Future Contracts and Price Options

Without Firm Prices, Contractors Will Need Other Provisions

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If a subcontractor finds he cannot get his suppliers to agree to firm price supply contracts, the subcontractor will have to explore the various other means of obtaining beneficial provisions for future contracts.

Using Selective Judgement

The first alternative is to simply use judgment in bidding or negotiating on long-term construction projects until economical conditions stabilize to a point that a reasonably accurate prediction of anticipated price increases is again possible. Such a decision would mean short-term hardship for the subcontractor, but if the alternative is gambling with a reasonable possibility of bankruptcy, it may be a decision that has to be made. The severity of the short-term hardship will, of course, vary depending on the size of the subcontractor’s business, the profitability of the other long-term contracts that the subcontractor is currently performing and the profitability of whatever short-term work the subcontractor can enter into during the period of economic uncertainty. Many roofing subcontractors have turned to reroofing work which can be completed in a short time rather than perform long-term contracts on new construction.

Anticipated Price Increases

A second alternative is for the subcontractor to continue to negotiate or bid fixed price construction subcontracts but to gaze somewhat deeper into his crystal ball and submit prices that include an estimate of the outside maximum increase of materials or equipment prices that he expects to occur between the date of the subcontract and the date of delivery of the materials. Many roofing subcontractors did precisely that back in September, 1973, or even as late as January, 1974, and added into their construction subcontracts prices of 5% to 15% above their current material costs. Their guesses turned out to be incorrect, however, and many are now suffering the consequences. Any subcontractor who turns to this alternative will just have to hope that his guesses turn out to be accurate.

Third Party Purchases

A third alternative to using the fixed price supply contracts is to shift the risk of price instability in materials or equipment to the owner or general contractor by having one of them directly purchase the materials or equipment. Under such an agreement, the
subcontractor would only bid on the labor required for the particular construction project, leaving the supply aspect to the owner or general contractor. Some subcontractors will disagree with this approach because of their practice of adding a percentage markup to the total cost of labor and materials. However, there is no reason that the subcontractor cannot take into consideration the value of materials purchased by others in pricing a labor only subcontract.

**Early Purchases**

A fourth alternative to the fixed price supply contract is for the subcontractor to purchase the materials and accept delivery at the beginning of the construction subcontract to hedge against future price increases and to ensure the availability of the materials at the time they are needed in the construction project. The subcontractor pursuing this alternative of early purchase and delivery of materials and equipment should make sure that he can obtain progress payments from the owner in order to pay for the materials and equipment purchased at the initial base of the construction job and to cover the cost of storage. 

Early delivery of materials and equipment should be encouraged, even though not immediately needed in the performance of the construction. In order to achieve availability and price protection, the construction user should be willing to accept items delivered to an approved storage site and pay for them. If additional expenses for storage or handling charges are incurred, the construction user should also pay the extra costs.

There are two ways for the subcontractor to be reimbursed for the additional expenses of extra storage and insurance costs. He can be reimbursed directly by the owner or he can include the additional expenses of storage and insurance costs in his initial price on the job. To get the owner to reimburse him, the subcontractor should include in his contract a clause such as the following:

**The subcontractor will immediately undertake to purchase certain materials required by the contract. Subcontractors will suitably store and insure the materials on the job site or at other storage facilities. The Owner agrees to pay for said materials when delivered to the job site or other storage facilities and in addition to the contract price to pay for the cost of storage and the costs of insurance for said stored materials.**

Including the additional storage expenses and insurance costs in his price is perhaps the safest method of reimbursement because if the subcontractor’s price is accepted, the additional storage and insurance costs will come out of the subcontractor’s price.

The Board of Directors of the American Institute of Architects has recognized the need to allow payment for early delivery of materials and equipment. The AIA General Conditions (AIA Document A-201) states that payment for materials suitably stored on the site or at some other location may be agreed upon in writing between the parties and Article 9.3.2 of the AIA General Conditions provides:

If payments are to be made on account of materials or equipment not incorporated in the Work but delivered and suitably stored at the site, or at some other location agreed upon in writing, such payments shall be conditioned upon submission by the Contractor of bills of sale or such other procedures satisfactory to the Owner to establish the Owner’s title to such materials or equipment or otherwise protect the Owner’s interest including applicable insurance and transportation to the site.

Under this clause the subcontractor must have a written agreement that protects the owner’s interest in the stored materials to establish title to the materials and insurance in favor of the owner.