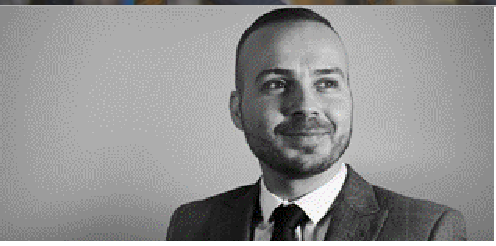
# The Material Shortage Crisis – How to Plan During These Uncertain Times




**JAMES SARGEANT**
**LLB (Hons) PGDip (LP) MCI-OB**

**Senior Associate**


Supply chain problems, cash flow issues and suspension of work are all factors which threaten insolvency for businesses in the construction industry. All these problems have become very real and persisting issues in 2021 due to the material shortage crisis.

This article outlines the current situation in the UK and how contracting parties should operate their contracts to minimise risks to their business.

*The Construction Leadership Council ('CLC') issued a Construction Product Availability Statement ('CPAS') in April 2021, warning that the ongoing high demand for construction products, both in the UK and globally, means that product availability issues are likely to worsen before they improve. The CLC warned that construction professionals should continue to plan for increased demand and longer delays. Fast-forward to September's CPAS and the overall picture remains largely unchanged albeit material price increases have levelled off slightly for some products. However, the CLC has warned that this moderation will likely be short-lived due to continued pressure on labour, transport, and the cost of raw materials. What has become clear from the CPAS' is that the construction supply chain is just about keeping its head above water in these unprecedented times.*

## *Why*

*No surprise here, COVID-19 has had a profound impact on the construction supply chain and Brexit has only added to the existing material and labour difficulties in the UK. Construction demand rose sharply when the COVID-19 national lockdown eased as building sites reopened and home building projects gained in popularity. Social distancing, loss of labour and increased demand for manufactured goods because of the pandemic have all contributed to price rises in materials and transportation costs. With the end of the Transition Period, the EU-UK Trade Cooperation Agreement came into effect and with it brought increased administration processes at UK ports which subsequently increased shipping costs and delayed delivery of materials.*

## Impacts

*The construction industry may have received a welcome rise in demand thanks to lockdown easing in 2020, but it was not well enough equipped for an unprecedented disruption in supply chains. Materials are being purchased at unexpectedly high costs and Works are being delayed or re-organised until the required materials are accessible. Profits are being significantly undercut, there is an all-time high for payment claims, and many projects have suffered complete failure.*

*By July 2021 the cost of materials had risen by 20% in the past six months. Jewson has issued a material shortage warning and a price-increase warning for a range of materials and goods. Their latest supplier updates are all labelled with 'Price Increases' on their website, and indeed some product prices are reflective of the 20% cost increase mentioned above.*

*As it stands, issues surrounding transport and a severe shortage of HGV drivers are the most pressing concerns for the construction supply chain, and many other supply chains, globally. Even where factories are meeting market demands, manufacturers cannot move these supplies into the hands of the buyers due to the transport crisis. The HGV driver shortage highlights the effects of Brexit on the construction industry as the influx of migrant workers, who were once available due to the EU free movement of workers, are no longer available.*


## What can contracting parties do?

*With cost-increases practically unavoidable, the question arises of who pays the extra cost of materials where the cost has been factored into the price agreed in the contract? The general rule is that where the contract does not provide a mechanism for contractors/subcontractors to share the effects of price increases with other involved parties, then it is the contractors/subcontractors who will shoulder the effects of the price difference. The risk lies where it falls.*

*The Procurement Advisory Note (PAN01/21) in Northern Ireland has recommended that parties work together in 'a spirit of mutual trust and cooperation' where the crisis has affected existing contracts. The good news is that parties can plan ahead effectively for future contracts. Contractors and subcontractors must be careful to include clauses in their contracts to prevent future financial disaster. We consider some of the contractual options available to contracting parties below:*

## Price Variation Clauses

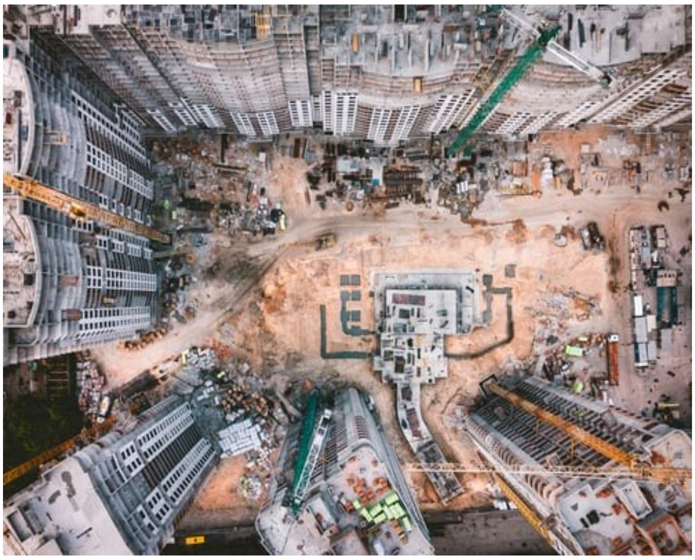
*You can include a price variation clause within a contract. Most standard form contracts have the option for including such provisions. These clauses can be used when there is a set price contracted for the Works, and when a cost-plus contract has been used by the parties. JCT contracts provide an option for contract particulars to allow the adjustment of rates to deal with unforeseen additional costs due to inflation. These take the form of Price Variation Clauses. Price Variation Clauses exist to provide a safeguard against unforeseen changes to the price of materials which are needed to fulfil the contracted Works.*

*However, parties should note that the threshold to trigger a Price Variation Clause is high – the price increase must go beyond the regular fluctuation in market prices, which is what we have seen in 2021. These clauses can be used when there is a set price contracted for the Works, and when a cost-plus contract has been used by the parties.*
*Employers may not initially see the benefit of a Price Variation Clause where there is an increase in costs. However, these clauses can help to maintain progress on a project as they aim to prevent delay and disruption caused by unforeseen market circumstances. Such provisions are likely to protect cash-flow, reduce the risk of disputes and prevent contractors from becoming insolvent, which is bad for all parties connected to the project.*

## NEC4 X Clause for Inflation

*The NEC provides various contract pricing options (Options A through to E). Under Main Options A and B, the Contractor will assume the risk of inflation, but under Main Options C and D, the risk is shared between the parties. However, the risk allocation can be altered by Secondary Option X1.*

**NEC4 Secondary Option X1: Price adjustment for inflation** *is a Secondary Option Clause provided by the NEC – this is a bolt-on clause which the parties can add to their contract, should they wish. Option X1 allows for price adjustments to the Works by considering the price set against the latest price index.*



## JCT

*The JCT suite of contracts provide a list of Relevant Events which may entitle a Contractor to claim for an extension of time. With regards to material price increases, Relevant Events upon which a Contractor might be able to rely include:*
*Changes. For example, if the design is changed from one material to another due to material shortages (the applicability of this Relevant Event is likely to be very dependent on the facts); and*
*Force majeure. This is an undefined term in the JCT suite of contracts, but it could be argued to apply to global material price increases.*
*Contractors should however be aware that although "force majeure" is a Relevant Event, it is not a Relevant Matter. This means that although the contractor may be entitled to additional time (thereby offering protection against LADs), the contractor will not usually be entitled to additional money.*

*Most JCT contracts also provide an option for the parties to include "Fluctuation Provisions" which deals with changes in respect of the cost of labour, materials and tax. These provisions can be included in the contract via the contract particulars. However, in our experience they are usually excluded from the contract. This perhaps indicates that either (1) parties are not aware of these provisions or (2) choose not to include them. Either way, this can have significant detrimental consequences.*

## Other considerations

*Parties would be advised to set a budget for price increases as well as including Price Variation Clauses such as the JCT Fluctuation Provisions and NEC4 Secondary Option X1. Design teams should review raw material availability and estimated delivery times to determine a realistic estimation of the Completion Date. Alternative material options should be identified or where there is no alternative, then this should be made very clear in the tendering process. Parties would be advised to operate on an open-book basis and contractors need to be ready to provide compelling evidence with regards to the effects of inflation on both existing and future contracts.*

Quigg Golden

## *Quigg Golden Comment*

*The construction industry continues to be faced with the reality of a landscape shaped by both COVID-19 and Brexit in recent years. Supply chains remain acutely affected in an ever-more expensive and delayed market. When it comes to drafting contractual clauses that concern delay and/or suspension of the Works due to material shortages and/or rising costs, you should identify the potential risks and clearly set out how that risk is to be split between the parties to the contract. In particular, you should set out any entitlement that the contractor may have for additional time and/or money if the project is affected by material shortages/price increases. The actual form of words you should use in the contract can be tricky. It needs to be precise and work with all the other terms of the contract.*

*So, think ahead, and be careful what you sign.*

*If you are currently facing any of the problems set out above, then Quigg Golden can provide you with further advice. Do not hesitate to* ***contact us.***