



Mitigating Contractors' Exposure to Escalating Material Prices

by George W. Gift III, Esq.

As many within the construction industry are aware, prices for goods and materials have been skyrocketing since the COVID-19 outbreak. In addition to these drastic price increases within the construction industry, many other businesses and industries are facing unprecedented difficulties in obtaining materials due to supply chain and other related problems. These economic impacts are still being felt throughout the construction industry and many of the parties involved (owners, contractors, subcontractors, material suppliers, etc.) have been actively seeking ways to mitigate their risks. Contractors are under constant pressure to bid on projects in such a manner to predict the escalating price of materials, while also bidding projects low enough to remain competitive. This raises the following questions: Who bears the risk associated with price increases during the course of a project, and how can I protect my company from such risk?

Since the price of materials continue to escalate, it is in a contractor's best interest to always be aware of contractual provisions that – depending on how they are phrased – may positively or negatively impact their business. One of the most useful and proactive approaches to address liability associated with price increases and supply chain issues is during the negotiation of the construction contract.

One provision worth considering is a material price escalation clause. A material price escalation clause can provide a way for contractors to mitigate its exposure by recovering some, or all, of the cost increases that accrue over the course of a project. The purpose of the provision is to address the volatility of the market; specifically, where the price of materials continues to climb and, at best, remains unpredictable. Securing the price of materials today may certainly be different than securing a similar price in the future.

SAMPLE PRICE ESCALATION CLAUSES

There are several price escalation provisions available to contracting parties, each of which may impact the contract positively or negatively. Below is an example of a material price escalation provision that construction contractors should be aware of, and keep an eye out for, during the review of any construction contract:

SAMPLE NO. 1: By executing this Contract, Contractor guarantees its prices contained herein for the duration of the Project. Contractor expressly agrees that any conditions outside the control of Contractor including, but not limited to, material shortages, material and labor price escalations, labor shortages and similar conditions, have been accounted for in the Contract price and shall not constitute a basis for a time extension or a claim for additional compensation of any type.

As you can see, this is a provision designed to shift the liability of an increase in the price of materials, delays in material deliveries, and other associated conditions, onto the contractor. Certainly, if you were to come across a provision like the aforementioned, you would want to address it, or you may be subject to guaranteeing your prices for the entirety of the project. Below is an example of a material price escalation clause constructed in a manner that distributes the additional cost and liability equally throughout the contractual hierarchy:

SAMPLE NO. 2: If, at any time during the performance of this Contract, the cost of materials significantly increases through no fault of Contractor or Subcontractor, the price of this Contract shall be equitably adjusted by an amount reasonably necessary to cover any such significant increase in the costs of materials. As used herein, a significant cost increase shall mean any increase in cost of materials exceeding ___% from the date of executing the Subcontract. Subcontractor shall document any material increases through quotes, invoices, or receipts and provide them to Contractor for review. Where the delivery of materials is delayed through no fault of the Subcontractor as a result of the shortage or unavailability of the materials, Subcontractor shall not be liable for any additional costs or damages associated with such delay(s) and shall be provided with a reasonable time extension to account for such delay.

As you can see, material price escalation clauses can be drafted in a manner that reduces the risk of price increases. The manner which it is phrased in your construction contract determines who bears the risk of such price increases.

At a minimum, all construction contractors should be reviewing their contracts before they sign them to understand the risks associated with signing on the dotted line. Please make sure you consult with your construction counsel to draft, negotiate, and/or explain the consequences that material escalation provisions can have for you and your company. Each project is different so a thorough review and drafting on the front end can save you much time, effort, and expenses at the end of the project.

Disclaimer: The information contained in this article is for general educational information only. This information does not constitute legal advice, is not intended to constitute legal advice, nor should it be relied upon as legal advice for your specific factual situation.

George W. Gift III, Esq.

George is an attorney with Knott Ebelini Hart and concentrates his practice in the areas of construction litigation, business litigation, contract litigation, commercial litigation, and commercial collections. George has a comprehensive construction law practice that involves representation of commercial and residential contractors from contract review and formation, construction lien and payment disputes, construction defect claims, and overall project counseling that is designed to assist his construction clients improve their businesses.

In addition to his practice, George serves as General Counsel to the Lee County Building Industry Association, which is a Southwest Florida-based construction association designed to assist local contractors with their professional development. George is also on the board for the American Subcontractors Association of Southwest Florida, which develops and assists local subcontractors through furthering education courses, networking, and professional development.