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Managing Change through Variations with a Focus on the Rail Sector

Is change an inevitable part of a construction, manufacturing, or supply contract? The short answer is probably yes. Therefore, it is always worthwhile ensuring you know what must be done when either instructing a change or carrying one out.

It is now not uncommon for customers, owners, and operators to set up early engagement sessions with the prospective contractors, manufacturers, and suppliers. The intention is to engage with all relevant parties as early as the feasibility stage of a project in order to ensure that the specifications are as defined as possible to allow the bidding parties for the works to be able to properly value and complete the work as envisaged at the outset. However, this is not always realistic or achievable. Indeed, even with the engagement and input from a wide array of parties early into a project's life cycle, the speed at which new technologies, processes and systems develop mean change can still readily occur.

There is then a need for flexibility; inherently though, that means there will need to be an acceptance of change. In turn, the impact on design, construction or manufacture of such change will inevitably have to be managed by the contract.

To make a change to the specification of work, a contract would, in principle, have to be re-negotiated. However, this would not be feasible in the 'real' world and therefore, most contracts include change provisions enabling the parties to that contract to vary the work specification. Such provisions are usually termed variations, although a variety of other terms can be used to identify change, such as: 'compensation event', 'modifications', 'changes', 'variations', 'variation order'. The list goes on. It all usually depends on the contract form and the defined terms or simply the industry.

The Contract Value

An important factor in any contract is the calculation and payment of the amount of money to be paid by the customer to the contractor, manufacturer, or supplier.

Projects start with a contract value and this amount is typically set out in varying degrees of detail within the conditions of the contract. It is unlikely that the original contract value will remain the same and be paid as the final account value. Inevitably, variations beyond the control of either party will occur and these variations must be assessed, and the appropriate amount of compensation calculated (+/-).

Typically, a contract will contain provisions for how variations are to be evaluated in terms of time and money.

Why are Variations Needed?

There are three main reasons why variations are needed:

i. the customer may change its mind about a certain aspect of the project e.g. look to rebrand the franchise, prior to the detailed design or completion of the entire works;
ii. the customer or the designers may require changes to the specifications e.g. a change in technology, or a new system may be more advantageous for passenger comfort and safety; and

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iii. there may be a change in law e.g. a revision to ERTMS, or other external factors which could force a change to be made.

The reasons for potential variations identified above are different, however, most contracts ignore this fact and deal with all variations in the same manner.

Definition of a Variation
Simply put, a variation is something that changes the works intended to be completed at the time of signing the contract.

The definition of a 'variation' in most contracts is wide and includes for changes to: the design; material specification; the removal of work; access to the site; and the working conditions. The definition applies to the content of the work and the working method.

Limits on Scope of a Variation
Many contracts contain words to the effect that "no variation shall invalidate the contract" and that a contractor, manufacturer, or supplier cannot refuse to undertake an instruction from a customer or its appointed agent e.g. the project manager. This is somewhat misleading, and variations are not unlimited in scope.

The existence of a variation clause does not entitle the customer to make significant changes to the nature of the work. The nature and scale of the works are typically defined in the recitals. For example, if the recitals state that 10 trains are to be supplied, but a variation was the instructed for an additional 90 trains. This would be construed as going to the root of the contract and not be deemed as a valid variation. More importantly is that if the contract was for the refurbishment of old stock, but that a variation attempts to change it to a new supply of rolling stock vehicles this would be beyond the scope of the contract.

"A clearly drafted variation clause means changes can be administered without protracted negotiation"

Issuing Variations
Standard forms of contract typically place the onus on the customer or it's project manager to issue instructions to vary the works. Without a written instruction from the customer, most contracts prohibit the contractor, manufacturer, or supplier from carrying out a variation. If the variation was to be carried out without agreement this is typically done at the contractors, manufacturers, or suppliers risk. In other words, they would not be entitled to time and cost.

The customer may issue instructions at any time until the completion of the works, however, some contracts forbid variations to be made after the design has been finalised.

Within the provisions of the contract, the contractor, manufacturer, or supplier tends to have a right of reasonable objection not to carry out an instruction.

It is not uncommon for contractors to be able to vary the works, however, this should not be done without the express permission of the customer.

Valuing a Variation
When a valid instruction is issued to vary the works, the work needs to be valued. It is likely that the rules for valuing a variation are set out within the change provisions and this method of valuation must be followed. However, there can also be provisions which allow the two parties to a contract to negotiate a price of the work to be completed.

Prior to negotiating a price for the works, it is likely that as part of the instruction to vary the works that the customer will also request a quotation. This quotation is either prepared in accordance with the contract or by measurement of the work. Where the work is unmeasurable, the contractor, manufacturer, or supplier may request that the value the work is calculated on a dayworks basis utilising a schedule of pre-agree rates.

Evaluating an Extension of Time
Inevitably, dealing with a variation will not only cause the original contract value to increase, but it will also require an extension to the time for completion of the works. Therefore, as part of a contractor's, manufacturer's or supplier's response to a variation, it should also include an assessment of any additional time that is required to complete the varied work and an assessment on how this effects the completion or delivery date(s).

An extension of time grants the contractor, manufacturer, or supplier relief to complete its works after the contractual completion date, without becoming liable to pay the customer liquidated damages (or, where no provision exists for liquidated damages, general damages for delay).

The assessment of the extension of time should be done utilising the latest accepted project programme. This should then be impacted with the variation to demonstrate whether an extension of time is required for the variation to be carried out.

Summary
Managing change, be that by issuing notices of potential delay or dealing with the change itself, can cause tension between the contracting parties. The change provisions in the contract may even be perceived as adversarial in nature. However, do not be afraid to rely on and utilise the provisions. They are a contractual requirement and merely facilitate positive communication between the parties.

Consequently, a clearly drafted variation clause means changes can be administered without protracted negotiation and provide a level of cost and time certainty for both parties. Ultimately, the end customer gets a much more tailored product and the manufacturer or supplier gets paid a fair amount for implementing the change.

As a contractor, manufacturer, or supplier, make sure that when quantifying a variation, you encapsulate all time and costs implications associated with the change. It is highly unlikely that time and cost impacts will be reviewed after the implementation of a change has taken place if you have incorrectly quoted for the works.

If you require any further information, please contact Carl Simms at carlsimms@hka.com.

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