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Can Material Price Escalation be Treated as a Delay Impact Cost?

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Introduction

In recent months, the price of construction materials has increased significantly. The price of plywood is up 17%, soft wood lumber is up 23%, hot rolled steel bars, plates, and structural shapes are collectively up 45%, rebar is up 38%, ready mix concrete is up 7%, and let's not forget the ever volatile unleaded regular gasoline and diesel, which are respectively up 62% and 64% as compared to this time last year.[1]

There are many driving forces behind these price increases, but perhaps the most notable causes are supply chain disruptions, labour shortages, the war in Ukraine, lingering effects from the COVID-19 pandemic and unbalanced supply and demand.

The onset of these material price increases has been relatively sudden and the magnitude of the increases is arguably outside a range that anyone pricing a project could have reasonably predicted. As shown in Figure 1, with the exception of ready mix concrete prices, which tend to increase at the standard rate of inflation, material prices have been relatively stable over the past 5 years. However, in the early part of January 2021, material prices increased suddenly beyond ranges recently seen.

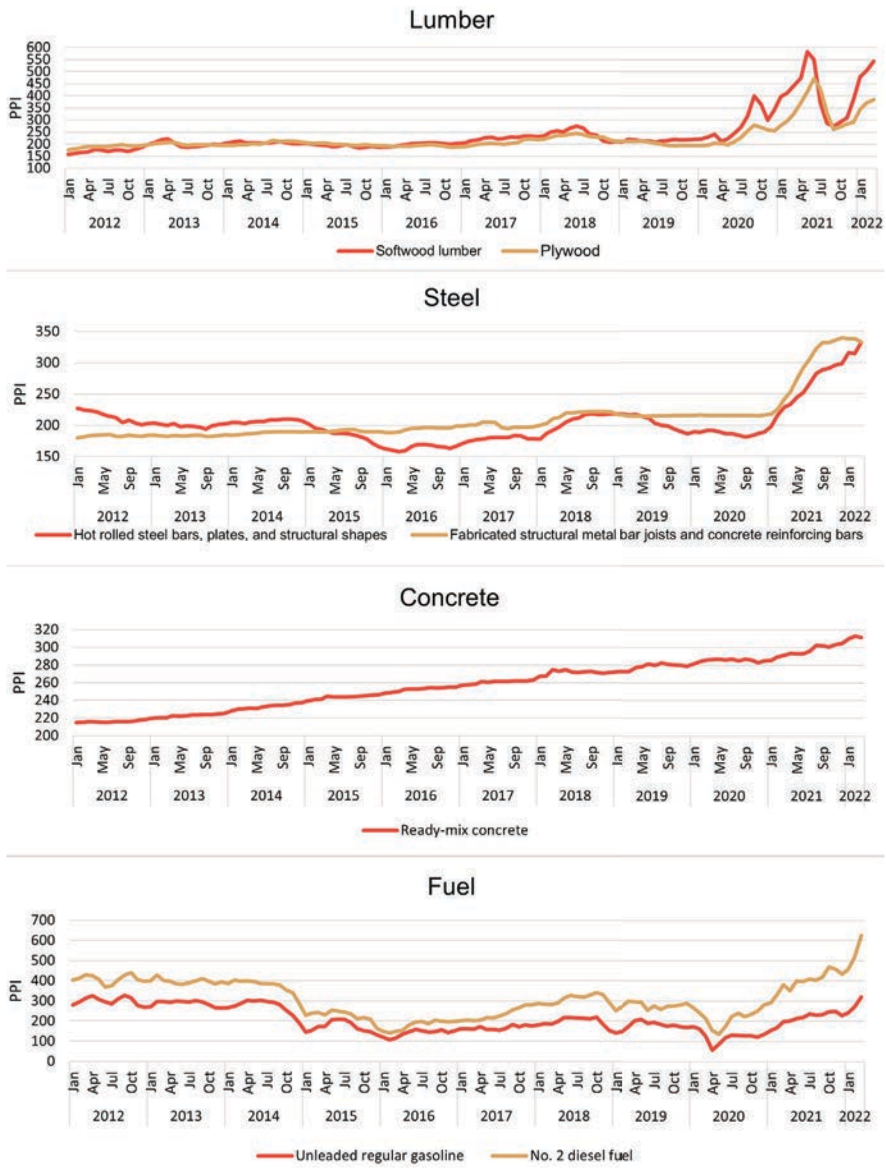

Figure 1 - Material price increases[2]

These increased prices have created an environment in which it is unclear which party has the responsibility to pay for the additional construction costs. The parties may choose to rely on material price escalation clauses in the contract, which the standard CCDC 2 contract does not address, or the parties may come to a mutually acceptable commercial agreement simply to keep the project moving forward. Either way, there is generally no universal method in determining the amount, if any, that is payable to cover the cost stemming from material price escalation.

What happens when the project is delayed?

When the project is delayed in some form, the parties may have an interesting remedy that does not rely on material price escalation clauses in the contract. In this case, the escalation costs may be treated as delay impact costs.

Below we explore specific scenarios in which a project delay results in the contractor incurring additional costs due to material price escalation and how these may or may not form a basis for entitlement.

Owner caused delay

In the first example, the contractor planned to procure structural steel beginning in June 2020, and planned to complete procurement by the end of December 2020. However, as a result of delays in receiving the IFC drawings from the owner, it could only commence procurement at the beginning of October 2020, and due to the owner's delay in finalizing the design, the procurement period was extended and the contractor was only able to complete procurement by the end of September 2021. This scenario is represented in Figure 2, in which the delay is shown in relation to the Producer Price Index of structural steel shapes over time (shown in red).

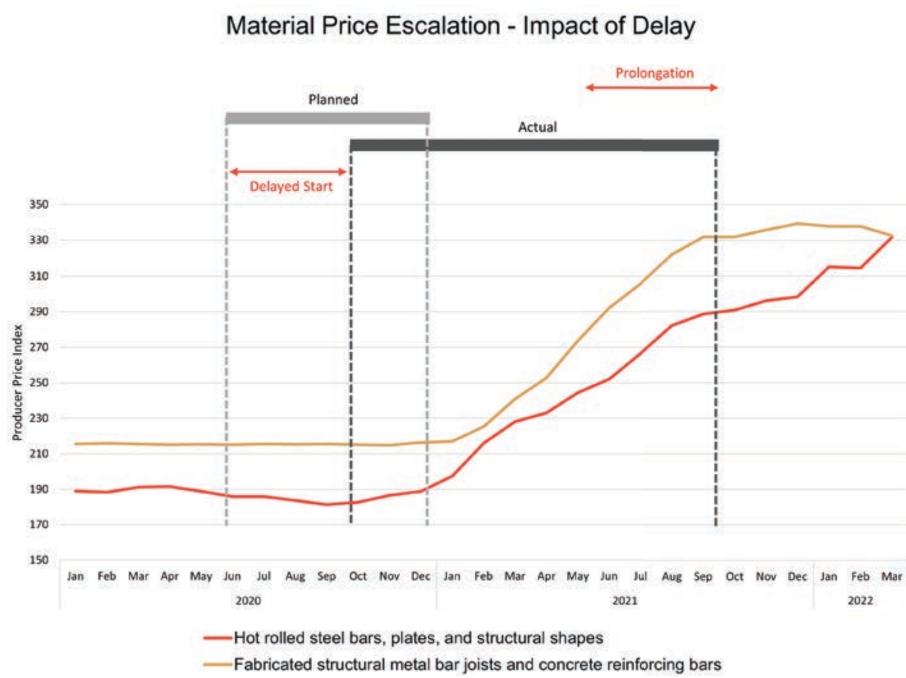

Figure 2 - Example of Impact of Delay on Material Price Escalation

In this case, had the contractor not been delayed in its procurement of steel, it would have been able to procure the material during a non-escalation period (planned period shown between the two vertical light grey lines); however, due to the delay, the contractor is now subjected to material price escalation (actual period between the two vertical dark grey lines). In this theoretical case and assuming no other delays on the project, the contractor may be entitled to delay impact costs representing the actual additional cost it incurred as a result of material price escalation.

Contractor caused delay

In the second example, the planned period shown in Figure 2 represents the period the contractor planned to install reinforcing bars, but due to its own delays performing earthworks, the contractor was delayed in starting the reinforcing work, and in addition, the duration of reinforcing work was prolonged due to its own poor performance. In this case, the owner would not be held responsible for the additional costs incurred as a result of the increase in material prices since the delay is the responsibility of the contractor and had the contractor not caused the delay it may not have been subjected to material price escalation.

Delay resulting from COVID-19

In the final example, the planned period shown in Figure 2 represents the planned procurement period, however, due to COVID-19 the contractor is delayed in commencing procurement, and the procurement period is also extended due to COVID-19. In this case, careful consideration will need to be taken to determine whether, according to the terms of the contract, this delay is excusable and compensable, or simply excusable. In the former case, the contractor would be entitled to compensation for the additional costs due to material price escalation, whereas in the latter case, the contractor would generally not be entitled to receive any additional compensation.

Concurrent delay

When one or more of the above mentioned scenarios occur at the same time we have what is known as a concurrent delay. In this case, the extent to which additional costs may be payable will depend on the apportionment of responsibility of the project delay between the parties.

In summary, material price escalation has raised uncertainty and complexity as to which party is responsible for the additional cost of construction. In the context of project delays, perhaps there lies a simpler solution- treat the additional costs as delay impact costs.

1 Increases are taken from the Producer Price Index (PPI) and measures the 12-month percentage change from March 2022. The PPI program measures the average change over time in the selling prices received by US domestic producers for their output. This provides a good proxy for Canadian price increases. Data taken from the U.S. Bureau of Labor Statistics.

2 PPI data taken from the U.S. Bureau of Labor Statistics.

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