



Cost-Plus Contracts Can be a Minus

The Goal of Setting an Outside Limit on Costs Puts A Premium on Contract Language

Under a cost-plus-a-fee-compensation arrangement, the owner pays the contractor for costs necessarily incurred in the construction and either a fixed fee or a fee based on a percentage of the cost of construction.

Using the cost-plus-a-fee contract, an owner assumes the risk of greater construction costs than originally estimated. The owner may desire to set an outside limit on this risk by requiring the contractor to guarantee the maximum cost of the contract and thereby fix a limit on the amount of the owner's investment in the project.

The cost-plus-a-fee contract is also useful to the owner who does not know at the time of contracting whether or not a construction project will be completed in full or who wishes to begin on the construction before the plans and specifications are finally completed.

This method normally allows the contractor to accept a smaller profit margin than under a lump-sum contract because the contractor does

not have to assume the risk of cost increases.

The addition of a maximum guaranteed cost provides a sharing of this risk by the parties, and the contractor must be able to determine from the plans and specifications if he can perform the work within the guaranteed maximum cost.

Generally speaking, the contractor should expect the "upset price" to be higher than on a fixed-price basis because without a clause giving the contractor a share of the savings, these "not to exceed" contracts work solely for the benefit of the owner. Where there is no maximum-cost guarantee, the contractor's fixed or percentage fee simply reflects other factors such as management costs for the type of work and the hazards that are involved in its performance.

Another clause which may be inserted along with the guaranteed maximum cost is the savings clause. Using this combination the contractor is paid upon completion of the contract a certain percentage of the amount by which the actual cost of

performance falls below the guaranteed maximum cost. This incentive is a bonus in addition to the contractor's fee.

The contractor should be aware that legally there does not have to be a savings clause in a contract with a guaranteed maximum cost.

The main questions which should be resolved are proper language in the cost-plus-a-fee construction contract for identification of those costs that are reimbursable, those that are not reimbursable, and those that are included in the base figure from which the percentage fee is calculated. The reimbursable cost figure and base figure from which the percentage fee is calculated are not necessarily identical.

A cost-plus-a-fee contract must be very specific in setting out which costs are or are not included in the costs which the owner must reimburse the contractor.

The costs to be reimbursed typically are specified to mean those

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necessarily incurred in the proper performance of the work, which include: wages, payroll taxes, and fringe benefits; cost of all materials, supplies, and equipment incorporated in the work, including transportation charges therefor; payments to subcontractors; rental and maintenance charges for all necessary equipment, trucks, and hand tools; cost of salaries for contractor's employees stationed at the field office or while they are expediting production or transportation or materials or equipment; proration of reasonable travel, meals, and hotel expenses of the officers or employees of the contractor directly incurred with the work; premiums of all bonds and insurance, seals, and use taxes related to the work; permit fees; minor expenses, such as telephone and

telegraph costs, cost of temporary site facilities and removal of debris; and losses and expenses not compensated by insurance which result from causes other than the fault or negligence of the contractor.

Typically the costs not to be reimbursed are stipulated as: salaries or other compensation for the contrac-

tor's officers and employees while working at the contractor's main office or branch offices; expenses of the contractor's principal or branch offices other than the field office; any capital expenses including interest on the contractor's capital and any additional capital required to perform the work; all general overhead expenses; and costs due to negligence of the contractor, subcontractors, or anyone directly employed by the contractor.

The contractor should specify in great detail which costs are to be reimbursed, which costs are not reimbursable, and which costs and services are covered in the fee.

The reason such care is necessary becomes apparent upon the examination of cases where the contract covered the matter in general terms only, such as "The contractor shall be paid the cost of the building plus 10 percent."

The courts vary widely in what they consider the undefined term "costs" to mean. A frequent source of discrepancy is whether overhead is a cost or whether it is covered by the fee. Some courts consider the various components of overhead to be chargeable as costs, whereas others reason that it is an indirect expense which is difficult to compute and should therefore be, recovered through the fee.

Most courts do not consider general overhead to be a cost.

Labeling of items such as taxes and insurance is frequently a source of disagreement.