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Material Cost Escalation in DBB/CSP Projects

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"Since 1900, we've averaged a financial downturn about every four years" (Jackson, 2019), but that does not necessarily mean that it occurs like clockwork. We are now seeing a trend of eight to 10 years.

As a positive effect of the last century's fast-paced technological unfolding, the United States has seen an economic boom that was never expected; but this can only mean one thing - tougher and deeper recession occurrences. To back this up, a recent article published by The Balance (2019) reveals that the Great Recession of 2008 was the worst financial crisis in the United States since the 1929 Depression. As a logical conclusion of this thought, we can only understand that a massive recession is already overdue and has been slowly making itself visible to us with the help of mother nature putting out COVID-19 in 2020.

All areas of construction, in particular, are seeing a drastic impact following the start of the Coronavirus Era. As reported by trusted cost indexes worldwide, material costs to include PVC, steel, and copper, have evidently gone up. For example, Business Insider (2022) reported the price of lumber going up as much as a 5-year, 395% in May 2021, and Iron Ore a 5-year, 171% in July 2021. To make matters even worse, inflation, which commonly stays around 2% to maintain a healthy economy, has hit a high record greater than 7% in January 2022. That was a 5% increase in less than 18 months, a crisis that will undoubtedly be remembered for many generations

to come. Nevertheless, considering the large timeline gap that went by without a recession, this may be only the tip of the iceberg.

As far as general contractors currently engaged in Design-Bid-Build (DBB) and Competitive Sealed Proposed (CSP) projects are concerned, is this event considered force-majeure, and is it covered in most standard contracts used in public jobs throughout the United States? Most importantly, how can General Contractors and Owners involved under these two delivery methods work on this together for a mutual benefit?

What Does the Contract Say?

Generally speaking, force majeure is a term used to describe an unforeseeable circumstance that prevents a party from fulfilling a contract, i.e., an act of God. Many standard construction contracts, including the ConsensusDocs Forms, cover force majeure and even epidemics. The ConsensusDocs 200-2017 Agreement between GC and Owner, more specifically Article 6.3, gives the General Contractor the right to an equitable extension of time. Furthermore, it elaborates on a possible relief covered under circumstances including epidemics, adverse governmental actions, and other unavoidable scenarios.

As it pertains to Public Works procured through DBB and CSP, the most commonly used contract is the AIA A201-2007, used almost all across the board. It does not cover force majeure in specifics, and the closest it gets to an impact by God is shown under Section 8.3.1, as it addresses delays and extension of time. Language will slightly differ from one client to another, but it will generally read similar to the following piece, pulled from the Department of Construction Services within the Dallas Independent School District.

> *"If the Contractor is delayed in performing work that is critical to the overall completion of the work by an act of changes caused by work/labor disputes, unavoidable casualties, including fire, or by unusually adverse weather conditions, then the contract time shall be extended for a reasonable time to reflect the impact of the delay of work to achieve completion as per contract. Adjustments in the contract time will be permitted for a delay only to the extent where the cause could not have reasonably been anticipated by the GC, and could not be limited or avoided by the GC's timely notice to the Owner of the delay.*

Section 8.3.1.1 of this particular Owner's contract, lists permissible lost time due to adverse weather (a.k.a. an act of God) that can be used by the contractor to be inserted in its project schedule as anticipated lost time based on historical data. Dallas I.S.D. asks the GC to count on losing 55 working days of lost time.

Readers quickly realize that this has nothing to do with material cost escalation, and the presumption is correct.

Generally, the AIA A201-2007 was developed mainly to handle DBB and CSP to protect both parties financially, which is why it avoids monetary language in its entirety related to force majeure. There are many goals behind the maneuver, but the ones focused on this article has the following objectives:

1. To financially protect the General Contractor: Ideally, the lowest and most qualified bidder will buy-out all packages shortly after being awarded the project, and per contract language, the Owner has no right to go after the GC's savings after all negotiations with the trades are completed.
2. To financially protect the Owner: If the GC's buy-outs come over budget, the contract leaves no room for cost readjustment with the Owner if the contractor fails to negotiate within the range proposed on the bid package. Any other event preventing the GC from maintaining his/her allocated budget is also not a justification for seeking additional costs under the AIA 201-2007 contract.

The Burden of Proof

As already stated, the existence of a force majeure or commercial impracticality are factual factors that most General Contractors are dealing with daily. **The burden of proof to seek an excuse or request to recoup costs and perhaps time is on the contractor.** This statement applies to all delivery methods to include CMR, DB, IPD, etc., but when the subject is DBB and CSP, the Owner does not, and often, WILL NOT attempt acceptance and try to seek a way out, simply because he/she is not required based on the AIA-201-2007. Generally speaking, the fact that force majeure is not directly reflected in the contract forces the party seeking support to have the burden of proving that it is applicable and that other alternatives were already sought before attempting relief through this doctrine.

Many will argue that if a material cost escalation directly impacting the GC is caused by a project delay not created by the contractor, i.e., a permit delay or a catastrophic weather event, then the contractor can dispute that the functional element is what is triggering the request for support, and therefore, the party should be entitled to recovering the increased costs. However, as already implied, this argument has no binding precedent. It is up to the Owner whether the agency wants help in good faith to avoid any possible project impact

that can lead to other major implications.

The contractor has the burden of proof!

How to Resolve This?

In recent months, cost indexes stopped with the upward-only-trend. We're now seeing a very interesting balance of ups and downs all throughout the world. Take for example the unprecedented cost of lumber mentioned earlier. Interestingly enough, that same 395% came down to a 42% only three months later, but it is now quickly going up again.

If the Owner denies an informal request for financial support, and a claim is filed, it is hard to imagine it being successful simply because of the lack of contractual support. However, owners will be inclined to support if the contractor shows that he/she has done his research and worked hard before presenting the facts. Investing time and resources revising cost proposals every time the index changes are not beneficial for either side of the table. Instead, it behooves the Owner, if deemed possible and reasonable, to sit down and conversate if the GC has shown good faith when presenting the facts.

"The result of the increase and the subcontractor's inability to perform can cripple the completion of the project, which is not in the best interest of any party. There may be acceptable alternatives to avoid a shutdown to the project through timely communication among all. Perhaps other materials can be used? Perhaps there can be a sharing in the cost? Perhaps design changes can be made?" (Last, 2021). Most importantly, if the Owner fails to assist, he/she can immediately put many small subcontractors out of business throughout the region, and the results can be instantaneous and long-term. Perhaps even impact the entire nation's economy if all Owners are on the same page and decide not to intervene.

There are many ways for an owner to tackle this, but it boils down to mutual agreement and collaboration. To make it successful, the general contractor needs to be willing and prepared to open the books, going back to the bidding period. This shows good faith to the Owner and complete transparency. Was the bid based on a sound estimate, or was the GC awarded the job not based on everything captured on the estimate but based on what he/she missed on the estimate? The GC needs to show bid completeness based on current data.

"Typically, a contractor seeking cost escalation relief would provide a bid sheet, which estimates the price of the job down to the labor hours and material required" (Donato, Donnelly, Grossman, 2021). The Owner will audit the books and identify any cost difference based on buy-outs and current invoices from subcontractors, manufacturers, and vendors. This can be done internally using the owners' own resources or through a third-party auditor. After the facts of the impact are established, the Owner can opt to share half the costs or a small percentage, i.e., 20% or 15%, etc. The negotiation begins!

Conclusion

Costs variances are legitimate problems but claims to recoup costs must be reviewed in a case-by-case scenario. The fact that Owner X helped alleviate the burden does not mean that Owner Y should also collaborate. Cost Indexes are unbalanced these days, meaning that while some costs are going up, others are going down. Additionally, if product Z went up last month, it is likely going down this month. Key Term: Case-By-Case.

Contractors will need to be candid if they request the Owner's assistance. As stated by the HKA, a California Based Group specialized in legal construction disputes, it is imperative for the GC to bring forward all reasonable details with sufficient and relevant evidence, all in compliance with the contractor's terms, including but not necessarily limited to the claims and provisions part of the contract. Open the books!

If you are a GC, do not use this economic downturn as an opportunity for unsound, baseless, and perhaps illegal financial gains. Also, keep in mind that as you communicate, convey the message in a manner that informs; avoid agitating. "Attacking the other side and putting them on the defensive may yield a short-term tactical advantage but will likely have an opposite effect in front of legal experts or perhaps the court if it ever gets to that point" (Shaughnessy, Underwood, 2021).

If you are an owner, allow the GC to work on her/his burden of proof and use the best judgment to avoid more significant problems potentially impacting the construction project. If it sounds reasonable and practical, collaborate.

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