

CASE STUDY

Impact of Hurricanes on Construction Costs

INDUSTRY

Water

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ABOUT BATES WHITE

Bates White is a consulting firm offering services in economics, finance, and business strategy to leading law firms, Fortune 500 companies, and government agencies. Bates White has offices in Washington, D.C., and San Diego, California.

SUMMARY

Our experts analyzed the impact of the 2005 Gulf Coast hurricanes on construction costs in connection with negotiations over the construction of a water treatment plant. To quantify the effects of the Gulf Coast hurricanes on significant input prices, we adopted an econometric approach designed to estimate the causal impact of events on economic outcomes. Based on the econometric results, almost 70% of the relevant escalation was attributed to the impact of the hurricanes.

BACKGROUND

Hurricanes Rita and Katrina disrupted oil and gas supply chains and production capacity. Resultant sharp increases in domestic crude oil and natural gas prices triggered both direct and indirect price increases for construction-related products. A company that undertook the construction of a water treatment plant for a fixed design-build price assumed the risk of price increases attributed to “general economic conditions” but also assumed it was entitled to recover price increases arising from “uncontrollable circumstances.” The parties to the construction contract disagreed as to the impact of the hurricanes on construction materials and as to who should bear the increased costs.

ANALYSIS

Our experts focused on seven significant pricing inputs—diesel fuel, asphalt, concrete, copper wire, stainless steel, steel pipe and labor—all of which factor heavily into the total project construction costs. We also considered the impact of the hurricanes on prices of finished products that include these inputs in their manufacturing process. For example, contractors purchase stainless steel directly in the form of stainless steel bolts and pipes and indirectly through the stainless steel contained in products such as membrane or ozone systems used for water treatment. Recovery estimates needed to account for direct purchases of significant inputs as well as indirect purchases through finished products.

OUTCOME

The parties settled under terms that remain undisclosed.