

CLIENT PRACTICE NOTE

SAND SHORTAGES

A Client Practice Note of KPK Contracts Support Group

INTRODUCTION

Indonesia's ban on sand exports caught many in the construction industry by surprise given that Singapore imports 6 to 8 million tonnes of sand from a country which is our sole supplier.

BCA has given some assurances that the pressing requirements for concreting sand can be met through alternative sources from the region and the release from the government's stockpile. Undoubtedly, the immediate fallout of the ban is the increase in the prices of sand and ready-mix concrete, and work disruptions arising from uncertainties in the supply of concrete. Quite understandably, contractors especially the smaller firms are concerned that the escalating costs may be far too much for some to absorb on a fixed-price contract.

Following a meeting between BCA and the construction industry groups and key procurement agencies, private sector developers have been urged to consider a cost-sharing regime with contractors to alleviate the pain. In this regard, the government is expected to take the lead by sharing the risk burden of up to 75% of the increase in the price of sand.

CONTRACTUAL ENTITLEMENTS

SIA Form

Almost all projects using the SIA Form allocate the risk ownership of materials price fluctuations and extension of time due to shortages of materials to the contractor through deletion of the optional fluctuation clause and time extension ground respectively. It follows that contractually, a contractor does not have a valid entitlement to claim for price increases in sand and/or an extension of time for shortage of materials which as SIA clause

23(1)(m) states, '*could not reasonably have been foreseen at the date of the Contract resulting from domestic or foreign government actions, embargoes or regulations*'.

REDAS D&B Form

Under REDAS D&B Form, there are no provisions for adjustments to the contract sum arising from fluctuations in prices of materials. However, where there is '*any change in the law, regulations or bye-laws or conditions made by the relevant authorities*' after the letter of acceptance and the contractor incurs an increase in cost, the contract sum has to be adjusted pursuant to clause 21.2. As regards extension of time, unlike the position under the SIA Form, a *force majeure* event falls as one of the valid grounds in clause 16.1.2. Of the list of definitions under clause 18.2, such event includes, *inter alia*, '*embargoes affecting directly the Works*'.

Hence, in contrast to the SIA Form, the contractor has valid grounds to pursue a claim for a rise in the price of sand by reason of a '*change in the law, regulations or bye-laws or conditions made by the relevant authorities*' and apply for an extension of time in accordance with the procedural requirements set out under clause 16.2.

FORCE MAJEURE

Can an extension of time arising from the shortage of sand be admitted on the ground of *force majeure*? First, what is *force majeure*?

The one and minimum factor as commented in Hudson's Building and Engineering Contracts is that '*the event in question must be beyond the control of the party relying on it*'.

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FORCE MAJEURE (Continued)

FIDIC provides separately for a *force majeure* clause and expressly defines the term as:

- An exceptional event or circumstance;
- (An event) beyond a party's control which such party could not reasonably have provided against before entering into the contract;
- (The event) having arisen, such party could not reasonably have avoided or overcome; or
- (An event) not substantially attributable to the other party.

SIA Form

Shortage of materials [SIA clause 23(1)(m)] is listed as a ground for extension in addition to the separate ground of *force majeure* [SIA clause 23(1)(a)] in the extension of time clause. If the term *force majeure* encompasses materials shortages, what is the merit or necessity of identifying such shortages as another ground?

When the contractor tenders for a project, he accepts certain risks that are allocated to him and promises to bear these risks if and when they eventuate. That the clause on shortage of materials has (as it usually is) been deleted implies that the contractor enters into contractual obligations freely on the premise that he will have to deal with and manage this risk by pricing for whatever attendant effects.

REDAS D&B Form

The position under SIA Form is contrasted with REDAS D&B Form where as explained above, the *force majeure* event is defined to mean, *inter alia*, '*embargoes affecting directly the Works*'(clause 18.2.4).

The shortage of sand arising from Indonesia's ban on the export of this building material can be construed as a legal prohibition on commerce and is in our view likely to be caught by the definition of *force majeure*.

RISK-SHARING INITIATIVE

That said, to mitigate the unpalatable effects and reduce any potential delays in the overall completion of the project, an employer may be prepared to consider sharing the price and time burden with the contractor on a sympathetic, or what is commonly known as *ex gratia*, basis.

Existing projects

Under the SIA Form, given that the architect has no express authority to vary a term in the contract, the risk-sharing initiative must be formalised by way of a supplementary agreement setting out the compensation amount whether paid as a one-time lump sum within an agreed number of days from the signing of the agreement, or in instalments at prescribed intervals throughout the duration of the construction period. The one-time lump sum compensation is preferred as opposed to the conventional method of fluctuation adjustments based on the difference in prices between the Base Date price (to be established at the time of signing the agreement) and the invoice prices of sand - it offers parties certainty as to price as opposed to varying price fluctuations each month.

The compensation amount will cover the employer's share portion of the price burden of the increase arising out of and in connection with sand and may include the prolongation cost, loss and/or expense (arising from any extension of time given) for the shortage of sand.

For REDAS D&B projects, a supplementary agreement can also be drawn up on the one-time lump sum payment so as to place a cap on the amount payable. It can also deal with the extension of time to be granted as mutually agreed by the contracting parties.

KPK can help prepare the first outline draft of the supplementary agreement for review and approval by the client's legal advisers and is further prepared to work in conjunction with them to finalise the document for execution by the contracting parties.

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RISK-SHARING INITIATIVE (Continued)

New projects

In the case of new projects, unless the sand shortages stabilise within the foreseeable period of time, it may be necessary to introduce a fluctuation clause along the lines of the current provisions in the SIA Form for cement and steel reinforcement. This provides a controlled and measurable method of reimbursement as opposed to passing the whole parcel of risk to the contractor who may over-provide upfront in his pricing for the potential uncertainties and err on the side of caution leading to an untenable situation of the employer paying too much.

We propose to insert a new clause (say, clause 39A) in our Particular Conditions of the SIA Form to provide for fluctuations in the price of sand and also supplementary procedures for adjustment of such fluctuations referred to in the proposed new clause 39A.

No amendments are necessary for projects on the REDAS D&B Form as there are existing provisions for compensation of any increase in costs and for extension of time. However, supplementary procedures for adjustment of the contract sum to include the increase in the price of sand will have to be incorporated.

Projects tendered but pending award

For projects tendered on the SIA Form but

pending award, the employer may either issue a tender addendum on the new fluctuations clause on sand and amendments to clause 23(1)(m) to provide for an extension of time for shortage of sand only and not all 'goods or materials' in generality, or alternatively, the employer may wish to consider in the course of their commercial negotiations to agree with the likely successful tenderer on the payment of a one-time lump sum compensation amount to cover the expected increase in price of sand and any prolongation costs arising from an extension of time, which amount shall be added to the final offer price. If this alternative option is pursued, suitable terms must be expressly stated in the letter of acceptance when this is issued to the successful tenderer.

A similar approach can also be explored as an alternative option for projects on the REDAS D&B Form with the intention of having a cap on the amount payable for the price increase.

SUMMARY AND PROPOSED RECOMMENDATIONS

The various courses of action and KPK's proposed recommendations outlined above under the two commonly used standard forms are summarised here and depending on the stage of the individual project in question, approval of the client must be obtained prior to incorporation of any of the provisions into the contract.

Standard Form Used	Contractual Entitlement	KPK's Proposed Recommendations		
		Existing Projects	New Projects	Projects tendered but pending Award
SIA Form	<u>Price fluctuation:</u> <ul style="list-style-type: none"> Optional clause 39 for cement and steel reinforcement typically deleted. 	<u>Draw up supplementary agreement:</u> <ul style="list-style-type: none"> One-time lump sum payment for price-sharing regime and any prolongation costs arising from time extension. Paid on <i>ex gratia</i> basis. 	<ul style="list-style-type: none"> New clause 39A in Particular Conditions for fluctuation in price of sand. Supplementary procedures for adjustment of fluctuation in price of sand. 	<u>Option 1:</u> <ul style="list-style-type: none"> Similar to recommendations under 'New Projects'. Issue tender addendum prior to award. <u>Option 2:</u> <ul style="list-style-type: none"> Employer negotiates with likely successful tenderer on one-time lump sum for price increase and prolongation costs.

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Standard Form Used	Contractual Entitlement	KPK's Proposed Recommendations		
		Existing Projects	New Projects	Projects tendered but pending Award
SIA Form (Cont'd)	<u>Ground for extension of time:</u> <ul style="list-style-type: none"> Shortage of materials under clause 23(1)(m) typically deleted. 	<u>Draw up supplementary agreement (Cont'd):</u> <ul style="list-style-type: none"> Giving of appropriate extension of time, duration to be mutually agreed by parties. 	<ul style="list-style-type: none"> Amendment to existing clause 23(1)(m) to provide that extension of time given only for shortage of sand and not all 'goods or materials' in generality. 	<u>Option 2 (Cont'd):</u> <ul style="list-style-type: none"> Issue tender addendum on amendment to existing clause 23(1)(m) to provide that extension of time given only for shortage of sand and not all 'goods or materials' in generality. Final offer price adjusted where appropriate and reflected in letter of acceptance.
REDAS D&B Form	<u>Price fluctuation:</u> <ul style="list-style-type: none"> No provision for any materials. Increase in cost by reason of change in law, regulations or bye-laws or conditions after letter of acceptance admissible under clause 21.2. Sand may fall under this circumstance. <u>Ground for extension of time:</u> <ul style="list-style-type: none"> <i>Force majeure</i> event under clauses 16.1.2 and 18.2. 	<u>Draw up supplementary agreement:</u> <ul style="list-style-type: none"> One-time lump sum payment for increase in costs and any prolongation costs arising from time extension. Intention is to cap amount payable. Giving of appropriate extension of time, duration to be mutually agreed by parties. 	Provisions exist for: <ul style="list-style-type: none"> Compensation for any increase in costs by reason of change in law, regulations or bye-laws or conditions after letter of acceptance [clause 21.2]. Extension of time as a <i>force majeure</i> event to be assessed and where appropriate given by Employer's Representative. <p>No amendments required to standard form but supplementary procedures to be included on contract sum adjustment for increase in price of sand.</p>	<ul style="list-style-type: none"> Employer negotiates with likely successful tenderer on one-time lump sum to cap amount payable for price increase and prolongation costs. Final offer price adjusted where appropriate and reflected in letter of acceptance. Extension of time assessed and where appropriate given by Employer's Representative.

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