

Current Industry Challenges: Navigating Fluctuations & Materials Shortages

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ENLIGHTENED THINKING

WHAT ARE THE CURRENT CHALLENGES AND WHY?

- Problem: Significant price increases and extended lead in times for materials resulting in delays to projects.
- What is particularly affected?: M&E equipment, steel, cement, timber, insulation and more...the list is ever changing!
- Also, there is a shortage of skilled labour – difficult for contractors to price going forward
- Funders of projects are taking a strict approach – is it possible to have a fixed price in the current market?
- Why?: A perfect storm!

Covid-19, Brexit, housing boom, markets dipping, Ukraine conflict/Russian sanctions, supplier opportunism and..... recession?

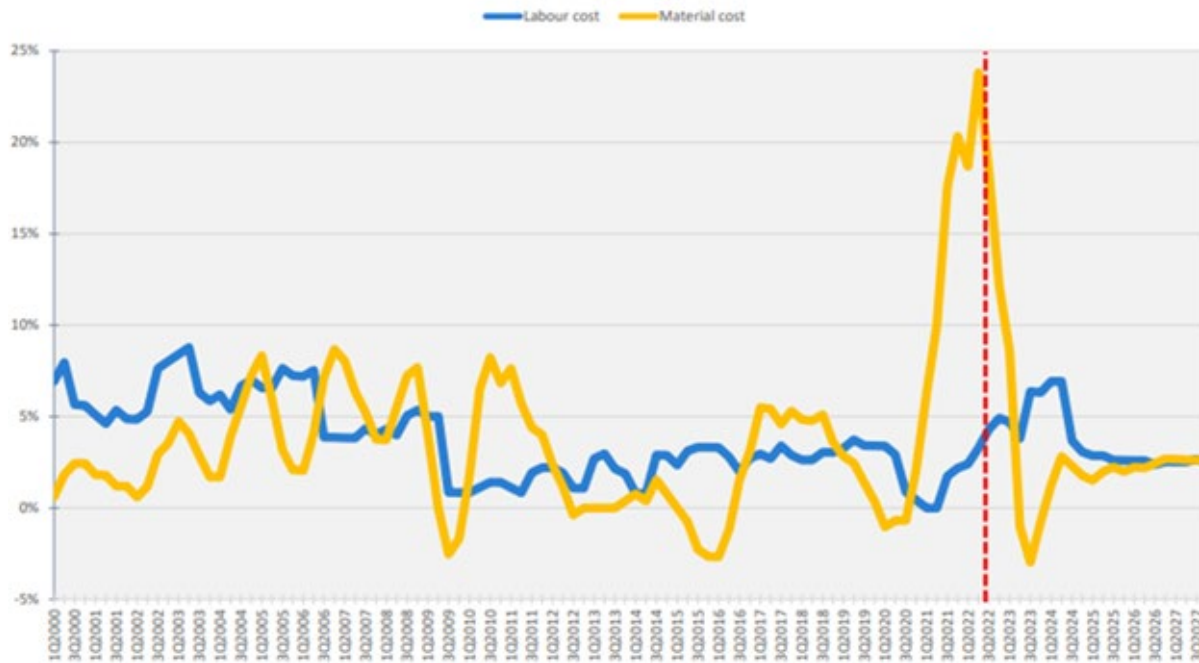
FEEDBACK ON COSTS (Q3 2022)

Material	Increase since Q4 2020	Reason
Timber	122%	Volatile commodity/ Global demand
Plasterboard	53%	Raw material shortages/ Input cost increases/ Transportation constraints
Fuel	248%-291%	Global influence /Red diesel
Cladding	68%	Steel volatility/ Raw material from Russia & Ukraine/ Mineral fibre and glass wool costs
Rebar	111%	Market volatility/ High demand in UK (HS2)/ Quotes only held for 24 hours
Concrete	No info	Input costs/ Energy costs/ Fuel costs
Labour	No info	Shortage of skilled labour/ Lack of foreign labour/ Covid career changes/ Lack of training since Covid began

Building Cost Information Service – 9 December 2022

- **8.6% increase** between 4Q 2021 and 4Q 2022
- Materials that are **energy intensive to produce** (i.e., steel, insulation, plasterboard and concrete) will continue to increase until the energy crisis is abated.
- Material **supply issues appear to be lessening**. Contributing factors include (i) transit being booked earlier and (ii) "storage sites" being used to guarantee materials are available. However, these sites add to project costs and transport prices are still rising.
- Predict that in the long-term, supply constraints of labour and materials will ease, leading to costs and prices stabilising. **But in the immediate future both look challenging.**
- The rate of increase in costs and prices will get lower – they will still increase, just at a lower rate. Forecast is for prices to rapidly decline over this year and return to trend in 2024. Labour costs are likely to persist for longer and return to trend in 2025.

Growth in BCIS material & labour cost indices (BCIS 2022)



Cost increases in materials have far outstripped labour cost increases, although forecast to rapidly return to trend. Labour cost increases to persist for slightly longer into the forecast

PRACTICAL MITIGATION MEASURES

- **Forward ordering** - Increased notification for long lead items
- **Forward purchase** - Pre purchase goods (Off-Site Materials Agreements where required – to be discussed)
- **Bulk Buying** - Maximising project/ region/ business / group / supply chain requirements
- **Value Engineering** - Sourcing compatible alternative materials
- **Redesign** - Working with clients to identify alternative solutions.
- Placing projects on pause? Hopefully not!

**EXISTING CONTRACTS:
HOW DO THEY DEAL WITH MATERIAL
UNAVAILABILITY AND PRICE INCREASES**

JCT/SBCC BUILDING CONTRACTS

(Clauses based on JCT Design and Build 2016/
SBCC/DB/Scot 2016)

Under the JCT/SBCC forms there are fewer potentially relevant clauses for dealing with the current situation than under NEC. The potentially relevant clauses include:

- Clause 2.2.1 – Materials – if described in ER's/CP's or the Contractor's other design documents, then the Employer's consent is required to substitute any materials.
- Clause 2.26 – Relevant Events
 - Extensions of time can be sought for the Relevant Events listed in clause 2.26. There are very few that will assist the Contractor in relation to delays caused by a lack of materials. The most likely clauses will be:
 - 2.26.1 – If delayed materials are required as a consequence of an instructed Change then the delay can be recovered through that Change instruction.
 - 2.26.12 – if the delay in supply of materials is caused by the exercise of a statutory power after the Base Date then that will be a Relevant Event. Note the importance of agreeing an appropriate Base Date.

JCT/SBCC BUILDING CONTRACTS

(Clauses based on JCT Design and Build 2016/SBCC DB/Scot 2016)

- Clause 2.26.14 – if the delay in the supply of materials is a result of force majeure then that will be a Relevant Event. Delays caused by Covid may fall within this clause provided the contract was entered into before Covid was a foreseeable risk.
- NOTE
 - If earlier Relevant Events have pushed a project into a period where material/labour availability has become an issue then Contractors may try to seek an extension of time against those earlier Relevant Events in the same way as one would if a Contractor was pushed into a period of winter working.
 - This will require careful consideration of the programme, when materials were required, when materials were ordered, etc.

JCT/SBCC BUILDING CONTRACTS

(Clauses based on JCT Design and Build 2016/ SBCC DB/Scot 2016)

Clause 4.21 – Relevant Matters

- Loss and expense can be sought by a Contractor for the Relevant Matters listed in clause 4.21.
- As with extensions of time there are very few that are relevant to delays caused by a lack of materials.
- The most likely clause will be 4.21.1. If delayed materials are required as a consequence of an instructed Change, then the loss and expense caused by the delay can be recovered through that Change instruction.
- Again, as a general point, if earlier Relevant Matters have pushed the project into a period where material availability has become an issue then Contractors may seek to recover loss and expense against those earlier Relevant Matters.

JCT/SBCC BUILDING CONTRACTS

(Clauses based on JCT Design and Build 2016/ SBCC DB/Scot 2016)

Clause 4.2.3 and Schedule Part 7 – Fluctuation Provisions

- If the Contract Particulars state that the fluctuation provisions apply, then the Contract Sum may be adjusted as a consequence of price increases.
- There are 3 options for fluctuations – Options A, B and C. The paper version of JCT Design and Build/SBCC DB/Scot 2016 only includes Option A. Options B and C are to be found on the JCT/SBCC website. Options B and C allow greater recovery for a Contractor.
- The provisions do not apply beyond the Completion Date.

NEC ENGINEERING AND CONSTRUCTION CONTRACT (NEC3)

- Under NEC there are a number of clauses that may be potentially relevant depending on the Options selected and the terms of any Z clauses. The potentially relevant clauses include:
- Clause 16 – Early Warning
 - Contractor/PM should give an early warning as soon as become aware of any matter which could delay Completion or delay meeting a Key Date. Can also give early warning of other matters which could increase total of Prices.
 - Risk reduction meeting can be called by either and those who attend cooperate to agree actions.
 - If outcome requires a change to the Works Information (e.g. use of different product/material) then the PM gives an instruction to that effect.
 - An Instruction changing the Works Information can amount to a Compensation Event under clause 60.1(1).
 - Can foresee the PM being reluctant to instruct a change if it will result in a Compensation Event. They should however be mindful of the obligation to cooperate in terms of clause 16.3 and the obligation to act in the spirit of mutual trust and cooperation under clause 10.

- Clause 18 – Impossibility
 - If the Works Information requires the Contractor to do anything which is impossible, the Contractor can notify the PM.
 - It may be possible to argue that this means commercially impossible rather than absolute impossibility (e.g. that the Works Information requires the Contractor to use a particular material/product, the unavailability of which will make it impossible to meet the Completion Date or a Key Date).
 - If the PM agrees then he gives an instruction to change the Works Information. Such a change can amount to a Compensation Event in terms of clause 60.1(1).
 - As before, we can foresee PM's being reluctant to instruct changes if it will result in a Compensation Event.

- Clause 19 – Prevention
 - If an event occurs which will stop the Contractor completing the Works by the date shown on the Accepted Programme and which (i) neither party could prevent, and (ii) it would have been unreasonable for the Contractor to have allowed for it when the Contract was entered into, then the PM should give the Contractor an instruction as to how to deal with the event.
 - The event causing the delay can itself amount to a Compensation Event in terms of clause 60.1(19). The PM's instruction can amount to a Compensation Event in terms of clause 60.1(1).
 - The critical issues under these provisions are that the event will have to impact on the Contractor's ability to complete by the date shown on the Accepted Programme and cannot be an event that the Contractor should reasonably have anticipated and allowed for.

NEC3 ENGINEERING AND CONSTRUCTION CONTRACT

- Clause 21 – The Contractor’s Design
 - If the Contractor is carrying out any design, they may consider amending that design to omit any product/material that is causing difficulty and substitute an alternative, provided that alternative complies with the Works Information.
 - The PM requires to accept the design but should not refuse acceptance if the Works Information and Applicable law is met.

NEC3 ENGINEERING AND CONSTRUCTION CONTRACT

- Clause 60.1(1) – Compensation Event
 - As noted earlier, if the PM changes the Works Information in terms of clause 16, 18, 19 or otherwise then this can be a Compensation Event in terms of clause 60.1(1).
 - If the change relates to the Contractor's design and is made at the Contractor's request, then the PM may rely on the second bullet point to clause 60.1(1) to refuse the Compensation Event.

NEC3 ENGINEERING AND CONSTRUCTION CONTRACT

- Clause 60.1(19) – Compensation Event
 - If an event occurs which will stop the Contractor completing the Works by the date shown on the Accepted Programme and which (i) neither party could prevent, and (ii) it would have been unreasonable for the Contractor to have allowed for it when the Contract was entered into then this can amount to a Compensation Event in terms of clause 60.1(19).
 - As before, the critical issues under this clause are that the event will have to impact on the Contractor's ability to complete by the date shown on the Accepted Programme and cannot be an event that the Contractor should reasonably have anticipated and allowed for.

NEC3 ENGINEERING AND CONSTRUCTION CONTRACT

- Option X1- Price Adjustment for Inflation
 - If this secondary option has been selected, it may provide for some increase in the amount payable to Contractors for cost increases arising as a result of inflation.
 - Under Options A and B, the Contractor bears the risk of cost increases in the absence of X1.
 - Under Options C and D any cost increases will be paid through the Price for Work done to Date but then possibly re-couped by the Employer to some degree through the Contractor's Share mechanism.
 - Under Options E and F the Employer bears the risk of cost increases.

- Option X2- Change in Law
 - If the product/material difficulty can be identified as being the result of a change in law then this will be treated as a Compensation Event under Option X2 assuming that Option has been selected.
 - The change in law must be a change in the law of the country where the Site is located.
 - The change in law must occur after the Contract Date.

- Clause 63 – Assessing Compensation Events
 - A final route Contractors may attempt is to argue is that earlier Compensation Events have pushed them into a position whereby product/material availability/labour availability is an issue but would not have been but for earlier Compensation Events.
 - If those earlier Compensation Events have not been quoted and/or agreed/implemented, Contractors may try to review the quotations for those earlier Compensation Events and include an allowance for material unavailability/labour unavailability/price increases.
 - Similarly, when pricing new Compensation Events then Contractors may seek to build in an allowance/risk element to cover product/material/labour shortage risks.

WHAT WE ARE CURRENTLY SEEING IN
CONTRACTS TO DEAL WITH MATERIALS
SHORTAGES/DISRUPTION AND PRICE
INCREASES

MATERIALS SHORTAGES – WHAT ARE WE SEEING IN NEW CONTRACTS?

JCT/SBCC Design and Build Contract (2016)

Clause 2.2.1

"All materials and goods for the Works shall, so far as **timeously** procurable, be of the kinds and standards described in the Employer's Requirements or, if not there specifically described, as described in the Contractor's Proposals or other Contractor's Design Documents. The Contractor shall not substitute any materials or goods so described without the Employer's consent (**which consent shall not to be unreasonably withheld or delayed**) which, if given, shall not relieve the Contractor of his other obligations."

JCT/SBCC DESIGN & BUILD CONTRACT 2016

New Relevant Events/ Relevant Matters

Clause 2.26 & Clause 4.21

Include new Relevant Events/Relevant Matters as follows:

"constraints upon the availability of materials and goods for the Works and/or equipment required by the Contractor to carry out the Works which the Contractor has taken all reasonable steps to avoid or mitigate except to the extent such constraints are caused or contributed to be any default, whether by act or omission, of the Contractor or any Contractor's Person".

"constraints or restrictions upon the ability of the Contractor or any Contractor's Persons to source labour which the Contractor has taken all reasonable steps to avoid or mitigate except to the extent such constraints or restrictions are caused or contributed to be any default, whether by act or omission, of the Contractor or any Contractor's Person".

JCT/SBCC DESIGN & BUILD CONTRACT 2016

Fluctuations / Instructions on Provisional Sums

- Fluctuations Options? Generally not being included “wholesale”
- Option A – Contribution, levy and tax: if any of the rates [of tax etc] change, or a new tax is introduced, there will be an adjustment
- Option B - labour and materials cost and tax fluctuations: if any of these rates of wages or other emoluments change after the base date, then the contract sum will be adjusted to reflect the increase (or decrease)
- Option C - Formula adjustment: using JCT Formula rules and indices maintained by BCIS
- Some Contractors are including Provisional Sums for fluctuating materials in their Proposals and seeking to rely on Clauses 2.26.2.2 and 4.21.2.1 to claim additional time and/or loss/expense.
- Drafting is required to address this and to make allowance where provisional sums are included in the Employer’s Requirements and Contractor’s Proposals.

NEC ENGINEERING AND CONSTRUCTION CONTRACT

- **Clause 60.1 – new compensation event**

New compensation event could be added: any constraint on the ability of the Contractor to source X materials [by the date stated in the Accepted Programme] which the Contractor has taken all reasonable steps to avoid.

- **Option X1 – Price adjustment for inflation**

Assumes that the Contractor will carry the risk of inflation on a portion of the Price but that the Client will take the risk of inflationary Price increases for (specified) elements eg steel, concrete etc.

BESPOKE MEASURES: PROVISIONAL SUMS

Provisional Works Packages

- Provisional Works Packages identified within a Schedule
- Listed Suppliers/ Sub-Contractors (pre-agreed) to tender per package
- Tenders are returned to the Employer's Agent/ Contract Administrator for opening
- Contractor to ensure optimal value achieved – tender conducted on an open book basis
- Contractor recommends preferred Supplier/ Sub-Contractor
- Pre-agreed %age of profit and overhead on Tenderer's costs to be paid to Contractor

OFF-SITE MATERIALS AGREEMENTS (FOR SCOTLAND!)

Contractual protection for payment for offsite material

Contractual protection for payment for Offsite Material

- Pressure to secure pricing for materials upfront and place orders
- Employer/Contractor may have to **pay for materials even though they remain off-site.**
- If **payment has been made without the proper contractual protections**, problems may arise
- In Scotland, under a contract for the provision of goods and services, ownership of the goods will typically pass from the buyer to the seller when the goods are **delivered to the buyer and incorporated into the works** and affixed to the structure. England is different, but Vesting Agreements are often put in place.
- OSMA – documents **when title passes, marking** of products and materials, **inspection rights and insurance obligations.**
- Can be tri-partite
- Palatable to Banks also!

USE OF 2 STAGE TENDERING

Pre-Construction Services Agreements

Two-stage tender process

- We've seen a significant increase in the use of two stage procurement on all types of projects (both in the private and public sectors) over the past year.
- PCSAs aim to **involve a contractor at an earlier stage** of the design and construction process.
- Typically used to engage a contractor to assist in the design process or to **advise on a wide range of pre-construction matters** (e.g. buildability, programming, construction risk, works packages and interface issues) - all with a view to working up a fixed or target cost.
- Allow the contractor/time to select and **finalise pricing with sub-contractors/ suppliers**.

ADVANCE PAYMENT

ADVANCE PAYMENT BONDS

- To **assist with the cash flow** required to cover initial expenses by the contractor, supplier or service provider (e.g. **ordering materials with long lead times**).
- **Consider intentions of parties and draft accordingly** Is interest to be charged? How does the contract deal with repayment in the event of termination? Restrictions on how the advance payment is to be used?

Advanced Payment Bonds

- **Protect the payments made** to the contractor upfront. Regarded as a **substitute for cash**, beneficiaries will generally prescribe an **on demand** instrument.
- If or to the extent that the contractor/fails to meet its contractual obligations, the issuer **will refund the advance payments** made by the employer or the **unearned element** of the advance payment.
- There will, however, be a **cost for obtaining an Advance Payment Bond**, which should be considered, and these are currently quite difficult to secure in the current market.

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