



Technical

Ramskill Martin's Advice to Common Questions during the Material Supply and Cost "Crisis"

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Ramskill Martin ("RM") is aware of the challenges that its Clients are encountering due to the shortage of materials and price escalation currently affecting the construction industry.

To help you, RM has provided below its answers to some of the common questions it has recently been asked:

"We are just about to sign a Contract to supply and install a steel structure, the material price has increased (and may rise again shortly), am I bound to my tendered price?"

If you have not signed the Contract, and you have not started the installation, the simple answer is "no"

BUT you should check:

Have you accepted a Contract by conduct?

Are you bound by a Letter of Intent?

Have you started the design process which forms part of the Contract?

Until there is accord between the Parties, it is highly unlikely that you would be bound to an offer. The difficulty arises when you have, by conduct, accepted that a Contract exists between you and the other Party.

Most commonly, this conduct is physically starting on site. This is because it is the most obvious and indisputable action, however, it can be any conduct which indicates the intention of the Parties to be bound by a Contract.

Commencing design would be deemed to be such conduct under a Design and Build Contract, although obviously this is always harder to accurately ascertain (especially for the Employer) but if you have issued drawings for approval, it will be clear that you have commenced design and you would be bound by a Contract.

When you have accepted a Contract by conduct the next complication to be unravelled is what are the terms of the Contract, including what is the price and what is the duration; this often requires careful and thorough consideration.

RM's Contract Specialists can help you quickly ascertain if you are bound to a Contract and what that Contract is.

"Can I claim material increase as a Change or something else under a JCT Contract?"

Under most forms of the 2016 JCT Suite of Contracts, the Contract Price is effectively fixed for the duration of the Contract. A change in material price would not constitute a variation and, if a change is instructed and it includes the materials that have increased in price, your exposure unfortunately increases.

Only if the material in question is not within the original Contract Works is there an opportunity to take into account this increased price, as the valuation rules requires the change (“*a fair valuation*”) should be made and such a valuation would incorporate the cost price of the materials at the time of such change. As such, this would include for any recent increases in material price.

Unless the Contract Particulars state that Option B or C (or some other fluctuation provision agreed) of the Fluctuations Rules apply, then you will not be able to include such price increases in your valuation.

If your Contract Particulars do refer to Option B or C, utilising the JCT Fluctuations Rules, you will be (at least partially) protected from any cost increases.

RM’s Contract Specialists can help you quickly ascertain if the Fluctuation Rules apply and assist in calculating the adjustments you can make to your valuation.

If you are under the JCT Cost Reimbursement Contract, you are entitled to claim the cost of the materials at the time of carrying out the work provided invoices can be presented to demonstrate these costs.

“I am unable to progress the concrete foundations at the rate included in my programme, as my Concrete Supplier is only able to deliver 50% of the volume of concrete I require per day. I am under a JCT Contract, what can I do?”

Unfortunately, material shortages are not a Relevant Event under the JCT Suite of Contracts and the opportunity to make a claim on this basis is limited.

There has been much discussion if the current COVID-19 pandemic is or was a Force Majeure Event under the provisions of JCT and, at this stage, there has been little decided in the UK Courts to provide clear assistance.

The cause of the material shortage, and arguably therefore the increase in price due to this shortage, may, as a fact, have been the impact of COVID-19 but the effect may be so remote from the effect that the Courts would not consider this as sustainable argument.

RM’s advice would be to engage early with the Employer, issue a Notice to give all Parties visibility of the challenges you are facing and the potential repercussions and then enter into a dialogue. Securing an Extension of Time without a commensurate Relevant Matter, and thus Loss and Expense, would be a reasonable outcome. It is difficult to see an Employer accepting that it should compensate for the cost of the delay in combination with losing its right to deduct Damages, but removing the threat of Damages would undoubtedly be an equitable solution to events which were outside the control of both Parties.

It would be sensible to also review your Programme and investigate opportunities to mitigate the effect of the delay. If you are seen to be doing everything you can to reduce the impact of the delay due to the material shortage, this would be welcomed by the Employer and may encourage a more favourable consideration of any request for an Extension of Time. It may even be prudent to consider acts of mitigation which to some extent is expected under the contract.

“How can I secure recovery for fluctuating prices of plant and materials under an NEC Contract?”

The NEC Contract can provide some relief in the event of an increase in the market price of supplies or materials. Such price fluctuations can be due to inflation; foreign exchange rates where elements of the works are procured in another currency or merely due to being procured at a different time than was otherwise planned.

Secondary Option X1: Price Adjustment for Inflation

The NEC3 provides for, in Secondary Option X1, a Price Adjustment for inflation. Where this is not chosen, as stated in the NEC3 Guidance Notes, the decision of who should bear the risk of inflation is the Employer’s. This will ultimately be manifested in the selection of the Main Option of the Contract:

- As Options A and B are Fixed Priced Contracts, the inflation risk is entirely with the Contractor.
- In Options C and D, as the Contractor is being paid his incurred Defined Costs (which will be contemporary and inherently contain the effect of inflation), the Employer bears the risk. Ultimately, the long-term inflation risk will be shared via the pain/gain mechanism as the Target Price under the Contract will remain a fixed threshold unaffected by the effects of inflation.
- Options E and F mean that the Employer entirely bears the risk as the Contractor's Defined Cost will be paid throughout the project.

This is where Option X1 can be brought into play. By including it, the Employer may expressly alter the risk profile in the project; the decision of whether to do so may depend on various commercial considerations.

Under Option X1 the Employer can provide, in the Contract Data Part One (data provided by the Employer), each proportion of the Contract Sum (or of the value of works completed to date in each Application for Payment) which is to be linked to an index for inflation. The sum of these proportions provides the total proportion of the Contract Sum in which the Employer bears the risk of inflation.

Using Clauses X.1 through X1.5, the Contract provides (depending upon the Main Option) for calculation of the Price Adjustment Formula to affect either the calculation of the Interim Payment due (Options A and B) or the Target Price (Options C and D). The former relieves the Contractor of the inflation of risk by way of monthly payments and the latter in the eventual pain/gain calculations.

For Option X1 to be included and work effectively:

- The proportions, indices, the base date and the publishing source of the indices must be set out in the Contract Data;
- The use of Option X1 should be stipulated in the Conditions of Contract set out in the Contract Data; and
- Ideally, the drafting for Secondary Option X1 should be included in the Contract.

In a tendering situation, if the *draft* Form of Contract does not contain these provisions, then there may be an opportunity to include something in the eventual Contract through any dialogue or negotiation with the Employer.

Bearing of Additional Risks by the Employer

The NEC3, in its standard drafting, sets out an apportionment of risk between the Parties. For example, by virtue of Clause 60.1(12), the Employer will bear the risk of physical conditions that are encountered outside of the parameters set out therein. This bearing of risk will mean that the Contractor has entitlement to a Compensation Event to compensate him for the costs and time that arise from encountering physical conditions that differ.

This is needed, as Clause 81.1 states, that "*From the starting date until the Defects Certificate has been issued, the risks which are not carried by the Employer are carried by the Contractor*".

In an NEC3 Contract, a way in which the Employer can bear additional risk is by listing them in the Contract Data Part One. The Contractor can then raise a Notice of Compensation Event under Clause 60.1(14) if one of these materialises and, providing such Notice is accepted by the Employer, then the Contractor will be compensated according to his submitted quotation and any review or acceptance by the Project Manager (all as per the contractual mechanisms for Compensation Events).

Though Option X1 provides for proportions of the value of the works being linked to inflationary indices, more specific risks can be dealt with in this way. For example, a key piece of plant which will form an integral part of the operation of the works may be coming from another country and,

as that piece of plant is essential, the Employer may wish to relieve the Contractor from the risk of any price fluctuations for it which may occur (this may be for reasons other than a fluctuating foreign exchange rate - see Option X3 later in this Article).

Where a Compensation Event Delays Procurement

Here, periodic revised submissions of the Revised Programme for acceptance should have been submitted and ideally reviewed by the named Project Manager under the Contract, such that there is an Accepted Programme in existence that is at most four weeks old (or the period for revised submissions, if this has been amended). **Note:** the NEC4 Contract contains deemed acceptance provisions should the Project Manager not respond to the Revised Programme for acceptance in the time allowed.

If the Compensation Event delays the procurement of some materials, plant etc., then if these items are being procured in different market conditions (such that the procured items are more costly) then the additional cost of procuring the item(s) will be recoverable. The corollary of this, however, is that falling prices may result in a saving to the Employer in the Compensation Event, although it is likely only the Contractor is going to be in possession of the requisite knowledge of such.

The procurement activity is likely to be on the Critical Path of the last Accepted Programme but need not be, it just needs to be delayed by the Compensation Event. It may be on a parallel “*work stream*” which may not, at that point in time, be on the Critical Path. However, if procurement of the materials could have happened earlier and is only delayed by the Compensation Event because it was not ordered earlier, then the argument is unlikely to prevail.

Secondary Option X3: Multiple Currencies

Similar to the earlier situation where a key piece of plant is being sourced from a foreign country, where any element of the works is being procured abroad or paid for in a different currency, the Contract offers Option X3. Option X3.1 provides that, although the currency of the Contract is fixed, the payments made to the Contractor can be in other currencies if so desired.

The Contract Data Part One will set out the items and activities where payment in another currency is appropriate, and allow for a cap to be set on the maximum payment in that other currency so the exchange rate risk borne by the Employer can be kept within some bounds.

As for Option X1, for Option X3 to be included and work effectively:

- The appropriate items and activities, other currencies, the cap for the maximum payment in another currency and the publishing source of the exchange rates must be set out in the Contract Data;
- The use of Option X3 should be stipulated in the Conditions of Contract set out in the Contract Data; and
- Ideally, the drafting for Secondary Option X1 should be included in the Contract.

Summary

Whilst not commonly utilised in the UK, both the standard Form JCT and NEC do have mechanisms within them that provide a modicum of protection to the Contractor/Sub-Contractor. However, under both Forms, these require agreement prior to Contract conclusions and under neither Form is this protection “*automatic*”.

The choices available are fairly stark if these Terms are not or cannot be incorporated into the Contract. The Contractor/Sub-Contractor could simply submit a price based on current prices and hope for the best. Alternatively, they could attempt to speculate on the likely cost increases during the lifetime of the project and run the risk of losing out to others who take the first approach.

If there is an absence of protection under the contract the most effective solution to this challenge is to try and work with your Employer to resolve this issue in a collaborative manner. As Harold

Macmillan (and not Winston Churchill as is often thought) said “Jaw-Jaw is better than War-War” although ascertaining how you can create the leverage to encourage the “Jaw-Jaw” may be necessary first.