and expense).

Prolongation costs are those time-related costs incurred by the Contractor as a result of critical delay to the Works (and therefore an extension of the contract period) for which the Contractor is not responsible. *Keating on Construction Contracts* defines prolongation costs as:

*"... costs and losses incurred as a result of delays to the activity in question or the works as a whole which have led to critical delay to the contract completion date."*²

Prolongation costs are intended to compensate the Contractor for its time-related costs which it would not have incurred but for the Employer-risk delay event. The *SCL Delay & Disruption Protocol* puts it like this:

*"The objective is to put the Contractor in the same financial position it would have been if the Employer Risk Event had not occurred."*³

When claiming prolongation costs, the Contractor will generally need to demonstrate that it has actually incurred costs/losses because of delay, and that it would not have incurred those costs/losses but for the Employer Risk Event.

Extensions of time and prolongation costs

Prolongation costs are often considered to be the financial element of a Contractor delay claim. It is sometimes assumed that, where a Contractor is granted an extension of time, prolongation costs should automatically flow. This is incorrect as:

*"... although prolongation costs are often seen as the financial side of a "delay claim", there is no automatic entitlement to loss and expense or damages even if a right to an extension of time is established."*⁴ [Emphasis added]

This is because where there are other non-critical Contractor delays on the project, the scale of those delays may mean that the Employer Risk Event doesn't cause additional costs to be incurred for the full period of the extension of time awarded to the Contractor. The "excusable delay", in respect of which the Contractor is entitled to an extension of time, may be different to the "compensable delay" in respect of which the Contractor is entitled to its prolongation costs.

In other words, time doesn't always equal money.

It is also important to remember that the analysis necessary to establish a Contractor's entitlement to an extension of time is different to that needed to establish entitlement to prolongation costs. The differences between extension of time claims and prolongation costs claims were explained in *Costain Limited v Charles Haswell & Partners Limited*⁵:

"... When an extension of time of the project completion date is claimed, the contractor needs to establish that a delay to an activity on the critical path has occurred of a certain number of days or weeks and that that delay has in fact pushed out the completion date at the end of the project by a given number of days or weeks, after taking account of any mitigation or acceleration measures. If the contractor establishes those facts, he is entitled to an extension of time for completion of the whole project including, of course, all those activities which were not in fact delayed by the delaying events at all, i.e. they were not on the critical path.

But a claim for damages on account of delays to construction work is rather different. There, in order to recover substantial damages, the contractor needs to show what losses he has incurred as a result of the prolongation of the activity in question. Those losses will include the increased and additional costs of carrying out the delayed activity itself as well as the additional costs caused to other site activities as a result of the delaying event. But the contractor will not recover the general site overheads of

carrying out all the activities on site as a matter of course unless he can establish that the delaying event to one activity in fact impacted on all the other site activities. Simply because the delaying event itself is on the critical path does not mean that in point of fact it impacted on any other site activity save for those immediately following and dependent upon the activities in question.”⁶
[Emphasis added]

Claiming prolongation costs during the project

When claiming prolongation costs, the Contractor must ensure that its claim includes sufficient information to enable the amount of its incurred loss and expense to be ascertained. Detailed submissions with comprehensive supporting information should be provided by the Contractor, if possible. However, per the TCC’s judgment in *Walter Lilly & Company Limited v Giles Patrick Cyril Mackay* [2012] EWHC 1773 (TCC), there is no requirement for the Contractor to provide “every conceivable detail”, and it must be borne in mind that the “Architect and the Quantity Surveyor are not strangers to the project in considering what needs to be provided to them.”⁷

Prolongation costs claimed by the Contractor must be linked to the alleged Employer delay. Global claims which assume a link between costs and the Employer risk event should be avoided. The Contractor must demonstrate that that overspend is the direct result of the Employer risk delay event. As stated in *Walter Lilly*:

“Ultimately, claims by contractors for delay or disruption related loss and expense must be proved as a matter of fact. Thus, the Contractor has to demonstrate on a balance of probabilities that, first, events occurred which entitle it to loss and expense, secondly, that those events caused delay and/or disruption and thirdly that such delay or disruption caused it to incur loss and/or expense (or loss and damage as the case may be).”⁸

Further, task-related costs, which are those costs that would have been incurred in any event to complete the Works (and which are not the result of the increased duration of the Contractor’s Works), are not recoverable as prolongation costs.

What do the standard form contracts provide in respect of prolongation costs?

JCT 2016

The JCT suite of contracts provides that, where the Contractor “incurs or is likely to incur any direct loss and/or expense” as a result of the regular progress of the Works being “materially affected by any Relevant Matter”, the Contractor will be entitled to be reimbursed for that loss and/or expense.⁹ The event giving rise to the delay must, therefore, be a Relevant Matter in order to give rise to an entitlement on the part of the Contractor to its “direct loss and expense.”

As held by the Court of Appeal in *F.G. Minter v WHTSO*¹⁰, “direct loss and/or expense” is loss and expense which arises naturally and in the ordinary course of things. It follows that “the sole question which arises in relation to any head of claim put forward by a Contractor is whether such a claim properly falls within the first limb of *Hadley v Baxendale* so that it may be said to arise naturally and in the ordinary course of things.”¹¹

A Contractor’s prolongation costs claim under the JCT form must be for its actual losses and expenditure incurred as a direct result of the Relevant Matter. Interest and financing charges on direct loss and expense can be included by the Contractor in its claim.¹²

The JCT suite of contracts also provide that the Contractor “shall notify the Architect/Contract Administrator as soon as the likely effect of a Relevant Matter on regular progress ... becomes (or should have become) reasonably apparent to him.”¹³ There

remains debate as to whether this notification requirement is a condition precedent to the Contractor’s entitlement to prolongation costs. As such, the golden rule must be to notify prolongation costs claims without delay.

As well as notifying the claim, the Contractor is obliged to provide “its initial assessment of the loss and/or expense incurred and any further amounts likely to be incurred, together with such information as is reasonably necessary to enable the Employer to ascertain the loss and/or expense incurred.” That information should be provided with the Contractor’s original notification “or as soon as reasonably practicable.”¹⁴

The Contractor is also under an obligation to provide monthly updates (to its initial assessment and information) to the Employer, “in such form and manner as the Employer may reasonably require.” The Contractor must do so “until all information reasonably necessary to allow ascertainment of the total amount of such loss and expense has been supplied.”¹⁵ It is obviously sensible for both parties to engage in discussions as to the format of any information required to evidence prolongation costs especially when delays are likely to be ongoing for a number of months.

NEC4

Under the NEC4 suite of contracts, where the project has been delayed by the Client,¹⁶ the Contractor can claim for additional time and money by submitting a claim for a compensation event. Compensation events are events which are not the fault of the Contractor and which have the effect of changing the cost of the work and/or the time needed to complete it. If a delay has occurred as a result of a compensation event, the Contractor may be entitled to make changes to the prices, key dates, and/or the completion date.

In contrast to the JCT suite of contracts, in which time (Relevant Events) and money (Relevant Matters) are assessed separately, time and cost impacts are assessed together under the NEC4 compensation event regime. This is all too often forgotten!

Notification and Assessment

The NEC4 contains a time bar for notification by the Contractor of a compensation event. The Contractor must notify the Project Manager of a compensation event *“within eight weeks of becoming aware that the event has happened.”*¹⁷ This is a condition precedent to the Contractor’s entitlement to time and money, so the Contractor must comply with this requirement. A failure to issue a notice by this deadline may well result in any entitlement to additional time and/or money being lost.

The impact of compensation events is intended to be assessed prospectively based on forecasts, as evidenced by core clause 63.1:

“The change to the Prices is assessed as the effect of the compensation event upon

- *The actual Defined Cost of the work done by the dividing date,*¹⁸
- *The forecast Defined Cost of the work not done by the dividing date, and*
- *The resulting fee.”*¹⁹

However, all too often, compensation events end up being assessed retrospectively. It is essential, therefore, that the Contractor keeps detailed and comprehensive records demonstrating its costs. As was stated by Deeny J in *Northern Ireland Housing Executive v Healthy Buildings (Ireland) Ltd*²⁰:

“Evidence from time sheets and other material, of what the consultant actually did in that period, particularly with reference to the change in

instructions, is not only relevant evidence but clearly the best evidence to assist the court in calculating the “compensation” to which the consultant is entitled ...

... why should I shut my eyes and grope in the dark when the material is available to show what work they actually did and how much it cost them?” [Emphasis added]

What is Defined Cost?

Defined Cost is used to assess compensation events. For Options A and B, the Defined Cost is as stated in the Short Schedule of Cost Components (SSCC). For Options C, D, and E, it is as stated in the Schedule of Cost Components (SCC).

The SSCC and SCC set out the rules on recoverable costs and relevant rates, including in respect of People, Equipment, and Plant and Materials. Given that NEC4 core clause 52.1 provides that *“All the Contractor’s costs which are not included in the Defined Cost are treated as included in the Fee”*,²¹ it is important for the Contractor to check what is included in the SSCC/SCC – and what is deemed to be included in the Fee – before submitting its compensation event claim.

Record-keeping

It is vital that the Contractor keeps detailed records demonstrating the Defined Costs (in respect of People, Equipment, and Plant and Materials etc) which it has incurred. Indeed, under Option C, the Contractor must keep the following records:

- Accounts of payment of Defined Cost;
- Proof that the payments have been made;
- Communications about and assessments of compensation events for Subcontractors; and
- Other records as stated in the Scope.²²

Underlining the importance of keeping the above detailed records, the Contractor is also obliged under Option C to permit the Project Manager to inspect those records.²³

Specific types of prolongation costs

Prolongation costs can be divided into two broad categories. These are:

- (1) “on-site overheads” (sometimes referred to as “preliminaries”); and
- (2) “off-site (or “head office”) overheads.”

But, what do we mean when we talk about “on-site” and “off-site” overheads?

On-site preliminaries / overheads

On-site overheads are the Contractor’s direct costs associated with the performance of its Works on site.²⁴ These include labour costs, plant and equipment costs, and “preliminaries”:

(i) Labour costs

Where, as a direct consequence of an Employer-risk delay event, the Contractor’s labour resources have been required to remain on site for longer than originally anticipated (or the Contractor has used additional labour resources), the Contractor is entitled to recover its costs incurred in respect of that extended or additional labour.

The Contractor must demonstrate that the extended or additional labour was the direct result of the Employer-risk delay event, and that the original labour resource levels and durations provided for in its tender were realistic and reasonable (such that it should be entitled to recover the extended/additional labour costs). In circumstances where the Contractor’s labour resource is idle, the Contractor will be expected to mitigate its losses

by redeploying that resource to other, productive work. They will not be entitled to the costs of idle labour if they don't take steps to mitigate their losses.²⁵

(ii) Plant and equipment

If the Contractor has hired plant and equipment which has sat idle as a result of the Employer-risk delay event, then the Contractor may be entitled to recover the hire charges which it has incurred in respect of that plant and machinery during the idle period.²⁶

Alternatively, if the plant and equipment is owned by the Contractor, the Contractor may be able to recover costs in respect of the loss of opportunity to hire out the plant to others during the period of delay.²⁷ If the Contractor cannot demonstrate such a loss of opportunity, then it may still be able to recover depreciation and maintenance costs in respect of the plant and equipment.

(iii) "Preliminaries"

These are the Contractor's costs of maintaining its site establishment, and include fencing and hoarding for the site, cabins or site huts, and utilities.²⁸ Where the project duration has been extended as a result of an Employer-risk delay event, these time-related preliminaries may increase. The Contractor is entitled to recover its additional costs in respect of these extended preliminaries. However, in order to do so, it will need to prove its actual additional costs incurred as a result of the prolongation.

Costs should be calculated by reference to the period of delay rather than the period of overrun at the end of the project.²⁹ As explained in the SCL Delay and Disruption Protocol:

"Once it is established that compensation for prolongation is due, the evaluation of the sum due is made by reference to the period when the

*effect of the Employer Risk Event was felt, not by reference to the extended period at the end of the contract."*³⁰

Head office (off-site) overheads

Head office, or off-site, overheads are the costs incurred by the Contractor as part of its normal business operations. Head office overheads include the costs of the Contractor's head office staff, head office utilities (electricity, water, etc.), lease payments on the head office, and insurance.³¹ Head office overheads are distinguishable from the Contractor's on-site overheads incurred on the project.

Where the Contractor's works are delayed as a direct result of an Employer-risk delay event, the Contractor may be entitled to recover its head office overheads attributable to that delay.³² There are two categories of head office overhead claim:

(i) Increased head office overheads

Where particular head office costs of the Contractor have increased as a result of the Employer-risk delay event, the Contractor is entitled to recover these additional costs. One example of such a cost is the cost of additional staff recruited by the Contractor because the project was in difficulties.

When claiming for increased head office overheads, the Contractor will need to demonstrate cause and effect. In other words, they need to show that, as a direct result of the Employer-risk delay event, the Contractor had to (for example) recruit the additional staff to deal with the project, and that its increased overheads were therefore incurred (necessarily) as a direct result of the Employer-risk delay event.

Claims for increased head office overheads are relatively unusual compared to claims for lost contributions to head office overheads.³³

(ii) Lost contribution to head office overheads

Overheads are normally recovered from the income of the Contractor's business as a whole. Where a particular project is delayed, there may then be a reduction in the Contractor's income from that particular project. The Contractor's overall turnover reduces, whilst its expenditure on overheads – which it cannot avoid or reduce – continues. However, had the particular project not been delayed as a result of the Employer-risk delay event, the Contractor would have had the opportunity to deploy its labour on another project. This would have had the effect of contributing to the Contractor's overheads during the period of overrun.³⁴

As was stated in *JF Finnegan Ltd v Sheffield City Council*³⁵:

"It is generally accepted that, on principle, a contractor who is delayed in completing a contract due to the default 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 work-force, 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."

In order to be successful in a claim for lost contribution to overheads, however, the Contractor will need to establish that other work was available which it would have secured but for the delay. The Contractor might do this by demonstrating that it declined invitations to tender because its resources were tied up on the delayed project (and so it had insufficient capacity to take on the new work), or by demonstrating a reduction in its turnover (by reference to its accounts).³⁶

Loss of profit

A further category of cost/loss which can be included in a Contractor's prolongation claim, and which is often categorised alongside "off-site overheads", is loss of profit. It is open to the Contractor to claim a loss of profit arising from its reduced turnover as a result of the delayed project.

As with a claim for lost contribution to head office overheads, the Contractor will need to establish that it was unable to tender for, and work on, other projects as a result of the delays on the particular project. The Contractor should, therefore, keep detailed records of all tender opportunities it has received and been forced to decline. As was noted in *Walter Lilly*:

*"... During that period, WLC had to and did decline a number of tendering opportunities: that was not said vaguely, or in a vacuum of support: the opportunities received and declined were precisely detailed on a comprehensive schedule ..."*³⁷

The Contractor will also need to show, on the balance of probabilities, that *"at the time of the delay, it could have used the lost turnover profitably."*³⁸ Contemporaneous evidence as to these lost opportunities is therefore key.

Formulae for calculating loss of off-site overheads and profit

There are three alternative formulae which can be used to calculate claims for loss of off-site overheads and profit. These are the *Hudson*, *Emden*, and *Eichleay* formulae.³⁹ These formulae are not assessments of the Contractor's actual costs, but instead produce an approximation of the Contractor's losses. Whilst these formulae can be used where necessary, therefore,⁴⁰ if the Contractor is able to provide better proof of its actual losses incurred, it should do so.⁴¹

Crucially, these formulae do not in themselves prove the Contractor's losses. The formulae are only of assistance in quantifying the Contractor's losses where the Contractor has proved causation, i.e. that it has suffered loss as a result of the prolonging Employer-risk delay event. As was stated in *Alfred McAlpine Homes North Ltd v Property and Land Contractors Ltd* (1995) 76 B.L.R.:

"... such formulae are likely only to be of value if the event causing delay is (or has the characteristics of) a breach of contract ..."

Practical tips for the Contractor preparing a prolongation claim

For a Contractor seeking to advance a claim for prolongation costs, the following golden rules should be obeyed:

1. **The rules of the contract must be followed!** As discussed above, the JCT and NEC standard forms have different requirements for the claiming of time-related prolongation costs. The Contractor must ensure that it complies with the requirements of its particular contract when preparing and submitting its claim.
2. **Causation must be established.** A global-type claim which simply assumes that the Contractor's overspend results from Employer delays will not be successful. The Contractor must prove (on the balance of probabilities) that the Employer-risk delay event occurred, it caused delay to the Contractor, and the Contractor suffered loss and expense as a direct result.
3. **Evidence is key.** It is essential that comprehensive contemporaneous records (both in respect of causation and quantum) are kept and provided by the Contractor with its claim – *"records, records, records."*

4. **The Contractor should seek to establish its actual costs and losses incurred.** Where it cannot do so for its off-site overhead and profit losses, formulae can be used – but this should be done with caution. Formulae provide an approximation of the Contractor's losses, rather than a calculation of its actual losses. If the Contractor is able to provide better proof of its actual losses but instead chooses to use a formula, it risks having its claim for loss of off-site overheads and profit rejected by the courts. The Contractor should also bear in mind that formulae assist only in quantifying losses – they do not prove causation.

For Employers seeking to resist such claims, a failure to follow the rules set out above makes life much easier.

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Footnotes

1. By Claire King and Matthew Simson. With thanks to Sanjay Patel from 4 Pump Court for his input into our Fenwick Elliott webinar on this topic which can be downloaded at <https://www.fenwickelliott.com/research-insight/webinars-podcasts/prolongation-costs-construction-projects>.
2. *Keating on Construction Contracts*, 11th Ed., para. 9-046.
3. Society of Construction Law Delay and Disruption Protocol, 2nd Ed (February 2017), "Core Principles", para. 20.
4. *Keating on Construction Contracts*, 11th Ed., para. 9-048.
5. [2009] EWHC 3140 (TCC).
6. *Costain Limited v Charles Haswell & Partners Limited* [2009] EWHC 3140 (TCC) at 183-184.
7. *Walter Lilly & Company Limited v Giles Patrick Cyril Mackay* [2012] EWHC 1773 (TCC) at 467.
8. *Walter Lilly & Company Limited v Giles Patrick Cyril Mackay* [2012] EWHC 1773 (TCC) at 486.
9. Standard Building Contract 2016 clauses 4.19.1 (Without Quantities) / 4.20.1 (With Quantities / With Approximate Quantities); and Design & Build Contract 2016 clause 4.19.1.
10. (1980) 13 B.L.R. 1 CA.
11. *Keating on Construction Contracts*, 10th Ed., para. 20-353. Importantly, the use by the Contractor of formulae (such as Hudson and Emden) does not detract from this principle.
12. These were held to be recoverable in *F.G. Minter v WHTSO* (1980) 13 B.L.R. 1 CA.
13. Standard Building Contract 2016 clauses 4.20.1 (Without Quantities) / 4.21.1 (With Quantities / With Approximate Quantities); and Design & Build Contract 2016 clause 4.20.1.
14. Standard Building Contract 2016 clauses 4.20.2 (Without Quantities) / 4.21.2 (With Quantities / With Approximate Quantities); and Design & Build Contract 2016 clause 4.20.2.
15. Standard Building Contract 2016 clauses 4.20.3 (Without Quantities) / 4.21.3 (With Quantities / With Approximate Quantities); and Design & Build Contract 2016 clause 4.20.3.
16. In the NEC4 suite of contracts, the Employer is referred to as the Client.
17. NEC4 Engineering & Construction Contract, clause 61.3.
18. For compensation events other than those arising from a Project Manager's instruction, notification, issuing of a certificate, or changing of an earlier decision, the dividing date is the date of notification of the compensation event.
19. NEC4 Engineering & Construction Contract, clause 63.1.
20. [2017] NIQB 43.
21. NEC4 Engineering & Construction Contract, clause 52.1.
22. NEC4 Engineering & Construction Contract, Option C, clause 52.2.
23. NEC4 Engineering & Construction Contract, Option C, clause 52.3.
24. *Construction Law*, 3rd Ed., Julian Bailey, Vol. II, para. 11.139.
25. *Construction Law*, 3rd Ed., Julian Bailey, Vol. II, para. 11.140.
26. *Shore & Horwitz Construction Co Ltd v Franki of Canada Ltd* [1964] S.C.R. 589 (Canada SC).
27. *Alfred McAlpine Homes North Ltd v Property and Land Contractors Ltd* (1995) 76 B.L.R. 59.
28. *Construction Law*, 3rd Ed., Julian Bailey, Vol. II, para. 11.145.
29. *Keating on Construction Contracts*, 11th Ed., para. 9.050; *Ascon Contracting Ltd v Alfred McAlpine Construction Isle of Man Ltd* (1999) 66 Con. L.R. 119 (TCC) at 43.
30. Society of Construction Law Delay and Disruption Protocol, 2nd Ed (February 2017), "Core Principles", para. 22.
31. *Construction Law*, 3rd Ed., Julian Bailey, Vol. II, para. 11.146.
32. *Construction Law*, 3rd Ed., Julian Bailey, Vol. II, para. 11.146.
33. *Keating on Construction Contracts*, 11th Ed., para. 9.052.
34. *Keating on Construction Contracts*, 11th Ed., para. 9.053.
35. (1988) 43 B.L.R. 124.
36. *Keating on Construction Contracts*, 11th Ed., para. 9.053.
37. *Walter Lilly & Company Limited v Giles Patrick Cyril Mackay* [2012] EWHC 1773 (TCC) at 543.
38. *Keating on Construction Contracts*, 11th Ed., para. 9.054; *B Sunley & Co Ltd v Cunard White Star Ltd* [1940] 1 K.B. 740 CA.
39. The *Hudson and Emden* formulae are used to calculate loss of head office overheads and profit taken together, whereas the *Eichleay* formula is used only for the calculation of head office overheads.
40. See *Walter Lilly & Company Limited v Giles Patrick Cyril Mackay* [2012] EWHC 1773 (TCC) at 543(c) – "The use of a formula, such as *Emden or Hudson*, is a legitimate and indeed helpful way of ascertaining, on the balance of probabilities, what that return can be calculated to be."
41. See *Keating on Construction Contracts*, 11th Ed., para. 9.055 and *Tate & Lyle v GLC* [1982] 1 W.L.R. 149 at 152.