

Provisional Sums in Construction Contracts

This guidance note explains how Members can engage on works by incorporating provisional sums into their construction contracts to mitigate against inflationary and materials cost risks.

- What are provisional sums?
- Defined and undefined provisional sums
- Why are provisional sums used?
- Provisional sums under the JCT standard forms
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- Practical considerations to take into account when incorporating provisional sums into a contract

ECA has a number of other key guidance notes dealing with pricing under construction and maintenance contracts which will also enable Members to consider how to share, spread and collaborate on risks in pricing allowing parties to move away from the fixed lump sum pricing model that has dominated the industry.

1. What are provisional sums?

Provisional sums are an amount incorporated into the fixed lump sum price through the contract sum analysis or the bill of quantities in a construction or maintenance contract to cover items of work that cannot accurately defined or priced at the time of tender.

Members may often find themselves in position at the tender stage where elements of the work or design are undecided or unfinished, and by using provisional sums Members are not held to a fixed price at the time that works are commenced.

Provisional sums are called such as neither party is held to that figure. If an employer/main contractor decides not to proceed with an element of the works that is a provisional sum item, then the contract will have a mechanism to determine the amount to be deducted from the contract sum.

Alternatively, if the provisional sum item is required, then the Member shall be paid a demonstrable or reasonable amount for the item, which may be lesser or greater than the provisional sum allowance.

Essentially, a provisional sum is a budget amount rather than a fixed element of the price.

Members should note that provisional sums are distinct from risk allowances or contingencies that are made within cost budgets or pricing. Such elements are dealt with under the risk allocation and variation provisions of a contract, to provide contractual mechanisms to deal with unexpected occurrences or the realisation of risk events that would constitute a change under the contract.

2. Defined and undefined provisional sums

Members should note that provisional sums in JCT can be categorised as defined or undefined provisional sums.

Some standard form contracts have adopted wording to distinguish between defined and undefined provisional sums. For example, the JCT Standard Building Contract with Quantities 2016 (SBC/Q) adopts the definitions from paragraph 2.9.1 of the New Rules of Measurement—Detailed Measurement for Building Works (NRM2) published by the Royal Institute of Chartered Surveyors (RICS) in 2012.

Under these rules a defined provisional sum applies to an element of work which is not completely designed but the nature and construction of the work, a statement of how and where the work is fixed to the building or quantities that indicate scope of work can be provided to the Member. Where provisional sums are given for defined work, Members will be deemed to have made due allowance in their programming, planning, and pricing preliminaries.

An undefined provisional sum, on the other hand, arises where the employer/main contractor is unable to provide the Member with detailed information, such as the quantity of work sufficient to indicate the scope and extent of the work. Unlike defined work, the Member is not taken to have made due allowance for such work in its programming or preliminaries.

3. Why are provisional sums used?

Provisional sums can be a useful tool to enable a project to start moving in circumstances where the design is incomplete, to cover contingencies or where a Member cannot verify its price at the time the contract is entered into. The last situation is more common where the provisional work is of a specialist nature—information may be awaited from other specialist sub-contractors or suppliers, or the Member could be using state of the art technology that cannot be accurately priced until the works have progressed

Provisional sums are generally included to give the parties an idea of the potential cost and to enable them to make some allowance, for example, in budgets (employer/main contractor) and programmes (Member) for the item in question.

4. Provisional sums under the JCT standard forms

The JCT suite of contracts contain provisions dealing with the instruction of provisional sums—for example, under clause 3.16 of the Standard Building Contract With Quantities (both 2011 and 2016 editions) and under clause 4.16 of the Standard Building Sub-contract With Sub-contractor's Design 2016 the architect/contract administrator can issue instructions with regard to the expenditure of provisional sums. There is an equivalent provision in clause 3.11 of the Design & Build Contract 2011/2016 and clause 4.16 of the Design & Build Sub-contract 2016.

The standard approach taken in JCT contracts is that the employer/main contractor may include provisional sums within the Employer's Requirements which will then form part of the contract sum and should be identified in the contract bills/contract sum analysis.

An alternative situation may arise where Members incorporate a provisional sum in their tender/contract sum. In such circumstances, it may be argued that there is no contractual mechanism to instruct or establish a final valuation of such works. Hence, it is advisable for Members pricing in this way to ensure that they clearly state:

- (i) the basis of their price(s),
- (ii) that further information is required from the employer/main contractor to establish a final valuation, and
- (iii) whether the final valuation shall be established from first principle, or the change between tender information and final information.

Where a more standard approach is taken, once the employer/main contractor has sufficient information available it will issue instructions to the Member to proceed with the provisional sum work, including elements of design as required. The Member will either be instructed to issue a quotation prior to proceeding, or the works will be valued in accordance with the Valuation Rules set out in the Conditions of the contract – being a sliding scale of options based on how closely the varied work resembles the work that is part of the contract documents.

The Valuation Rules in JCT contracts are essentially that additional or substituted work shall be consistent with the values of work of a similar character set out in the contract bills/contract sum analysis, making due allowance for any change in the conditions under which the work is carried out and/or any significant change in the quantity of the work so set out.

Where there is no work of a similar character set out in the contract bills/contract sum analysis a fair valuation shall be made, using fair rates and prices.

The RICS 'Valuing Change' Guidance Note (1st edition) looks in more detail at the Valuation Rules and their practical application.

The definition of a provisional sum may be included within the contract, but if it is not, then the RICS provides a working definition of valuing provisional sums and the prevailing case law provides an example of how the courts have dealt with provisional sums historically.

The alternative procedures for the valuation of provisional sums that exist in many of the JCT standard forms include an option for the Member being asked to provide a value, including the effect on time, for agreement with the employer/main contractor before the work is executed. This is known as a sub-contractor's 'Schedule 2 Quotation'. The alternative is for the work to be valued in accordance with the Valuation Rules.

Under JCT contracts, where provisional sums are incorporated, they form part of the scope of the Works whether or not the provisional sum is defined and irrespective of the level of detail to which it is scoped or specified.

As a result, an employer/main contractor who subsequently decides to omit the provisional sum work and appoints another sub-contractor to complete this item could in theory be faced with a breach of contract claim for the loss of profit suffered by the Member who was originally engaged.

5. Provisional sums under the NEC standard form

The NEC suite of contracts take a different approach to the JCT contracts and do not make reference to provisional sums. NEC's view is that if items cannot be precisely defined, they should not be included as such. Where the employer/main contractor (called the Client in NEC4) wishes for the Member to carry out works that may have been covered as a provisional sum in a JCT contract, under an NEC contract the parties would instead operate the early warning system (clause 16 of NEC3 and clause 15 of NEC4), resulting, where appropriate, in a compensation event being awarded.

If the employer/main contractor absolutely has to include an item in the contract which cannot be priced with certainty, the NEC's view is that all the information, in as much detail as is available, should be included in the Works Information/Scope and that this should then be updated whenever possible (e.g. a basic sketch, key dimensions, etc) to allow the Member to make assumptions based on the information that the employer/main contractor does have, rather than having to make a guess in the form of a provisional sum.

6. Practical considerations to take into account when incorporating provisional sums into a contract

Sometimes Members may find that the inclusion of a provisional sum within a contract will, for both parties, be unavoidable or in fact will be desirable, for example, in order to secure an overall budget for a project or enable the Member to prepare a realistic programme.

The system of provisional sums may also assist Members who need to use it to carve out the risk of inflation on specifically identified elements of works/materials. It will allow for a fixed lump sum pricing mechanism, but with certain element carved out.

Where this necessity arises, Members should ensure that the employer/main contractor provides as much information about the unknown element of works or known but unpriced, as possible at the outset of the project

The terms of the contract relating to the instruction, valuation and effect of provisional sum work need to be as clear as possible and adequately reflect the parties' intentions. Particular care and consideration should be given to:

- the extent and scope of the provisional sum work – clearly identify exactly what is being included in the provisional sum carve-out;
- how and when provisional sums can be instructed, by who and what records are required to support the process;
- what allowance has, or will be, made in the contract programme for carrying out the work (or

not carrying it out, as the case may be);

- whether extension of time provisions will apply in respect of provisional sum work;
- most importantly, how the contract price will be adjusted to reflect the actual work done. A commonly agreed position is that the provisional sum will be replaced by the actual cost of the work but, depending on the extent to which the original sum provided for additional costs such as preliminaries or profit, the parties should also specifically consider these and ensure the contract explicitly deals with the agreement of the implications on price; and
- although the employer/main contractor does not have to instruct the Member to proceed with the provisional sum work, it will not be able to give it to another sub-contractor to carry out unless very clear words are used in the contract. Members who base their price on the volume of work will need to factor in any risk that their provisional sum work could be removed from their scope reducing volume and therefore margin.

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