

Risk Management Advisory

Construction material price escalation can result in claims

For more than a year, economic factors have been pushing up the price of construction materials. In Canada, similar to other jurisdictions, construction costs were up across all building sectors in the last year; the rising construction costs are mostly attributable to material shortages, snarled supply chains and rising commodity prices. For instance, the cost of softwood lumber is up nearly 28 per cent from the first to the second quarter in 2021 due in part to low supply following the temporary shutdown of sawmills during the first wave of the COVID-19 pandemic and increased demand for residential construction projects across the country; similarly, the non-residential construction building prices rose 5.7 per cent year over year; this is the largest increase since the fourth quarter of 2008 (Statistics Canada, 2021).¹

Construction contractors and subcontractors who submit a fixed-price bid are particularly vulnerable to the impact of escalating material costs and other factors beyond their control such as availability of skilled labour. The risk of material price escalation does not rest solely on those performing the work on projects; this risk can also reach the design teams.

Materials often represent half or more of the cost of a fixed-price contract. Unanticipated increases could easily wipe out the construction team's profit and create severe financial hardship for contractors and subcontractors unless they can pass on the added costs. In some cases, project owners recognize such conditions and provide greater flexibility in contracts through cost-sharing arrangements. Rather than holding a contractor to bid prices when costs are fluctuating, some project owners



are agreeable to contract time and contract price alterations caused by specific supply chain interruptions, unanticipated government interventions or unforeseen price escalations. Construction contracts might also accommodate other increased costs, such as from delayed deliveries or increased sanitation and protective equipment on construction sites resulting from pandemic impacts or regulations. Usually, other increased expenses, such as for fuel, additional labour costs, and other operational costs that could delay projects or disrupt construction budgets, are not contractually recognized.

Design teams on projects affected by pandemic costs, material price increases or completion delays out of the construction team's control can be the target of cost recovery efforts. Any delay in a project costs money—usually for the construction team and certainly for the project owner—and the owner will bring a claim if they can trace that delay and the resultant costs to a contract breach or professional negligence by the design team.

¹ Statistics Canada, The Daily: "Building construction price indexes, second quarter 2021", July 28, 2021, online: <https://www150.statcan.gc.ca/n1/daily-quotidien/210728/dq210728d-eng.htm>.

Increased costs could result in contractual or professional liability claims in other ways. Designing to the project owner's budget might not be achievable when material costs increase rapidly. If a design consultant's contract does not clearly state the parties' responsibilities, reliance with respect to the project budget and remuneration for any additional services rendered could mean that any redesign services required to stay within an acceptable margin of the budget are rendered free of charge. ACEC-Canada's Document 31, Engineering Agreement between Client and Engineer, touches on these issues throughout the form's General Conditions. For instance, section 5.8 of Part 5, Engineer's Responsibilities, allows the engineer to rely on the information and data provided by their client. Section 9.2 of Part 9, Construction Cost and Contract Time Estimates, goes on to state that when the engineer's mandate includes estimating construction cost and duration, these estimates are not guaranteed for accuracy and are contingent upon factors out of the engineer's control such as market forces. Section 16.7 of Part 16, Payment, allows the engineer to seek remuneration based on an agreed-upon hourly rate for any rework or revised plans and specifications for reasons which the engineer could not reasonably foresee at the time the consulting agreement was signed.

There are other indirect risks attributable to rising construction costs that can impact design firms. One is that if the design team causes a project delay or requirement of corrective construction through its negligence, the inflation in material prices means that the claim for remedial work could cost more. Inflation in claims costs can have an adverse effect on a firm's loss experience. Another is the general dissatisfaction of the client and dissatisfaction can lead to allegations of negligent performance of professional services.

During times of price volatility, it is incumbent on firms to reinforce their risk management practices. That emphasis could include the following:

- Inform clients that it is impossible to predict increases in the costs of materials or systems.
- Educate the project owner that holding a contractor to a fixed-price bid that is unrealistic could be counterproductive.
- Check the material price escalation provision in the construction contract for compatibility with the professional services agreement.
- Avoid contracts that require redesign for no fee if the design professional should have anticipated increases in building construction costs.
- Include a standard waiver of consequential damages provision to limit liability for project delays because of cost escalations or supply disruptions.
- Be wary of contractor-requested substitutions that now, more than ever, are caused by cost-cutting.
- Recognize during site visits any contractor efforts to cut material costs in a way that could affect construction quality.
- Work with the client to solve problems quickly, including any disputes about possible fault that led to a delay.

With price volatility common, materials in short supply and inflation increasing, design firms have to be especially attuned to project owner cost sensitivity and the impact that underpriced projects can have on their contractual and professional exposures.

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