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“Variation of Price Clauses: A necessary solution for the construction industry?”

Introduction

Should a variation of price clause be introduced to the construction industry?

Covid-19 has forced almost anyone who has signed a contract or an agreement to review their obligations and seek ways to mitigate catastrophic damages caused by the unprecedented pandemic over the past two years. Some contracts were renegotiated and varied to prepare for the worst possible scenario. In the construction industry, one of the solutions has been to introduce the Variation of Price (VOP) clause. What does this mean and will it become one of the emergency pandemic measures that stays with us ever after Covid?

A VOP clause is a clause introduced in a contract to tackle the inflation of building material costs, relieve the burden of contractors, ensure cash flow, and timely project completions.¹

On 28 June 2021, the Pakej Perlindungan Rakyat dan Pemulihan Ekonomi (PEMULIH programme) was released by the Malaysian government to help mitigate the effects of Covid-19 in Malaysia. Among the initiatives it introduced, one of the most significant is to allow VOP clauses to be included for government projects due to the rise in construction materials prices until 31 December 2021.²

This initiative comes after the Construction Industry Development Board (CIDB) of Malaysia's recommendation for VOP clauses to be included for government projects on 3 May 2021. While this is certainly great news for construction players, the Master Builders Association Malaysia (MBAM) has called for the VOP to be extended to projects in the private sector as well.³

The VOP Clause

A VOP clause is precautionary and allows the prices in a contract to be varied. In the instance of a construction contract, it would usually refer to the price of building materials. As one can imagine, fluctuating prices in building materials impact the cash flow of those in the supply chain and have a knock-on effect on a project's completion and the end-price.

The CIDB has revealed that an increase in the price of building materials would affect both large and small players in construction. There are various factors that come into play including purchase quantity, raw material cost increases, limited quantities of building materials, and incidental costs. In

¹ Construction Plus Asia, 'CIDB urges variation of price to be allocated to government projects - Construction Plus Asia', 4 May 2021, <<https://www.constructionplusasia.com/my/rising-prices-of-building-materials-the-proposed-price-change-clause-should-be-revised/>>.

² See, Pakej Perlindungan Rakyat dan Pemulihan Ekonomi, <https://cdn.thestar.com.my/Content/PDF/Teks_Perutusan_YAB_PM_PEMULIH-Final.pdf>.

³ The Sun Daily, 'VOP and EOT should also be applied to projects in private sector: MBAM', 29 June 2021, <<https://www.thesundaily.my/local/vop-and-eot-should-also-be-applied-to-projects-in-private-sector-mbam-ID8014802>>.

fact, the CIDB reports that a simulation carried out for the price hike showed a seven percent increase in construction costs and a fifteen to twenty percent profit margin decrease for small contractors.

In normal circumstances, a VOP clause would not be ideal as it places an extra burden on the value of the agreement. However, without it, construction projects have another factor contributing to delays in completion. As things stand, there are already various hindrances. The construction industry is facing a lack of manpower, uncertain construction periods, as well as the unexpected cost of carrying out Covid-19 tests on a regular basis.⁴

VOP Clause and Contracts Types

Notably, the VOP clause has only been included for government contracts. What about private contracts? Perhaps the type of contracts should not be a factor as to who gets a VOP. It is likely that other construction contracts or contractors or both need VOP clauses too.

In Malaysia's Department of Works's (JKR) standard form of contract when bills of quantities form part of the contract is the P.W.D. Form 203A (Rev. 1/2010). It includes an optional inclusion of the 'fluctuation of price' clause. However, this is a standard government form.

The common standard form of contracts used by the private sector is that of the Malaysian Institute of Architects's (*Pertubuhan Arkitek Malaysia*) standard form contract, also known as the PAM Contract. At the moment, there is no opt-in VOP clause for neither its 2006 nor 2018 versions.

Rather than segregate based on the type of construction contract or project – whether government or private, the inclusion of the VOP clause should be a mandatory blanket provision for all construction contracts. An analogy can perhaps be drawn against Section 35 of the Construction Industry Payment and Adjudication Act 2012 (CIPAA) where pay-when-paid clauses are deemed void in an adjudication regardless of whether the contract is a private or government construction contract.

Applying a VOP Clause

Whilst the intention of the VOP clause is virtuous, one may face difficulty in implementation. The PEMULIH initiative mentioned the inclusion of VOP clause that it would be valid until 31 December 2021. But what if the Covid-19 pandemic situation improves before that date? If the situation is still bleak, will the initiative be extended?

Further, is it a mandatory clause? The PEMULIH package announcement uses the word "*membenarkan*" which means "to allow". In such circumstances, what if one of the parties disagrees with the implementation of the VOP clause? Such problems may also arise with private contracts.

If the intention is to tackle the ongoing price inflation caused by the pandemic, then perhaps the need for a VOP clause or one similar to that, should be included in the Covid-19 Act.

⁴ Meng Yew Choong, 'Construction sector seeks govt subsidy to test foreign workers', *The Star*, 3 February 2021, <<https://www.thestar.com.my/news/nation/2021/02/03/construction-sector-seeks-govt-subsidy-to-test-foreign-workers>>.

VOP Clauses and the Covid-19 Act

Similar to how Section 7 of the Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) Act 2020 (the COVID-19 Act) is to a certain extent, akin to a *force majeure* clause. Could an expanded VOP clause provision for the private sector be included in the Covid-19 Act? By doing so, parties could rely on the COVID-19 Act to deal with price inflation.

A statutory provision would certainly carry more weight as opposed to a government announcement. The announcement, arguably, has no legal weight to compel parties to include a VOP clause in their contracts. At the same time, the inclusion of such VOP clauses in the Covid-19 Act would be able to detail their extent, operation and duration.

Conclusion

The introduction of VOP clauses to construction contracts would be welcomed by at least one party to each construction contract in Malaysia. However, further studies must be carried out on its wider implications to the cost of development, how such VOP clauses are to be implemented, and the consequences of introducing it *before* it has been announced. As the Covid-19 pandemic seems to be becoming a permanent resident in our lives rather than a visitor, perhaps incorporating a VOP clause would be the way forward for future construction contracts in the private and public sector.

However, these are still very early days. At the moment, it also remains to be seen whether the optional inclusion of a VOP clause in government construction contracts serves as a headache or a bother to the construction businesses.