

0-6799: Price Adjustment Clauses

Background

A price adjustment clause (PAC) is a contractual mechanism that allows a contractor to be at least partially protected against material or fuel price increases that may occur between the contract award and the execution of the work. Price adjustment mechanisms exist in other industries to account for fluctuations in commodity prices. Figure 1 shows the fluctuation in liquid asphalt prices over the last few years.

According to a 2011 study, 47 out of 50 state departments of transportation (DOTs) use price adjustment clauses. PACs have the advantages of decreased bid prices, more bidders and fewer bid retractions, better market stability, better reliability in the supply chain, and more consistent contractor profit margins. Since the Texas Department of Transportation (TxDOT) does not currently use PACs and there are some risks associated with them, researchers examined the feasibility of establishing PACs in Texas.

What the Researchers Did

Researchers performed a literature review on PAC use, interviewed other state officials regarding their use of PACs, and surveyed TxDOT district personnel on how PACs could be used in Texas. The research team also interviewed private contractors and materials suppliers for their insight.

What They Found

Other researchers found that most state DOTs and contractors interviewed view PACs favorably for use in highway construction. The Federal Highway Administration maintains a neutral position on whether or not Texas should implement PACs but would support their use. Most TxDOT engineers believe that PACs would be a benefit, but there was not a consensus on how PACs could be applied in Texas. Texas contractors were mostly against the use of PACs, but all understood the rationale behind using them.

What This Means

Because there is not a clear agreement at this time between contractors and TxDOT personnel interviewed, implementation of PACs on construction projects cannot be recommended. However, a decision not to institute PACs is still a decision and carries risks as outlined in this report, especially the lack of stability in the industry in times of high price variability and the potential for contract defaults.

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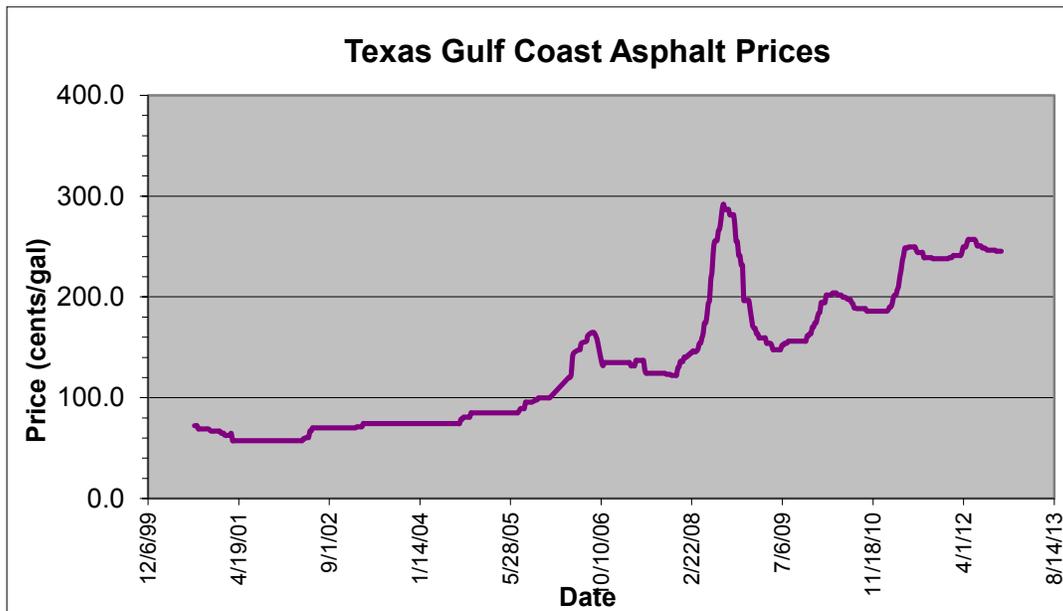


Figure 1. Changes in Liquid Asphalt Prices from 2001 through 2012.

In the event that PACs are ever to be considered, researchers recommend that:

- TxDOT undertake a study of past price fluctuations of commodities being considered to understand what trigger values of price changes would be most advantageous to mitigating risk.
- If PACs are ever implemented, discussions with stakeholders should take place to define the conditions under which PACs would be employed, including project duration and contract amounts.
- If PACs are ever implemented, TxDOT should use them for both price increases and decreases.
- TxDOT should use the American Association of State Highway and Transportation Officials (AASHTO) SiteManager software to automate calculations of payouts and rebates should PACs ever be instituted.

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