



INFLATION MITIGATION

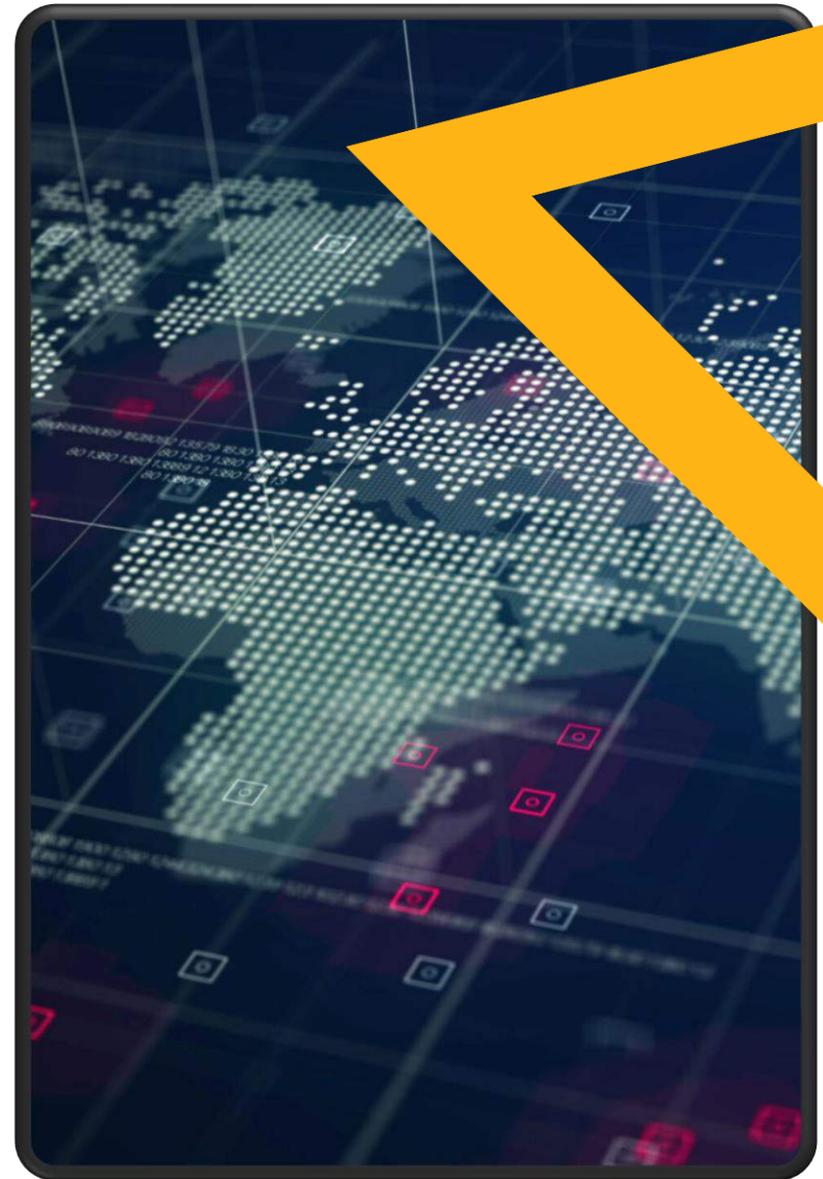
INNOVATIVE DRAFTING TO MITIGATE INFLATION
RISKS AND SUPPLY CHAIN DISRUPTION

Presented by Kerri Crossen

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Inflation Mitigation

How can new and innovative drafting strategies help you manage and mitigate inflation risks and supply chain disruption while addressing stakeholder concerns about going to market?



Inflationary Outlook Remains Uncertain

- Effects of Brexit, Covid-19 and the war in Ukraine
- Levels of inflation significant and protracted affecting most industries and supply chains
- Certain areas affected to greater extents than others
- Risk at the forefront of the minds of CAs and tenderers – non-performance, insolvency, profit margins, delays, disputes, termination



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Who bears the risk?

- Decisions to be made pre-contract if possible
- If not anticipated, can contract be modified?
- *Finding creative ways to mitigate supply inflation is a skill that lies dormant in many organizations. But with the right approach, companies can rebuild their price-negotiation capabilities—and their long-term resilience (McKinsey & Co – January 2022)*



CWMF Documents – Dealing with Inflation

- GCCC response to inflationary pressures
- Several changes in last 12-18 months (Inflation Co-op Agreement, ex gratia 70%/30% share, voluntary)
- Recent amended Public Works Contracts – price variation clauses (July 2023) – GN 1.5.2
- Permitted Increase Threshold- range of 3-10% set by CA- risk assessment to select value, expert cost advice may be sought for this exercise



CWMF Documents – Dealing with Inflation

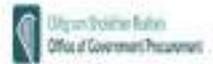
- Price Variation Clause 15 – **materials, fuel and labour**
- Movements in specified categories/sub-categories of CSO Wholesale Price Indices for Building and Construction Materials
- Employer assigns nominal % of Contract Sum to **labour, materials, fuel**, non-adjustable overheads/plant
- Tenderers may comment on the nominal % and weightings
- 2 years fixed price period for labour – relates to changes in SEOs
- Employer may recover for downward movements in the indices (– 10%)

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Capital Works
Management Framework



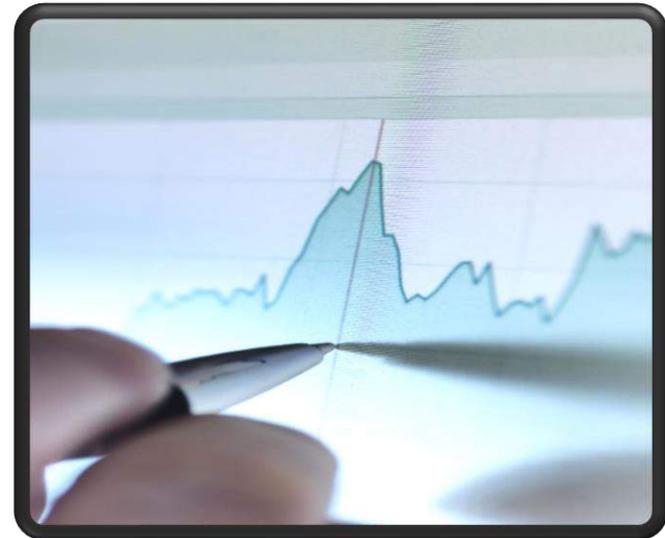
Factors to consider for inflation clauses

- Tying inflationary updates to cost index
- Start date of contract
- Inflationary climate in particular sector
- Value and nature of works/supplies/services



Factors to consider for inflation clauses

- Employer budget/risk appetite
- Duration of contract
- Careful consideration of appropriate index (CPI, WPI, SCSi)
- CPI unlikely to be appropriate in many agreements
- Note indices may not reflect actual supplier costs – proven cost method
- Transparency on supplier costs



Consumer Price Index

CPM01 ●
Consumer Price Index

Last Updated: 13/04/2023 11:00:00
English

Commodity Group Month 1575 November - 2023 March
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Table Chart Add to favourites

Statistic 7

Filter

- Consumer Price Index (Base Dec 2016=100) (Base Dec 2016=100)
- Consumer Price Index (Base Dec 2011=100) (Base Dec 2011=100)
- Consumer Price Index (Base Dec 2006=100) (Base Dec 2006=100)
- Consumer Price Index (Base Dec 2001=100) (Base Dec 2001=100)
- Consumer Price Index (Base Nov 1996=100) (Base Nov 1996=100)
- Percentage Change over 1 month for Consumer Price Index (%)
- Percentage Change over 12 months for Consumer Price Index (%)

Month 609

Filter

- 2023 March
- 2023 February
- 2023 January
- 2022 December
- 2022 November
- 2022 October
- 2022 September

Commodity Group 13

Filter

- All Items
- Food and non-alcoholic beverages
- Alcoholic beverages and tobacco
- Clothing and footwear
- Housing, water, electricity, gas and other fuels
- Furnishings, household equipment and routine household maintenance
- Health

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Wholesale Price Index

WPM28 ● Last Updated: 23/03/2023 11:05:00

Wholesale Price Index (Excl VAT) for Building and Construction Materials

Type of Material Month 2015 January - 2023 February English

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Table Chart Add to favourites

Statistic 3

Filter

- Wholesale Price Index (Excl VAT) for Building and Construction Materials (Base 2015=100)
- Percentage Change over 1 month in Wholesale Price Index (%)
- Percentage Change over 12 month in Wholesale Price Index (%)

Month 58

Filter

- 2023 February
- 2023 January
- 2022 December
- 2022 November
- 2022 October
- 2022 September
- 2022 August

Type of Material 40

Filter

- Materials**
- Stone, sand and gravel
- Sand and gravel
- Stone
- Cement
- Ready mixed mortar and concrete
- Concrete blocks and bricks

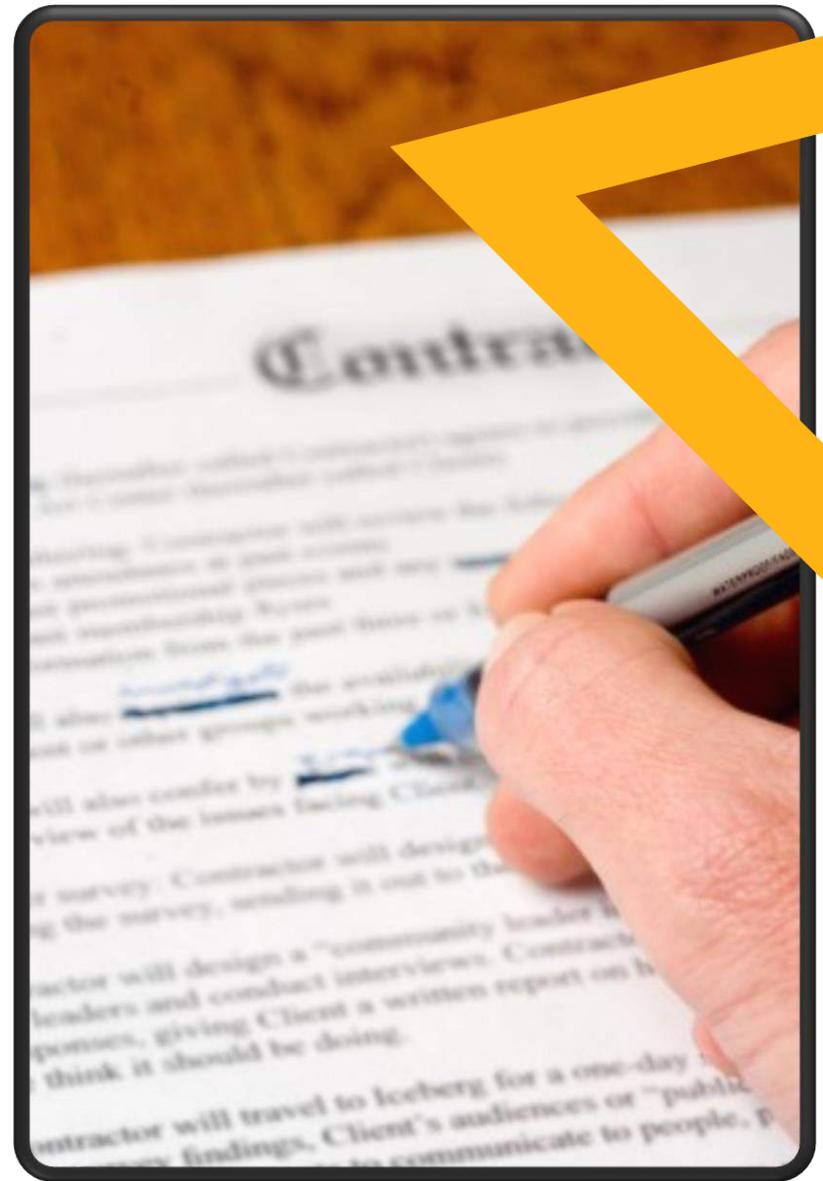
Decisions for Contracting Authority

- When to apply from? (e.g. Designated Date)- tender period, start of contract, 3/6 months in?
- Risk Sharing - % split between CA/Supplier
- Split- different indices apply to different elements (materials/labour/fuel)
- Who calculates and when -QS Role?
- Substantiation of costs/change to profit margins
- Pass down to sub-contractors?
- Deflation?
- Buy out risk for cost certainty?



Modification of Contracts during Term

Compliance with Public Procurement Obligations



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Modification of Contracts – Article 72

- Article 72 Directive 2014/24/EU – Deals with requirements for modification of contracts during their term
- Caution required even where both parties amenable to amendment
- Modification must not materially alter the contract



Requirements under Article 72

- **Article 72.1(a)**- Contractual basis to modify must be “**clear, precise and unequivocal review clauses**”
- May include price revision clauses
- Clauses should state scope and nature of modifications and conditions under which they can be used
- Cannot alter the overall nature of the contract



Requirements under Article 72

- **Article 72.1(c)** – unforeseeable?
- Circumstances which diligent CA could not have foreseen
- Does not alter overall nature of contract
- Any increase in price may not exceed **50%** of contract value
- **Contract modification notice must be published**



Article 72.1(c) – unforeseeable

- Recital 109 of EU Directive 2014/24/EU provides:-

“Contracting authorities can be faced with external circumstances that they could not foresee when they awarded the contract, in particular when the performance of the contract covers a long period. In this case, a certain degree of flexibility is needed to adapt the contract to those circumstances without a new procurement procedure. The notion of unforeseeable circumstances refers to circumstances that could not have been predicted despite reasonably diligent preparation of the initial award by the contracting authority, taking into account its available means, the nature and characteristics of the specific project, good practice in the field in question and the need to ensure an appropriate relationship between the resources spent in preparing the award and its foreseeable value.”

Article 72.1(c) – unforeseeable (Modification Notices)

- *“Owing to high, sustained and unprecedented levels of price inflation in the market, the Contracting Authority intends to use the Change Control Procedure provided for in clause 25 of the framework contract to incorporate a price review mechanism into the framework contract to mitigate inflationary risks and allow for price variations to the products and services under the framework contract, based on a price review methodology incorporating price indices for raw materials used in tyre production e.g. natural and synthetic rubber, steel cord, carbon black.*
- *The Contracting Authority estimates that the total contract value over the full term of the framework contract and any extensions will increase from € to €*”

Permitted under Article 72

- Article 72.2 – can modify if value below
 - (a) relevant threshold **and**
 - (b) 10%/15% (supplies, services/works) of contract value
- Threshold cap can limit changes, not always helpful



Ideas to minimise risk

- Preliminary Market Consultations (Article 40)
- Flexible Procurement Procedures – Competitive Dialogue/Competitive Procedure with Negotiation
- Test inflation provisions with market to ensure workable /not over complicated
- Advance orders?/Shorter contracts?



Ideas to minimise risk

- Security – PCGs, bonds, vesting certificates
- Rights to terminate if supplier pressure for price escalation
- Tailor clauses to contract, no one size fits all, not all elements of pricing will be affected
- Ensure agreed clauses passed down to supply chain
- Precedents in UK (NEC4/FIDIC/JCT)



Conclusion

- Consider options pre-contract
- Avoid quick fixes – disputes/ challenges
- Inflation no longer “unforeseeable”
- Prevention better than cure!
- Get cost advice (and legal)



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