

A FAIR VALUATION?

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INTRODUCTION

Unlike other jurisdictions, English contract law has no explicit doctrine of good faith. There are, however, specific instances where legislators and the courts have addressed the implicit obligation to act fairly, and examples include the doctrines of mistake, duress, and misrepresentation.

In the absence of an overarching principle of good faith, many construction contracts, including some of the standard forms, include references to fairness in an attempt to offer a level of protection to the parties. However, many agree that whilst 'soft obligations' introduce commercial common sense, it is at the expense of certainty.



This article explores the principles of fairness in the valuation of variations under the ICE and the ICC forms of contract and the contractor's right to include provisions for overheads and profit in a fair valuation.

ICE

The ICE form of contract 6th editionⁱ provided that the value of Variations be ascertained by the Engineer, after consultation with the Contractor, in the following hierarchy:

- a) Using rates and prices contained in the Bill of Quantities ("Rule 1");
- b) Using adjusted rates and prices contained in the Bill of Quantities ("Rule 2"); and
- c) Making a fair valuation ("Rule 3").

The principles for valuing Variations were amended in the 7th edition of the ICE form of contractⁱⁱ. Whilst the valuation of the Variation still had to have "due regard to any rates or prices in the Contract"ⁱⁱⁱ the onus was then on the Contractor to submit a quotation for the Variation. In the event that the Engineer and Contractor were unable to agree on the

i ICE Conditions of Contract, Sixth Edition, Thomas Telford, January 1991
ii ICE Conditions of Contract, Sixth Edition, Thomas Telford, January 1991, Clause 52(1)
iii ICE Conditions of Contract, Seventh Edition Measurement Version, Thomas Telford, September 1999
iv ICE Conditions of Contract, Seventh Edition Measurement Version, Thomas Telford, September 1999, Clause 52(3)(a)(i)

appropriate change to the Contract Price, then the Engineer had to follow the same hierarchy listed above.

In the case of *Henry Boot v Alstom*^v, the concept of a fair valuation was considered following an arbitration in which the arbitrator arrived at his own fair valuation. The contractor, Henry Boot, quoted a passage by Max Abrahamson^{vi} which purports to place reliance on the use of rates and prices in the Bill of Quantities. The excerpt states:



"It is not unreasonable to apply rates as a basis for pricing varied work merely because the rates are mistaken (page 14), or uneconomic, certainly in relation to the normal type of variation which is endemic in civil engineering works. What is

reasonable is to be decided purely by reference to the nature of the original and varied work, not extraneous considerations".

However, the Court of Appeal judges found that the arbitrator had the discretion not to use contract rates (Rule 1 and Rule 2) and to make his own fair valuation (Rule 3), where the arbitrator considered, as a matter of fact, that the use of those rates is not a reasonable use.

As to what a fair valuation might be, we can ascertain from the decision that it must be 'reasonable', a term that is used repeatedly. Furthermore, the valuation should give the contractor *"a reasonable profit on the work done."*^{vii}

A fair valuation was further considered in the case of *Weldon Plant v Commission for the New Towns*^{viii}.

Here, an Instruction was given to the contractor, and the parties were unable to agree a valuation. In

arbitration, the arbitrator had found that *Weldon*, the contractor, *"should not be worse off as a result of having complied with the Instruction. It would be improper for Weldon to suffer financially because of the situation imposed upon them."*^{ix} The arbitrator's decision was akin to the principle

v *Henry Boot Construction v Alston Combined Cycles* [2000] EWCA Civ 99 (4 April 2000)

vi *Engineering Law and the ICE Contracts*, 4th edition

vii *Henry Boot Construction v Alston Combined Cycles* [2000] EWCA Civ 99 (4 April 2000)

viii *Weldon Plant Ltd v. The Commission for the New Towns* [2000] EWHC Technology 76 (14th July, 2000)

ix *Weldon Plant Ltd v. The Commission for the New Towns* [2000] EWHC Technology 76 (14th July, 2000)

of general damages in that a fair valuation *“should leave the Claimant in the same financial situation it would have been in had the Instruction not been given.”*^x

The question arose as to whether a fair valuation made under Rule 3 should include overheads and profit, which the arbitrator had not included in his calculations because:

- a) The contractor had not established that it had incurred additional overheads or that it had been denied overhead recovery; and,
- b) The addition of profit would have put the contractor in a better position than it would have been in had the Instruction not been given.

In the decision, the judge highlighted the difference between overhead costs relating to the value of work undertaken and those that are unrelated (being the fixed and running costs for the business).

The judge agreed with the arbitrator that for time-related costs, it was necessary for the contractor to prove that the costs had been incurred. There was, however, a divergence from the arbitrator’s decision on the point of overheads unrelated to the value of works. Here, the judge found that it was not necessary to prove that they were actually incurred for the purposes of a fair valuation but that *“their approximate amount must be established, eg by deriving a percentage from the accounts of the contractor.”*

The decision also found that, in the absence of special circumstances, a fair valuation should include an element of profit. This is because:

- a) A contractor is in business to make a profit on the cost of deploying its resources; and,
- b) Profit is an integral part of Rules 1 and 2 (i.e., the rates and prices in the bill of quantities), and it would go against the principles of clause 52 if Rule 3 did not include the same relevant elements.

Clause 10.2 of the NEC form of contract, which replaced the ICE suite, requires parties to *“act in a spirit of mutual trust and co-operation.”* Yet, the contract is noticeably devoid of the word *“fair”*. This is addressed in the guidance notes^{xi} which state:

“A fundamental objective of the ECC is that its use should minimise the incidence of disputes. Thus words like ‘fair’, ‘reasonable’ and ‘opinion’ have been used as little as possible.”

The only reference to the Project Manager or Contractor acting fairly can be found in the guidance notes^{xii} relating to the Project Manager’s assessment of a compensation event, which state:

“The Project Manager will be motivated to make a fair and reasonable assessment in the knowledge that the Contractor may refer the matter to the Adjudicator, who may change the assessment.”

x Weldon Plant Ltd v. The Commission for the New Towns [2000] EWHC Technology 76 (14th July, 2000)

xi NEC3 ECC Guidance Notes April 2013, page 3

xii NEC3 ECC Guidance Notes April 2013, page 79

Controversially, no similar guidance is provided to the Contractor as to how a compensation event quotation should be assessed.

ICC

Whilst based on the ICE conditions of contract, there are noticeable differences in the ICC form of contract. The valuation of alterations^{xiii} under the Design and Construct Version of the Infrastructure Conditions of Contract^{xiv} is set out at clause 51(4), which reads:

“the fair and reasonable value (if any) of all such alterations shall be taken into account in ascertaining the amount of the Contract Price.”

Other than having “due regard to any rates or prices included in the Contract^{xv} ” the Contractor is free to value alterations in any way it sees fit, as long as it is fair and reasonable. Equally, in the event that the Employer’s Representative does not agree with the Contractor’s valuation of alterations, he is required to notify the Contractor of his own opinion of a “fair and reasonable valuation”.^{xvi}

Similarly the JCT suite of contracts is littered with phrases such as ‘fair and reasonable’, leaving a degree of uncertainty in the valuations of Variations.

SUMMARY

In summary, these cases and guidance notes stress the importance of ensuring that the most appropriate methodology is adopted to value variations, taking into account the contract and any specific circumstances relating to the instruction and variation.

The decision in *Weldon Plant* also reminds us that, subject to satisfying the evidential burden, the contractor can recover overheads and profit under a fair valuation. In light of this evidential burden, we recommend that before a ‘fair valuation’ issue escalates into a dispute or difference, a party obtains an independent opinion.



xiii The term ‘alterations’ is not defined but “may include additions and/or omissions”

xiv Infrastructure Conditions of Contract, Design and Construct Version, August 2011

xv Infrastructure Conditions of Contract, Design and Construct Version, August 2011, Clause 52(3)(a)(i)

xvi Infrastructure Conditions of Contract, Design and Construct Version, August 2011,, Clause 52(3)(d)

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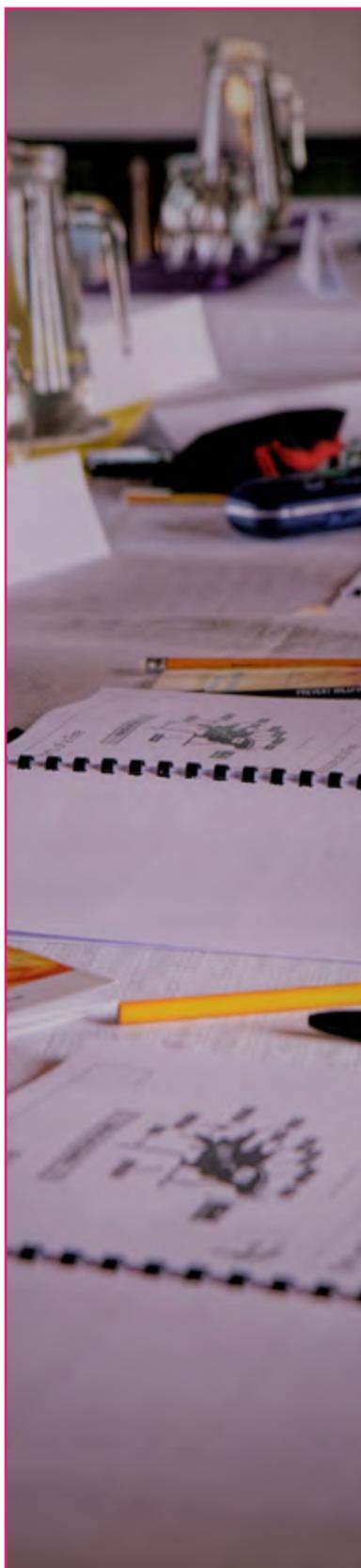
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