

Indirect hit

Overhead costs can burden contractors



BY LARRY CAUDLE

When a contractor encounters delays on a project, it will no doubt incur additional indirect costs to support the project for the extended duration. Such indirect costs are often referred to as extended site overhead costs. In addition, the extended duration of the project also may affect a contractor's home office overhead costs in one of two ways. More commonly, a delay suf-

fered on a project results in unabsorbed/underabsorbed home office overhead because the contractor's forces and equipment must remain on the project for a longer period of time and are thus foreclosed from earning revenue on other projects that would contribute to, or absorb, the contractor's home office expenses. Less commonly, a contractor also might incur increased home office expenses if the dedication of home office personnel to a troubled project requires the hiring of additional personnel. This is typically referred to as extended home office overhead.

Despite the recognition by courts that site and home office overhead costs are legitimate delay damages, some owners simply refuse to acknowledge that they constitute real costs. Indeed, during claim negotiations, owners frequently demand that contractors compromise or dispose altogether with such costs.

No argument there

The argument over delay-related costs becomes more complicated when the duration of a project is extended by the introduction of additional work. On one hand, the markups permitted under the contract are typically intended to cover the contractor's site overhead, home office overhead and profit. On the other hand, the markups on the additional work might not adequately cover additional delay-related costs. The tendency of many state DOTs is to pay solely for the direct cost of the changed work along with any idle equipment and/or direct labor costs the contractor incurs as a result of the delay and argue that the markups on the direct cost fully cover such overhead costs. Consequently, delay-related costs stand out as the most hotly contested elements of contractor claims and often are the single roadblock to successful claim resolution, with Florida and Ohio serving as the

exceptions.

Shortly after the new millennium, the Florida Department of Transportation (FDOT), in cooperation with the Florida Transportation Builders' Association (FTBA), devised a provision within FDOT's standard "Alteration of Plans or of Character of Work" clause that recognizes delay-related costs and essentially eliminates any argument over delay-related damages. After adequately establishing entitlement to a time extension, an FDOT contractor is entitled to payment for delay-related costs under a simple formula. Under

Section 4-3.2.1 of FDOT's specifications, the contractor is awarded the greater of (1) a 17.5% markup on any additional work associated with an extension of time; or (2) a daily overhead rate computed in accordance with a formula contained in the contract, multiplied by the time extension. The daily overhead rate is computed by dividing 8% of the original contract amount by the original contract duration in days.

Close to perfect

FDOT's approach to compensating a contractor for delay-related costs constitutes an equitable solution to the delay-cost dilemma, because it takes into account the concerns of both parties. If the delay is associated with a significant amount of additional work, the markup on such work will be sufficient to cover additional overhead costs. If not, the daily rate applies. The Ohio Department of Transportation has followed FDOT's lead and adopted a similar approach. Although the solution crafted by FDOT and FTBA might not always result in a perfect scenario for the state DOT or contractor, it clearly represents a fair compromise that has likely saved millions in dispute-resolution costs, and other state DOTs would be well served to follow suit. 🍌

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