

## Does a Cost Plus Contract Include Profit and Overhead?

by

James R. Keller

This article appeared in *St. Louis Construction News & Real Estate*, p. 24-26, September/October 2006.

A Missouri jury will decide whether a 15% markup for profit and overhead can be included as a cost in a cost plus construction contract that does not mention profit or overhead. The case is *Essex Development, Inc. v. Cotton Custom Homes, L.L.C.*, 2006 WL 1888696, issued July 11 by the Eastern District Court of Appeals for Missouri.

At stake is \$200,000 that Cotton and Essex agreed to place into an escrow account until this dispute is resolved. A jury could go “either way” on this issue, according to the Eastern District.

This case underscores the importance of spelling out clearly in a cost plus construction contract if there is to be a fee on top of other costs, and if so, how much and how calculated. Certainly, no owner or contractor enters into a contract expecting that a jury will decide what they intended when they executed the contract. Yet that is what now faces Essex and Cotton for the appellate court held that the trial judge erred by deciding this issue on a pretrial motion for summary judgment.

Cost plus construction contracts are popular and used frequently. When drafted carefully, they are designed to reduce or eliminate disputes about construction costs and how much the contractor will be paid.

Unless the fee arrangement is detailed in the written contract, Missouri's courts may now leave it up to the jury to sort out who agreed to what. Even if there is to be no fee in addition to other reimbursable costs, the facts of this case show why the fee arrangement should now be set out in the contract itself.

Cotton as owner and Essex as a contractor/developer entered into a contract to develop a community of single-family homes called Buena Vista Development on undeveloped land that Cotton owned in Jefferson County. Originally, Cotton planned to develop the land through another company it owned called Buena Vista L.L.C., a real estate development company.

Cotton could not obtain the necessary financing on its own to go forward as planned, so it entered into the contract in question in this case with

**Essex Development.** Cotton also conveyed Buena Vista's assets (and perhaps the company itself, although unclear from the court case) to Essex Development.

The plan was for Essex Development to use its resources and expertise to develop the property, and then ultimately to convey the developed lots back to Cotton. Cotton was then going to market the lots to the general public.

The contract also provided that Buena Vista (now owned by Essex) could petition Jefferson County to create a Neighborhood Improvement District ("NID"). The NID, which was approved, allowed for financial assistance from Jefferson County.

Essex Development used another of its related companies, Essex Contracting, Inc., to submit a bid to Jefferson County for the NID work. This bid did not include an extra charge of 15% for profit and overhead. Jefferson County awarded the contract to Essex Contracting.

Essex Contracting did the work for Buena Vista. Pursuant to a separate oral agreement between them, each pay application contained a handwritten notation adding 15% to the final cost. Cotton did not know about this and was not a party to this.

In the final payment application that Buena Vista and Essex Contracting (both controlled by Essex Development) sought from Cotton upon the closing of the contract between Cotton and Essex for development of the lots, Essex Contracting added 15% to cover profit and overhead on top of all other costs. This is what generated the dispute.

Cotton refused to pay the extra \$200,000. The money was put into escrow so the closing could proceed.

The original contract between Cotton and Essex Development stated that the "purchase price" for Cotton to buy the developed lots was equal to Essex' original acquisition costs and "all otherwise unreimbursed costs of development of the subdivision incurred by Seller [Essex Development], including all costs of construction of the Improvements, and all costs of maintenance of the subdivision until the last Lot is sold or conveyed."

Essex Development argued that this provision allowed it to pass along to Cotton the 15% charge for profit and overhead as one of the other "unreimbursed costs of development." Cotton contended this was not a cost and it was not contemplated by the parties when they signed the contract.

**Cotton also argued that an agreement between Essex Development, Essex Contracting and Buena Vista to pay the extra 15% as a cost meant nothing because these companies were all owned by the same principals. They had a common interest, Cotton contended.**

**The Eastern District distilled “the real issue” to whether the 15% “surcharges” constitute legitimate costs under the contract. Given the contract’s broad definition of all costs, and since the contract neither explicitly included nor excluded a “cost plus fee” arrangement, a jury will have to decide this issue.**

**James R. Keller is a partner at Herzog Crebs LLP where he concentrates his practice on complex business litigation, construction and real estate law and ADR. He also is a mediator and an arbitrator with the American Arbitration Association.**