Fair Valuations

John B Molloy, LLB (Hons), BSc (Hons), FHKIS, FRICS, MCIArb, FInstCES, RPS (QS)

Valuing variations and like items is one of a quantity surveyor's primary functions, but it is also an area in which disputes occur frequently.

Most forms of contract used locally set out three basic rules for valuing variations, which despite minor differences in wording can generally be summarised as follows:

[RULE 1] where work is of similar character and executed under similar conditions to work priced in the Bill of Quantities it shall be valued at such rates and prices contained therein as may be applicable

[RULE 2] where work is not of a similar character or is not executed under similar conditions the rates and prices in the Bill of Quantities shall be used as the basis for valuation so far as may be reasonable.

[RULE 3] failing which a fair valuation shall be made.

Rule 1 is not a problem.

Rule 2 and in particular the phrase 'so far as may be reasonable' has been the subject of two important legal cases within the last year (Henry Boot Construction Ltd v. Alstom Combined Cycles Ltd and Aldi Stores Ltd v Galliford (UK) Ltd), both of which I have described in detail in previous articles.

However, now we also have judicial guidance regarding Rule 3 and the elements necessary for a 'fair valuation'?from the very recent case in the UK of Weldon Plant Limited v. The Commission for the New Towns a case which interestingly was heard by His Honour, Judge Humphrey LLoyd, QC, who was also the judge in the Henry Boot case.

Weldon Plant entered into a contract with the Commission for the New Towns for the construction of Duston Mill Reservoir. The contract incorporated the ICE Conditions, 6th Edition. The material to be excavated consisted of clay and gravel. Since Weldon were to be able to sell the gravel, the contract rate for gravel removal was negative £3.60/m^3. The clay was however to be carted to an off-site tip for which the rate was £3.66/m^3. The contract made provision for Weldon, at its own risk, to excavate below the design level for the bed of the reservoir (55.06 AOD) and to obtain more gravel which it would also be entitled to sell. On 20 November 1995, the Engineer issued Site Instruction 17 which required Weldon to excavate all the gravel below the bed and to back fill with clay to the design level. Weldon notified the Engineer that this instruction would give rise to a claim. The Engineer valued the additional gravel extraction and clay backfill at bill rates.

Weldon did not consider that the Engineer's treatment of the consequences of S.I. 17 was correct, so the ensuing dispute was referred to arbitration.

In the award, the arbitrator firstly decided that Weldon had had an option to extract the gravel in the original contract, rather than an obligation to do so and on this basis he concluded that S.I. 17 was a true variation under clause 51 of the ICE conditions. He further considered that because the option had been removed from Weldon that contract rates should not be used to value the variation and that a fair valuation, i.e. Rule 3, was appropriate.

So far so good.

The problems however arose with the arbitrator's fair valuation. He concluded that the basis of determining a fair valuation was

that such valuation should leave Weldon in the same financial situation it would have been had the instruction not been given, i.e. a loss and expense or damages type approach.

In then making such a valuation he assessed the cost of the works themselves but refused to add any allowance for head office overheads or for profit.

With regard to these elements, he considered that as (in his opinion) the correct ascertainment of any additional costs by Weldon should put it back in the position absent S.I. 17, profit was never recoverable and for head office overheads it was necessary that Weldon establish that it either incurred additional overheads (which it had not done) or that it was denied overhead recovery, i.e. a loss of opportunity concept whereby a contractor must prove it has not taken on other works because of the delayed completion (which again it had not done).

Weldon appealed on the basis that they considered the arbitrator had made an error in law, in that, he had incorrectly valued the variation as though it were a loss and expense claim rather than a valuation of a variation.

Permission to appeal was granted for the following question of law:

"**Whether on the facts found by the arbitrator, clause 52(1)(b) of the ICE Conditions permits a fair valuation to be made which excludes [profit and] an allowance for overheads on the basis that the contractor has to establish that it either incurred additional overheads or that it was denied overhead recovery**."

His Honour, Judge Humphrey LLoyd, QC, held that the answer was no. He considered that Weldon were correct in their assertion that the arbitrator was in error in his approach and that in his judgment, clause 52(1) contemplates that the contractor will be able to recover in a valuation of a variation, those elements included in the contract rates or prices for overheads and profit.

With regard to profit, he stated firstly, that a contractor is in business to make a profit on the costs of deploying its resources, and accordingly an employer must under clause 52(1) pay profit in a valuation made under any Rule (via the rates or otherwise on a fair valuation) on costs because a valuation under clause 52 would not otherwise be a fair valuation within the meaning of those words. Secondly, he considered that a valuation, which did not include profit, would not contain an element, which is an integral part of a valuation under Rules 1 and 2. A fair valuation under Rule 3 would not be in accordance with the principles of clause 52 if it did not include all relevant elements to be valued or represented in some significant manner in a valuation under that clause.

The same point held good for head office overheads. In particular, he considered that the arbitrator had failed to deal with the addition which has to be made in order to ensure that the contractor obtains a contribution from the costs of the business it undertakes towards its fixed or running overheads. As with profit, he held that it would not be fair if the valuation did not include an element on account of such contribution. It would mean that such a contribution would have to be found elsewhere, presumably from the contractor's margin for profit or risk. In his view, a valuation which in effect required the contractor to bear that contribution itself, would not be a fair valuation, in accordance with the principles of clause 52(1) which are intended to secure that the contractor should not lose as a result of having to execute a variation (except to the extent its costs etc. are of its making). Unlike overheads such as time-related overheads, it is not necessary to prove that they were actually incurred for the purposes of a fair valuation (although

their approximate amount must of course be established, e.g. by deriving a percentage from the accounts of the contractor including where appropriate associated companies that provide services or the like that qualify as overheads).

Accordingly, the judge held that when a quantity surveyor makes a valuation in accordance with contract rates or based on contract rates, i.e. Rules 1 and 2, such valuation will naturally include allowances for head office overheads and profit, and on this basis, when making a fair valuation under Rule 3 it would not by definition be fair unless such valuation included similar allowances for overheads and profit.

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