

Protect Yourself from Rising Material Costs

By Seth M. Pasakarnis, Esq. and Ronald D. Ciotti, Esq.

Current economic conditions and shifts in public policy by the Trump Administration concerning tariffs on imports have the potential to dramatically impact the prices of certain materials critically important to roadway construction projects, namely fuel, steel, and asphalt. Although fuel, steel, and asphalt prices have fluctuated significantly over the past 10 years, it appears that prices will continue to rise over the next several years (and perhaps beyond). This article provides risk management strategies for contractors seeking to mitigate the impacts that rising material prices have on profitability.

"Sharing" the Risk

Contractors that execute a lump-sum contract (in the absence of specific language addressing price escalation) generally assume the financial impact of fluctuations in material prices.

As contractors well know, once the lump sum contract is executed, the contractor is committed to the original price. Although a contractor stands to benefit if material prices decrease, in the more likely scenario of rising material prices, the contractor's contingency, overhead, and profit may all be at risk. Accounting for this risk at bid time may not be an easy task. At times, prices may fluctuate rapidly, making it extremely difficult for a contractor to accurately assess and account for this risk before submitting the bid or proposal. Of course, the obvious way to address the risk of price fluctuations is to include a significant contingency in the bid; however, this is likely a long-term losing strategy in a highly competitive industry where the margin between a winning and losing a bid may be 1% or less.

In the absence of a massive contingency, how can contractors protect themselves from rising material costs? One strategy is "sharing" the risk by including a "material escalation" clause in the upstream contract.

Material Escalation Clauses

The basic principle of drafting and negotiating construction contracts is to fairly and appropriately allocate risk to the party in the best position to handle and manage that risk. The degree to which a contractor may be protected from the significant risk of rising material costs (or exposed to this risk) depends on the language in the contract.

There are three basic types of escalation clauses: (1) a "day one" escalation clause, (2) a "threshold" escalation clause, and (3) a "delay" escalation clause.

A "day one" escalation clause requires the upstream party to pay for any increases in material costs once the contract is executed. This type of escalation clause states:

The prices of materials contained in this contract are those in effect as of (date); Contractor shall be reimbursed for all increases in the cost of material as of the date of purchase plus overhead and profit.

The contract must define exactly what materials are subject to this clause (e.g. structural steel, rebar, concrete) as well as the baseline prices for those materials.

Although a "day one" escalation clause allocates all risk to the upstream party, a "threshold" escalation clause shares the risk by requiring the upstream party to pay for material price increases above a defined threshold:

In the event the price of certain materials (e.g. structural

steel) increases 10% between the date of this contract and the date of installation (or purchase by the contractor), the contract sum shall be equitably adjusted by change order in accordance with the procedures of the contract documents.

In this example, the contractor is reimbursed only for significant price increases which occur between the bid (or contract date) and the date of installation or purchase of materials. This clause shifts the risk of significant price increases to the upstream party, but vests the contractor with the risk of price increases up to the threshold level, effectively capping the contractor's potential exposure.

Finally, delay escalation clauses hold a fixed price for a limited period of time, but allow the contractor to receive an equitable adjustment if the project is delayed or, more commonly, it is not feasible to purchase all materials for the project at the start of construction. A delay escalation clause typically states:

This Contract contemplates that the Contractor will complete its work by (date). In the event the Contractor's work is not completed by that date, through no fault of the Contractor, the Contractor shall be reimbursed for all increases in the costs the following materials: (e.g. steel, asphalt) plus overhead and profit.

Other Strategies for Managing Risk

Contractors may not be able to negotiate and include cost escalation clauses in upstream contracts, especially for public contracts that leave little room for negotiation. Under these circumstances, contractors can still protect themselves by implementing these strategies:

- Limit the time under which bids and proposals may be accepted. Depending on the size and scope of the project, a small increase in material prices can have a dramatic impact on profitability.
- Attempt to lock in suppliers early and at fixed prices. Shifting the risk downstream to the supplier can be a successful strategy.
- Limit the suppliers' rights to only those rights the contractor has upstream for material price increases. Alternatively, limit the suppliers' ability to raise prices to a fixed amount, thereby capping the risk.
- Buy early. If it is feasible to buy, ship, and store materials before they are needed, purchasing materials at current prices limits future exposure to price increases.

Consensus Docs 200.1

In 2007 ConsensusDocs created its "Potentially Time and Price-Impacted Materials" document to fairly allocate the risk of material price volatility using a mutually beneficial threshold clause. ConsensusDocs 200.1 acts as an amendment to your contract and requires the owner and contractor to share the cost of a material price increase as well as allowing the owner to share in the benefit of a material price decrease. It allows the parties to set the threshold percentage relating to the increase or decrease in the baseline prices of specific materials, as well as the pricing method to be used. This document creates a more team-like approach to this divisive issue.

Rising material prices always present a serious and

significant risk. Contractors can address this risk head-on by negotiating price escalation clauses into their upstream contracts and by implementing other strategies in the bid/subcontracting/and procurement phases of a project. Risk identification and management is the key to successfully handling the impact of rising material prices.

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Twenty-Two Leading U.S. Organizations Launch “Smart Surfaces Coalition” to Help Cities Reduce Urban Heat and Better Fight and Adapt to Climate Change

U.S. cities can cut excess heat days by half, save \$700 billion, and create 270,000 new jobs by deploying smart surfaces that reflect away heat and help prevent flooding.

Twenty-two leading sustainability and urban organizations, including USGBC, announced the formation of the Smart Surfaces Coalition, a group of experts and organizations helping cities rapidly adopt cost-effective solutions to cut excess heat radiation from buildings and surfaces, reduce flood risk, and improve livability, health and equity – while saving billions of dollars and creating hundreds of thousands of new jobs.

“The Smart Surfaces Coalition shows cities how to use advanced surface technologies to reduce heat and prevent flooding,” said Greg Kats, Smart Surfaces Coalition founder. “These solutions deliver enormous health and financial benefits, slowing global warming, enhancing quality of life, and saving taxpayers billions of dollars in energy costs.”

Excessive summer heat waves are the new norm in the U.S., with scientists finding that most American cities will experience a huge jump, up to five or even 10 times as many excessively hot (90+ degrees Fahrenheit) days, within just a few decades. The five hottest years on record globally have all occurred since 2010. In the U.S., May 2018 was the hottest on record and June 2018 was the third hottest in the 124 year temperature record. Rapidly rising temperatures are already costing consumers and companies billions in higher energy and health care costs, and making American communities less livable and healthy.

By adopting proven smart surface measures, such as reflective or green roofs, cities can reduce the amount of hot air being reflected back into the surrounding environment, lowering temperatures of cities and communities, saving money, and improving lives.

Smart surface technologies allow cities to better manage sun radiation and runoff through:

- Cool roofs and pavements that reflect away (instead of absorbing) sunlight – cutting temperatures and smog
- Green roofs and trees that provide shade and reduce flood risk
- Solar PV that converts sunshine into electricity and provides shade
- Porous pavements, sidewalks, and roads that reduce water runoff, flooding, and cut the cost of managing storm water

USGBC, which manages the LEED® green building rating system, incorporates many of these tactics into credits that building owners can use to earn LEED certification. LEED is the most widely used green building rating system in the world.

The Smart Surfaces Coalition is already working with a dozen cities to develop tools and training to support mayors,

city managers, and other key officials around the U.S. to understand and adopt these remarkable new opportunities to improve quality of life, health, and fiscal bottom line. The Coalition’s goal is to partner with more than 250 cities to adopt and begin implementing smart surfaces as standard city-wide policy by 2023.

The Coalition today released a new 8-page white paper, “Stay Cool/Save Cash.” Its recommendations and findings are based on a 300-page report, “Delivering Urban Resilience,” which is built on four years of data collection and research on greening the cities of El Paso, Philadelphia, and Washington, D.C.

Fifteen organizations, including USGBC, the American Institute of Architects, the National League of Cities, the National Housing Trust, the Chesapeake Bay Foundation, and The JPB Foundation collaborated on the report, which found that smart surface adoption would save El Paso \$540 million, Philadelphia \$3.6 billion, and Washington, D.C. \$1.8 billion, not including large additional financial benefits from avoiding lost tourism revenue.

Smart surface technologies produce savings in the form of lower energy and water bills, lower health costs, reduced water treatment, and infrastructure costs. New jobs would result from the manufacture, installation, and maintenance of smart surfaces, many of which are labor intensive.

Low-income urban areas are generally more vulnerable to extreme heat, as they have less green spaces and more impervious surfaces, resulting in hotter temperatures and poor environmental air quality. This leads to higher energy bills and greater health risks. Smart surfaces help solve all these structural inequalities.

“Cities are increasingly at risk from severe summer heat,” said Kats. “This coalition will support adoption of smart surface technologies to save billions of dollars and cut greenhouse gasses while making cities cooler, more resilient, healthier, and equitable.”

About the U.S. Green Building Council: The U.S. Green Building Council (USGBC) is committed to a prosperous, healthy, and sustainable future through its LEED green building certification program, robust educational offerings, nationwide network of local members, the annual Greenbuild International Conference & Expo, and advocacy in support of public policy that support cost-efficient and energy-saving green buildings and communities. USGBC serves a diverse marketplace and its LEED green building program is the foremost program for green building in the world – saving money for families, businesses, and taxpayers; reducing carbon emissions; and contributing to a healthier environment.