

PANDEMIC TO PANIC

How to Protect
your Business
from Supply
Chain Disruption
and Material
Price Escalations



PRESENTED BY:

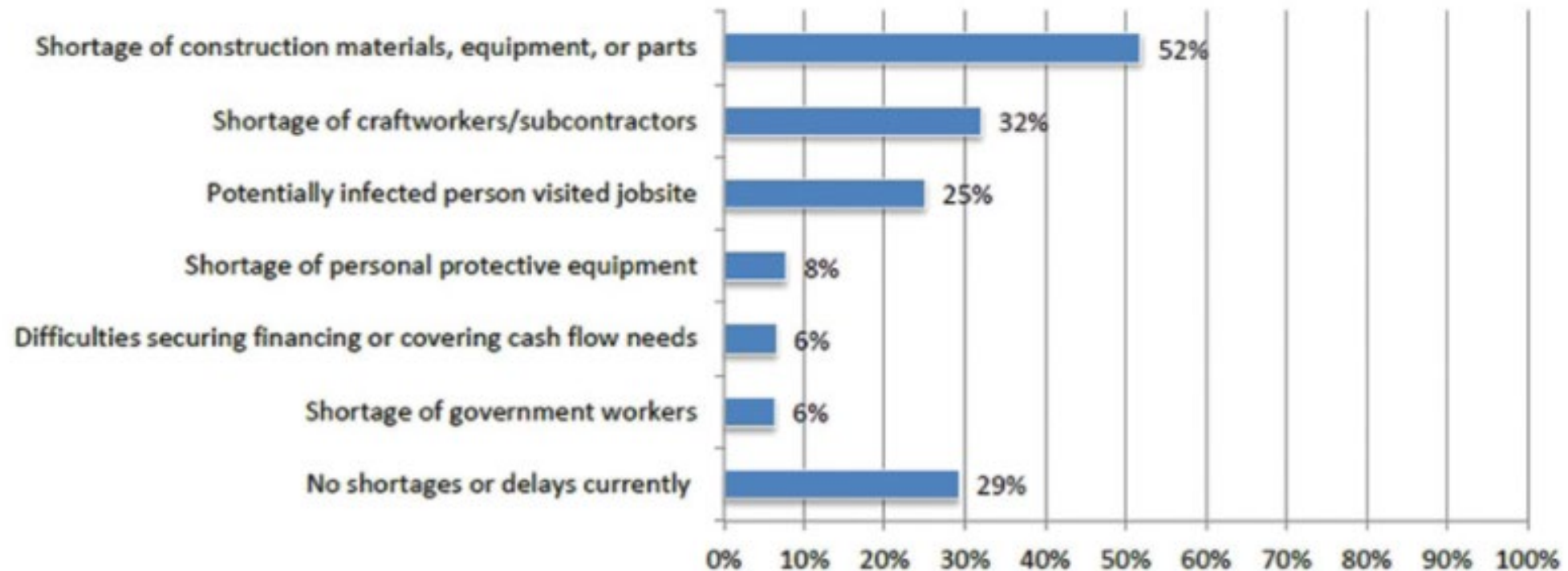
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AGC Coronavirus Survey National Results (Feb 19- Mar 4, 2021)

Total Responses: 1489. Responses varied for some questions. Percentages are based on responses to each question and may not sum to 100 due to rounding.

1. Are you currently experiencing any project delays or disruptions due to the following (mark all that apply):



52% of 1,489 AGC member contractors have reported a project delay due to a shortage of construction materials, parts or equipment.

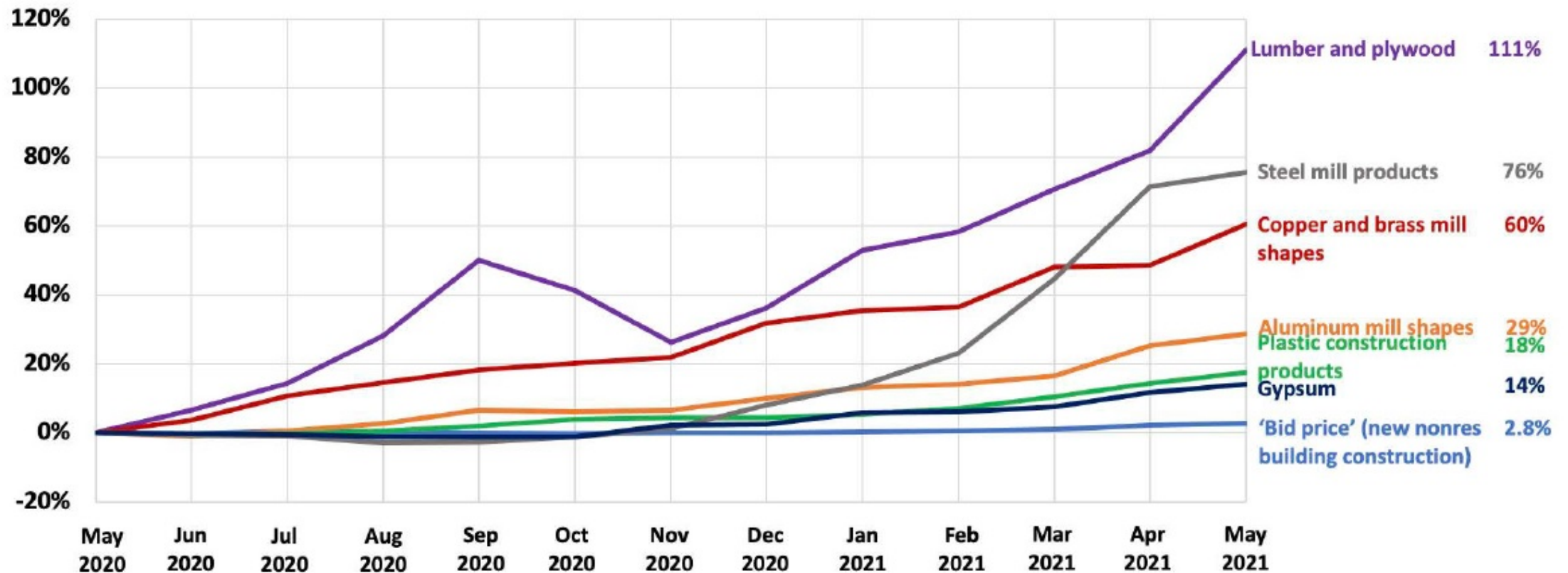
GRAPH COURTESY OF AGC OF AMERICA

FIGURE 2

Price changes for construction and selected materials

May 2020- May 2021

% change
May 2020-
May 2021:



Source: Bureau of Labor Statistics, producer price indexes (PPIs) for new nonresidential building construction (bid prices), gypsum products, wood, metal products, and plastic products, not seasonally adjusted

Increased Cost of Building Materials

Who should bear the risk?

How can the parties mitigate the risks?



Addressing Shortages

Owner's Perspective

- Prices are fixed once a contract is signed
- Increases must be limited to signed change orders
- Unless entitlement to recovery for an increase in material costs is specifically addressed through an escalation clause or other language, the contractor and suppliers are out of luck

Addressing Shortages

Contractor's Perspective

- Entitled to compensation because the impacts of material and labor shortages caused by the coronavirus could not have been expected at the time the contract was executed.
- An owner must pay for the related consequences:
 - Delayed projects caused by lack of labor and/or materials
 - The owner will be unjustly enriched by the contractor having to absorb the costs and the increased value from the original contract amount

Addressing Shortages

Supplier's Perspective

- Potentially liable for breach of contract when the availability of a material is outside the supplier's control
- Lumber, steel, concrete shortages and accompanying price increases – contractor is benefiting from an unreasonable and unattainable fixed price which was negotiated before the pandemic

Addressing Shortages: Look to the Contract



Addressing Shortages: Look to the Contract

COVID-19 as a Force Majeure Event

- *"Force Majeure"* is an unforeseen circumstance not created by the parties which renders one of the party's performance impossible
 - Beyond reasonable control
 - Materially affects performance
 - Could not have been reasonably foreseen
 - Not due to general economic conditions or market effects

Addressing Shortages: Look to the Contract

COVID-19 as a Force Majeure Event

Means an event beyond the control of the Authority and the Operator, which prevents a Party from complying with any of its obligations under this Contract, including but not limited to:

- 1.1.1 act of God (such as, but not limited to, fires, explosions, earthquakes, drought, tidal waves and floods);
- 1.1.2 war, hostilities (whether war be declared or not), invasion, act of foreign enemies, mobilization, requisition, or embargo;
- 1.1.3 rebellion, revolution, insurrection, or military or usurped power, or civil war;
- 1.1.4 contamination by radio-activity from any nuclear fuel, or from any nuclear waste from the combustion of nuclear fuel, radio-active toxic explosive, or other hazardous properties of any explosive nuclear assembly or nuclear component of such assembly;
- 1.1.5 riot, commotion, strikes, go slows, lock outs or disorder, unless solely restricted to employees of the Supplier or of his Subcontractors; or
- 1.1.6 acts or threats of terrorism.

Addressing Shortages: Look to the Contract

COVID-19 as a Force Majeure Event

- BEWARE: Most “force majeure” provisions only allow for extra time, not extra costs
- If the “force majeure” provision is detailed, the failure to reference the exact circumstance can be read to exclude the event.

Addressing Shortages: Look to the Contract

What if no Force Majeure Clause?

- AIA A201 (2007 & 2017) *does* address delays in the contractor's performance caused by the owner or caused "by any other circumstances beyond its control, including, but not limited to, adverse weather, flood, fires, acts of god, war, unavoidable casualties or ***other causes beyond the Contractor's control***" AIA A201 (2007). The 2017 AIA A201 is essentially identical.

Addressing Shortages: Look to the Contract

What if no Force Majeure Clause?

§ 8.3.1 *If the Contractor is delayed at any time in the commencement or progress of the Work by (1) an act or neglect of the Owner or Architect, of an employee of either, or of a Separate Contractor; (2) by changes ordered in the Work; (3) by labor disputes, fire, **unusual delay in deliveries**, unavoidable casualties, adverse weather conditions documented in accordance with Section 15.1.6.2, **or other causes beyond the Contractor's control**; (4) by delay authorized by the Owner pending mediation and binding dispute resolution; or (5) **by other causes that the Contractor asserts, and the Architect determines, justify delay**, then the Contract Time shall be extended for such reasonable time as the Architect may determine.*

Addressing Shortages: Look to the Contract

What if no Force Majeure Clause?

- ConsensusDocs 200.1 – Time and Price Impacted Materials addendum provides a method for addressing material escalations

Addressing Shortages: Look to the Contract

What if no Force Majeure Clause?

“Doctrine of Impracticability” can be a defense when no force majeure event

BEWARE: Generally, requires that a party who is able to perform its contractual obligations must do so - even if the obligations have become more difficult or more burdensome

Higher costs alone usually will not justify non-performance or allow for a price adjustment

Addressing Shortages: Look to the Contract

Material Price Escalation Clauses

Allows the parties to adjust the price on an agreed upon metric. A material escalation clause in a fixed-price contract may look something like this:

8.7.1 Escalation Clause. In the event of significant delay or price increase of material, equipment, or energy occurring during the performance of the contract through no fault of the contractor, the contract sum, time of completion or contract requirements shall be equitably adjusted by change order in accordance with the procedures of the contract documents. A change in price of an item of material, equipment, or energy will be considered significant when the price of an item increases 20% between the date of this Contract and the date of installation. The amount of the increase shall be capped at five percent (5%) of the original budgeted price for the item.

Addressing Shortages: Look to the Contract

Material Price Escalation Clauses: Different Types

- Invoice Method
- Index Method
- Combination of Invoice/Index Method
- Threshold
- Delay

Addressing Shortages

Escalation Clauses – Take Aways

- Permit contractors to receive increases in contract price if costs for particular materials or labor increase over the course of the contract if the circumstances described in the clause are met
- Unit priced items may be increased if hardship results from increased quantity requirements
- Usually kicks in after agreed upon threshold increase in cost
- Protect contractor from price increases that could not have been predicted during bid submission
- Without an escalation clause, contractor typically bears entire risk of material and labor price escalations, regardless of cause

Addressing Shortages

Law of Business Wisdom

- Can specific materials be identified that will likely have short term volatile pricing?
- Can a common understanding be reached as to what construes “volatile” pricing (such as 5% over 30 days or 30% over 180 days)?
- Can contractors or owners identify any suppliers that will provide fixed pricing for specific materials for a period of time?
- Can materials be ordered at commencement of the project and stored on-site or at an approved location until needed?
- Can the parties agree to give benefits to the Owner if material prices go down?

Addressing Shortages

Contract between Contractor and Supplier

- Does the contract have a fixed price?

Addressing Shortages

Contract between Contractor and Supplier

- Does the contract have a specific term or is the term indefinite?

Addressing Shortages

Contract between Contractor and Supplier

- When does the contract expire?

Addressing Shortages

Contract between Contractor and Supplier

- Renewal rights/obligations?

Addressing Shortages

Contract between Contractor and Supplier

- Does the contract allow early termination?

Tools for Mitigating and Sharing

Practical Escalation Risk Solutions

- Value Engineering for Substitute Materials
- Early Material Purchases
- Early Material Supply Commitments
- Bulk Material Purchases and Supplier Partnerships



Project Suspensions

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Project Suspensions – Affected Parties



Owner



Design
Professional



Construction
Manager



General
Contractor



Subcontractor(s)



Supplier



Surety

Project Suspensions – Common Issues



Cause

Who is Responsible?



**Increased
Performance Costs**
How much will this cost?



Duration

*How long will this
last?*

Who is Responsible for Suspension Costs?

- Who directed suspension?
- Reason for suspension?
 - Foreseeable/Unforeseeable
 - Mistake
- Other parties affected by suspension

Responsibility for Suspension

- Who controls/directs the suspension?
- Did the party directing the suspension change the planned manner/method of work?
- Proof of cause of suspension/delay

Who is Responsible for Suspension Costs?

- Read the contract
 - Changes clause
 - Force majeure clause
 - Delay/suspension of work clause
 - Default clause
 - Direction of work



Increased Performance Costs

- Labor, material, equipment, and subcontractor (direct) costs
- Productivity/efficiency impacts
- Extended general conditions
- Home office overhead/administrative

Direct Costs

- Examples:
 - Added health and safety costs for jobsite personnel
 - Additional cleaning supplies
 - Increased material costs
 - Increased labor rates
 - Extended equipment rental times
- Segregate increased direct costs associated with suspension

Productivity/Efficiency Impacts

- Added de-mobilization/mobilization efforts
- Re-sequencing or reordering of work to overcome impacts of suspension
- As-planned productivity negatively impacted
- Less than expected productivity can mean increased costs

Extended General Conditions

- Examples:
 - Project management/supervision/admin
 - Job trailer
 - Job site sanitary facilities
 - Office supplies
 - Job site vehicles



Extended General Conditions

- Typically recovered as:
 - Percentage of cost markup (non-time impact); or
 - Daily rate, where time impact involved
- Is recovery allowable under contract?
- Tracking extended GCs as suspension costs

Home Office Overhead

- Indirect costs allocated proportionally to all projects
- Examples
 - Corporate/management/salaries
 - Accounting
 - Health and Safety
 - HR/Personnel
 - Rent/Property Ownership
 - Taxes and Insurance

Home Office Overhead

- Typically recovered as:
 - Markup to direct cost/percentage basis; or
 - Extended overhead at daily rate where time impacts involved
- Contractual restrictions to recovery

Extended Project Duration

- Owner delay damages (actual or liquidated)
- Acceleration of work
- Coordination of trades
- Impacts to other jobs
- Time is money!



Calculating Delay/Lost Productivity

- Damage Quantification Methods
 - Measured Mile Method
 - Earned Value Method
 - Project Comparison Method
 - Modified Total Cost Method
 - Total Cost Method

Calculating Delay/Lost Productivity *Measured Mile*

- Impacted Productivity vs Unimpacted Productivity
- Currently most successful approach for recovery

Calculating Delay/Lost Productivity

Earned Value Method

- Look to original proposal/bid
- Look to portion of the project that is less than 10%

Loss of efficiency = $\sum_{k=1}^n$

(Actual LHsk - Earned LHsk) (in LHs), or

Loss of efficiency = $\sum_{k=1}^n$

(Actual Costk - Earned Valuek) (in \$)

where k is the k th month (day, week) of the impacted period and n is the number of months (day, week) of the impacted period.

Calculating Delay/Lost Productivity

Project Comparison Method

- Similarity between disrupted vs nondisrupted productivity

Calculating Delay/Lost Productivity

Modified Total Cost Method

- Actual expenditures spent during the project to the bid/proposal, with adjustments

Calculating Delay/Disruption Costs

Total Cost Method

- Similar to modified, but no adjustment

Calculating Delay/Disruption Costs

Other Methods to Consider

- MCAA Approach: 16 factors recognized as being harmful
- NECA Approach: worsening effects
- BRT approach: worsening effect over time

Calculating Delay/Disruption Costs

Impact of Paycheck Protection Program



Paycheck Protection Program

Calculating Delay/Disruption Costs

Impact of Paycheck Protection Program

- Ability to designate between compensation through PPP vs. damages/reimbursement sought



Paycheck Protection Program



Status of Business Interruption Insurance Claims for COVID-19

Status of Business Interruption Insurance Claims for COVID-19

- Are temporary COVID-19-related closures and shutdowns of property compensable under business interruption insurance?
- As of April 2021, 180+ COVID-19-related insurance lawsuits have been filed
 - Most results favorable to insurance carriers
 - Temporary loss of functionality of property from COVID government restrictions did not constitute “physical loss or damage” to the property, and therefore did not trigger insurance coverage



Mitigation Strategies

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Landmines

- Proving responsibility for suspension
- Lack of timely notice
- Failure to document impacts
- Foreseeability of impacts before signing contract
- Exculpatory clauses
- Flow-down clauses



Timely Notice

- Proper notice(s) to contracted/responsible party
 - Must contractually required notice be given even if other party has actual notice?
 - Failure to give proper notice may result in waiver of right to recover added costs or time.

Timely Notice

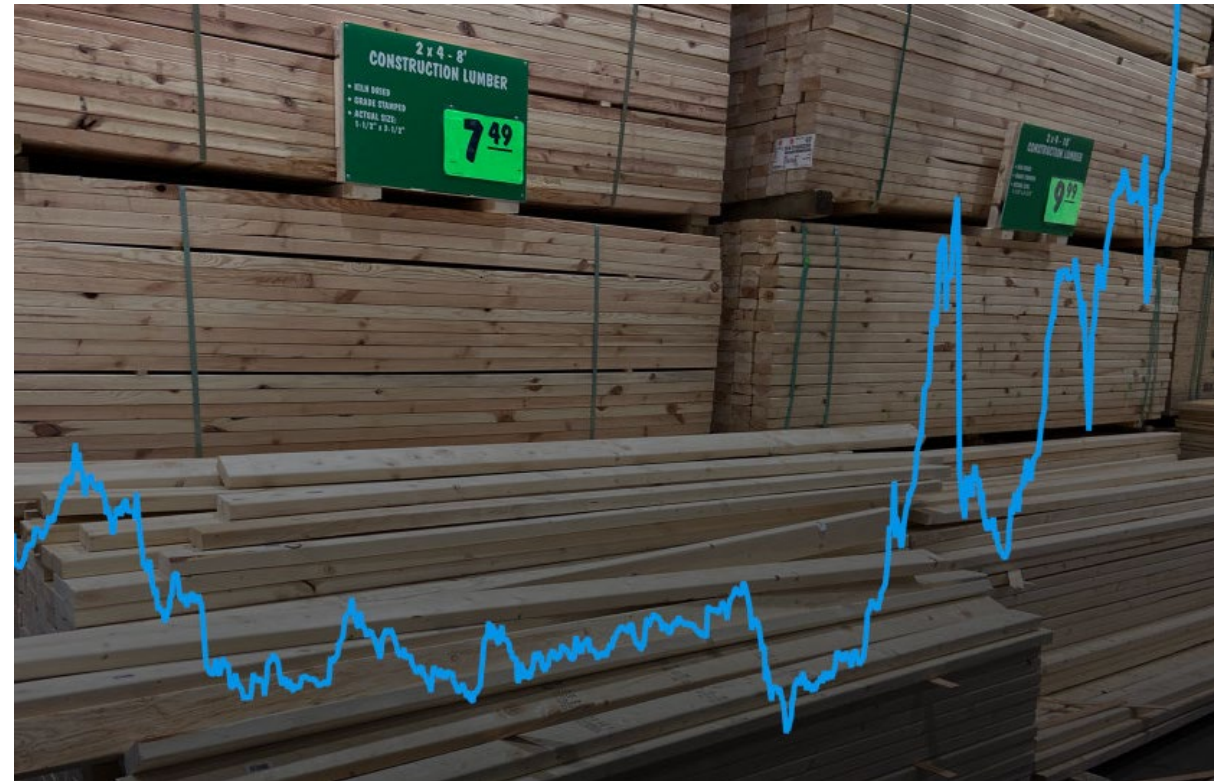
- Proper notice(s) to contracted/responsible party
 - Failure to give proper notice may result in waiver of right to recover added costs or time.

Documenting Impacts

- May help establish causation
 - Courts have consistently held that a project's owner was not liable for escalated steel pricing suffered by the general contractor, because the general contractor failed to provide evidence of the impact

Foreseeability of Impact

- Known likely causes of suspension
 - Pandemic
 - Significant price fluctuations in certain building materials
 - Supply chain disruption
 - Labor shortage



Exculpatory Clauses

- Contractor bears risk of project suspension due to delayed delivery of materials or equipment
- No damages for delay (or) suspension
 - May get time; but not compensation

Flow-Down

- Is subcontractor bound to same terms as contractor?
 - “Flow Down Clause”
 - What is the order of precedence between the contract documents?

Best Practices

- Contract is king
 - Know and understand existing clauses
 - Consider mitigating clauses
- Timely notice
- Document, document, document



Best Practices: Existing Clauses

- Changes clause
- Suspension of work clause
- Force majeure clause
- Default clause
- Control of work

Mitigating Clauses

Example:

The Contract Sum is based upon the current material and labor rates as of [] ("Current Rate"). The Contract Sum shall be increased if and when the costs of material or labor increases by []% greater than the Current Rate ("Significant Escalation"). If material and/or labor prices experience Significant Escalation during Project, [] will be entitled to submit evidence of the Significant Escalation and the Contract Sum will be equitably adjusted by the amount necessary to cover all costs associated with the Significant Escalation.

Notice

- Know/understand contract's notice requirements
- Give notice properly and timely
- Understand intent of notice
 - Preserve rights
 - Avoid disputes
 - Tell your story
- Don't be afraid to give notice



Document, Document, Document

Daily Reports	Meeting Minutes
Emails	Requests for Information
Text Messages	Change Order Requests
Photos/Videos	Shop Drawing and Submittal Log
Project Schedule and Schedule Updates	Field Order Status Chart
	Notice Letters



Questions?

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