



Legal Brief

by Timothy J. Woolford, Esquire

Protect Yourself in the Contract against Escalating Materials Prices

With the unrest in the Middle East and fuel prices rising, prices for construction materials are on the rise. As of the date of this writing, the price of a barrel of crude oil stood at over \$108, its highest level in two-and-a-half years. The sharp rise in fuel prices will affect transportation costs, and prices of most construction materials are likely to increase as a result. Materials containing crude oil, such as asphalt, are likely to increase quickly. The price increases are frustrating because it is difficult to pass these cost increases on to owners. Weak demand for construction has forced contractors to hold the line on bid prices. Paying more to make less is the last thing contractors want in this market.

When prices of materials increase sharply, contractors and subcontractors often seek legal advice on whether they can obtain equitable adjustments, i.e., change orders, for the cost increases. Unfortunately, the law is not very accommodating, and it is difficult to obtain relief unless a contract provision specifically permits recovery of the additional costs. Absent a contract provision, the general rule is that, in a lump sum or a fixed-price contract, the contractor bears the risk of price increases.

Without a contract provision addressing materials price increases, contractors have two legal arguments to support requests for equitable adjustments. These two arguments, which are based on the doctrines of commercial impracticability and frustration of purpose, rarely succeed because the claimant must prove that the

price increases were so severe that they actually forced the claimant to sustain a loss on the project.

Because the courts do not afford much relief, the best way to address price increases is to include a contract provision addressing the subject. If the contract gives you the right to additional compensation for materials price increases, there is no need to resort to the two doctrines described above because the contract will govern. To that end, I have recommended the use of the following clause:

In the event of a significant delay or price increase of material, equipment or energy occurring during the performance of the Contract through no fault of the Contractor, the Contract sum, time of completion or Contract requirements shall be adjusted in accordance with the procedures of the Contract Documents. A change in price of an item of material, equipment or energy will be considered significant when the price of an item increases twenty-five percent (25%) between the date of this Contract and the date of installation.

Under the above clause, if the cost of a material increases more than 25 percent, the contractor is entitled to a change order for the amount that exceeds 25 percent. The contractor would absorb the first 25 percent, but after that, the owner would be responsible. The percentage can be negotiated – it does not have to be 25

percent. If you want the ability to get a change order for a smaller increase, simply reduce the percentage which triggers the equitable adjustment to, say, 15 percent, 10 percent or even lower. The lower the percentage triggering the equitable adjustment, the less risk the contractor is assuming. The clause is reasonable because it allows the contractor and the owner to share the cost of these unexpected cost increases occurring after the bid. Subcontractors will want to modify the language by substituting Subcontractor for Contractor.

Another tool to limit the risk of sharp increases is to impose a limit on the time within which your bid or proposal can be accepted. In this economy, many projects are slow to get underway. The contractor which does not state in its proposal that the price is only valid for a limited period of time (e.g. 15 days, 30 days, etc.) is taking a significant risk that prices will increase and it will be bound to the bid price. Change order pricing should be expressly limited in a similar fashion. Another tool to consider is ordering as many materials as possible in advance and storing them, if it is feasible to do so. Negotiate early for a provision permitting payment for stored materials. Avoid waiting until the middle of the project to address this issue because many contracts permit the owner to decide, in its sole discretion, whether to pay for stored materials. Be proactive and address this important issue up front as it could make or break the project, particularly in this environment of low margins.