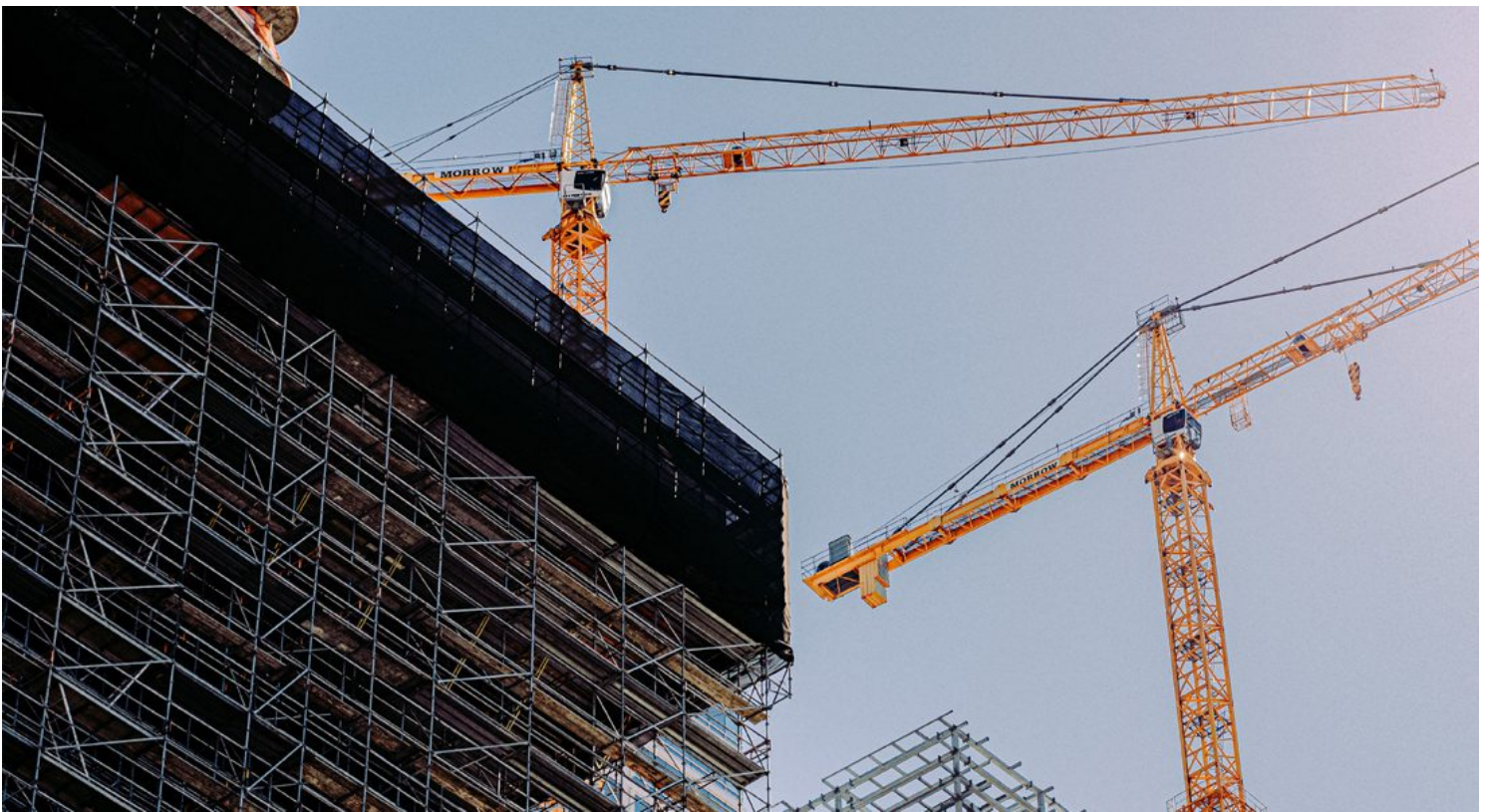


NEWS & INSIGHTS

Legal rights and tactics for addressing price volatility in materials and supply chains

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Over the past year, many construction projects have suffered from volatile price fluctuations for materials. For example, the National Association of Home Builders estimates that increased lumber prices alone have added nearly \$36,000 to the average new single family home price. The impact of material price volatility is even more pronounced on a larger-scale project, such as a college dormitory, hotel, or senior living facility campus, where material cost increases have caused overages of six or seven figures.

Projects over the past year have seen volatility stemming from emergencies and disasters such as the pandemic, hurricanes or the Texas energy crisis. Price volatility, especially when linked to an unprecedented event, raises the question of who bears the liability for the material cost increases and whether there is any relief for those stuck with the bill.

Baseline principles for addressing price fluctuation: the contract controls and unless a specific clause applies, often, the contractor carries the risk

The rights and obligations on a construction project will almost always arise from a contract. The most direct approach to address price risks is through a price escalator or price fluctuation clause where the parties negotiate the potential risk. Some specific points for consideration in such negotiations are set forth at the end of this article. But in the scenarios where a written contract exists and there is no escalator or fluctuation clause, the general baseline rule is that the contractor takes the risk and is responsible for price fluctuations in the materials. See, e.g., *Lakeshore Engineering Services, Inc. v. U.S.*, 110 Fed.Cl. 230, 240 (Fed. Cl. 2013); *Appeal of Southern Dredging Co., Inc.*, 92-2 BCA P 24886 (Eng. B.C.A. 1992).

Regardless of the contract type, the contractor has promised to perform a scope of work at a specified price, and any extraneous hardship to the contractor is generally the contractor's risk unless the contract or a special theory of law dictates otherwise.

Force majeure and change order clauses are unlikely to afford relief

During this recent pandemic, many parties have looked to force majeure clauses in hopes of relief from price volatility. Force majeure clauses are express contract clauses that identify and allocate the risk of certain events that are often referred to as "Acts of God."

Theoretically, a force majeure clause could expressly identify price volatility; however, in practice, very few (if any) force majeure clauses address price fluctuations. This is because price volatility is not considered an Act of God. For example, the standard AIA General Conditions and also the ConsensusDocs clauses both address occurrences such as labor disputes, fire, unusual delays in deliveries, and adverse weather conditions. Typical force majeure clauses also include events like earthquakes, tornados, and terrorism. None of these force majeure events constitute a price fluctuation. See *Langham-Hill Petroleum, Inc. v. Southern Fuels Co.*, 813 F.2d 1327, 1330 (4th Cir. 1987) (in context of oil purchase contract, "normal risk of a fixed price contract is that the market price will change."); *Shelter Forest Int'l Acquisition, Inc. v. COSCO Shipping (USA) Inc.*, 475 F.Supp.3d 1171, 1186 (D. Or. 2020).

Even if the price fluctuation is caused by an Act of God, it is unlikely that the contract would afford additional compensation to cover the increased cost. Often, a force majeure clause limits its remedy to an extension of time. For example, the AIA A201-2017 General Conditions section 8 provides for an extension of time, but it is silent on the potential for compensation. Similarly, the ConsensusDocs provide an extension of time for force majeure events; additional compensation is restricted, however, to delays caused by the Owner. ConsensusDocs, 200 *Standard Agreement and General Conditions Between Owner and Construction*, § 6.3.1. This approach is in accord with the common law approach to delays which provides a time extension for excusable delays that are outside the control

of the parties but not additional compensation.

Similarly, change order clauses are unlikely to offer relief to a contractor for price volatility. Change order clauses address a change to the work that occurs because of an Owner-instructed change, extra work, a change to the design, or an unanticipated site condition that requires the work to be changed. Nearly all of these changes occur when the owner, architect of record, or owner's representative instruct the work to proceed differently than shown in the contract documents. A differing site condition arises when the onsite conditions are different than shown in the contract documents, or they are unusual and unforeseeable. Off-site fluctuations of material costs are not covered by these types of clauses. See *Hallman v. U.S.*, 68 F. Supp. 204 (Fed. Ct. Cl. 1946); *Olympus Corp. v. U.S.*, 98 F.3d 1314, 1318 (Fed. Cir. 1996).

In all of these change order circumstances, the actual work onsite is changed. But when a price fluctuates, the work has not changed – only the price.

Some public contracts include material price escalator clauses

In federal projects, FAR 16.203-4 and 52.216-4 provide an Economic Price Adjustment when the unit prices of materials in the contract schedule increase or decrease. Generally, the clause is only allowed in certain situations, such as work that will last for an extended period of performance of more than one year. The unit price must change by at least three percent for the clause to be applicable, and the contract can limit the aggregate increases to 10 percent.

Similarly, some PennDOT, roadwork, and bridgework public contracts include price escalator clauses for materials, particularly indexed materials such as steel and asphalt. *Publication 408/2020*, PennDOT, §110.04 (Apr. 9, 2021); 67 Pa. Code § 449.6. Thus, if working on a public project, it is possible that the contract includes price escalators.

Common law doctrines generally provide no relief

Having gone through the typical contract clauses, which generally do not provide relief, litigants often turn to the common law. However, these arguments tend to fare no better. It is difficult to argue that there was a mutual mistake because the risk of price fluctuation is a risk of any contract.

The doctrine of commercial impracticability is also unlikely to prevail. Commercial impracticability “occurs when unreasonable, excessive, and unforeseen increases occur in a contract’s cost of performance making performance senseless from a business standpoint.” *Appeal of Southern Dredging Co., Inc.*, 92-2 BCA P 24,886. Among other elements, the advocate must show the risk of the unexpected occurrence is not assigned to them, and the occurrence must render the performance commercially senseless. As previously stated, the risk of price fluctuations is generally allocated to the contractor, unless a contract clause specifically says otherwise. Further, an increase in costs alone is insufficient for a finding of commercial impracticability. Even a large increase in a specific material cost alone is unlikely to render the contract commercially impracticable. For example, it has been held that a 23 percent increase in steel costing an additional \$199,008.29 was insufficient for commercial impracticability when the increase was less than two percent of the prime contract. In re *Spindler Const. Corp.*, ASBCA No. 06-2 BCA P

33,376 (2006). The price increase must be so drastic to make performance of the entire contract senseless.

Some negotiation points to consider for a material price escalator clause

1. Baseline price – to determine that a material price has increased, there must be a baseline price. This could be a selected unit price or index tied to a specific date.
2. Identified material – the negotiated clause should specify the exact material that is subject to the escalator clause.
3. Notice and process – the negotiated clause should identify the timing and process for notice and payment of additional monies.
4. Maximum aggregate increase – typically, a clause will have a maximum aggregate cap on the increase amount to the baseline price.
5. Triggering threshold – typically, a clause will have a triggering threshold of price increase that is more than *de minimis* and must occur as a condition precedent to the additional moneys being paid.

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