MEMORANDUM

TO: FIRESTOP CONTRACTORS INTERNATIONAL ASSOCIATION
Bill McHugh

FROM: HENDRICK, PHILLIPS, SALZMAN & SIEGEL
Stephen M. Phillips
C. Leanne Prybylski

DATE: April 13, 2021

SUBJECT: **MANAGING VOLATILE MATERIAL PRICING**

Recent price volatility of construction materials, including, but not limited to, steel, copper, lumber, and PVC, has left contractors faced with another challenge in completing their work at the price they quoted. This is especially true for contractors that have already entered into a fixed-price contract. Price volatility in construction is not new; however, the fact that price volatility of materials recurs from time to time does not make it any less challenging to manage when it occurs. Although contractors have attempted various legal theories to seek relief from contractual obligations when substantial material price increases occur, none of the theories have been very successful. Absent a contract provision to the contrary, the general rule is that the contractor bears the risk of increases in the price of materials in fixed-price construction contracts. So, what can contractors do to manage the risks of price volatility and escalation?

Jobs Not Yet Under Contract

While legal relief is not readily available to a contractor who is already bound to a fixed-price contract, contractors can and should use contract provisions with customers and vendors to avoid getting themselves in an economic quagmire on jobs not yet under contract. There are a few, not mutually exclusive, approaches for contractors to take to avoid being placed in the position of being locked into a fixed-price with a general contractor or owner, while facing continuously rising prices for materials from suppliers.

First, the contractor should work to make sure that the commitments it has received downstream from a material supplier parallel the contractor's upstream obligations to a prospective customer. If a material supplier says that it can only provide quotes for materials ordered or shipped within a certain number of days or through a certain date, the contractor needs to be certain that its proposal and contract contain an identical provision. The contractor needs both to lock-in the supplier's quote for the designated period so that it is contractually entitled to rely on the supplier's quote and make sure that whatever conditions and contingencies are part of the supplier's quote are part of the contractor's proposal and contract with its customer. If a contractor intends to rely upon an oral or written quote from a supplier, the contractor should follow-up with a written communication to the supplier, confirming the quote, the contractor's reliance thereon in making a proposal or contracting with a customer, and the duration the quote will remain in effect.

Given current market conditions, a contractor's role as a middleman and coordinator between material suppliers and building owners becomes more demanding and critical. The successful contractor needs to be able to work with suppliers to obtain quotes and conditions that will be acceptable to the owner and work with owners so that they understand and accept conditions that will allow the job to proceed in a timely and cost-effective manner. For instance, in order to be able to obtain materials at a fixed-price without a huge contingency for potential future price increases and to be sure that material is available when needed, an owner may be best served by having the contractor purchase, take delivery of the materials much earlier than normal or needed, and arrange for suitable storage. If the contractor is unable to make parallel arrangements with the supplier and customer, the contractor should consider whether a different supplier and/or substitute products will satisfy the owner's needs.

Price Escalation Clauses

Contractors should also attempt to negotiate and include provisions in their contracts to deal with price escalation, particularly if the conditions of the supplier's quote are not satisfied. The purpose of a price escalation clause is to shift the risk (or possibly the benefit) of price changes to the owner.

Although at first blush the idea of including a price escalation clause in the contract might seem objectionable to an owner, the clause may be more appealing to the owner if it is written to provide a savings to the owner if material price costs decrease prior to the time the materials are needed. The owner also benefits from the escalation clause because, otherwise, in a volatile market with rising prices, a prudent contractor will build a substantial contingency into its price. A negotiated price escalation clause, which could allow the owner to benefit if material prices decrease or which might be triggered by increases of a stipulated magnitude, allows an owner to have greater knowledge and more control over material pricing than if the contractor simply includes a very high number in the contract price to eliminate or reduce the contractor's risk from escalating material prices. In today's market, an owner might save money by basing the contract on current prices charged to the contractor and actual increases and decreases than if the owner received only fixed-price quotes that include speculative contingencies.

With regard to contracts with the federal government, there is a Federal Acquisition Regulation permitting inclusion of economic price adjustment clauses in fixed-price contracts in situations "when (i) there is serious doubt concerning the stability of market or labor conditions that will exist during an extended period of contract performance, and (ii) contingencies that would otherwise be included in the contract price can be identified and covered separately in the contract." 48 C.F.R. § 16.203-2. The Contracting Officer has the discretion to include this clause in contracts. Contractors contemplating working on government projects should request that this provision be included in the contract documents.

Jobs Already Under Contract

For existing contracts, the best course of action for the contractor is to work with suppliers and customers and develop strategies to mitigate the effect of substantial increases in material prices. As soon as the contractor realizes that prices are increasing or are expected to increase, the contractor should communicate with its customer and discuss whether materials can be purchased before prices escalate and stored on or off site. Many contracts allow contractors to invoice for properly stored materials if insurance is in place to cover the materials. Contractors should also communicate with their suppliers about the possibility of purchasing materials before prices increase.

When prices of materials increase through no fault of the owner or general contractor, upstream contracts may not provide the contractor an entitlement to an increase in the contract price, but the contractor may have a right to recover additional costs of materials if the general contractor or owner stops the work for causes beyond the contractor's control and prices of materials increase while the work is suspended. Contractors should also consider whether there have been any changes in the work that would provide for recovery of additional costs for materials under the change order provisions. Contractors should carefully review their existing contracts to identify provisions that may provide some relief and should make sure they comply with all contractual notice requirements applicable to potential changes and claims. Contractors performing work under a subcontract with a general contractor, should also review the prime contract to understand the rights and remedies that the general contractor has against the owner and make sure they comply with any notice requirements that must be met to seek such rights and remedies.

Summing Up

Contractors should not expect judicial relief from the economic consequences of fixed-price contracts that have become unprofitable because of price increases. Contractors need to be pro-active in managing the problem of material price escalation, primarily through contracts and communications with customers and vendors. With respect to existing contracts, the best course of action for the contractor is to work with suppliers and customers to try to mitigate the effect of price increases. Prompt communication and compliance with contractual notice requirements is important.

With regard to jobs not yet under contract, the contractor needs to work closely with suppliers and customers so that the contractor's legal obligations to the owner match the supplier's legal obligations to the contractor. If possible, contractors should negotiate and include in their contracts price adjustment clauses as a mechanism to allocate the risk of price volatility, particularly in situations where the contractor cannot obtain firm, legally binding prices from a supplier.

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This information does not constitute legal advice, nor does it identify each and every legal issue that may arise in connection with the price volatility of materials. If you have questions, please contact Leanne Prybylski or Stephen Phillips of Hendrick, Phillips, Salzman & Siegel at (404) 522-1410 or via e-mail at clp@hpsslaw.com or smp@hpsslaw.com.

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Here are some examples of contract provisions you may want to consider:

- Due to high volatility in material prices, the price(s) stated in this proposal is/are valid only for contracts accepted and executed within _____ days of the date of this proposal.

- Due to volatility in material prices, the price(s) stated in this contract are valid only for materials for which customer agrees to purchase and make payment for within ___ days.

- The construction industry is experiencing substantial volatility in material prices, material price escalation, material delays and material unavailability particularly with regard to steel, lumber, PVC and some insulation products. If the cost incurred by the Contractor/Subcontractor to purchase a material specified or approved for this job increases by ________% or more between the date of this contract and the time when the materials are to be installed, the Contractor/Subcontractor shall be entitled to an equitable adjustment of the contract sum equal to the additional cost incurred by the Contractor/Subcontractor to obtain the material. Contractor/Subcontractor is to provide written notice to customer upon learning of the price increase and provide documentation of the price of the material as of the date of this contract and the revised price.

  Similarly, if the price of a material decreases by _________% or more, the Contractor/Subcontractor shall provide a credit equal to the reduction in purchase price between the cost of the material as of the date of this contract and the price paid for the material for the project. Contractor/Subcontractor shall provide documentation of the price as of the date of this contract and purchase price upon request.

- In lieu of including a price escalation provision in this contract, the parties agree that the Contractor/Subcontractor is authorized to purchase materials for this project upon execution of this contract and the contract sum shall be adjusted to include the cost of storage, additional delivery charges, and insurance to cover the stored materials.

- Contractor shall perform the work described herein at the price quoted, provided that in the event the price to the contractor for any materials to be used in the contractor's work shall increase by __________ percent or greater from the price relied upon by contractor in preparing and submitting this proposal/contract, then the owner/general contractor agrees that the proposal/contract price shall be increased to this same extent upon contractor's submitting documentation thereof.

- The parties acknowledge that some of the materials and products to be used and installed in the construction of this project may become unavailable, delayed in shipment and/or subject to price increases due to circumstances beyond the control of the contractor, including the COVID-19 pandemic. If a specified product is unavailable or shipment is delayed, contractor shall provide written notice to customer and shall be afforded additional time and substitute products may be considered. If there is an increase in price of materials, equipment or products between the date of this Agreement and the time when the project is ready for the installation of the affected material, the contract sum shall be increased to reflect the additional cost to obtain the materials, provided that the contractor gives the customer written notice and documentation of the increased costs.

- Because of uncertainty in future material availability and unpredictable and rapidly increasing pricing of some construction materials, the materials referenced in this proposal and contract may not be available when needed for this job or can only be obtained at prices in excess of what has been budgeted for this job. In order to reduce these risks, Contractor recommends that the materials be ordered at this time with payment to be made at the time of delivery and the materials suitably stored, with appropriate insurance in place, until the materials are needed at the job site. The costs to store and insure the materials and to transport the materials from the storage facility to the job site would be at customer's expense.

  Alternatively, if the customer prefers not to have the Contractor obtain the materials at this time as described above, the customer accepts the risk of material unavailability and price escalation in the costs incurred to obtain and have the materials delivered to the job site.