

# The Risk of Inflation under the Public Works Contracts

**Denise Kennedy, Construction Consultant**

**2nd February 2023**

# Agenda

- ❑ What has been the impact of price volatility on projects over the last 12 months?
- ❑ Has the OGP Inflation Cooperation Framework helped? Is it being used?
- ❑ What are the benefits of the Jan 2022 versions of the Public Works Contract?
- ❑ What practical solutions are parties applying to minimise the impact of inflation?
- ❑ What further steps are necessary to ensure the viability of construction projects?

# What has been the impact of price volatility on projects over the last 12 months?

## What level of material price inflation has the industry experienced in the past 12 months?

Wholesale prices for construction products increased by 16.2% over 12 months

Notable annual increases in construction products as shown in Table 3 include:

- Structural Steel Fabricated Metal: 57.1%
- Plaster: 36.2%
- Cement: 29.2%
- Ready Mixed Mortar and Concrete: 29.2%
- Plumbing Materials incl. Sanitary Ware: 27.9%
- PVC Pipes and Fittings: 26.3%

Source: CSO Wholesale Price Index December 2022, published 20 January 2023

## I'm no economist but.....

- The annual rate of construction inflation over the first half of 2022 was 14%.
- The Building and Construction index which combines Materials and Wages, rose by 9.9% in 2022 but showed no change in December 2022.
- Rate of material price inflation at much lower growth rates since Q3 2022.
- Some material prices appear to be stabilising.



## What are the reasons for cost inflation?

- Labour and material shortages brought on by Covid 19 and the war in Ukraine.
- Lack of availability of skilled personnel.
- Energy inflation – prices of oil and gas have risen significantly.
- Tightening PI insurance market



## What is the impact?

Projects are being postponed, retendered or delayed.

---

# Has the OGP Inflation Cooperation Framework helped?

## Why was it needed?

- No entitlement to EOT in PWC's for supply chain issues
- Limited potential to recover costs associated with inflation by applying PV1/PV2 under PWC's.

## What is the purpose of the Framework?

- To facilitate a proportionate approach to mitigate
  - Risk of delay due to supply chain issues
  - Cost increase due to inflation
- To facilitate burden sharing.
- To mitigate risk of increase in claims being referred to adjudication or conciliation.



---

## What is the approach?

- Voluntary
- Sits outside the Contract.
- Talks held on a “without prejudice” basis to determine the extent of the impact.
- Provides for up to 70% of the uplift to be covered by the Contracting Authority
- No Additional funding is provided – where will the money come from?



## How is it applied ?

- **Live projects** - where the cert of Substantial Completion was not requested by the Contractor by 10<sup>th</sup> May 2022.
- **Live Tender**
  - Optional
  - Should be stated in tender documents
  - Expert procurement advice recommended
- **Future Tender** – recommended for use until the PWC's are amended to address the issues.



## Project Categories

- **Category 1:**
  - Projects being delivered under PWC form dated 7<sup>th</sup> January 2022.
  - Material price inflation does not apply to Category 1 projects using PV1. Only energy and fuel price inflation can be considered.
- **Category 2**
  - Projects being delivered under a PWC form dated prior to 7<sup>th</sup> January 2022.
  - Materials, energy and fuel costs included.



## How is the relief calculated and applied?

- Ex-gratia inflation amount is determined by applying wholesale price indices published by the CSO
- **Fuel & Energy**
  - Based on the movement in a specific price index applied to a portion, “The percentage”, of the “Effective Value” of an interim or final cert.
  - The “Effective Value” is the sum certified by the ER.
- **Material Inflation**
  - It’s more complicated!
  - A threshold figure is deducted from the change in the relevant index to determine the factor to be applied.
- **EOT**
  - Where agreed, the ER issues a “Inflation/supply chain delay notice” and LAD’s are waived if the project will be delayed beyond the Date for Substantial Completion.



---

## Meanwhile, what happens under the Contract?

- Clause 10.3 claims are paused until the outcome of the Ex-gratia process is known.
- Any determination made for EOT/money under the Contract will be deducted from the ex-gratia EOT/Ex-gratia Inflation Amount, as applicable.

## What happens if a party wants to opt out?

- The Inflation Cooperation Framework Agreement can be terminated by either party giving 2 weeks written notice of the intention to terminate.
- If notice is given to terminate the co-operation framework any clause 10.3 notice is deemed to have been submitted the day after the last exploratory co-operation meeting.



## Has the Inflation Cooperation Framework helped? Are parties using it?

- The short answer is it has had mixed results.
- Voluntary status reduces its availability to contractors.
- Significant reliance on trust and relationships to make it work.
- Contracting entities relying on multiple funding streams less likely to engage because of inability to fund the framework.
- Contractors and Quantity Surveyors generally reporting good uptake by local authorities and other state bodies with a single funding stream.
- Most Contracting Entities that do engage are agreeing to the 70/30 split.
- Recovery by contractors reported as reasonable but issues with supply chain still remain a challenge particularly for projects tendered early 2022.
- Lack of exchequer backing seen as a major obstacle.
- Lack of contractual status is a significant concern and limits its appeal.

# The amendments to PV1 & PV2 in the Public Works Contracts

## What are PV1 and PV2 all about?

- Provide a mechanism to amend the Contract Sum in the event of exceptional price increases or decreases over a protracted contract period (previously 36 months).
- PV1 is the proven cost method, requiring the Contractor to provide evidence by way of invoices to support its claim.
- PV2 is the formula fluctuations method whereby any increases or decreases in the price of materials and fuels is calculated based on CSO indices.
- PV1 has typically been specified in the Schedule and the provisions have largely been ignored until 2021.



---

## January 2022 amendments to the PWC's

- A reduction of the Base Date for PV1 and PV2 from 30 months to 24 months from the Tender Inflation Indexation Date.
- The Tender Inflation Indexation Date is the last day of the month in which the latest available Index is published as at the Contract Date.
- The sub-clauses in PV1 and PV2 dealing with exceptional material price increases have been amended to adjust the threshold from 50% to 15%

### Do these amendments go far enough?

- The short answer is no – framework required to fill the gaps.
- 15% inflation not sustainable in a market operating on such low margins.
- Potentially devastating implications for supply chain.



## What Practical solutions are being used to limit the impact of inflation?

- Early procurement of packages to limit impact of inflation.
- Employers assisting with materials storage facilities/costs.
- Valuations allowing for higher percentage of unfixed Works items to help cover Contractor early outlay for materials and equipment.
- Designers and Employer willing to consider alternatives to avoid or minimise lead-in time delays.
- Value engineering to achieve project budget.



## How can we ensure the viability of construction projects?

- Consider material lead-in time during the design process and engage with Contractors to find innovative solutions.
- Encourage and incentivise cooperation between the parties – the role of the conditions of contract.
- Support the supply chain – without them, nothing gets built!
- Foster an environment where transparency is rewarded and making a profit is not considered a bad thing.
- Invest time in building relationships instead of preparing or defending claims – you will reap the rewards.



[www.rdj.ie](http://www.rdj.ie)  
[info@rdj.ie](mailto:info@rdj.ie)

[twitter.com/RDJ\\_LLPL](https://twitter.com/RDJ_LLPL)  
[linkedin.com/company/rdj-llp](https://www.linkedin.com/company/rdj-llp)

**Thank you for your time.  
Any questions?**

**RDJ**

Legal Insight  
Human Intelligence  
Business Impact