Recovery of Overhead in Unit Price Contracts

Overview

Accurate and detailed tracking of a construction project’s costs is a critical component to the successful project. These costs can resemble an iceberg floating in the ocean. Some costs are easily noticeable; other costs are hidden beneath the surface. Generally speaking, construction project costs are divided into two categories -- direct and indirect. Direct costs can be traced to performing specific work. Common examples of direct costs on construction projects are the cost of materials, labor, equipment, and subcontracts. Just like the tip of the iceberg, direct costs are noticeable because the contractor knows how much money it must spend to obtain the necessary materials, labor, and equipment on the project.

Indirect costs, also commonly referred to as overhead, are costs of operation which are generally incurred in support of a range of activities but may not be uniquely attributed to any individual work item. In construction projects, typical overhead costs are home and field office expenses, including rent, management and staff salaries and wages, financing costs, utilities costs, insurance, taxes, and other expenses incurred by the contractor that may not be directly attributable to one specific project. In contrast to direct costs, overhead costs are not as evident and are oftentimes more difficult to calculate than direct costs.

Still, a prudent contractor should be able to track and identify project overhead costs. This is particularly important in unit price contracts. In such contracts estimated quantities of various items or deliverables are provided, and the contractor is required to furnish pricing based on a particular unit of measure based on these estimated quantities. During performance, the contractor applies these unit prices to actual quantities for the particular line item. It is expected that these unit prices include all direct costs, as well as indirect costs and profit. Because costs, particularly overhead costs, are time sensitive, it is imperative in a unit price contract that the contractor adequately and accurately identify all indirect costs that need to be include in the unit rate, and understand how delays to the project might impact those costs.

Further, if the contractor experiences delays or significant variations in quantities of unit price work performed, it needs to know whether the contract will permit recovery of extended overhead, or of overhead that might have been applied to a subsequently deducted item of work, and, if so, how such a claim must be made. One recent case illustrates how a failure to understand these dynamics can be very costly.

Background

In CAMO Construction Co., Inc. v. Town of Vidalia, 966 So.2d 796 (La. App. 3 Cir. 2007), the contractor (“CAMO”) was awarded a unit price contract for a street improvement and drainage project in Vidalia, Louisiana. Under the unit pricing provision, CAMO was to be paid on actual quantities of work performed. In this regard, the bid form contained a description of each item, the estimated quantity of that item needed for the project, and the measurement unit for that item (linear foot, square yard, cubic yard, etc.). The bid documents stated that unit prices were for each item installed. As such, these unit prices specifically included labor, material, and equipment costs, as well as overhead, profit, and “any other contractor cost associated with the installation.”

The project suffered delays from the beginning, and after two time extensions, work was still not finished. Several change orders were issued during the project. Two of these change orders extended the project completion date due to: (1) delays in material deliveries; (2) delays in material fabrication; (3) extreme weather conditions; (4) and conflicts with existing underground utilities. These two change orders did not adjust the contract price. Another change order removed one of the unit items from CAMO’s work scope, but did not adjust the contract time. A fourth change order added four line items to the scope of work and removed other line items, resulting in a net overall increase to the contract price, but no further adjustment to the contract time. CAMO accepted all of these change orders.

After these change orders were issued, but before project completion, CAMO asserted a claim for extended overhead and delay damages, and for an additional extension to the contract
time. This claim was reduced to a change order but the Town never signed it. To the contrary, the Town ultimately rejected CAMO’s claim and offset CAMO’s last payment by $80,000 for liquidated damages for 160 of the days that CAMO went beyond the last approved contract extension date. Consequently, CAMO filed suit for breach of contract seeking to recover the liquidated damages and compensation for extended overhead and delay damages. The trial court dismissed CAMO’s lawsuit.

On appeal, the Louisiana Court of Appeal upheld the trial court’s ruling. As to CAMO’s extended overhead and delay claim, the court explained that with regard to having CAMO’s crew and equipment on the job longer than was anticipated when the job was bid, that extra cost was covered in the numerous sections requiring CAMO to anticipate and include all such delays and underground obstructions in its bid price. Moreover, the court found that that CAMO had already been compensated for its extended overhead and delay claims in time extensions and price increases through the various change orders. The court concluded it was well settled that after adjustments have been negotiated to a contract and agreed on by all parties, one party can not subsequently seek additional relief. According to the court, the contractor may have made a bad bargain, but it had made a legally binding bargain.

Practical Application

CAMO Construction exemplifies the importance of accurately projecting overhead costs when pricing construction work on a unit price basis. Where unit prices cover an estimated quantity of work to be performed over a set time, the fiscally prudent contractor must recognize the impact on overhead costs when these quantities change or when the project is delayed. If there are changes that impact the units of work or the time for completion, the prudent contractor must timely recognize this and notify the owner accordingly. Most importantly, before executing any change orders adjusting contract price or time, the contractor must determine if that contract modification fully and completely compensates it for additional time, as well as for all extended or unrecovered overhead that might have been incurred due to the changes in project scope or duration.