CICA Position Paper

February 2024

Increased Prices and Possible Ways-Forward for Construction Contracts

Table of contents

CICA is the world's largest, most representative organization for the construction industry. It gathers and defends the concerns of the construction industry worldwide. CICA has unrivalled authority in promoting rules to improve the conduct of the construction business across borders. Established in 1974, its mission is to serve, promote and enhance the image of the construction industry across the world.

Preface

During recent years, the construction industry has been facing several obstacles which carry the possible consequence of suffering a significant financial burden if adequate relief is not foreseen.

Especially after the effects of the COVID-19 pandemic on global inflation, trade relations, transportation, availability of skilled labour, disruption in the supply chain, and compulsory halts on the continuation of many construction projects, the uncertainty derived by these extraordinary circumstances and differing policies of countries has continued for a considerably long time, causing a persistent increase of costs especially in the construction material prices.

As other factors in this regard, post-Brexit procedures and the war in Ukraine have also been triggering the rising costs of construction contracts by implication, causing a material shortage, delay and again an inflationary price increase. Additionally, power crisis in Europe and unstable hikes in global energy prices had impact on manufacturing of resources and certain construction processes.

Finally, Middle East is facing today a conflict that could increase the scenario of instability prevailing in the last years.

The aftermath of these circumstances is that we are now facing increasing costs of some basic materials for construction (e.g., iron, steel, concrete, copper, bitumen); disruptions in the supply chain and transportation, affecting the delivery of materials and spare parts; energy crises and ensuing price hikes; worldwide inflation and an alerted phase for risk of recession in many zones. The echo of all these on construction projects have been the increasing costs of construction and reducing possibility of finishing the projects; the situation of unsteadiness for the economic health and cash flow for contractors and subcontractors with risk of bankruptcy in many scenarios; extended periods of payments; lack of trust from banking sector and therefore reducing credit lines and financing to contractors; and uncertainty in conditions of proposals from suppliers.

Considering the above, it becomes more challenging to ensure an equitable distribution of risks and more necessary to evaluate the employer-contractor dynamic to avoid these burdens' infliction on solely or mainly one party and to eliminate the consequences detrimental to the construction

industry in the long-term. This Position Paper discusses possible solutions and concepts to be relied on to alleviate the damaging impacts of price increases for construction contracts.

I. Diagnosis

The following table identifies key aspects of the construction process along with possible solutions as identified in general, covering the most important pieces. Even though it is not exhaustive; we believe it would be useful to assess a way-forward for circumstances sharing common issues.

DIAGNOSIS	POSSIBLE SOLUTION
Tender Process	
Lack of contractual treatment for exceptional circumstances: Contractual clauses in traditional contract structures may not include provisions sufficient to manage extraordinary circumstances, and instead use the same framework as for a regular case of force majeure.	The wording of the contracts -particularly risk balance in case of extraordinary circumstances- should be reviewed and drafted properly. To correctly price their bid and to raise the issue to the employer at the outset timely, tendering contractors must understand that it is essential to scrutinize the bidding documents as well as raising questions and requesting clarifications on risk allocation on the COVID-19 pandemic, inflation, excessive increase in the Project costs and similar issues.
Lack of collaborative approach: Considering the still traditional approach in tendering even though there is a consensus that the global economy is facing quite difficult	The use of collaborative and more flexible contracting models, or, at least, the introduction of collaborative tools in

challenges which were not taking place until the recent past, the tender processes lack the inclusion of either a collaborative project delivery system or even a collaborative project management approach, concreted in the use of collaborative contracts or collaborative tools in traditional contracts.	traditional contracts (as Dispute Boards, or BIM) should be taken into consideration, which introduce joint evaluation of risk as a part of the contract governance. It would be beneficial and to a certain extent preventive to include contractual provisions which provide parties with sufficient tools and measures to jointly manage newly arisen conditions and execute works in the most efficient manner.
Insufficient analysis of the applicable law and/or the law of the Country: Where the contract is poorly or strictly drafted, seeking of remedies outside the contract may become necessary and the concept of hardship is triggered under certain jurisdictions.	To ensure that the appropriate additional clauses are included in the contract, it is crucial to analyse the applicable law and/or the law of the Country at the tender stage and determine the additional risks or benefits that a specific contractor may have. For more details related to this issue, please see **Section II** below.
Financial health: The parties may not be sufficiently robust to deal with the crisis effectively.	It is important to set contractual mechanisms for an appropriate suspension of the works in case there is a justifiable concern on the financial capacity of the parties
Unbalanced risk assumptions: Contractor may have to bear the imposition of financial burden of exceptional circumstances in many cases.	Employer risks should be adopted and included in the contract for certain circumstances, to establish the burden of extra costs raised by legal procedures, force majeure and hardship that occur after the contract is signed.

	Determining complimentary and flexible mechanisms of compensation depending on the magnitude or impact of the exceptional financial circumstances could be a key step forward where it cannot be reasonably expected from the contractor to control the situation.
Lack of specified adjustment and claim clauses: In cases where the employer chooses not to accept the risk of inflation or where this is not negotiated when tendering for work, the Contractor bears the risk of inflation without a proper formula for adjustment or sufficient remedies existing at law.	Specific cost relief in particular circumstances would be beneficial to be provided, such as the case in "Adjustment for Changes in Costs" provision foreseen in FIDIC standards (Sub-Clause 13.8) where some of the risk of increased cost due to inflationary pressure on the cost of goods and labour lies with the employer.
Project Execution Phase	
Contract management: The importance of care in drafting of contracts and contractual risk analysis as mentioned above needs to be held effective for the execution of necessary mechanisms to be processed properly.	The contract's proper drafting should be followed by management of specific clauses on changing circumstances. Notices to be given should thoroughly address the relevant issues to ensure that the cost or time impact is informed and dealt with in a timely manner so that the issue is not fully left at the employer's discretion.
Operation of Dispute Avoidance Provisions: Pursuing an adversarial system may prevent timely solutions and cause additional abeyance for the status of the project.	Referring to a DAAB (Dispute Avoidance/Adjudication Board) where possible under the agreed terms of the contract should be encouraged.

Consideration of Force Majeure/Exceptional Events and Hardship Clauses: Depending on the extent to which the contractor is prevented from performing its obligations under the contract, the legal treatment of these situations could be different as to what qualifies as "prevention" and the possible consequences and may not always provide a proper relief.	Seeking legal advice to navigate through the governing law plays an important role in this regard as there may be different options such as general hardship provisions which provide additional remedies for the contractor. For more details, please see **Section II** below.
Dispute Resolution	
Lack of alternative dispute resolution processes: Non-existence or lack of proper dispute resolution mechanisms such as mediation and dispute boards may imply significant disadvantages.	Contractors are encouraged to make full use of contractual mechanisms for a timely resolution of any kind of disputes that could arise, when available. For instance, it is highly recommended that standing dispute boards be implemented for projects. It would be beneficial to follow the guidelines published by leading institutions such as the Dispute Resolution Board Foundation and International Chamber of Commerce closely to be familiar with possible solutions fit for the purpose in question.

II. The Analysis of the Applicable Law for Possible Legal Remedies

As mentioned above, the need for adequate price adjustments has been considerably increased in recent years as the actual financial burden has been over and above the agreed prices in many cases. Where the contract does not provide remedies for project price increases resulting from exceptional circumstances such as the COVID-19 pandemic, high inflation, and similar issues, or if it lacks remedies altogether, it may become necessary to explore legal alternatives. It is advisable to examine the law of the Country and the applicable law of the contract, as they might contain provisions that offer remedies to the parties involved in such situations. These legal regulations should be considered when contractual mechanisms are insufficient to address exceptional circumstances effectively.

The situation and circumstances discussed herein are established as reasonably unforeseeable as understood from the fact that many governments have been taking the position of introducing new legislation fit for purposes. In many cases, these new legislations or provisions acted as directly applicable mandatory rules to the construction contracts. Examples of this can be seen in Germany, where a special administrative regulation has been enacted for rise in costs of certain product groups to balance unpredictable price escalations (BMWSB decree of 25 March 2022); Turkey, where the options of receiving a price adjustment or assigning the contract was given to the contractors under certain circumstances with application of a Provisional Article to the Public Procurement Law for unforeseeable price escalations (Provisional Article 5 of the Public Procurement Law No. 4735, taken effect on 22 January 2022); and Switzerland, where recommendations were published by the coordination body of the federal building authorities ("KBOB") in 2021 and 2022 even if these were not in the form of specific legislative regulations.

In this regard, it would be beneficial to examine the concepts of force majeure and hardship in comparative law perspective between continental law approach and common law approach, bearing in mind the potential operation of the concept of "change in law" under the applicable law of the contract. Likewise, it is important to point out that the applicable law stated in the contract is not necessarily the law of the Country.

Even though the finer points of regulation and scope differs among those, many civil law countries adopted the hardship principle in the situation that we discuss to deal with unexpected and unbearable economic challenges, taking the principle of good faith as a basis. In this regard, if the financial burden of one party has unendurably increased in an unforeseeable and uncontrollable way, a relief might be available in form of non-performance on the overly disadvantaged party's site, renegotiation, adaptation of contract terms or termination of the contract depending on its adequateness and the particulars of the jurisdiction.

To provide more context, clausula rebus sic stantibus doctrine, which represents a departure from the *pacta sunt servanda* principle, primarily aims to restore the balance between the obligations of the parties that has been disturbed as a result of a fundamental change in circumstances after the conclusion of the contract. In civil law systems, this doctrine is akin to hardship or extreme difficulty in performance and some jurisdictions explicitly codify this remedy in their legislation.

On the other hand, the common law tradition does not inherently include the concept of hardship for such scenarios. Apart from this concept and in the absence of an express contractual provision, the doctrine of frustration may become applicable as a tool to discharge the contract in extraordinary circumstances. Essentially, this doctrine comes into play if an event renders the performance of a contract impossible, illegal, or radically different from what the parties originally intended when forming the contract. In such cases, the contract is deemed "frustrated" and can only be terminated without an option to adapt the contract. In this regard, it should be specifically noted that the scope of application for frustration is concerned with an absolute impossibility rather than an impractical or commercial burden. As the presence of an inclusive provision for subject matter would also make the frustration doctrine inoperable, the solution for such economic hardship situation might be found under provisions of change in law, price adjustment or force majeure if these are suitably worded, since the term "economic hardship" is generally not considered as a basis for relief on contrary of its characterization in continental law approach. Additionally, a claim for damages may also be an option for recovery for a party if the circumstances in question constitute a breach of contract.

Considering the information provided, it is evident that common law systems seem to be less favourable for parties looking to make price adjustments compared to the adaptation options

available in civil law systems when these are compared as the legal remedies of applicable law or the law of the Country.

In light of the above, it is recommended to incorporate well-drafted provisions especially in contracts governed by the rules of common law jurisdictions and specifically when addressing adjustments, force majeure and hardship. These provisions should be designed to handle unexpected events or circumstances and their impacts on the contract, as the common law approach generally provide less flexibility in this regard. It should also be emphasised that it is essential for the parties to be familiar with the possible remedies under the applicable law of the contract in any case in addition to the structure of agreed contract terms to avoid challenging situations as much as possible.

III. Restoring the contractual unbalance

The search for a legal solution must also go hand in hand with ensuring the continuity of the contract through a re-balancing of risks.
For this reason, governments of some countries have determined compensation rules for Contractors, especially in the public works sector, in order to grant economic viability to the contract, irrespectively what is stated in the law of the Country or applicable law.

These compensations are presented in some fashions. For example, paying retrospectively the increased costs already incurred by the Contractor for certain items or materials; or establishing readjustment mechanisms that take into account the volatility of the prices of materials that are most important in the contract.

However, these measures do not resolve the underlying issue, which is the need for contracts to allocate the risks with more flexibility and keeping in mind the exceptional situations that are occurring in recent years and which everything seems to indicate will finally become a general rule.

Conclusions

The main way-out to re-balance the contract in case of an unforeseeable and unbearable price increase would be to resolve the structural problem of contractual risk allocation. Different ways of compensation can be considered as a good step ahead in this regard; but it could not by itself resolve the issue in many scenarios.

It is also important to know where to draw the line between the concepts such as force majeure and hardship for the basis to be relied on for some exceptional events, as the legal treatment of these situations could be different under different jurisdictions. Indeed, the applicable law and the law of the Country may play a pivotal role when contractual provisions are insufficient. Carefully selecting the applicable law in construction contracts can be a significant advantage for the parties involved, as it can greatly impact the outcomes and available remedies.

Likewise, a true way-forward should be to work on a collaborative approach where the risks could be faced jointly, with more flexible provisions, scrutinizing the traditional process seriously, and/or to the extent possible, determining particular complimentary mechanisms of compensation depending on the magnitude or impact of these exceptional events where it cannot be reasonably expected from the contractor to control the situation.

Written by Alex Wagemann and Yasemin Cetinel, Chairman and member of the Working Group "Construction Contracts", CICA.

Confederation of International Contractors' Associations (CICA)

3 rue de Berri, Paris

Phone: +33 1 44 13 37 13

Email: cica@cica.net