Cost reimbursable contracts - Owner's recovery of overpayment

There are millions of dollars to be recovered by owners from overpaying contractors on cost-reimbursable contracts. The author has been involved in reviewing and assessing extension of time and additional cost claims for owners on several large-scale international engineering, procurement and construction (EPC) contracts where the method of compensation was on a cost-reimbursable basis and found this to be the case.

This article explores how and why this overpayment occurs and what actions owners can take to recover these amounts.

> "… to recover any overpayment, the owner will need to demonstrate that the contractor caused the non-compensable critical delays and that it was not entitled to payment of compensation during these periods of delay."

What is a cost-reimbursable contract?

The nature of a cost-reimbursable contract is that the contractor is reimbursed for its actual costs incurred for engineering, procurement and construction, plus an additional fee to cover the contractor's overhead and profit. The additional fee is usually in the form of a percentage of its costs or a fixed fee.

Incorporated into these types of contracts, by way of an exhibit or attachment, will usually be a detailed estimate of anticipated costs for the work together with documents that set out which costs are reimbursable and those that are non-reimbursable. The risk of cost increases for these types of contracts rests with the owner rather than the contractor.

The contractor prepares its payment applications for the work undertaken during the periods and provides records to evidence the costs claimed, plus the agreed fee. These applications tend to be very detailed, with the costs entered into the project's accounts system for the owner to review and approve for payment.

The problem that arises with cost-reimbursable contracts and contractor delay

In addition to the cost risk residing with the owner, another benefit of cost-reimbursable contracts to the contractor is that it can submit what it views to be its reimbursable project costs in its payment application, and then wait for challenges from the owner as to their validity. This is where the problem arises, particularly when it comes to applying for time-related costs during contractor delays.

At the time of preparing its payment applications, there may be multiple ongoing events that are causing delays, some of which may critically impact the completion of the works or milestones dates. It may be uncertain if the contractor will be entitled to an extension of time (full, partial or none) and to what extent the contractor may be responsible for these delays.

In the author's experience, whilst a contractor may have submitted notices for the events per the provisions in the contract, it is usually slow to submit detailed particulars demonstrating its entitlement to an extension of time. Sometimes, it can be many months before the owner receives these for review and assessment. In the meantime, the contractor will most likely include in its payment application all the time-related costs it has incurred on the basis or future belief that it will be entitled to a full extension of time.

The owner will conduct its payment evaluation based on the cost records submitted by the contractor and records of the work performed. It will then issue the payment certificate based on its evaluation and make the payment to the contractor accordingly. However, in doing so, it is unlikely to take into consideration the extent of any contractor critical delay and to make any adjustment to the associated time-related cost in its evaluation because it may be unknown at that time.

As remarked above, it may be some months later that the impact of the delays is fully understood, and the contractor submits an extension of time submission to claim relief from liquidated damages. Such claims usually only focus on extension of time, they rarely if ever, identify the contractor's delays or the contractor's concurrent delays. It is then left to the owner to perform its own detailed delay analysis to assess the contractor's entitlement to an extension of time, and the extent of the contractor's delays and concurrent critical delays, to ascertain the compensable periods of delay.

For example, after assessing the contractor's extension of time claim, it may be found that the owner is responsible for 40% of the delay period claimed, the contractor for 60%, plus there is 20% contractor critical concurrent delay. From the results of the delay analysis, the contractor would only be entitled to an extension of time of 40% of the delay period, of which only half is compensable, because of the occurrence of the 20% contractor critical concurrent delay.

Depending on the provisions in the contract, the contractor may be exposed to the recovery of liquidated damages by the owner for 60% of the critical delay (up to the limit of liability stated in the contract). But what about the time-related costs during the non-compensable periods (contractor delays and concurrent critical delays), 80% of the delay period, for which the owner may have already paid the contractor its associated time-related costs by way of its regular payments? If the contractor is allowed to retain these costs, the author considers that the contractor would be benefiting from its own delays and breaches.

Recovery of overpayment

So how does the owner recover any overpayment of time-related costs incurred during periods of non-compensable delay? There are several provisions to look for in the contract that may assist the owner in formulating a contractual position.

The first is a clear expression of the contractor's liability in respect of its accepted risk events and that it is not entitled to an extension of time, additional cost, or other relief if these occur.

For example:

> Save pursuant to an express provision of the contract, the occurrence or effects of any risk borne by the contractor shall not relieve it of any obligation or liability under the contract and the contractor shall not by reason thereof become entitled to any additional payment, extension of time or other relief. Any other such entitlement is excluded.

The second is a condition in the contract terms or compensation exhibit stating that the time-related costs during periods of non-compensable delay are non-reimbursable.

The third is a condition that provides the owner with the ability to correct issued payment certificates.

The fourth is a condition that allows the owner to set off any overpayments against monies due and payable to the contractor.

For example:

> The owner may deduct, withhold, or set off from any payment due or amounts owing to the contractor under this contract any amounts due and payable to the owner under this contract, including any delay liquidated damages, performance liquidated damages or any earlier overpayment to the contractor by the owner.

The final is a non-waiver provision, which prevents an owner's non-exercise of its contractual rights to recover the overpayments or over-certifying and paying in the first place, as constituting a waiver.

For example:

> A failure to exercise or delay in exercising a right or remedy provided by the contract or by law does not constitute a waiver of a right or remedy or a waiver of other rights or remedies. Any waiver of rights arising under or in relation to the contract by either party shall be effective only if contained in a document which is duly signed on behalf of the waiving party and expressly stated to be a waiver under this clause.

The author considers that not having these provisions in the contract is by no means fatal to the owner's chances of recovering overpayments, but they would certainly go a long way to assisting the process.

From a practical perspective, in terms of identifying and analysing contractor non-compensable delay periods, this can be achieved by the project controls team on a 'live' project closely monitoring the progress of the works to capture the critical delays, assigning causational responsibility, and making the appropriate discounts to the contractor's payments. However, this can be challenging to achieve accurately on a 'live' project with multiple delay events that may be ongoing and impacting the schedule, especially if the project controls are not set up to identify these periods to the required level of detail.

Another approach is for the owner to undertake a detailed retrospective analysis once the contractor has submitted its extension of time claim or its own delay analysis periodically, to identify and analyse the critical delays, assign responsibility, and then assess the contractor's associated time-related cost during the contractor's critical periods of delay for deduction from the next payment certificate.

Either way, to recover any overpayment, the owner will need to demonstrate that the contractor caused the non-compensable critical delays and that it was not entitled to payment of compensation during these periods of delay.

Potential legal challenges

It is appreciated that in some jurisdictions there may be legal challenges to the recovery of monies certified and paid to the contractor, and legal advice should be obtained before embarking on recovering any overpaid time-related costs from the contractor. There may be provisions in the law which may also assist the owner in recovering the overpayments in the absence of contractual provisions to support the recovery.

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About the author

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