

## Include Materials Price Escalation Clauses in Construction Contracts

The construction sector has been in a bull market for an unprecedented period of time. With the novel impacts from the coronavirus - and all the associated side effects, such as government moratoria, shipping delays, and materials availability - we are now in a market of extreme volatility in

the construction sector continues to plow forward despite uncertainty, producing critical infrastructure, and much necessary housing, among other projects. The signs are that this trend will continue at least through Q1 of 2023, and likely beyond that, especially when you factor into the equation the many billions of dollars being placed into the market through the Bipartisan Infrastructure Law.

It is not surprising, therefore, that the number one issue in construction contracts in 2022 was how parties handle

and in the negotiations for new contracts. There is no other issue more heavily negotiated, often disputed and hotly debated in the construction sector today.

While this may sound provocative, the private market reality is this: Hard lump sum and guaranteed maximum price contracts are a thing of the past, at least for the near-term future. It's not common to see a hard GMP or lump sum that does not provide some form of relief for unavoidable materials cost escalations. Some projects are proceeding on a cost-plus basis, which, historically, was a contracting model reserved for unique projects with a challenging number of unknown conditions



or incomplete designs. The data is admittedly a bit more unique in the public sector, at least on hard-bid jobs where contractors can bid with a contingency to cover this risk, but it is a line item that is generally not seen in any breakdown. The

The intent of this column is to identify the current market realities and risk and outline the various contract mechanisms that parties can use to allocate risk and cost in an equitable manner.

### CONTRACT OPTIONS

escalation on a construction project. The most common contractual approaches to address the risk allocation for materials cost escalations include the following:

1. Perhaps the most common option is to simply set a benchmark for price increases that become compensable to the contractor. For example, the contract can designate a certain percentage of price increase above the materials or subcontract line item in a schedule of values, say something like 5% and every dollar above that benchmark becomes reimbursable. While the percentage benchmark is obviously subject to negotiation, it is normally correlated compromise is setting a benchmark that is below the fee, so

2. exclusive remedy for materials price escalations. This option provides the contractor with a bucket of certain monies allocated to the risk of price escalation and, for the owner, caps exposure to a certain negotiated sum. The strategy can be used in a standard construction contingency provision or, in more sophisticated contracts, setting aside a second, the scenario where two contingencies are used, the parties should address whether they are mutually exclusive and how each can be drawn down.

3. Some more sophisticated contracts use a hybrid approach, with a materials price escalation clause that is only triggered after the price escalation of the materials in question exceeds a certain benchmark percentage or amount. Parties can also set up this approach where there is an allocation of liability after the materials escalation clause contingency is exhausted. For example, the contractor carries 75% of the price escalation for the parties share the materials price escalation, 50% each, for is allocated 25% to the contractor and 75% to the owner. Obviously, that "ladder" of risk allocation can be negotiated in a myriad of ways.



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### About the Author

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