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Claims Management: The Blueprint to Success

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One of the more challenging tasks that a contractor will face during a construction project is dealing with claims. Claims — and change orders, depending on where they are in the dispute resolution process — arise out of the numerous issues encountered during construction, such as scope changes, differing site conditions, and project delays.

Not only are substantial sums of money on the line, but so are a contractor's relationships with the owner, subcontractors, suppliers, sureties, and other project stakeholders. Because of this, it's imperative that contractors are strategically positioned to support their claims and defend them against opposition and scrutiny.



This article discusses how contractors can prepare accurate and well-supported claims, including early identification of cost impacts, employing proactive cost accounting and project control measures, and maintaining adequate documentation to support their claims calculations. Various methods of preparing claims as well as the requisite data and documentation to achieve the most favorable outcomes will also be explored.

OVERVIEW OF CLAIMS

Construction is an inherently complex undertaking. It requires the coordination and cooperation of multiple parties — many of whom have not previously worked together — that all have significant resources invested in the end product.

It also involves the conversion of a set of drawings (two- or three-dimensional) into a physical, tangible structure. There are volumes of architectural, engineering, and contractual documents to consider, as well as real-time decisions that must be made and agreed to by a consortium of project stakeholders.

Compared to other manufacturing industries, there are few opportunities to improve the final product through research and development; in construction, the prototype is the finished good. It would be incredible if all these factors and inputs magically came together at once to create a perfect product, but in reality, they usually don't.

Changes occur on construction projects all the time. For example, these changes can be due to:

- Design errors and omissions (intentional or otherwise)
- Additions or deductions to the project's scope
- Unforeseen or discovered site conditions
- Delays due to weather, permitting, and other issues outside of the contractor's control
- The availability of labor, equipment, and materials
- Inefficient communication and coordination among project participants

Whether the changes are minor or significant typically depends on the impact to the schedule or budget. Minor changes can generally be resolved with minimal paperwork and deliberation.

Significant changes, however, will almost always result in a change order and, if disputed or unsupported, may lead to a claim. When claims ensue, the information required to prove the contractor's entitlement to the additional costs and/or time can be substantial and daunting.

Fortunately, claims can be supported and quantified with enough foresight and preparation including the implementation of appropriate project controls and maintenance of relevant contemporaneous project documentation.

TYPES OF RECORDS & DOCUMENTS TO MAINTAIN

Identification & Notice Documents

For a contractor to be in the best position to support its claim, it should identify change impacts as early in the process as possible and maintain adequate documentation of their origin and impact. Typically, requests for information and responses, meeting minutes, and emails are a good foundation for establishing the origin of a changed condition.

As changes progress, the architect's bulletins and supplemental instructions, the contractor's change order requests, and the owner's change directives can provide further support for the contractor's entitlement to a change order and its negotiation between parties.

Despite the convenience of verbal discussions, contractors should avoid relying solely on verbal agreements or statements. At a minimum, a contractor should always submit a written understanding of any verbal agreements made between itself and the owner or architect and request written confirmation thereof to establish a reliable documentation trail.

The contractor should also pay careful attention to notice requirements for claims in the contract and the timelines for submission and response included therein. For example, most contracts include clauses identifying notification periods due to disruptions or other

events. Similarly, some contracts prohibit contractors from retaining change order requests until the end of the project.

Certain contract and payment documents (such as executed change orders or lien waivers) may waive a contractor's rights to future recovery through the claims process. Prior to signing a change order, a contractor should consider whether the extent of the impact is fully known or whether it may potentially warrant future work.

If a contractor has not yet determined the order and magnitude of a cost or schedule impact, then the contractor may decline signing any documents that waive its rights to additional compensation or excusable delay through the claims process.

Accounting Records & Documents

One effective approach that a contractor may use to quantify its claim is the *discrete pricing or specific identification methodology*. This methodology identifies the link between the cause of an impact (which is necessary to establish liability) and the effect (the quantification of damages). To rely on this methodology, it's important for contractors to begin tracking the costs associated with change impacts early in the process.

Ideally, a contractor will have the ability to set up separate cost or account codes in its project ledger to capture the additional costs incurred from the impact (sometimes referred to as extra work or force accounts). The costs captured in these accounts can be verified through a review of the contractor's project ledger and substantiated with supporting documentation such as invoices, timesheets, and subcontract documents.

Although these types of accounts are useful for capturing the direct costs of change impacts, contractors should be cognizant of any incremental costs that the accounts fail to capture such as additional general conditions and site requirements, crew downtime, equipment standby, and productivity impacts.

To the greatest extent possible, contractors should avoid including an excessive

number of transfers between cost accounts or journal voucher entries in their claimed costs. These entries may later prove challenging for the contractor's claims experts to validate and/or for the contractor to defend as compensable costs without onerous explanation and support.

Payroll & Timekeeping Records

In accordance with best practices for discrete pricing, contractors should direct their employees (both craft and supervisory) to record time spent on tasks associated with change impacts under separate cost or activity codes on their timesheets. Contractors should ensure timesheets are signed by supervisors attesting to the crews' classification of time and include detailed notes related to weather, unforeseen conditions, or other obstacles outside of the contractor's control that required additional time or effort.

On some projects, a contractor may be forced to accelerate its work due to circumstances outside of its control. If acceleration is directed by the owner, either by order or constructively, then the contractor may be able to recover the costs of overtime or workforce expansion to adhere to the existing project schedule.

In these situations, it behooves the contractor to account for the additional personnel added and/or overtime incurred because of the acceleration. This is particularly true when the contractor is only able to recover the premium portion of wages and benefits paid to employees (as the straight-time portion is assumed to have already been included in the contractor's bid). The accelerated labor costs can typically be captured and substantiated using a combination of the foreperson or superintendent's daily reports, timesheets, and corresponding payroll data.

Equipment Cost & Usage Documents

After labor, one of the most significant drivers of increased costs is additional equipment charges. As part of a claim

or request for additional compensation, contractors often include costs for extra equipment procured that was not contemplated in the bid, equipment that was onsite longer than planned, and equipment placed on standby due to delay.

The types of equipment claimed generally fall into two buckets: rented equipment and owned equipment. Rented equipment costs can be supported with third-party rental agreements and invoices. There is generally little dispute over rented equipment, as they are assumed to be incurred via an arm's length transaction. However, owned equipment is often the subject of both factual and pricing challenges from owners and their representatives.

Disagreements can arise as to whether:

- Owned equipment was necessary to be onsite
- Its location and usage has been adequately documented in contemporaneous project documentation
- Its pricing comports with contractual requirements and stipulated rates
- A contractor's calculation of *actual* costs reflect the contractor's *true* costs of equipment ownership and operation

Many contracts provide for agreed-upon owned equipment rates or refer to industry-standard publications, such as the *Rental Rate Blue Book for Construction Equipment* (also known as the "Blue Book"), or the *U.S. Army Corps of Engineers' Construction Equipment Ownership and Operating Expense Schedules* (COE Guide).

If using agreed-upon rates, then the contractor should ensure the equipment rate schedules attached to the contract are as detailed as possible (i.e., inclusive of make and model numbers) for both equipment included in the bid and additional equipment that may be added to the project at a future date.

If the contract incorporates one of the industry-standard publications, then

contractors should be familiar with differences between the publications and the types of ownership and operating costs included in the equipment rates (e.g., the “Blue Book” includes the costs of property taxes and insurance in the rates, whereas the COE Guide does not). Furthermore, an understanding of the differences between ownership, operating, and standby rates in these guides can also better support costs.

If equipment rates are not agreed upon or industry-standard publications are not incorporated by reference into the contract, then contractors should be prepared to support the costs of owned equipment as thoroughly and exhaustively as possible.

Generally, rates can be developed using a contractor’s accounting records, such as depreciation schedules and general ledger details, as the basis for the rate as well as an estimate of the annual hours

of operation. Contractors should strive for the highest degree of reasonableness and accuracy in both the numerator (cost) and denominator (hours) components of this calculation — both may be scrutinized and challenged in a claim environment.

Contractors should also ensure that project controls are adequate to track the location and usage of additional owned equipment. Typically, a project ledger showing owned equipment costs as incurred is not sufficient to establish the necessity of the equipment to the project. Other contemporaneous project documentation — such as equipment usage logs, equipment yard in-and-out tickets, and operator timesheets — should be maintained to demonstrate that owned equipment was onsite and in use (or on standby) during the periods in question.

Material Cost Documentation

When additional material costs are incurred, it’s generally due to a higher quantity of material needed for the project or a higher price per unit of material. For the former, contractors should ensure that additional claimed material costs are not due to estimating errors or rework. For the latter, a contractor should carefully consider the causes of material price escalation. Given the current state of supply chain constraints and goods inflation, any challenges in obtaining construction materials at the prices stipulated in (and the timeframes anticipated by) the bid should be documented by the contractor.

Many contracts today include material escalation clauses that allow for the sharing of supply chain risk between the parties and/or indicate thresholds at which a contractor is entitled to additional compensation for price increases. Whether a contract includes such provi-

sions or not, a contractor should separately track all material price escalations due to circumstances beyond its control.

Subcontractor Cost Documentation

Like the other third-party costs discussed previously, additional subcontractor costs can be readily verified through a review of subcontractor change orders and payment applications. However, additional services performed by a subcontractor as the result of a changed condition or impact are not always clearly delineated in subcontract documentation.

A subcontractor may be granted a change order relating to more than one impact, and/or an impact may only be linked to certain costs within a change order. Often, identifying the support for these costs includes a review of the underlying change order requests, price proposals, and project correspondence, which can be an inexact and tedious exercise.

To the extent specific subcontractor costs are anticipated to be incorporated into a claim, contractors should request subcontractors separately identify those costs as line items in both change orders and payment applications. Doing so will allow the additional costs to be verified with minimal effort and withstand potential challenges.

Contractors should also take note of any flow-down provisions within their prime contract that may affect a subcontractor's obligations and responsibilities to the contractor and owner, including how the subcontractor is paid.

For example, many prime contracts limit the cumulative overhead and profit markup that a subcontractor can apply in change orders to its own costs and the costs of sub-tier subcontractors. In the same vein, an owner may be afforded similar audits rights in respect to a subcontractor's books and records as under the prime contract, if subcontracts are let on a cost-plus basis.

Schedule Documents

In order to be compensated for a schedule delay, a contractor must be able to:

- Demonstrate that the critical path of the project was delayed
- Quantify the delay incurred
- Show that it did not cause the delay¹

In order to meet the first requirement, the contractor must have a proper baseline schedule developed at the outset of the project with discrete activities of reasonable durations that have logical relationships between them. The baseline schedule will become the foundational measuring stick against which progress will be compared during the project.

Contractors should also create a schedule basis, which is a document that sets out the assumptions made when developing the baseline schedule. This can include items such as the project's critical path, anticipated production rates for various activities, preferential logic that has been included in the schedule, or any exclusions from the schedule and their accompanying reasons. The schedule basis works in tandem with the baseline schedule to assist the contractor in preparing and defending any unanticipated deviations during project execution.

If a disruption does occur, then the disruption event can be incorporated into the most current schedule update so that any downstream delays or impacts can be readily identified. This can be done by inserting a fragnet (a sequence of new activities that are proposed to be added) into the schedule that represents the duration of the impact and is tied using schedule logic to the affected activities.

For example, if a hurricane delays grading work by five days, then an activity with a five-day duration can be inserted into the schedule as a predecessor to grading. This action will enable the contractor to model how the impact affects the critical path and provide support for any time-related claim to the owner.

When preparing a time-related claim, contractors should be aware that the baseline schedule and any subsequent schedule updates are simply models and should be validated by project documents. Typically, this is done by comparing the as-built dates in the schedule against the contractor daily reports, project photographs, and/or emails discussing the impact of the same date. Meeting minutes can also be a useful schedule tool to validate that an impact was discussed with project stakeholders contemporaneously.

For claims related to a weather impact, it is helpful to include photos that clearly represent the condition of the work area during the disruption period. These photos, in tandem with basic weather data from the daily reports or historical data from the National Oceanic and Atmospheric Administration, can be compelling evidence supporting a contractor's weather-related time extension request. Make sure you're aware of any contract provisions that require such support for weather-related delays.

USE OF OTHER DAMAGES METHODOLOGIES

There will be certain instances in which the costs of impacted activities cannot be determined and segregated from other non-impacted activities.

For example, a differing site condition may cause widespread disruptions to productivity that cannot be tracked separately from base scope activities. In these cases, a different damages quantification methodology, such as a measured mile analysis, may provide a better basis for measuring the differences in production on impacted vs. non-impacted project areas.

In other instances, a contractor may not be able to separately quantify an impact's cost. The impact may be so ingrained in other scopes of work or may be so intertwined with other impacts that parsing the costs would be impracticable.

For example, a project may have undergone so many design changes and

revisions that isolating the cost of one design change from the others would not be feasible. In such situations, the contractor may consider employing the total cost or modified total cost approach.

The total cost claim approach measures the contractor's total costs, plus a reasonable markup for overhead and profit, against its bid amount (or revised contract price). This approach is used to calculate the excess of the actual costs incurred over the costs it would have otherwise expected to incur (and be compensated for) but for the delays or disruptions caused by others. This methodology, which can be used on the cost of the entire project or a specific subset of costs affected, has been accepted by courts and other triers of fact to the extent it passes this four-part test:²

1. The damages cannot be reasonably quantified under any other method
2. The bid was reasonable and free from material errors
3. The contractor's actual costs are reasonable and accurate
4. The contractor was not responsible for any of the additional cost

This approach has obvious weaknesses, namely that it makes no attempt to account for the contractor's own errors or inefficiencies and assumes the budgeted costs are entirely accurate.

Given the nature of construction, it is unlikely that a contractor is not responsible for at least some element of the increased project costs. To overcome this obstacle, a contractor could also consider the modified total cost claim approach, which attempts to identify, quantify, and remove from the claim any additional costs due to the contractor's own errors or inefficiencies and/or adjust the bid price for possible bid errors or omissions.

With either approach, it is imperative that a contractor's bid is reasonable,

accurate, and not overly reliant upon unsupported factors or assumptions. Similarly, the viability of either the total cost claim or modified total cost claim approach is contingent upon a contractor's maintenance of accurate and reliable project cost records.

CONCLUSION

Construction is a complex undertaking, prone to significant changes and cost increases that must be analyzed, mitigated, negotiated, and resolved between project stakeholders in real time.

During project execution, it may be challenging for contractors to track and document the numerous issues that arise daily, while also maintaining the level of support necessary to substantiate the impacts. However, with the implementation of effective project controls and the maintenance of relevant contemporaneous project documentation, a contractor can feel confident that its claims are well-supported, accurately presented, and able to withstand scrutiny and challenge. **BP**

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Endnotes

1. *Manshul v. Dormitory Auth. Appellate Division of the Supreme Court of New York, First Department. March 10, 1981. casetext.com/case/manshul-v-dormitory-auth.*
2. *John F. Harkins Co. v. Sch. Dist. of Phil. Superior Court of Pennsylvania. April 22, 1983. casetext.com/case/john-f-harkins-v-sch-dist-of-phil.*