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Variations Arising Under a Construction Contract

Objection Your Honour?

With the outbreak of COVID-19, contractors are experiencing severe disruption across many of their projects, with construction and engineering works facing significant delays, site closures and members of the project team being asked to work from home or forced to self-isolate.

I was recently asked whether a contractor could reject a project manager's instruction to provide a quotation for additional work under an NEC3 contract. In that particular situation, the contractor was close to completing a difficult contract and the request for the quotation involved a significant amount of additional work that would extend the contract duration on unfavourable terms. That question has led me to reviewing a contractor's right of reasonable objection to an instruction under the FIDIC, NEC and JCT contracts.

In my experience, variations can be a welcome source of additional work with contractors pricing on the basis of expected variations. Variations can present opportunities and/or risks for a contractor depending on the type of contract and timing of the instruction(s). For example, a contract such as the JCT SBC/Q/2016 edition that incorporates a bill of quantities may include an opportunity for a contractor to increase profit for an item that includes a high rate. Conversely, it may present a risk and potentially erode the contractor's profit margin where an item includes a low rate.

In *Henry Boot Construction Ltd v Alstom Combined Cycles Ltd*¹ it was held that mistakes in the contractor's rates and prices were to be disregarded for the purposes of arriving at a new rate pursuant to cl.52(1) of the ICE 6th edition even though the practical effect of such an approach was to give the contractor a windfall.²

Whilst the FIDIC, NEC and JCT standard forms of contract include express terms for the administrator to vary the contract, HKA's own CRUX research has also established that "change of scope" and "variations" rank as the No. 1 and No. 2 primary reasons for causation in construction and engineering disputes.³

This article looks at variations, how an instruction may be given and whether a contractor can reasonably object to an instruction to vary the contract.

What are Variations or Extra Work?

Whether an event constitutes a variation depends on the circumstances and the facts. The complex nature of construction and engineering works mean that, in most cases, variations are required to account for changes to the design, quality or quantity of the work.

The ability to make variations under the contract benefits both parties as it:

¹ [2000] 4 WLUK 96

² Chitty on Contracts 33rd Ed.

³ <https://www.hka.com/crux-insight-claims-and-dispute-causation/>

- Gives the employer the power to instruct the contractor to alter or modify “the design, quality or quantity of the Works”⁴ at agreed rates and/or comparable prices whilst also ensuring that the contractor is paid for providing extra or different work or materials.
- Provides the employer the flexibility to make changes so that it gets the product it wants.
- Preserves the contract while allowing changes and therefore ensures that the contract is not frustrated.⁵

The form of contract will determine the party’s obligations and contractual mechanisms for administration of variations.

What are Instructions?

Not all instructions constitute a variation and most standard form contracts expressly provide that the Contractor is obliged to comply with all instructions.

For example:

- Clause 3.5 of the FIDIC Red Book 2017.
- Clause 27.3 of the NEC4 Engineering and Construction Contract (ECC), 2017 edition.
- Clause 3.10 of the JCT Standard Building Contract with Quantities, 2011 Edition (JCT SBC/Q 2011) and JCT Standard Building Contract with Quantities, 2016 Edition (JCT SBC/Q 2016).

Can a Contractor Object to an Instruction?

Some contracts allow the contractor to object to an instruction in limited circumstances.

In the JCT SBC/XQ/2016 contract the requirement to comply with a valid instruction is subject to certain exceptions:

- clause 5.1.2 variation instruction (access and use of the site, etc.) to the extent that the contractor makes a reasonable objection (cl 3.10.1);
- an instruction relating to a Schedule 2 variation quotation, until a confirmed acceptance has been given (cl 3.10.2);
- where the instruction might affect the efficacy of the design of the Contractors Designed Portion (cl 3.10.3);
- where the instruction might affect the contractor’s compliance with the CDM Regulations (cl 3.10.3);
- where the instruction may infringe patent rights (cl 3.10.4);
- where the instruction relates to a named specialist, and the contractor is unable to enter into a contract with that firm (cl 3.10.5, Schedule 8:9.3 and 9.4)⁶

The FIDIC Red, Yellow and Silver Books enable the contractor to object to a variation instruction on a number of grounds including the inability of the contractor to comply with its health and safety obligations and/or obtain the goods required for the variation.⁷ In addition to the grounds for objection in the Red Book, the Yellow and Silver Books contain two

⁴ JCT SBC/XQ/2016 Edition, clause 5.1.1

⁵ NEC3/4, clause 14.3 (Changing the Works Information/Scope or a Key Date) and FIDIC 2017 Red Book clause 13.1 (Right to Vary)

⁶ Guide to JCT Standard Building Contract 2016, p. 80

⁷ FIDIC 2017 Red, Yellow and Silver Book, Clause 13.1

additional grounds to object that reflect the different design risk allocation.

These are that the variation may adversely affect the contractor's ability:

- to achieve the performance guarantees; and
- to complete the works so that they are fit for the purposes for which they are intended.

Despite this, the engineer is entitled to confirm the instruction although the practical effect of this is not clear. If the engineer has dismissed the contractor's objection and confirmed its original variation instruction, can the contractor object all over again? Presumably not, as it would seem meaningless to repeat the process. If the contractor still wishes to maintain its objection to the variation, then it would be reasonable to notify a claim in accordance with clause 20.

Under the FIDIC 1999 suite, the engineer is not entitled to instruct a variation that omits any work which is to be carried out by others. However, the 2017 suite allows parties to agree that work can be omitted by a variation instruction and the contractor is entitled to recover any wasted costs. To the extent that the omitted work is to be carried out by others, the contractor is also entitled to recover loss of profits and any other losses or damages arising from the omission.

If a variation instruction has a price greater than 10% of the accepted contract amount/price or the accumulative total amount of all variations exceeds 30% of the accepted contract amount/price, the contractor may request the employer to provide reasonable evidence that financial arrangements have been made so that the employer can pay the outstanding balance. Failure to do so within the necessary period could entitle the contractor to suspend work and, eventually, terminate the contract⁸

“Variations can present opportunities and/or risks for a contractor depending on the type of contract and timing of the instruction(s).”

One of the most important provisions of NEC3 and NEC4 ECC is clause 27.3 which states that the contractor is required to obey an instruction which is in accordance with the contract and is given by the project manager or the Supervisor.

The importance of clause 27.3 is that in conjunction with clause 14.3 (changing the scope or a Key Date) and clause 20.1 (providing the works) it provides for variation of the works. However, clause 27.3 also implies that the contractor may resist invalid instructions that are not authorised "in accordance with the contract".

‘So for example an instruction going to the order and timing of the carrying out of the works or practical directions given on site might well go beyond instructions in accordance with the contract with the result that the contractor was not bound to obey. Whether this was so might well depend on the terms of the Works Information (NEC3) or Scope (NEC4) which the project manager undoubtedly has power to change under clause 14.3. It may be that the contractor disagrees with

⁸ FIDIC Red Book (2017), Practical Law UK Practice Note w-014-9936

*the entitlement to have provided any such instruction. If so, the contractor will be at risk of the consequences if he simply refuses to comply with it. Instead, the contractor should, if possible, proceed but use the project dispute resolution procedures. If the contractor expends money complying with an instruction the validity of which is successfully challenged, that outlay' would be recoverable as a compensation event (under clause 60.1(18): the issue of an invalid instruction by the project manager; as agent, would be a breach of contract by the employer)."*⁹

In NEC4, clause 17 has been renamed Requirements for Instructions with clause 17.2 introduced giving either party the power to notify each other "other as soon as either becomes aware that the Scope includes an illegal or impossible requirement."

Has a New Contract been Formed for the Varied Work?

A contractor may be able to demonstrate that a new contract has been formed for the varied work, under which the contractor would be entitled to be paid a reasonable sum for the work undertaken. However, the circumstances in each case will have to be considered carefully.

If a contractor decides to argue that the varied work fell outside the contract the point should be made at the time the instruction is issued.

In *Blue Circle Industries plc v Holland Dredging Co (UK) Ltd*,¹⁰ during the course of a dredging contract the parties agreed that the contractor would not deposit spoil into suitable areas of the lough as originally tendered, but instead on an artificial island it had agreed to construct from the dredged material.

The employer accepted the contractor's quotation for this work by letter, which stated that an official works order would follow in due course. The execution of the works to construct the island was unsuccessful and the employer brought proceedings.

The court held that because the construction of the island was work wholly outside the scope of the original dredging contract, the contractor was not obliged to accept the work as a variation. The construction of the island was not a variation of the dredging contract, but a fresh contract.

In *Supablast (Nationwide) Ltd v Story Rail Ltd*,¹¹ the sub-contractor, Supablast, carried out a significant amount of additional works. The court had to consider whether the additional works were carried out as a variation to the original sub-contract or under a new sub-contract.

The court held that there was only one sub-contract and: "*Other than it being an example of work which was considered not to be a variation in an engineering contract, [Blue Circle] does not lay down, at least on this topic, any great point of principle. What one needs to do is to look at the variation clause in question and determine, depending on what the variation clause covers, whether the extra or altered work falls within it or not.*"

⁹ Keating on NEC3, 3-058

¹⁰ (1987) 37 BLR 40

¹¹ [2010] EWHC 56 (TCC)

Conclusion

The standard forms of contract discussed above contain limited rights for a contractor to reasonably object to an instruction.

Although there are perfectly reasonable grounds to object to certain instructions, such as instructions that omit works for the purpose of awarding those works to another Contractor,¹² the consequences of failing to comply with reasonable instructions may constitute repudiatory breach by the contractor and may lead to the employer paying a third-party to execute work of any kind that may be necessary to give effect to that instruction, with the contractor being liable for the resultant cost.¹³

Many contracts also include amendments that allow the employer to omit work and award to others with no recourse for the contractor. Therefore, it is important that a contractor fully understands its contractual obligations and carefully considers its rights before it decides to enter into a specific form of contract which could lead to strict liabilities if it later decides to object to an instruction.

If you require any further information, please contact Christopher Devine at christopherdevine@hka.com.

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¹² Abbey Developments Ltd v PP Brickwork Ltd (2003) CILL 2033

¹³ JCT SBC/XQ/2016 Edition, clause 3.11