



# Guidelines for Valuing COVID-19 Project Variation Claims

Ministry of Education guidance for Capital Works and School-led property projects

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# Project Guidelines

## Introduction

These guidelines are intended for all internal and external project leads for school property projects to ensure a fair, equitable and consistent approach to the valuing of construction variation claims arising from the Government's regulatory response to COVID-19.

When New Zealand moved to COVID-19 Alert Level 4 on 25 March 2020 the Ministry of Education (Ministry) had to close all active construction sites for an initial period of 4 weeks. This has impacted the timing and costs for delivery of these projects.

Contractors are entitled under the terms of their respective construction contracts to recover time and/or additional costs resulting from the lockdown. Establishing the value of claims will be complex and require case-by-case assessment of affected projects.

In order to provide confidence and certainty to the construction sector, it is important that Government agencies adopt a consistent approach. This guidance document has been developed to help direct project teams working on Ministry projects as they review the legal and commercial issues associated with the lockdown period. It applies to standard NZS 3910:2013 contracts as well as the Ministry's Medium and Minor works variants.

If you are unsure about how this guidance applies to any of your individual contracts, please seek further guidance by contacting [COVID19Variations@education.govt.nz](mailto:COVID19Variations@education.govt.nz)

## Guidance in general

This guidance is general in nature and sets out the Ministry's expectations to assist in the consistent and equitable valuing of variation claims across school property projects. It is subject at all times to the specific terms of each project contract. It is also based upon information published as at the time of preparation and is subject to New Zealand's unfolding economic and financial situation and alert level requirements.

There will be some individual projects where specific complexities require greater analysis than provided in this guidance. Schools and their advisors should seek specific legal advice where further clarity is needed on an individual project.

## Further guidance for agencies

We have been working closely with the Ministry of Business, Innovation and Employment (MBIE) and the Infrastructure Commission (Infracom) to develop this guidance and ensure it follows and supports the Government's position. We anticipate further valuation guidance for agencies and we will incorporate any additional items from the guidance for agencies into the Ministry guidance and our valuing of variation claims.

## **Suspension of works by the Principal – Contractual Position**

With the commencement of the COVID-19 Alert Level 4 on 25 March 2020, the Ministry instructed engineers and project teams overseeing contracts for school property projects to issue instructions for on-site contract works to be suspended. These instructions were typically issued under either clause 6.7.3 as having become necessary or under clause 5.11.10 with reference to the Government's regulatory response to COVID 19.

Guidance from MBIE and the Construction Sector Accord records that in these instances, cost increases, including any time-related costs, are to be treated as a variation and recoverable by the contractor. This is essentially as a result of the fact that the suspension is not due to default on the part of the contractor.

## **Principles of managing variation claims under COVID-19**

We encourage adoption of the following principles when managing variation claims:

- Take an equitable, fair and reasonable approach in accordance with the guidance issued by MBIE.
- Principals are encouraged to take an open and collaborative approach in discussing and agreeing variation claims.
- Contractors are expected to act reasonably to mitigate costs throughout the process.
- Claims are encouraged to be submitted and processed by both parties as soon as practicable.

## **Principles of valuing variation claims under COVID-19**

We encourage adoption of the following principles when valuing variation claims:

- The onus of proof is on the contractor to evidence costs incurred and they should be encouraged to take an open-book approach to justifying costs.
- The review of claims should be undertaken in a standard and consistent manner for the majority of cases.
- Submissions and responses should be undertaken by the parties in a transparent, open and collaborative manner.
- All claims should be assessed on their merits but be treated equitably by adopting a fair & reasonable valuation of substantiated costs.
- Double dipping is discouraged. Where labour wage subsidies have been claimed – these should be clearly shown and deducted from labour costs.

COVID-19 and the lockdown is an unprecedented event in the construction industry. It is the Ministry's expectation that the parties, including engineers to contract, collaborate to agree variation values and an equitable outcome in the best interests of the project.

Parties are reminded the risk of contractor, sub-contractor and supplier insolvency is significantly increased due to COVID-19 with the potential to substantially and negatively impact both the industry and school property projects.

Parties are encouraged to treat those in their supply chain with regard and make efforts to minimise the stand down impact on them and their liquidity.

Diligent record keeping is also encouraged. This includes the filing of correspondence, meeting minutes, site photos and site visit reports. Key event timelines will also be important to enable robust and efficient claim assessments and engineer determinations.

### **Timing to submit variation claims under COVID-19**

It is our expectation parties work together to ensure variation claims are submitted and processed as soon as practicable.

We acknowledge the uncertainties and complexities of the cost impact of the level 4 lockdown and that it will take time for contractors to calculate and substantiate all additional costs. The amount of time required will vary project by project and between contractors.

We also expect some contractors to have multiple variation claims as additional costs from the level 3 remobilization of sites are incurred.

### **Payment of variation claims under COVID-19**

The Ministry intends to process and make payment of variations claims as soon as practicable after receipt. As claims are assessed, further information may be sought on some costs items. The Ministry will work with contractors to ensure, where possible, accepted costs are paid and not delayed by additional analysis required of more complex line items.

## Items which may be included in Contractor claims

There are a range of scenarios that may occur on a project as a direct or indirect result of COVID-19. The table below outlines some of the items we anticipate receiving claims for.

Type of Claim	Risk Title	Likely Project Variations	Calculating cost	Guidance Notes
<b>Delays</b>				
Delays	Extensions of Time	<i>The overall effect on project programmes as a result of the impact of direct and in-direct delays on the critical path, guidance specific to likely instances outlined below.</i>	EOT Claims	<i>Fair &amp; reasonable assessment of time lost in line with principles outlined.</i>
<b>Material Risks / Delivery etc.</b>				
Materials	Material cost increases	Impact of COVID on material availability leading to cost increases from merchants, alternative sourcing of materials to meet programme, applicable to all materials	Difference between tendered costs and actual	Must be evidenced
	Storage	Impact of COVID on material delivery – resulting in off-site storage	Extra storage costs	Must be evidenced
<b>Labour Issues</b>				
Labour	Labour shortages	Increase in subcontractor labour costs for projects in flight, re-negotiation	Difference between tendered costs and actual	Must be evidenced
	Sub-Contractor insolvency	Increase in pricing when procuring alternative subcontractors to pick up current works	Direct increase in sub-contractor costs	Must be demonstrated and evidenced
	Productivity reduced - post lockdown	Loss of productivity of site trade operations (indirect costs)	Reasonable valuation of increased costs	From discussions with industry there is an expected productivity drop due to working restrictions associated with level 3 and level 2 requirements. Reasonable evidence should be provided
		Increase of H&S requirements (L3 restart)	Reasonable valuation of increased costs for H&S & associated items	Issues such as developing cleaning regimes / extra costs for cleaning materials / working practices etc.

Labour Issues (Continued)				
Labour (ctd.)	Productivity reduced - post lockdown	Organising materials to site	Possible associated delays and increases in material transport costs due to high demand	
		Shortage in Labour	Associated Delays in re-establishing workforce on site	Evidenced by site documentation showing operative numbers and hours (pre and post lockdown)
		Indirect delays on critical path, downstream EOT claims	EOT claims	Reference to programme and critical path
Site Works				
Logistics	De-mobilisation	Demobilisation of projects under time constraints	Reasonable valuation of increased costs	Must be evidenced
		High demand for off hires – increase in transport & associated costs	Claim for off-hire costs at short notice	Must be evidenced
		Extra Labour required to shut down sites	Increase in personnel on site & potential loss of productivity in other work areas	Work on most sites would have stopped on Monday 23 <sup>rd</sup> March. Some labour may have been used for lockdown protection works
		Purchase and installation of protection measures	Associated material costs and transport costs due to high demand	Must be evidenced
	Re-mobilisation	Remobilisation	Reasonable valuation of re-start costs [including labour] and costs to implement COVID-19 Level 3 operating requirements	Must be evidenced
		Plant & site items back on site, increase in transport costs and delays	Reasonable Claim for on-hire costs	Must be evidenced

Site Works (Continued)				
Defects	Damage to buildings during lock down	Remediating defects from water damage, internal fit out, building structure/fabric & site works	All reasonable costs associated with remediating any defects	With due consideration to the reasonable mitigation steps taken at the time of the lockdown and the short time available to make sites secure.  <b>Note – there may be insurance cover for some of these items.</b>
		Damage resulting from vandalism	All reasonable associated costs with rectifying damage	
		Disposal and replacement of damaged materials currently stored on site	Disposal and replacement of projects materials	
		Other damage /theft related to sites/buildings	All reasonable costs associated with remediating any defects	
Plant, Equipment and Access				
Plant, Equipment & Access	Hire costs for temporary equipment during lock down	Costs over and above tender for site plant and equipment – time related hire costs and any protection, scaffolding/cabins	Hire costs and other costs for plant items which are not reasonably included in tender.	Contractors should have off-hired larger plant items on site but with time constraints this may not have been possible, all site protection and welfare items should have remained on site – and will be subject to a hire charge.
		Delays due to re-establishing and hiring plant / equipment	EOT claims and increase in transport costs due to high demand	Must be evidenced
		Costs for plant that was unable to be off hired	Hire costs for plant items kept on site	A potential benefit of these items being kept on-hire could mean an increase in return to full productivity on site
Programme				
Programme	Delays - end dates missed	EOT Claims	Claims for time lost	Refer to Delays above
Processing Costs				
Processing cost	Variation processing cost	Time and administrative cost for compiling and processing the variation claim	Percentage as per contract or reasonable evidenced cost	Note that the Special Conditions within Ministry and Schools Major Works contracts exclude the Contractor's right to claim for the cost of processing variation claims.

## Discussion of Types of Claim

### Delays

The suspension of contract works, or the period of lockdown, will have created delay. The MBIE guidelines establish that suspension entitles contractors to a variation and hence to claim time related and additional costs.

Under most contracts this will be an assessment of the cost for on-site overheads.

Under many contracts a Working Day Rate (WDR) may have been agreed. The Working Day Rate is defined under clause 9.3.11(a) and 'shall be deemed to provide for time-related on-site overheads and off-site overheads and profit'.

On-site overheads are the cost of the general establishing and running of the site. This includes accommodation and offices, welfare facilities, supervision of the work and other non-building related costs such as insurances, inspections, health and safety etc.

Where the contract contains a WDR that WDR shall, where it is equitable to do so, be used for the purposes of calculating time-related on-site overheads and off-site overheads and profit.

Where it is inequitable to use the WDR or the contract does not contain a WDR, then a 'reasonable' WDR can be used.

However, note that this cost includes off-site overheads and profit. Therefore we recommend the use and calculation of the WDR be checked to see what is included in the cost and that its use is equitable in the circumstances. Often a simple calculation that divides the P&G cost by the total project working days can be useful in identifying the 'average WDR'. However, a more equitable approach for some projects will be to identify and agree actual incurred on-site overheads and then agree a suitable allowance for 'off site overheads' including profit.

Actual costs should be substantiated by the Contractor on an open-book basis.

It is also important to note that variation claims may include allowances for on-site and off-site overheads and profit – usually in the form of a percentage applied to the net cost of the variation. Where these percentages are applied – it is important to make sure that double recovery (double-dipping) does not occur. This is because the percentage addition for on-site overheads is a recovery of time related cost. So if the WDR has been used then recovery of on-site costs is deemed to have been made.

Items that typically would be included as on-site overheads would be:

- Remuneration and expenses for management, administration, routine staff, and supervisory staff associated with the running of the site (excluding working foremen and leading hands) – the rates should be established on the actual costs for the staff including kiwi saver contributions, annual leave provisions, statutory holidays, sick leave, ACC levies and insurances, fringe benefits, clothing and other allowances. **Note that any Government wage subsidy should be offset / deducted from these actual costs claimed as a variation;**
- Insurance premiums / bond extensions;
- Site and temporary works and facilities – such as hire of office cabins, shelters, canteens, ablutions and toilets, security fencing, alarms (if applicable), scaffolding, craneage and other heavy plant; office equipment and communications; and
- There may also be other costs such as power and services running costs.

Off-site overhead and profit recovery should be demonstrated to ensure an equitable outcome. Amounts claimed should demonstrate that these off-site costs (for general running costs for the contractors business – administrative, financial and overhead costs for head office, and other off-site overheads dedicated to the contract) are apportioned correctly. This should be reviewed against the percentages identified within the contract.

Off-site recovery will need to adopt a common-sense and equitable approach making reference to stated rates within the tender – or other relevant information.

For clarity, a claim for profit margin within a WDR is anticipated by most NZS based construction contracts and is considered reasonable. This is not a claim for 'loss of profit' or 'loss of opportunity' which is not considered as reasonably included within Ministry contracts.

## Material Risks / Delivery

**Lack of materials** – potential shortage of materials following remobilisation may require alternative supply chains to be found, for which there may also be an increased cost for haulage and delivery and changes in forex.

**Lack of material availability** – possibly caused by a cessation of manufacture may also cause delays to the project. This will need to be reviewed against the programme and the critical path. This could lead to a further extension of time claim.

**Storage costs** – due to the lockdown there may be materials located at ports and other facilities that could not be delivered to site justifying a claim for additional storage costs.

## Labour Issues

Expect issues after the lockdown is lifted to impact the cost of running the site. Under Level 3 (and likely under Level 2) 'distancing and separation requirements' will still be required to minimise transference of the COVID-19 virus.

Expect additional costs implications arising from:

- SSSP updates – site specific safety plans and requirements will need to be updated and communicated to site workers
- Additional H&S requirements – distancing and separation
- PPE – masks / gloves / welfare facility etc
- Welfare facilities – alteration of site facilities to increase separation
- Cleaning regimes
- Access routes and separation
- General loss of productivity around number of staff and working area restrictions

This type of productivity cost is calculated based upon comparing non-productive allowances that are built into rates. Contractors will need to demonstrate the impact of the safety requirements upon the normal expected productive time during the working day.

Expect some sites to be impacted for a period of 4 to 6 weeks after the lockdown is lifted.

**Labour costs** – COVID-19 wage subsidies need to be taken into consideration and deducted from any costs submitted to ensure the no double dipping principle is upheld.

Additionally, staff pay rate deductions should also be taken into consideration. In parts of the industry, reduction in basic salaries has been implemented by some companies as a means to

reduce cashflow exposure. An open-book approach is encouraged as a means to demonstrate collaborative and equitable reviews.

## Site Works

At the time of the lockdown announcement, contractors were given two days (24<sup>th</sup> and 25<sup>th</sup> March) to secure and make safe sites prior to the lockdown. There will be costs associated with this process. The Ministry has previously confirmed its coverage of reasonable costs to secure sites. These costs should be relatively easy to identify and agree, based upon presentation of invoices for materials and timesheets/site diaries for operatives.

As part of the process the Ministry also asked for photographic evidence to be provided of the status of work and measures taken at the time of the lockdown. This should be supplied with claims and will further assist the evaluation of cost.

## Defects

**Re-work** – Given the speed of the lockdown there is risk that the reasonable preventative measures and protections put in place were not adequate to prevent damage during the suspension period caused by:

- Weather – wind and rain
- Vandalism
- Graffiti
- Services – pipe bursts etc

It is our expectation that damage and defects incurred despite the reasonable measures taken by contractors in the circumstances be covered. However, entitlement should not be automatic and the steps taken to secure and make safe sites should be assessed. Additional costs covered may include the removal and replacement of some damaged components or elements. It is recommended that photographic records of these defects be requested from contractors at the time of site re-establishment, before the materials are removed.

Rates and costs for removal and replacement should be established – preferably prior to the works being instructed.

## Plant & Equipment

There are likely to be plant and equipment costs incurred during the lockdown. Some contractors will have managed to off-hire and remove loose plant and equipment from sites prior to the lockdown, but others particularly in remote areas or where it is demonstrated to be impractical may not have been able to do this.

Items such as scaffolding, cabins, site security fencing and other semi-fixed temporary plant is likely to have been left on site. This is likely to incur hire charges during the lockdown.

Where there are plant hire costs, for hire of scaffold and other plant left on site during the suspension – the costs will need to be demonstrated by the contractor. Additionally it is recommended to check that these are not covered by the Working Day Rate – (noting that this is unlikely as scaffolding is becoming more traditionally regarded as a trade and not an on-site overhead or set up cost).

**Demobilisation** – These are costs directly arising from the instruction to secure the site and make safe and may include off-hire costs and charges, making safe costs etc.

**Remobilisation** – These are costs arising from the instruction to recommence site works, and compliance with the COVID-19 Level 3 operating requirements. This may include labour costs (if any) and delivery of plant / equipment back to the site.

**Additional plant hire** - Costs for hire of scaffold and other plant left on site during the suspension.

## Programme Risks – Risk Workshop

The main risk arising from the lockdown and associated cost is covered under delays.

However there may be additional risks of delay caused by a slower re-mobilisation during Level 3 and Level 2 stages, further compounded by shortages of labour and materials.

To help identify these risks and potential costs it is recommended that **a joint risk workshop** be convened. The purpose of the workshop is to identify risks that the project now faces. The origin of those risks should be from the contractor but there should also be consideration of risks from the Ministry and/or school. This is also an opportunity to work collaboratively with contractors to review potential labour and material supply threats. Careful consideration should also be given to appropriate cost mitigation options that could be implemented by contractors.

Ongoing site security arrangements during lockdown situations should also be included in the discussions.

The approved contract programme should be reviewed and updated prior to and following this risk meeting as this is an essential document to assess the anticipated time related claims.

While under normal circumstances a face to face workshop is preferred, an online session may now be necessary. Either way, ensure you are complying with current alert level requirements.

We hope that collaboration and workshop sessions like this will help reduce and/or simplify variation claims and result in quicker processing and payment to contractors.

## Excluded Claims

Claims for the following will not be accepted;

- Working from home setup costs
- Business continuity costs during the alert level 4 period
- Materials off-site payments outside of the terms of the contract
- Loss of profit and /or loss of opportunity

# Appendix 1. Valuing variations by Ministry Standard Contract type.

## Construction Contracts

### 3910 / 3916 Major Works Contracts

1. Section 9 of NZS 3910/3916 deals with variations and how they are valued. The Ministry's Special Conditions amend some of the standard provisions in Section 9. To understand how the contracts deal with variations, it is necessary to read the standard NZS provisions alongside the Ministry's relevant Special Conditions.
2. Below is a high level summary of some of the key points to note in relation to how variations are valued under the Ministry's NZS 3910/16 Major Works contracts. To be clear, this is a summary only and provides some high level guidance and should not be used in lieu of reading the relevant terms of each contract, including tags.
3. The following are the key points to note under 9.3 in terms of valuing variations:
  - The engineer is primarily responsible for assessing/agreeing the value of a variation (i.e. not the Ministry as Principal).
  - The value of variations should be by agreement where possible.
  - Where agreement can't be reached, the balance of the provisions in 9.3 are applied by the engineer.
  - Ministry DM's should confirm to engineers the Ministry's agreement to cover the cost of all reasonable works incurred to protect the site.
4. The provisions for valuing variations are complex, and often project specific (e.g. some but not all projects will include a complete schedule of prices etc.). The relevant provisions are worked through in sequence until the appropriate method, for the particular project, is identified. The Ministry cannot apply a blanket direction across all projects. It will be relying on the expertise and experience of its engineers in respect of their assessment for each specific project. While it is acknowledged that the unique circumstances of the lockdown may pose some challenges for engineers (and contractors), it will be for the engineer, in the first instance, to work through the process.
5. If agreement can't be reached, and the engineer therefore sets the value, both the Ministry and the contractor have a right to dispute the determined value (within 3 months of it being given).
6. We expect the majority of Major Works variations to be agreed and recorded by an engineer's determination (covering any changes to scope, costs and programme). If matters get complex, or you are wanting to record a change in actual contract terms, then a more formal deed of variation prepared by Legal will be required. If you are unsure, talk to Legal.
7. Note that, at the most basic level, the objective of clause 9.3 is to fairly compensate a contractor for the impact of the variation on the contractor's costs (in this case the impact of the COVID-19 lockdown).

## Medium Works Contract

1. The provisions for valuing variations in the Ministry's Medium Works contract are much less prescriptive than those in its Major Works contract. Clause 4 of the Medium Works contract provides that:
  - the parties should, where possible, agree the value of variations; and
  - in the absence of agreement, the Ministry shall set the value by reference to the schedule of prices (if any), the Contractor's prices for similar work (if any) and, perhaps most relevantly for present purposes, '...what is fair and reasonable in the circumstances.' With no engineer in our Medium Works contract, the responsibility for agreeing the value of variations, and ultimately setting the value, if not agreed, will sit with Ministry Delivery Managers. We expect the majority of these variations (covering any changes to scope, costs and programme) to be agreed in a clear exchange of emails between the parties. If matters get complex, or you are wanting to record a change in actual contract terms, then a more formal deed of variation prepared by Legal will be required. If you are unsure, talk to Legal.
2. It is difficult at this stage to predict all the costs a contractor may be entitled to claim, but we encourage you to bear in mind the Ministry's early agreement to cover the cost of all reasonable works incurred to protect the site and the key objective of the variation provisions to fairly compensate a contractor for the impact of the COVID-19 lockdown.

## Minor Works Contract

1. The provisions for valuing variations in Ministry Minor Works contracts effectively mirror those in the Medium Works contract. In short, clause 4.2 of the Minor Works contract provides that:
  - the parties should, where possible, agree the value of variations; and
  - in the absence of agreement, the Ministry determines the value by '*...what is fair and reasonable in the circumstances.*' Again, with no engineer in the Minor Works contract, the responsibility for agreeing the value of variations, and ultimately setting the value, if not agreed, will sit with Ministry Delivery Managers. Agreement should be recorded in a clear exchange of emails. If you are unsure, talk to Legal.
2. As with Medium Works, we encourage you to bear in mind the Ministry's early agreement to cover the cost of all reasonable works incurred to protect the site and the key objective of the variation provisions to fairly compensate a contractor for the impact of the COVID-19 lockdown.



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