



## **CONSTRUCTION LAWYERS**

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### **COST PLUS CONTRACTS**

Often a contractor celebrates when a customer agrees to contract with him on a cost plus arrangement. A cost plus arrangement can either be a simple cost plus contract or a more complex cost plus deal like a guaranteed maximum price with share of savings.

However, contractors should realise that the cost plus type of contract contemplates an approach to payment which is substantially different to that in a fixed price lump sum contract.

### **LUMP SUM**

In a fixed price lump sum contract the builder is entitled to spend whatever money he wishes to carry out the works. He is then to be paid the value of the works under the contract and whether or not he makes a profit or has been inefficient is a matter for himself.

Any expenses he incurs while undertaking a fixed price contract are a matter for the builder. He can employ an accounting system or a management style and culture to his satisfaction. If the work is done competently in accordance with the contract he is entitled to be paid and entitled to take whatever profit he has made from that project.

### **COST PLUS**

In contrast a cost plus arrangement makes the builder responsible for the justification of each and every item of the costs claimed and demonstrating the necessity and reasonableness of every cost to the owner. The owner often complains that costs have been incurred unnecessarily and have not been properly proved and cost too much, and the goods or services might have been used on other projects of the builder. Tight adherence to detailed budgets is essential

Additionally, if the builder has accounting processes do which not allow him to physically trace each invoice to its use on the owner's project then the owner may lose confidence in the builder's honesty.

### **MECHANICS**

Further all cost plus contracts should include specific provisions to ensure that the parties identify and agree the costs on a regular basis and either approve or disapprove of the costs progressively. This avoids a major dispute at the end of the project when one or two years of cost claims have to be reviewed in detail.

Further the charges for builder's preliminaries and builder supplied labour or equipment should be agreed up front and the quantity to be used budgeted in advance each month.



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### **THE SWINGS AND ROUNDABOUTS MAY BALANCE**

Additionally, of course in a lump sum contract the builder benefits by the cost savings in some sections of the work and bears the cost over runs in others.

In the cost plus contract he has no savings to take care of any cost over runs. Accordingly, his efficiency in one area will reduce the cost for which he will receive no benefit whereas his inefficiency in other areas might increase the costs where those costs may not be paid by the owner.

### **PLUS PLUS**

Additionally, the contractor should be careful to ensure that his margin is accurately defined as either including profit only, profit plus head office overheads, profit plus head office overheads, plus site office overheads and/or site resources. The clear definition of what is covered by the margin is vitally important to the overall success of the project to the builder.

### **DEFECTS**

The question of defects needs to be considered carefully. Is the builder to be paid for pursuing subcontractors who do defective work or is the builder out of his margin expected to rectify the defects of any disappearing or bankrupt subcontractor? The risk allocation should make a substantial change to the margin in the contract.

### **HEAVEN OR HELL**

Until a builder ensures that the contract protects him from an unnecessary and usually acrimonious dispute, he may expect nirvana and end up in hedes.