Doing Your Sums

The obligations of builders and contractors when undertaking estimates and providing for allowances in contract prices

Victoria Whitfield
Whitfield Braun Limited

Disputes arising as a result of estimates or contract allowances being exceeded by builders or contractors are an unfortunate but familiar occurrence.

Unlike quotations, estimates are not firm prices for proposed works but are intended to be a realistic guess of the final cost of the works. If works are undertaken pursuant to an estimate provided by a contractor, there is no obligation on the contractor to meet the estimated price. However, that does not mean that the contractor has an open cheque book to charge as he or she thinks fit, and in some circumstances the Court may require the contractor to pay damages to the homeowner where an estimate has been exceeded.

This article will consider the obligations of builders and contractors when undertaking estimates and providing for allowances in contract prices.

Guarantee as to reasonable price under the Consumer Guarantees Act 1993

A contractor may provide an estimate but agree to undertake works on a charge up basis with specified labour rates and an agreed contractor's margin. However, in some cases a contractor may provide an estimate and proceed with the works without any agreement as to the methodology for determining the final price for the works.

In circumstances where the price for the services is not determined by contract, or not left to be determined in a manner agreed by the contract or by the course of dealings between the parties, then the Consumer Guarantees Act 1993 provides that a consumer will not liable to pay to a supplier more than a reasonable price for services. A reasonable price is generally determined by reference to an objective assessment of the price, i.e. the price of the services determined in an independent market.

In addition to the potential remedies discussed below, where it is established that services were not charged reasonably, a consumer will be entitled to refuse to pay more for the services other than what is reasonable.

PC sum or provisional sum?

The terms PC (prime cost) sums and provisional sums are used in almost every residential building agreement. Contractors will usually say that they refer to allowances for items for which the exact cost is not yet known, and the actual prices will simply be substituted when the work is completed. Unfortunately, these terms are the cause of many disputes between contractors and homeowners. This is largely due to a lack of clarity in building contracts and inadequate communication between the contractor and the homeowner. Contractors need to understand their obligations when quoting, allowing for and expending PC sums and provisional sums.

Both PC sums and provisional sums refer to amounts allowed in contracts for work for which the actual cost is not known ahead of time. However, they have subtly different meanings. A PC sum (prime cost sum) covers the supply cost of a specific item that may not yet have been chosen. For example, the contractor may have an allowance for certain bathroom fixtures in the contract but the homeowner

may want different ones from those allowed. A PC sum is to be spent at the instruction of the homeowner, meaning they will have some ability to control the final amount.

A provisional sum is an estimate for particular work for which the extent is not yet known. Excavation works are an example – the contractor may not know how large an excavation is required until it has commenced. Accordingly, the amount of the provisional sum can be, to a large extent, outside either party's control.

Estimates must be reasonable

Both PC sums and provisional sums are essentially estimates of the cost of work by the contractor. A contractor is obliged to exercise reasonable skill and care when undertaking any estimate and can be sued in negligence, and potentially also contract[1], for failure to do so.

In *J & JC Abrams Ltd v Ancliffe*[2] the builder gave an estimate of costs of the construction of two residential townhouses of $35,000 each. The specifications showed the builder that the units contemplated by the owner were of a more expensive type than those on which he had based his estimate, he had problems with the foundations and building costs were escalating. Both before and after work commenced, the owner made continuous enquiries about the final price but received no indication of any significant alteration. By the time the owner was advised that the final price would be $57,500 each, $8,463 worth of work had been done on the units. The builder declined to complete the units for an overall cost of $40,000 and the owner then instructed another builder. The owner sought to recover the loss from the original builder.

In that case, the Court held that there was a sufficient relationship of proximity such that it was in the builder's reasonable contemplation that carelessness on his part was likely to cause damage to the owner. The test was what a reasonable builder would have done in those circumstances and with the information available to him, to ensure that the owner was given a realistic estimate. The Court stated:

"*[t]he latter clearly did not expect an exact – or even a close figure – but I am satisfied his expectation that it would be a reasonable relationship to building costs at the time accorded with Mr Abrams' view of the matter.*"

Similarly, in *K. M. Young Ltd v Cosgrove*[3] the Court held that a contractor is under a duty of care and is liable to the other contracting party for damage resulting from any negligence in the giving of the estimate.

In order to establish that a contractor has breached its obligation to a homeowner to exercise reasonable skill and care when undertaking any estimate, it is necessary to consider what a reasonable contractor would have done in those circumstances. This is likely to involve the contractor giving consideration to the type and extent of the work or goods needed, and comparable costs on previous projects. The contractor may have to consult with subcontractors to obtain a reasonable estimate for the work. At the end of the day, the contractor must be able to show that he or she has acted reasonably when providing the estimate for the work or goods.

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[1] A claim in contract would be made on the basis of an implied term of the contract. In *Brocklehurst v P I Vidovich Builders Limited (*High Court Auckland, CIV 2007-404-3526, 23 October 2007, Randerson J) the Court did find that there was no implied term that the costs would approximate the estimate. However, the difference in that case was that the parties agreed on hourly rates for labour and agreed that the works would be undertaken on a charge up basis.

[2] [1978] 2 NZLR 420 (NZSC)

[3] [1963] NZLR 967 (NZSC).

By way of example, a builder gives a price of $2,000 for the replacement of a window and during the works, discovers that the framing timber surrounding the window is rotten, causing a significant increase in costs. If it was not reasonable for the builder to foresee that the framing timber was rotten then the builder was not negligent in his preparation of the estimate. However, if the builder ought to have known that it was likely that the framing was rotten and failed to include it in his estimate, then he is arguably in breach of his obligations to exercise reasonable skill and care.

In addition to a potential claim in negligence, there may be an available cause of action to a homeowner for breach of section 9 of the Fair Trading Act 1986 which prohibits conduct, in trade, that is misleading or deceptive.

As a general rule, opinions or predictions (as an estimate would be) are not actionable as misleading or deceptive conduct unless there was no reasonable basis for this belief.

However, if it can be established that a contractor simply plucked a figure out of the air without any adequate consideration or even worse, provided an estimate with knowledge that the actual cost would be significantly greater, then this is likely to amount to misleading and deceptive conduct in breach of the Fair Trading Act 1986. A breach of section 9 would entitle the homeowner to claim damages as a result.

Quantification of loss

In respect of a claim in negligence or under the Fair Trading Act, a homeowner would be entitled to be placed in the position that they would have been in had the builder exercised reasonable skill and care in the preparation of the estimate. To determine loss requires consideration of the position the homeowner would otherwise have been in had the contractor not provided the homeowner with an incorrect estimate. The question is therefore what the homeowner would have done had they been provided with a more accurate estimate.

This can often cause difficulty in establishing loss for the homeowner. If an accurate estimate had been provided and the homeowner would have proceeded regardless then arguably no loss has been suffered. However, it is a rare case where a homeowner is not constrained by budgets and financial limitations when embarking on a building project. Had the homeowner been aware of the actual likely cost of the works, then they may have made different decisions in the planning stages, such as reducing the floor area or making amendments to the specifications.

The answer may also not be quite so simple where the increased cost has proportionately increased the value of the works and/or the property. In such a situation, whilst the homeowner may not have wanted to expend the amount of money and may have had a budget exceeded, the effect of the additional costs has arguably not caused a loss because the value of the works has increased proportionately.

In a matter that we were involved in recently we were able to establish that the effect of the excessive costs was that it did not amount to a comparable increase in the value of the property and as a result, whilst the homeowners' budget was exceeded, they suffered loss because the value of the property had not similarly increased. We were successful in receiving a significant award of damages in favour of the homeowner.

Communicate and avoid surprises

The contract may require certain steps to be taken before any PC sum or provisional sum is actually spent. In the case of a PC sum – such as an allowance for light fittings – it might be that the contractor must talk to the homeowner and get verbal or written confirmation of acceptance of price.

Provisional sums are more difficult as the final price is often not known until the works are completed. Communication between the contractor and homeowner is essential when expending any provisional sum. The contractor needs to ensure that the homeowner is kept fully informed of the situation and the likely costs, as and when they arise. If a contractor fails to do so, then the homeowner can consider whether there has been any breach of the obligation to exercise reasonable skill and care in providing the estimate for the provisional sum.

The contract should clearly set out whether the contractor's margin is to be added to PC sums and provisional sums.

Main points to remember

Four important points can be made about estimates and contract allowances:

(a) Where works are undertaken pursuant to an estimate and there is no agreement as to the determination of the price, the price must be reasonable.

(b) The contract should clearly define PC sums and provisional sums, and which apply to the particular works.

(c) A contractor must exercise reasonable skill and care when allowing for PC sums and provisional sums. This may require the contractor to consider similar works and/or goods on other projects, or consult with subcontractors.

(d) Communication between the contract and homeowner is essential when expending any PC sum or provisional sum and ideally the contract should provide the steps to be taken before incurring any such expenses.

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