

MANAGING MATERIAL COST ESCALATION

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MEET THE PRESENTERS



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CURRENT MARKET CONDITIONS

Material costs are on the rise!



CURRENT MARKET CONDITIONS

Producer Price Index, March 2021

	1-Month % Change	12-Month % Change
Inputs to Construction	3.5%	12.9%
Inputs to Nonresidential Construction	3.5%	12.4%
Plumbing Fixtures and Fittings	1.0%	1.9%
Fabricated Structural Metal Products	3.2%	9.4%
Iron and Steel	13.5%	37.5%
Steel Mill Products	17.6%	40.1%
Nonferrous Wire and Cable	3.8%	19.1%
Softwood Lumber	6.8%	83.4%
Concrete Products	0.2%	1.5%
Prepared Asphalt, Tar Roofing & Siding Products	2.5%	4.3%
Crude Petroleum	11.0%	90.6%
Natural Gas	46.6%	178.3%
Unprocessed Energy Materials	22.3%	96.7%

Source: U.S. Bureau of Labor Statistics

HOW TO ENSURE YOU GET PAID

- Contractors are **under pressure** to bid the price of materials sufficiently high to cover escalating costs, but low enough to remain competitive.
 - Recent examples include steel and copper, PVC piping, *etc.*
- Contractors can seek to address these costs through mechanisms in **existing contracts**.
- Contractors should proactively prepare for these while negotiating **future contracts**.

Existing Contracts



EXISTING CONTRACTS

- Review your contract's ***force majeure*** clause.
 - Note: it is often limited to delays and to compensation for lost time.
- Consider seeking an **equitable adjustment** or **change order** based on the commercial impracticality of the price increase.



FORCE MAJEURE

- *Force Majeure* = “superior force”
- A *force majeure* event is an unexpected event outside of the control of both of the parties to the contract
 - It affects the parties’ ability to perform under the contract
- **Examples:** Acts of God, war, labor strike, global pandemic



FORCE MAJEURE

- A clause that triggers something based on a force majeure event
- *Force majeure* clauses are not standardized
- **“If *force majeure* event occurs, then X happens”**
- Parties may customize to whatever they want



FORCE MAJEURE

- AIA A201 contains a *force majeure* clause that provides for a **time extension**
 - Section 8.3 does not specifically allow for delay damages, but it does not explicitly preclude them
- Other things a *force majeure* clause can provide:
 - Recovery of additional costs
 - Parties can terminate the contract without consequences



FORCE MAJEURE TERMS

- Does clause only reference events involving nature (e.g., “severe floods” or “earthquakes”)?
 - Pandemic may not be included
- What if your contract references “acts of God?”
 - Depends on the state.
 - Some states define broadly, some have limited only to events caused by “nature.”
 - Many construction contracts do not use the term “*force majeure*.” Instead, look to “delay” or “time extension” section.



SEEK EQUITABLE ADJUSTMENT

Escalation letter to Owner when Contract has no escalation clause

As you are aware, in 2021, the construction industry has been and will continue to face unprecedented escalation in material pricing as the world begins the rebound from COVID-19. Whether the cause is tariffs, supply shortages, weather, the blockage of the Suez Canal or other world events isn't relevant. What is relevant is that all of the parties to a construction contract must work together to face these staggering increases. For example, S&P Global Platts is forecasting copper prices to increase over 17% above what was originally forecast for 2021. Steel prices at mills in the United States are up 60% to 100% in the last 6 months, affecting the cost of structural steel, steel joists, reinforcing steel, metal deck, stairs and rails, metal panels, metal ceilings, wall studs, door frames, canopies, steel duct, steel pipe and conduit, pumps, cabinets and furniture. Similarly, according to RS Means, from the last quarter in 2020 to the end of the first quarter in 2021, lumber costs are up 32%, brick costs are up 10%, and insulating glass costs are up 12%. We could continue to list types of material and the impact that rising fuel costs, labor shortages and the lack of raw materials are having on their price, but we believe that all of us need a solution and not more facts and figures.

The purpose of this letter is to determine how we can work together to overcome these escalation issues, bring in our present project on time and avoid defaults and/or schedule delays due to our subcontractors' or suppliers' inability to obtain the needed materials to perform their work without bankrupting us or their companies. As with COVID, we need to find the middle ground and share the burden of these potential impacts.

In that vein, we would like to suggest an open book approach to material purchases. Specifically, we will share with the Owner our estimated costs for the relevant materials that are having the most impact on our ability to work. We will then track those costs through agreed to timely and credible, third-party price indices such as RS Means, Steel Market Update and the like. Our intention is to keep you fully apprised of the changes in the market so that you will be fully informed. We can meet on a regular basis with the idea that if the pricing cannot be overcome through value engineering, substitutions or early purchasing/warehousing, we can agree to change orders to share the burden of the escalation.

These change orders will never include overhead or profit mark-ups on the increases from either us or our subcontractors. In addition, since we must consider some risk of the escalation on our part, we suggest that the first _____ % of any increase be borne completely by us. Any increase above that will be [[the responsibility of the Owner] or [shared _____ % Owner and _____ % Contractor]]. To be fair, if prices decrease from what was in our original estimate, we would want the Owner to be able to benefit from that in the same way.

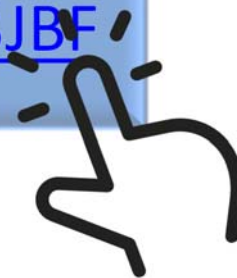
We are happy to schedule the first escalation meeting as soon as possible and ask for days and times in the next 7 days to schedule it. We recognize that no owner wants to see a higher invoice, but the alternative of a default or a delayed project due to the whims of the material market is a real one. The entire team of the owner, design professionals, contractor and subcontractors must work together to eliminate these unpleasant outcomes.

Thank you.

COHEN SEGLIAS' MATERIAL COST ESCALATION PACKAGE

- Sample notice letters for existing projects
- Language to add to COs and monthly releases
- Sample language to include in future contracts and proposals

<https://bit.ly/3iL3JBF>



Future Contracts



FUTURE CONTRACTS

- In future contracts, consider negotiating for the inclusion of a **material price escalation clause**.
- These allow parties to adjust price based on an agreed-upon metric.
 - Example: Difference between price quoted at bid time and price of material when delivered if price exceeds an agreed-upon **threshold** or **price index**.
- **Beware:** this can also work as **savings clauses** if material prices decrease beyond a certain threshold (which could eliminate traditional opportunity to make money buying out materials for less than amounts bid).

ESCALATION CLAUSE EXAMPLES

In the event of significant delay or price increase of material, equipment, or energy occurring during the performance of the contract through no fault of the construction manager, the contract sum, time of completion or contract requirements shall be equitably adjusted by change order 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 20% percent between the date of this Contract and the date of installation.

ESCALATION CLAUSE EXAMPLES

The contract price for this project has been calculated upon current material prices. However, the market for materials, including, but not limited to, asphalt paving, concrete, ductile iron, PVC, RCP, copper and fittings, is considered volatile and a sudden price increase could occur. Contractor agrees to use its best efforts to obtain the lowest possible prices from qualified material suppliers, but should there be an increase in the price of those materials that are purchased after the execution of the contract for use in this project, the owner agrees to pay the contract price increase to contractor. Any claim by contractor for the payment of a contract price increase, as provided above, shall require written notice to the owner from contractor stating the increased cost plus a 10% markup, the material(s) in questions and the source of the supply.

QUESTIONS?



THANK YOU FOR ATTENDING!



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