BoQ rates neither 'immutable nor sacrosanct'

Written by Steve Mangan

A contractor who has loaded a tender BoQ rate in the expectation of a windfall will be interested to learn that recent guidance from the Hong Kong Court of Appeal supports the engineer's request for evidence of the original tender build up and, among other things, will disallow all loading if substantial differences in actual quantities would make it reasonable to do so under the contract. This article explores that new guidance which finds contract rates to be neither immutable nor sacrosanct in such circumstances.

The 'loading' of BOQ tender rates is common practice when a contractor feels that quantities may have been under-estimated. "Intelligent pricing" is how it was described (without any disapproval) by the Judge at first instance in *Henry Boot Construction v Alstom Combined Cycles [1999]*[1]. There the contract rate had contained an inadvertent error to the great benefit of the contractor. The judge nevertheless went on to find that it was 'immutable and sacrosanct.' The English Court of Appeal endorsed the judge's decision in 2000. Now however the Hong Kong Court of Appeal has given guidance on when it may be justified to unpick a contract rate and fix a reasonable alternative.

Adjustment of BoQ rates under the contract

A re-measurement contract is unlikely to see final quantities of work items match those originally estimated in the BoQ. Re-measurement contracts frequently provide that when a quantities mismatch is substantial and certain criteria are met, the engineer is required to fix a new rate. In doing so he is to rely on concepts of reasonableness and/or appropriateness. The FIDIC 1999 Red Book, for example, adopts this approach.

But what may the engineer take account of in such a rate-fixing process? Must he for example confine himself strictly to the existing components of the rate under review? Or can he consider also the manner in which the contractor compiled or perhaps "loaded" that rate at tender stage and then set about reversing those additions? Can he correct an error in the original compilation? All these questions were considered by the High Court of Hong Kong (Court of Appeal) in the case of *Maeda Corporation v Government of the Hong Kong SAR*.[2] Details of the decision were released earlier this year.

Facts of Hong Kong dispute over rate review by engineer

The form of contract was the Government of Hong Kong General Conditions of Contract for Civil Engineering Works (1999 Edition) ('the HKGCC'). Clause 59(4)(b) required only that the quantities be substantially different before they acted as a trigger for the engineer to embark on a rate review. The clause states:

> *'Should the actual quantity of work executed in respect of any item be substantially greater or less than that stated in the Bills of Quantities … and if in the opinion of the engineer such increase or decrease of itself shall render the rate for such item unreasonable or inapplicable the engineer shall determine an appropriate increase or decrease of the rate for the item using the Bills of Quantities rate as the basis for such determination and shall notify the contractor accordingly.'*

The contractor had performed substantially greater quantities of a particular work item than estimated and the dispute over his entitlement to payment was referred to arbitration. It emerged that he had spotted a pricing opportunity whilst compiling his tender. He regarded the employer's BoQ estimates for this work item as a considerable under-estimate. He took advantage by transferring into his tender rate for that item an additional preliminary sum that had originally formed part of another unconnected rate. The additional preliminary sum had once been intended to cover

Tel: + 44 (0)20 8614 6200
Fax: + 44 (0)20 8614 6222
Email: info@corbett.co.uk
www.corbett.co.uk

miscellaneous items of unrelated costs, on-costs, contingencies and risks. These unrelated fixed costs would not have increased along with an increase in quantities of the new work item in question. The contractor was therefore set to make a large 'windfall' profit. To the arbitrator that made the contract rate for the item unreasonable and therefore inapplicable. The preliminary sum transferred across should be excluded, he held in his award. It was his view that in cases where a rate was a "composite" one involving a number of activities, he could adopt such a position.

Contractor's defence of rate loading

The contractor appealed to the Court claiming that as a matter of law it was permissible only for the arbitrator to consider the elements of the final rate and it was not for him to enquire into how those elements had come to be compiled for purposes of the tender. He also said the final (contract) rate itself was not relevant in determining reasonableness. Pointing to the English Court of Appeal decision in *Henry Boot v Alstom Combined Cycles*[3], the contractor argued that the contract rate was immutable and sacrosanct. It was a contractually agreed unitary price and must be used. He said the only consideration justifying a re-rating exercise was if there had been an increase in the work activities. If there had been such an increase, then only fixed costs related to that work could be considered. Other fixed costs, such as the ones that had been "transferred across," could not be re-opened and reconsidered, he said.

Hong Kong Court of Appeal's guidance

The Court of Appeal endorsed the arbitrator's findings and held that:

- Where a rate is being examined to determine whether increased quantities had caused it to become unreasonable or inapplicable under the contract, there is no rule of law or evidence to prevent consideration of the tender build-up. It was relevant. Even if 'rate loading' is common in the industry, the arbitrator was permitted to ask for and consider such information.
- In cases of increased quantities involving a rate for a single activity, a change in the work method or economics of working would be sufficient to cause that rate to become unreasonable or inapplicable.
- Where however there was a 'composite rate' involving several activities, all elements of fixed and variable costs may need to be identified and understood in order to determine the impact of the change in quantities.
- No distinction is to be drawn between a rate's preliminary items that had direct connection with the work in question and those that did not. Both could be re-opened if they caused the overall rate to become unreasonable.
- Whilst the English Court of Appeal decision of Henry Boot had found even an erroneous rate to be 'immutable and sacrosanct', the Hong Kong Court of Appeal distinguished that case from the present one. No deliberate rate loading had occurred in Henry Boot as had occurred here. The Hong Kong Court also relied on the fact that the Henry Boot contract expressly prevented the rectification of errors, omissions or wrong estimates in order to make its distinction.
- The very significant additional amount that would inure to the appellant, in effect as a windfall, by the application of the original rate to the changed quantity of work … demonstrates why, simply as a matter of fairness, [the Clause] ought to be applied in the way the arbitrator did.'

The Hong Kong Court of Appeal therefore appears to have based its decision on an overriding need for "fairness". It however had little to say regarding the potential for unfairness to the employer in Henry Boot, something that had not embarrassed the English Court of Appeal at all.

Conclusion

The contractor who has loaded his tender rates in the expectation of a windfall if BoQ quantities should prove to be a substantial under-estimate should be aware that as far as the Hong Kong Court of Appeal is concerned, his contract rates and their

Tel: + 44 (0)20 8614 6200
Fax: + 44 (0)20 8614 6222
Email: info@corbett.co.uk
www.corbett.co.uk

individual components are neither immutable nor sacrosanct. The engineer may request details of the tender build-up and disallow anything that he finds would make a rate unreasonable.

This decision relates directly to the use of the HKGCC. However, practitioners in other jurisdictions using international contracts that make similar provision for the engineer to determine a reasonable new rate after substantial changes in quantities will find this decision of particular interest.

1 Henry Boot Construction Ltd v. Alstom Combined Cycles Ltd (formerly GEC Alsthom Combined Cycles Ltd) [1999] EWHC Technology 263 – http://www.bailii.org/ew/cases/EWHC/TCC/1999/263.html

2 Maeda Corporation, Hitachi Zozen Corporation, Yokogawa Bridge Corporation, Hsin Chong Construction Co Ltd v. HKSAR [2012] HKCA 587; [2014] 1 HKLRD 1; CACV 230/2011 – http://www.hklii.hk/cgi-bin/sinodisp/eng/hk/cases/hkca/2012/587.html

3 Henry Boot Construction v Alston Combined Cycles [2000] EWCA Civ 99 – http://www.bailii.org/ew/cases/EWCA/Civ/2000/99.html

Article Author

Steve Mangan

Email: steve.mangan@corbett.co.uk

Tel: + 44 (0)20 8614 6200
Fax: + 44 (0)20 8614 6222
Email: info@corbett.co.uk
www.corbett.co.uk