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FIDIC recoverability of "cost"

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This note considers the definition of "Cost" in the current suite of FIDIC forms of contract and reviews the circumstances where "Cost" might be recovered.

Definition

The definition of "Cost" is the current suite of FIDIC contracts is the same. The definition provides that:

> *"Cost" means all expenditure reasonably incurred (or to be incurred) by the Contractor, whether on or off the Site, including overhead and similar charges, but does not include profit".*

Development of the definition from previous forms

The definition of Cost in the current suite of FIDIC contracts has remained relatively unchanged since the publishing of the 4th edition of the Red Book in 1987, which was the first time the definition expressly excluded profit. The 4th edition Red Book provides that:

> *""cost" means all expenditure properly incurred or to be incurred, whether on or off the Site, including overhead and other charges properly allocable thereto but does not include any allowance for profit."*

The differences between the definition in the 4th edition Red Book and the current suite of contracts are minimal, but include:

- that expenditure must be *"properly incurred"* under the 4th edition Red Book, where as under in the current suite it must be "reasonably incurred".
- that Cost is defined as *"including overhead and other charges properly allocable thereto"* under the 4th edition Red Book where as under the current suite it is defined as *"including overhead and similar charges".*

The final step towards the definition in the current suite occurred when FIDIC published the new Orange Book in 1995 in which the only difference was that expenditure must be *"properly incurred"* rather than *"reasonably incurred".*

What is recoverable as Cost?

In the current suite of FIDIC contracts the features of the definition of Cost are that:

- expenditure must be incurred and reasonably occurred
- expenditure can be on or off site
- overhead and similar charges included
- profit is excluded

Whilst the definition does expressly refer to financing charges, the FIDIC Guide first edition 2000 explains, that overhead charges may include reasonable financing costs incurred by reason of payment being received after expenditure. The FIDIC Guide also notes that in some countries financing costs might be included within Cost, even though funds were not borrowed because the Contractor had sufficient funds at his disposal.

Exclusion of profit

One of the main features of the definition of "Cost" is that it does not automatically include any element of profit. In order to ascertain whether an element of profit is recoverable one needs to look at the actual wording of the individual sub-clauses. In general terms, and as noted by the FIDIC Guide, an element of profit is recoverable in addition to Cost where the Employer is blameworthy. Where neither party is at fault then it is usually only Cost that is recoverable.

The current suite of FIDIC contracts use slightly different wording where it is stated that profit is recoverable in addition to Cost:

- *"Cost plus reasonable profit"* is used in the Red Book, Yellow Book and Silver Book.
- "Cost plus profit" is used in the MDB Harmonised Edition of the Red Book which is further defined to require "this profit to be one-twentieth (5%) of this Cost unless otherwise indicated in the Contract Data".
- "Cost Plus Profit" is used in the Gold Book which is further defined as "Cost plus the applicable percentage agreed and stated in the Contract Data. Such percentage shall only be added where the Sub-Clause states that the Contractor is entitled to Cost Plus Profit".

In the event that the parties to a contract using the Red Book, Yellow Book or Silver Book wish to specify the amount of profit recoverable the FIDIC Guide recommends that the following amendment can be included at sub-clause 1.2:

> *In these Conditions, provisions including the expression "Cost plus reasonable profit" require this profit to be [one-twentieth (5%)] of this Cost.*

When is Cost recoverable?

The circumstances in which the Contractor is able to recover Cost varies between the different forms in the current suite of contracts to reflect the different allocation of risks. By way of example under the Red Book the Contractor is able to recover Cost for unforeseen ground conditions, whereas under the Silver Book unforeseen ground conditions is a risk assumed by the Contractor and as such Cost is not recoverable.

Under the Red Book Cost is recoverable under the following provisions:

- 4.12 [Unforeseen Physical Conditions]
- 4.24 [Fossils]

- 8.9 [Consequences of Suspension]
- 13.7 [Adjustments for Changes in Legislation]
- 17.4 [Consequences of Employer's Risks]
- 19.4 [Consequences of Force Majeure] subject to exceptions

As the definition excludes profit, in each of the above circumstances, there is the potential for the Contractor to incur significant expenses without profit.

Recoverability of Cost is subject to Clause 20.1

The Contractor's entitlement to Cost is subject to sub-clause 20.1 of the FIDIC forms. Sub-clause 20.1 sets out the procedure that the Contractor must follow in order to claim additional payment.

Under the sub-clause 20.1 the Contractor must give notice of the event or circumstances giving rise to its claim as soon as practicable, and not later than 28 days after the Contractor became aware, or should have become aware, of the event or circumstances.

In the event the Contractor fails to comply with the notice requirements set out at sub-clause 20.1 the Contractor shall not be entitled to any additional payment.

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