

## **TRY TO AVOID COST-PLUS CONTRACTS**

### ***New Property***

By KIM LOVEGROVE

THERE are many ways to maximise the chances of getting a fixed-price contract but, be warned, do not enter into a cost-plus contract. They are fraught with danger for the simple reason that the final cost is unknown. Furthermore, these can only be used for contracts for over \$500,000.

Be careful of the prime cost (PCs) and provisional sum (PSs) components of a fixed-price contract. Very few people understand how PCs and PSs work. Some explanation is therefore necessary.

Building contracts typically have a mechanism that permits parties to allow for price adjustments on labor and materials components in certain instances. Typically, this occurs when the parties cannot agree on finishes or certain types of specified items when they enter into a contract. These items are specified in the PC and PS schedule. The schedule is sometimes located in the contract document but more often is located in the specification document.

By way of example, the contract may specify Italian marble finishes to the kitchen. At the time the contract is executed, the parties may not know the actual cost. This could be for a number of reasons: the marble may not yet be available, or the exact type of marble may not have been chosen.

The contract will normally have a provision that allows the parties to nominate a reasonable PC or PS allowance. Say \$5000 for supply and installation of marble. If the marble supply and installation ultimately costs more, then the builder is paid the \$5000 plus the excess. However, if the marble costs less, the owner pays the lesser amount.

The law requires that the PC and PS allowances be "reasonable". If the price is much higher than the builder allowed, the builder may have to justify such increase. The reason for this is that the estimate must be reasonable and must be prepared with skill.

The dangerous thing about PCs is that one can literally PC any component of a job. One could in theory PC bricks, electrical, tiling, painting. Net effect? An ostensibly fixed-price contract is turned into a cost-plus contract.

It is interesting to compare the PC and PS item specified when one gets three or more quotes for a job. One builder may provide a quote with a great many PCs and PSs, another may submit a quote with none, yet they have all quoted from the same set of plans. If anything can make a fiction of a fixed price, it is a battery of PC and PS's. The moral of the story is to watch the PCs - the fewer the better.

If the builder nominates the PCs, check them carefully. Ask why they can't be fixed. Get independent technical advice if there is any doubt.

Another contract provision that can impact upon a guaranteed fixed price concerns delay provisions that allow one to write in a delay cost calculation.

***Building contracts lawyer Kim Lovegrove is with Lovegrove Solicitors.***