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COMPUTATION OF HEAD OFFICE OVERHEADS AND LOSS OF PROFIT DAMAGES IN CONSTRUCTION DISPUTES

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I. INTRODUCTION

One of the major challenges in Construction disputes is the computation of damages on account of *overhead costs* ("**OC**") and *loss of profit* ("**LOP**") that a contractor is entitled to be awarded. Such damages are sought on the basis of delay in completion of the project that has been caused by the employer which resulted in the contractor incurring OC.

Determining delay damages in such disputes involves complex calculations and estimations. There are various formulae for computing construction delay damages in relation to the OC & LOP that may be applied by any Arbitral Tribunal ("**AT**") and Courts. In this piece, we discuss the various formulae for computation of damages on account of OC & LOP, the law governing the award of damages under the Indian Contract Act, 1872 ("**Contract Act**") and the approach of Courts towards the application of various formulae.

II. HEAD OFFICE OVERHEADS & LOSS OF PROFITS

A. Head-Office Overheads:

In construction disputes, the OC is generally categorised as 'Head-Office Overheads' ("**HOH**") which include administrative expenses, rent, electricity, utilities expenses, insurance costs etc. [1]. According to the Society of Construction Law's Delay and Disruption Protocol ("**SCL Delay Protocol**"), HOH refers to all incidental expenses associated with the contractor's overall business operations, including those that cannot be directly attributed to the project [2]. The contractor may claim such damages under two methods:

ABOUT THE FIRM

AKS Partners (formerly known as A.K. Singh & Co) is a law firm based in New Delhi (India) that provides a comprehensive range of legal services and solutions to domestic and international clients. The Firm offers a unique blend of the local knowledge to apply the regulatory, economic, political and cultural context to legal issues and develop case strategies.

We regularly handle technically challenging and complex multi-jurisdictional matters. Our team is spearheaded by one of the highly recognised lawyers with extensive experience in international dispute resolution and strong government and diplomatic backgrounds. This experience gives us the deepest understanding of the key decision points that are critical in navigating complex & complicated matters and managing government regulations.

i. Opportunity based claim: Due to the delay the contractor lost the opportunity to earn the OC and profit in other projects; or

ii. Actual OC that the contractor incurred based claim: Due to the delay the contractor incurred additional OC to complete the project.

Usually, a computation on the basis of the Actuals is difficult due to the reason that the contractor does not have the complete record of the OC expenses to quantify the HOH. Therefore, the preferred approach for calculating the HOH is the Opportunity based claims using the various established formulae [3]. However, the contractor is required to prove that he had projects other than the one that is the subject matter of the dispute and that he could have utilized his resources on the other project(s) [4].

B. Loss of profit:

Loss of profit is the loss incurred by a contractor due to a decline in the profit margin brought on by the extension of the contract, or due to the profit the contractor was unable to realize during the prolonged period as the contractor was unable to allocate resources and labour to another project due to the extension of the current contract, or when the contractor was unable to complete the work because the employer had violated the terms and conditions of the contract [5]. However, such a claim is only available to the contractor if they are able to show that while allocating their resources to the delayed contract, the contractor was aware of such profits that could have been earned in other projects [6].

III. FORMULAE FOR COMPUTATION OF HOH AND LOP:

The substantive provisions regarding damages for breach of contract in India, are as such silent on the method of calculation of such damages. Therefore, various formulae are applied by the courts and arbitral tribunals for calculating for computing HOH and LOP claims. The Supreme Court of India ("**SC**") discussed the three most applied formulae *viz Hudson*, *Emden* and *Eichleay* formula in the calculation of construction delay damages in the seminal judgment of ***McDermott International Inc. vs. Burn Standard Co. Ltd.*** [3] ("***McDermott***"). This section discusses the different formulae which are applied for calculation HOH and LOP rate in construction delay disputes.

A. Hudson Formula–

HO/Profit%*	x	Contract sum	x	Period of delay (In weeks)
100		Contract period		
*HOH and profit percentage as provided under the tender/contract.				

The *Hudson* formula links HOH and LOP together on the assumption that contractors normally add a single percentage to their prices to cover both and this percentage is provided in the tender/contract itself. This formula is to be applied on the total contract value and not the value of the works completed [7] . The formula would showcase that in the event there is a delay in the performance of the contract, the contractor will be entitled to get additional sums under the contract as the calculation is derived from a number which in itself contains an element of HOH and profit which ultimately leads to double counting. This double-counting has been subjected to criticism [8] . This formula needs to be adjusted before it is applied by any AT or Court as it assumes that there has been no variation in the contract price and ignores the responsibility of the contractor to realistically make best efforts to mitigate his losses during the period of delay [9] .

B. Eichleay Formula–

Step 1				
Contract Billings / Total Billings for Contract period	X	Total overhead for contract period	=	Overhead allocable to the contract
Step 2				
Allocable overhead / Days of Performance	=	Daily overhead rate		
Step 3				
Daily Contract Overhead Rate	x	Days of compensable delay	=	Amount of recovery

The *Eichleay* formula aims to first allocate HOH to the project for the entire duration of the full contract time, and then to reassess it on a daily basis to calculate the compensation due. The benefit of this method is that it takes into account actual instead of anticipated period to perform the contract, as the HOH & LOP is not double-counted in the result [1 0] . However, this *Eichleay* method is criticized for being theoretical and its inability to provide any mechanism for allocation of wasted overheads when there are two or more sources of delay.

C. Emden Formula–

$$\frac{\text{H or } [(\textit{Total HOH + Profit})/\textit{Total Turnover}]\ \%}{100} \times \frac{\text{Contract sum}}{\text{Agreed contract period (in weeks)}} \times \text{Period of delay caused by Employer (In weeks)}$$

The *Emden* formula was developed by Canadian courts [11] and operates on the lines of the *Eichleay* method. This formula may be preferred in the cases where the actual costs of head office staff directly engaged upon the individual contract are not obtainable as it takes the value of H (from the above formula) as the Head-Office percentage computed by dividing the cumulative OC & Profit of the Contractor's organisation by the Total Turnover [12]. The HOH percentage is calculate using the *Emden* formula by dividing the contractor's organization's overall overhead cost and profit by its overall turnover. Pertinently, the *Emden* formula only considers the actual HOH and profit percentage in contrast with the *Hudson* formula.

IV. PRE-REQUISITES UNDER LAW GOVERNING THE AWARD OF DAMAGES UNDER THE INDIAN CONTRACT ACT, 1872:

A. When Time is of Essence OR Extension of Time is provided:

Section 55 of the Contract Act deals with situations when a party to a contract in which time is of essence fails to perform its obligations within the stipulated time. In construction contracts, generally, time is not of essence unless specifically provided for [13] in the contract or determinable from the intention of the parties [14]. For claiming damages on account of *inter alia*, HOH and lost profit due to prolongation caused by the employer, a contractor must show that time is of essence under the contract.

B. Establishment of Losses suffered due to Breaches:

The SC while dealing with LOP claim under Section 73 of the Contract Act has held that once it is proved that the opposite party is guilty of breach of contract, and the claimant has executed its part of the contract, the claimant would be entitled to damages by way of LOP [15]. There is a catena of judgments that have stressed on the requirement for the contractor to establish the losses sustained due to the breaches of the employer in order to claim damages [16]. Further, a contractor is obligated to take reasonable steps to mitigate the loss consequent on the breach [17]. The aforesaid principles of proving loss and mitigation of damages have been held to be inviolable and a part of the fundamental public policy of India for the award of unliquidated damages under Section 73 of the Contract Act [18].

V. APPROACH OF COURTS IN INDIA VIS-À-VIS THE APPLICATION OF FORMULAE FOR CALCULATING HOH AND LOP DAMAGES:

a. The method applicable for the computation of damages generally depend on the facts and circumstances of each case [19] and only the legal obligations are to be considered and not the expectations, however reasonably it may be assumed [20].

b. It is in the domain of the arbitrator to apply the appropriate formula for the calculation of damages [21].

c. The selection of one formula over the other by the arbitrator for the calculation of delay damages, is not amenable to a challenge under Section 34 of the Arbitration and Conciliation Act, 1996 [22].

d. A mere reliance on any formula for determining damages in absence of any evidence of actual loss would be contrary to law and the principles of award of damages. Consequently, any formula applied without any proof of actual loss will be patently illegal and in conflict with public policy of India [23].

e. A Court may set aside an award which applies any formula without considering any overlap that may be present in the HOH and LOP claims [24].

f. A contractor is obligated to take reasonable steps to mitigate the loss consequent on the breach [25].

VI. CONCLUSION:

While the AT may apply any formulae for the computation of HOH and LOP claims, the pre-requisites discussed in the previous sections of this piece are to be necessarily followed, as per the dicta of the Courts. The contractor has to mandatorily provide evidence / proof of loss suffered by him due to delays caused by the employer for establishing claims for HOH and LOP. The contractor also has to showcase that he had means of mitigating the damages, and took reasonable measures to reduce the damages. It is only after considering these broad principles, any of the formulae for determining the construction delay damages, *inter alia*, HOH and LOP rates. Thus, any award of damages under HOH and LOP by simply relying on the formulae for the computation of damages, without following the pre-requisites/principles may be set aside for being in conflict with the public policy of India.

REFERENCES

[1] Society of Construction Delay and Disruption Protocol, 2nd ed., 2017, Guidance Part C, ¶2.3, Pg. 56.

[2] Society of Construction Delay and Disruption Protocol, 2nd ed., 2017, Appendix A- Definitions and Glossary, Pg. 64.

[3] Recovery of Unabsorbed Head Office Overheads | FTI Consulting. (2022, February 21). Recovery of Unabsorbed Head Office Overheads | FTI Consulting. Retrieved on: October 19, 2022 from <https://www.fticonsulting.com/emea/insights/articles/recovery-unabsorbed-head-office-overheads>

[4] *Finnegan v. Sheffield City Council* (1988) 43 BLR 124.

[5] *Bharat Coking Coal Ltd. v. L. K. Ahuja*, (2004) 5 SCC 109; *Kanchan Udyog Ltd. v. United Spirits Ltd.*, (2017) 8 SCC 237; *Ahluwalia Contract (India) Ltd. v. Union of India*, 244 (2017) DLT 360.

[6] David Chappel, *Building Contract Claims* (Wiley Blackwell; 5th Ed.), p. 112.

[7] *J.F. Finnegan, Ltd. V. Sheffield City Council,* 43 Build. L.R. 124 (Q.B. 1989).

[8] Society of Construction Delay and Disruption Protocol, 2nd ed., 2017, Guidance Part C, ¶ 2.10, Pg. 56.

[9] *Scott v. London & St Katherine's Docks Co* (1865) 3 H & C 596, See also, *Garnac Grain Co Inc v. Faure & Fairclough* [1968] AC 1130.

[10] *Supra,* 6

[11] *Alfred McAlpine Homes North, Ltd. v. Property & Land Contractors Ltd.*, 76 BLR 59 (1995).

[12] *Supra,* 6

[13] *Welspun Specialty Solutions Ltd. v. ONGC*, (2022) 2 SCC 382.

[14] *Supra,* 6

[15] *AT Brij Paul Singh & Ors v. State of Gujarat*, (1984) 4 SCC 59.

[16] *Bharat Coking Coal Ltd. v. L.K. Ahuja*, (2004) 5 SCC 109; *Kanchan Udyog Ltd. v. United Spirits Ltd.*, (2017) 8 SCC 237; *Ajay Singh Deol v. Suneel Darshan,* SCC Online Bom CR 204; *Ahluwalia Contract (India) Ltd. v. Union of India*, 244 (2017) DLT 360; *Mecamidi S.A. v. Respondent: Flovel MG Holdings Private Limited and Ors.*, 2019 (5) ARBLR 505 (Delhi).

[17] *A.K.A.S. Jamal v. Moolla Dawood, Sons and Co.*, 1916 (23) CLJ 137; *Murlidhar Chiranjilal v. Harishchandra Dwarkadas and Ors.*, AIR 1962 SC 366; *Kanchan Udyog Ltd. v. United Spirits Ltd.*, (2017) 8 SCC 237; *D.D.A v. Krishna Construction Company*, 183 (2011) DLT 331.

[18] *Anila Gautam Jain, Proprietor of M/s Badal Agency v. Hindustan Petroleum Corp. Ltd.*, 2018 SCC OnLine Bom 917, ¶ 26-27; *Home Care Retail Marts Pvt. Ltd. v. Haresh N. Sanghavi*, 2019 SCC OnLine Bom 392, ¶ 16; *Punj Lloyd Ltd. v. IOT Infrastructure and Energy Services Ltd.*, 2018 SCC OnLine Bom 19741 ¶ 17-18, 20.

[19] *M.N. Gangappa v. Atmakur Nagabhushanam Setty & Co. and Anr.*, AIR 1972 SC 696.

[20] *Id.*

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[21] *McDermott International Inc. Burn Standard Co. Ltd.*, (2006) 11 SCC 181.

[22] *McDermott International Inc. Burn Standard Co. Ltd.*, (2006) 11 SCC 181, ¶ 69; *Associate Builders v. Delhi Development Authority*, (2015) 3 SCC 49, ¶ 52-54.

[23] *Edifice Developers and Project Engineers Ltd. v. Essar Projects (India) Ltd.*, 2013 SCC OnLine Bom 5; *Essar Procurement Services Ltd. v. Paramount Constructions*, 2016 SCC OnLine Bom 9697; *Executive Engineers (C) DR-VI v. Bhasin Associates*, 2019 SCC OnLine Del 8121; *NTPC Ltd. v. Sri Avantika Contractors (I) Ltd.*, 2020 SCC OnLine Del 2409.

[24] *Essar Procurement Services Ltd. v. Paramount Constructions*, 2016 SCC OnLine Bom 9697.

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DOMESTIC ARBITRATION

NON-SIGNATORIES TO THE ARBITRATION AGREEMENT CAN ALSO BE REFERRED TO ARBITRATION BY INVOKING THE *'DOCTRINE OF ALTER EGO'*:

The Madras High Court in the case of *Vatsala Jagannathan & Anr. Vs Tristar Accommodations & Ors*, held that in order to invoke and apply the doctrine of *alter ego*, the corporate veil of the respondent must be pierced in order to see the party who lurked behind at relevant points in time. The court further noted that the whole company law is based upon the principle that the company must be considered as a distinct juristic entity and the corporate veil must be pierced in exceptional circumstances for instances in cases where tax is evaded or fraud is committed. The court further added in order to decide whether the non-signatory is an *alter ego*, considerable circumspection must be applied.

AWARD CANNOT BE SET ASIDE MERELY ON THE GROUND THAT THE ARBITRATOR HAS WRONGLY APPLIED THE .IN DOMAIN NAME DISPUTE RESOLUTION POLICY (INDRP) POLICY WHILE ADJUDICATING A DISPUTE OVER DOMAIN NAME: The Delhi High Court in the case *of Bright Simons v Sproxil Inc & Anr.,* referred to the judgment of *Associate Builders v Delhi Development Authority,* and reiterated three principles which forms part of the fundamental policy of the law, firstly that the arbitrator must take a judicial approach, secondly that natural justice must be adhered to and thirdly, that there must not be any perversity in the judgment given. After referring to the same, the court opined that merely giving a passing reference to trademark registration by the Arbitrator, will not lead to the conclusion that the principle of natural justice has not been complied with.

ARBITRATION CLAUSE CONTAINED IN A CONTRACT EXECUTED WITH A PARTNERSHIP FIRM WILL CONTINUE TO BE IN EFFECT EVEN AFTER THE DISSOLUTION OF THE PARTNERSHIP AS A RESULT OF THE DEATH OF ONE OF THE PARTNERS: The Delhi High Court in the case of *M/s Shyamjee Prepaid Services v M/s Top Steels & Mrs. Renu Devi & Anr,* took note of doctrine of severability of an arbitration clause under 16 (1) (a) of the Arbitration and

Conciliation Act ("A&C Act") which treats an arbitration agreement independent of other terms of the contract. The court also relied on section 40 (1) of the A&C Act, which states that an arbitration agreement shall not be discharged even on the death of the party. The court ruled that a *"Combined interpretation of Section 16(1)(a) and Section 40(1) of the Act, 1996 demonstrates unequivocally that the arbitration provision will continue in effect even after the death of a partner causes the dissolution of the partnership,"*

COURTS ARE EMPOWERED TO APPOINT ARBITRATORS IF A PARTY FORFEITS ITS RIGHT PROVIDED UNDER THE ARBITRATION AGREEMENT: The Bombay High Court in the case of *PSP Projects Limited v Bhiwandi Nizampur City Municipal Corp*, held that if a party forfeits its right to appoint arbitrators under the statutory period prescribed after receiving the notice of arbitration, the court may after considering the nature of dispute construct adequate arbitral tribunal. The court referred to the law laid down by the apex court that if period of thirty days elapses after invoking notice of arbitration, and a party files a petition under section 11 of the A&C Act before the court, the other party's right to appoint nominee would stand forfeited.

INSOLVENCY AND BANKRUPTCY CODE

DELAY IN INITIATING CORPORATE INSOLVENCY RESOLUTION PROCESS (CIRP) CAN BE CONDONED IN PRESENCE OF SUFFICIENT GROUNDS: The Supreme Court in the case of Sabarmati Gas Limited v Shah Alloys Limited, held that limitation for initiating CIRP under Section 9 of Insolvency Bankruptcy Code ("IBC") has to be seen from the date of default and not from the date of commencement of IBC which is prescribed as three years as per Article 137 of the Limitation Act and can be extended only by the application of Section 5 of the Act. The court further noted that "sufficient cause" are such causes where parties could not be blamed and are the only criterion for condoning delay under the said provision.

SECTION 17 OF THE LIMITATION ACT WILL NOT BE APPLICABLE WHERE THE PERIOD OF LIMITATION IS PRESCRIBED FOR AN APPEAL: NCLAT, New Delhi in the case of *Maharashtra State Electricity Distribution Company Ltd v NRC Ltd. & Anr.,* held that Section 61of IBC prescribes thirty days for filing an appeal and only fifteen days of delay can be condoned under section 61(2) proviso of IBC. Section 17 (1) of the Limitation Act, 1963 will not have any application over such sections where already period of limitation is prescribed for an appeal. Going by the understanding, the bench ruled that a delay of 244 days cannot be condoned in the present case and accordingly dismissed the application for condonation of delay.

APPROVAL OF A RESOLUTION PLAN WOULD NOT *IPSO FACTO* ABSOLVE THE LIABILITY OF THE SURETY/ GUARANTOR OF THE CORPORATE DEBTOR WHICH ARISES FROM THE INDEPENDENT CONTRACT OF GUARANTEE: The Allahabad High Court in the case of *Narendra Singh Panwar v Pashchimanchal Vidyut Vitran Nigam Limited & Ors.* held that the extent to which the liability of a guarantor can be pressed into service would depend on the terms of the guarantee/contract itself.

The court in the present case relied on the judgment of *Lalit Kumar Jain v Union of India and Ors.*, where it was opined that the guarantor/ surety would not be absolved from liability arising out of an independent contractor because the principal borrower was released from the debt owed to the creditor due to liquidation, operation of law or insolvency proceedings.

CORPORATE

ADDITIONAL DIRECTOR IS RESPONSIBLE FOR THE AFFAIRS OF THE COMPANY ON AN EQUAL FOOTING WITH THAT OF A DIRECTOR*:* The Calcutta High Court in the case of *Surendra Kumar Singhi v. Registrar of Companies, West Bengal & Anr* while taking note of the judgment of the Hon'ble Supreme Court in *Shiv Kumar Jatia vs. State of NCT of Delhi* held that the Additional Directors appointed under the Section 161(1) of the Companies Act, 2013 are on equal footing, in terms of, of power, rights, duties, and responsibilities, as other directors are and the only difference between them is with regard to their appointing authority and their term of office. The Court ruled that "*The responsibility of an Additional Director being the same as that of a director (but difficult from an independent director) they remain responsible, as the statute provides for the same."*

MINISTRY OF CORPORATE AFFAIRS RATIONALIZES VARIOUS FORMS FOR V3 PORTAL: The Ministry of Corporate Affairs ("**MCA**") recently rolled out the V3 portal under which a total of 56 forms will be e-filed. In the process of the transmission, the MCA has amended various forms seeking additional disclosures and information. The modification to the forms was carried out by publishing the following amendments notifications: (i) Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2023; (ii) Companies (Registration Offices and Fees) Amendment Rules, 2023; (iii) Companies (Accounts) Amendment Rules, 2023; (iv) Companies (Prospectus and Allotment of Securities) Amendment Rules, 2023; (v) Companies (Authorised to Register) Amendment Rules, 2023; (vi) Companies (Miscellaneous) Amendment Rules, 2023; (vii) Companies (Incorporation) Amendment Rules, 2023; (viii) Companies (Share Capital and Debentures) Amendment Rules, 2023; (ix) Companies (Management and Administration) Amendment Rules, 2023; (x) Companies (Appointment and Qualification of Directors) Amendment Rules, 2023; and (xi) Companies (Registration of Foreign Companies) Amendment Rules, 2023.

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