



Protect Yourself in the Subcontract Against Escalating Materials Prices & Supply Chain Delays

by Timothy Woolford, Woolford Law, PC

The good news for subcontractors is that the economy is beginning to take off following the Covid shutdown. The bad news, however, is that interruptions in the global supply chain and shortages in construction materials are causing delays and driving prices to all-time highs. *The Wall Street Journal* recently reported that lumber prices have soared to new records, and many economists believe that the skyrocketing materials prices will continue to remain at record highs for an extended duration. Associated General Contractors recently issued a Construction Inflation Alert indicating that prices of construction materials have risen nearly 13 percent since the Covid pandemic began.

When prices of materials increase sharply or there are supply chain shortages, subcontractors often seek legal advice on whether they can obtain change orders for the additional costs or time extensions for the delays. Unfortunately, the law is not very accommodating for those seeking relief and it is difficult to obtain relief unless a contract provision specifically permits recovery of the additional costs or entitles you to additional time. Absent a contract provision, the general rule is that in a lump-sum or a fixed-price contract, the subcontractor bears the risk of price increases.

If you are experiencing price escalation or supply chain delays on a project on which you have already signed a subcontract, the first step is to check the subcontract to see whether it affords any relief in these situations. In many cases, the subcontract will not contain specific language giving you the right to recover additional costs or to obtain a time extension. However, the subcontract might incorporate the contract between the general contractor and its customer,

referred to as the prime contract. If it does, check to see whether it includes the American Institute of Architects A201 General Conditions. Article 8.3.1 of the General Conditions may give you the right to a time extension, as it provides as follows:

If the Contractor is delayed at any time in the commencement or progress of the Work by ... unusual delay in deliveries ... then the Contract Time shall be extended for such reasonable time as the Architect may determine.

If the prime contract is incorporated by reference into the subcontract and if there is language in the subcontract providing that the subcontractor is entitled to all the benefits and rights that the contractor has against the owner under the contract documents (referred to as a flow-down or flow-through provision), then you have a good argument for entitlement to additional time. This provision only addresses additional time and does not authorize recovery of additional costs. Be sure to strictly comply with the contract provisions regarding notice of the claim and substantiating the delay.

With respect to additional compensation for the price escalation, unless a contract provision provides otherwise, the general rule unfortunately is that in a lump-sum or fixed-price subcontract, the subcontractor must absorb additional costs caused by materials price increases. The same rationale holds that a subcontractor is not ordinarily required to provide a credit to the customer in the event the price of a material goes down. Do not be surprised, therefore, if your customer (or the architect, engineer or owner) denies your change order request claiming that the risk of materials price increases is on you.

Without a contract provision addressing materials price increases or time extensions for material delivery delays, subcontractors have two primary arguments to support requests for additional compensation and time, which are based on the legal doctrines of *commercial impracticability* and *frustration of purpose*. Commercial impracticability is similar to force majeure. Unless the subcontract provides otherwise, the doctrine does not, generally, apply to fluctuations in materials prices. Many contracts include a force majeure clause, but they do not typically address materials price increases or shortages. They usually only provide relief in the event of a disaster, war, terrorism, strikes or fire. It is difficult to make out a case in court for relief based on either of these doctrines because the subcontractor must ordinarily prove that the price increases were so severe that the subcontractor would be put out of business due to the increases if it had to complete the project without additional compensation. Even then, the right to relief is not guaranteed.

While severe price increases can be devastating to the bottom line, they are not usually fatal to the company's mere existence and, as a result, courts often deny relief. Still, some courts have found that severe unforeseen price increases can, in some cases, justify an equitable adjustment to the contract price or contract time. Therefore, even if the subcontract does not expressly entitle you to relief, submit a change order request anyway and be sure to provide detailed backup for the additional costs and or additional time requested. Some owners are sympathetic to the predicament that contractors and subcontractors are confronted through no fault of their own with an extremely volatile pricing environment. They may

agree to provide you with financial and schedule relief even if the contract documents do not specifically authorize it. One thing is for sure – if you do not request relief, you certainly will not receive it.

To summarize, the most effective way to address price increases is to include a provision in the subcontract specifically addressing it and clearly giving you the right to relief in the event of price escalation or delays to material deliveries. If the subcontract gives you the express right to additional compensation for materials price increases, there is no need to resort to the two doctrines described above. To that end, you may elect to insist on inclusion of the following clause in the subcontract:

In the event of a significant delay or price increase of material, equipment or energy occurring during the performance of the Subcontract through no fault of the Subcontractor, the Subcontract sum, time of completion or Subcontract requirements shall be adjusted 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 ten percent (10%) between the date of this Subcontract and the date of installation.

Under the above clause, if the cost of a material increases more than 10 percent, the contractor is entitled to a change order for the amount that exceeds 10 percent. The subcontractor would absorb the first 10 percent of price increases, but after that, the customer would be responsible. The percentage can be negotiated up or down – it does not have to be 10 percent. If you want the ability to get a change order for a smaller increase, simply reduce the percentage which triggers the equitable adjustment to, say, 5 percent. The lower the percentage triggering the equitable adjustment, the less the risk to you. If the customer is still resistant, consider offering to increase the percentage to 20 or 25 percent or to include a clause that requires you to pass on any savings in materials prices to the customer. You might also inform

the customer that if an escalation clause is not included in the subcontract, you will have no choice but to increase your proposal cost to cover the risk of materials' price increases.

ConsensusDocs has a standardized amendment addressing materials price increases that can be customized and attached to the subcontract. It provides a baseline price and calculation method for potential adjustments due to materials price increases. The amendment contains a schedule in which the parties can elect to identify materials and if the price of the designated material goes up or down, the subcontract price is adjusted accordingly. The amendment also addresses time extensions in the event of a delay caused by delivery delay.

Another tool to limit the risk of sharp increases is to impose a limit on the time within which your bid or proposal can be accepted. The pandemic has made many projects slow to get underway and the subcontractor should therefore specifically limit the length of time that the proposal pricing remains valid (e.g. 15 days, 30 days, etc.). Also, the proposal should contain an escalation clause (such as that suggested above) and should state that it is expressly conditioned upon the escalation clause being included in the subcontract. Change order pricing should be expressly limited in similar fashion and the change order proposal should expressly state that it is valid only for a specific period of time, such as 30 days. Another tool to consider is ordering as many materials as possible in advance and storing them if it is feasible to do so. Negotiate early for a provision permitting payment for stored materials. Avoid waiting until the middle of the project to address this issue because many contracts permit the owner to decide, in its sole discretion, whether to pay for stored materials. Be proactive and address this important issue up front so there is no dispute regarding your entitlement to payment for stored materials.

Subcontractors should also be aware that it may be possible to recover the cost of price increases that occurred as a result of a delay during the construction

period. If a subcontractor can establish that the price increases occurred during a delay caused by the customer or the owner, an element of the delay cost may be escalated material costs. The theory is that as a result of the delays to the construction, the subcontractor had to postpone ordering materials and that by the time the project was ready to receive the materials, the price increased. However, the subcontract may contain no pay for delay or no damages for delay provisions which could prevent recovery of these additional costs. Subcontractors should always resist such provisions particularly now in the current environment where prices are escalating rapidly.

In summary, check the subcontract to see if an argument in favor of additional costs or time can be made based on its provisions. If not, there are a few legal arguments that can be made based on commercial impracticability and/or frustration of purpose, but courts have not been overly cordial to arguments based on those doctrines. For future projects, make sure an escalation clause is included and limit the duration of quotations and change order proposals. As always, consult with counsel on all of the above issues.

About the Author

Timothy Woolford, Woolford Law, P.C., is a construction attorney in Pennsylvania that represents subcontractors and other construction professionals. He is also an adjunct professor of law at the Penn State Law School where he teaches construction law to second- and third-year law students. He can be reached at (717) 290-1190 or twoxford@woolfordlaw.com.