

Volatility in the Market Place: Lessons Learned From Price Increases of Past Pandemics

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In the last year, materials, equipment, parts, and crafts workers have been in scarce supply due to the coronavirus pandemic. Disruptions to supply chains have increased the cost of such goods and labor. NUCA Members have experienced delays in the delivery of steel joists, insulation, stainless steel, copper, brass, ductile pipe fittings/valves, and PVC piping. Coupled with late delivery, these items are being sold at higher prices. But neither owners nor contractors expected these additional costs. This situation places contractors as well as others in the supply chain in the middle of extraordinary circumstances, where all face unexpected cost escalations. A contractor must remain adaptable, exploring multiple alternatives, to avoid becoming responsible for these cost increases.

What is a contractor to do? Unfortunately, there is no one correct answer to apply to all circumstances. There are too many individual and nuanced variables at play, including:

- Can the contractor obtain the material from multiple suppliers and, if so, does one supplier offer a price that mitigates the problem?
- Does the contractor have the buying power to purchase in bulk and reduce the cost?
- Has the contractor already entered into a contract with the owner, or is the project at the planning and design stage?
- If, at the design stage, can the engineer offer alternatives to bring the project in at the estimated price, despite the increased cost of goods?
- If the contractor already entered into a contract, what is the form of contract (lump sum), and what do the risk-shifting terms state?

Accordingly, it is impossible to provide one single answer as to who bears the risk of an increased cost of construction. A contractor must remain adaptable and explore multiple avenues to avoid becoming responsible for these cost increases.

Nevertheless, there are common contract terms that every contractor must know and incorporate when possible. Your particular contract should be reviewed with a professional to understand the obligations imposed. Terms should also be reviewed with an understanding of the case law from past pandemics and how the courts interpreted those clauses.

What To Do When a Project is Not Awarded

If the contract has not been awarded and the terms of the agreement are still being negotiated, this is the best opportunity to educate the owner on realistic prices for construction. The owner should be informed about the fluctuation in material prices and labor supply. With this understanding, the parties should explore various forms of contract types, including lump sum, cost of the work, cost of the work plus a fee, and guaranteed maximum price contract. Each of these forms of contract has its benefits and detriments. Some forms, like a lump sum contract, typically require the contractor to bear the risks for price increases in both material and labor after the contract is signed. That said, even a lump sum contract can be revised to diversify the risk. Two examples of how contract terms can address these risks follow.

First, the parties can include a price adjustment clause within the contract. These types of clauses allow the price of material or labor to increase due to events and circumstances beyond the contractor's control. What types of events are beyond the control of the contractor shall be a topic for negotiation between the parties.

Nevertheless, the price escalation clause allows the contractor to protect itself from the impacts of coronavirus pandemic proactively, but not to the detriment of the owner. These types of clauses can benefit both the contractor and the owner. To the owner's benefit, if the cost of goods and materials decreases during the construction of the project, typically, the owner would share in the cost savings. Also, by providing a more stabilized and fairer price adjustment, the project is more likely to complete on time.

Second, the owner and contractor could consider purchasing the material earlier and storing it onsite. The contract should include terms that allow the contractor to get paid for stored material. Through early acquisition of the material, the parties eliminate any price increases due to fluctuations in the supply chain due to logistics or material shortages. Further, this method does not cost the owner or contractor any more money than originally estimated.

What To Do When Material Prices Increase After the Contract Has Been Executed

Instructive on what to do when faced with a pandemic is a case of *Pernix Serka Joint Venture v. Department of State*. In the case of *Pernix Serka*, the Civilian Board of Contract Appeal (CBCA) denied a contractor's claim for additional costs incurred under a firm, fixed price contract after an outbreak of the Ebola virus. The CBCA concluded that the fixed priced contract placed the risk of such unexpected costs on the contractor. This is not the desired outcome for the members of NUCA, but the reasoning of the CBCA provides guidance for how contractors should deal with COVID-19 pandemic to obtain a different result.

By way of background, Pernix Serka Joint Venture (PSJV) entered into a contract to construct a rainwater capture and storage system in Sierra Leon. At 65% completion, the Ebola epidemic reached the project. PSJV requested direction from the contracting officer on how to proceed, but the contracting officer informed PSJV that the contractor must decide if its people would stay or leave. After the World Health Organization declared an international public health emergency, PSJV shut down its project and evacuated all personnel in Sierra Leone. PSJV notified the government of its decision. The government viewed PSJV's shutdown as unilateral as it provided no guidance. The case turned on this significant finding of fact as to which party made the decision to stop working. The CBCA held that there was no clause in the contract that shifted the risk to the government for costs incurred due to unforeseen epidemics. Further, the CBCA found that any changes to the contractor's work were

not the result of government action but unilateral decisions of the contractor. In fact, PSJV acknowledged that the government did not direct or order the evacuation of the project. Accordingly, the CBCA determined that the contractor was entitled to additional time but not additional money.

This case does not take into account any particular state statute or common law, so you need to understand those requirements and how they would impact your specific contract terms. That said, the case provides us with a “lessons learned” opportunity. The case suggests that COVID-19 would not be an excusable delay if based on unilateral decisions of the contractor. Therefore, direction must be provided by the owner in response to a contractor’s request for suspension, time, or money. This means the contractor must formally request both time and money. If the owner does not grant such a request, the contractor should seek a “construction change directive” from the owner. A construction change directive is a way for the owner to direct the contractor to perform work in addition to what has been agreed upon in the contract. Put the obligation on the owner to make the decisions that cannot be delegated to the contractor.

In addition to putting the owner on notice of the impacts and getting clear direction from the owner, you must understand your individual contract terms. The contract will control which party bears the burden of paying for events that cause the price to increase. The first clause to review in this context is the force majeure clause. A force majeure clause allows for the suspension of work due to events outside of the control of the contractor and unforeseen by either party. A typical force majeure clause might state:

Acts of God, acts of the government or public entity, natural disasters, fire, flood, epidemics, quarantine restrictions, strikes, freight embargos, war, acts of terrorism, or equipment breakage that are unavoidable or beyond the contractor’s control shall be cause for an extension of time to be provided to the contractor.

Important to note, the event giving rise to delay or suspension of work must render performance impossible and not just difficult and a hardship. Under such circumstances, the typical force majeure clause provides the contractor with time **but not extra money**. Receiving an increase in the amount of time to perform the work does not address the increase in price due to material escalation costs. In fact, more time might not help, as the cost of goods could increase instead of decreasing with the extra time. Therefore, the contractor cannot just rely on a clause that only entitles a contractor to time.

How can a contractor establish a right to extra money if the contract only provides for time or, worse, is silent on the issue? A causal connection must be established, in writing, by the contractor that connects the impacts of COVID-19 to the specific cost increases in material goods. For example, the contractor could demonstrate that the delay has pushed the performance of the work into a new time period; and within this new time period, the costs of the material and labor have increased. Put differently, had the delay not happened, could the contractor have purchased the goods and materials at the price originally contemplated in the contract? Under this hypothetical, if the contractor demonstrates such factors, it has causally related the pandemic as a delay event and tied it directly to the increase in the cost of performance. Your particular factual circumstances must be fully understood, and the facts developed to link the event causing delay (coronavirus) to your supply chain and ultimately to the effect of increasing the price.

Recap: What Steps Should a Contractor Take To Seek Compensation for Increases to Material and Labor Shortages?

First, the contractor should track COVID-19 impacts and notify the owner of this event pursuant to any agreed-upon time frames within the contract. This means identifying when the impacts started, how long they lasted and what changed on the project as a result. The effects of COVID-19 should be captured in project meetings, emails, and letters. The combined correspondence should make clear the impacts imposed on the contractor from this unanticipated event.

Second, the contractor must establish a causal connection between the virus impacts and the increased costs. It is not enough to state that pandemic caused delays—the contractor must associate the increased costs to COVID-19. Did the project push into a new project of time, where the material costs and labor increased? If so, the contractor should provide, in writing, these specific occurrences and costs. If the costs are not readily ascertainable, estimated costs should be sent to the owner.

Finally, the contractor must comply with all notice provisions in its contract. It must notify the owner of the occurrences of coronavirus as well as the need for time and money. Such notices of time and cost should be sent to the owner based on the times set forth in the contract, but best practice would be to send the notice on a monthly basis. This practice will keep the issue “top of mind” and allow all parties to collaborate and mitigate the ultimate cost. As noted, the contractor should include in such notices its best estimate for the duration of delay, the reasons for the delay, and the impacts on the project’s critical activities and costs items.

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