

29 March 2022

INDUSTRY RESPONSE TO THE UKRAINE CRISIS

Guidance Note 1

1 INTRODUCTION

1.1 This note has been developed as the first of a series by the Construction Leadership Council to support the response of the UK construction industry to the impacts of the Ukraine crisis. The CLC is monitoring the situation carefully and, working with government, will determine appropriate responses as developments occur. The CLC's Product Availability Group (PAG) has increased the frequency of its meetings to fortnightly in anticipation of rapid changes in materials markets.

2 PROBLEMS AND CONSEQUENCES

2.1 At time of publication (week commencing 28th March 2022), the timescale and extent of disruption associated with the invasion are unknown, and the potential for knock-on effects affecting industry capacity, logistics networks and client demand. What is becoming clear is that significant Ukrainian industrial capacity has been destroyed during the conflict. This means that there will be some long-term market impacts, such as reduced availability of steel in the mainland European market.

2.2 The situation is evolving very quickly and is being influenced by an even wider range of factors. The recent fall in energy prices for example has been influenced by an anticipated short-term slowdown in China triggered by Covid-19 lockdowns. **It is recommended that all businesses regularly monitor key market indicators including energy and commodity prices to keep informed of developments.**

3 DIRECT IMPACTS

➤ **Materials:** In the UK, it is anticipated that the withdrawal of materials and products sourced directly from Russia, Ukraine and Belorussia will have a limited impact on markets. The total share of construction material imports is less than 2%. However, there are some critical categories – the most important of which are bitumen, cast iron products, rebar and timber.

➤ **Energy:** Wholesale energy prices in the UK have been directly affected by supply constraints to Europe and other issues associated with the operation of the European energy market. These are having a direct impact on the costs of manufacture of energy intensive products including steel, cement, bricks and blocks and glass. Energy markets are also being disrupted by sanctions affecting energy trading intermediaries.

4 INDIRECT IMPACTS

4.1 Indirect impacts resulting from disrupted raw material and energy supply chains can already be felt and are expected to have a more serious impact. Some raw materials produced in Russia, including copper and timber, are processed in Europe and enter the UK supply chain via firms within the EU

- **Disruption to established supply chains:** Locating raw materials from a tight market that has lost capacity as a result of sanctions/buyer preference limiting sourcing from the conflict zone (e.g., iron ore and pulverised coal, timber).
- **Loss of access to fixed price agreements and hedges:** Disruption to pricing models and short-term requirements to secure raw materials at spot market prices.
- **Reduced production volumes:** Manufacturing shutdowns due uneconomic operation due to high energy costs.

4.2 The potential implications of both direct and indirect impacts on the UK construction sector are significant. Construction enterprises at all scales, from the largest tier one contractor to the smallest R&M specialist are being affected. The materials supply and distribution segment is also at risk. The main challenges are:

- **Rapidly increasing costs** affecting the viability of projects or pain/gain share on target cost projects.
- **Unexpected cost increases** affecting bids and projects on-site, which could result in losses if fixed price protection is not in place.
- **Inflexible or imbalanced commercial terms**, such as very short, fixed price periods preventing suppliers, sub-contractors and main contractors from obtaining fixed price protections in bids and change orders.
- **Potential for survivalist behaviours** and perhaps even business failure as a result of product availability issues, increased costs and other commercial pressures. Any of these outcomes could result in less obvious safety and quality compromises that are often associated with projects that are facing financial difficulties.

5 WHY A COLLABORATIVE RESPONSE IS NEEDED? (The benefits case)

5.1 The CLC's view is that a collaborative response to these challenges is needed to avoid the risk of damage to industry capacity and capability. This is necessary because the current level of cost uncertainty exceeds the capacity for the supply chain to carry all of the risk. If there ever was a time when a chain needed to be stronger than its weakest link, it is when most of the cost risk is being held by lower tier sub-contractors and suppliers. This time is now.

5.2 It may be in the interest of clients and main contractors in the current environment to work with suppliers to solve problems quickly so that issues do not spin out of control.

5.3 Such an approach worked well in 2020 when construction faced significant Covid-19 related disruption. The problem in 2022 is different. Contracts have been explicitly designed to manage the impact of cost escalation risk, and any change to these arrangements in response to the Ukraine crisis will need very careful consideration. However, these cost escalations are real and in many cases are unavoidable. Relying on contractual protections may not be without consequence for clients or contractors.

5.4 The benefits of a collaborative approaches applies to future as well as current (on-site) projects:

Future Projects

- Viability on future projects will be protected if the risk of inflation is shared across the supply chain, rather than being added to project costs through layers of risk allowances
- Future projects will be more resilient if less price risk is extended down into the supply chain
- The potential volume of project disputes will be reduced if major drivers (inflation or availability) are shared rather than transferred
- Problem sharing will encourage collaborative actions to mitigate cost escalation risk
- Collaboration will improve transparency and information quality, supporting better decision making.
- The procurement programme can be tailored to enable the supply chain to secure cost certainty in the current market (e.g., PC sums)

Existing Projects

- Problem sharing will encourage collaborative actions to mitigate cost escalation risk
- Collaboration will improve transparency and information quality, supporting better decision making.
- Improved understanding of the extent and strength of cost and time risk transfer will equip the client and project team to take appropriate steps to protect project outcomes
- Awareness of issues affecting the project supply chain will allow other mitigating steps to be taken – e.g., increased supervision and quality control

6. RECOMMENDATIONS

6.1. All projects are likely to be affected by issues triggered by the Ukraine conflict, ranging from inflation problems to issues associated with supply chain stability. The crisis may not be resolved quickly, and businesses should be ready for an extended period of disruption.

6.2. The CLC's recommendations are a combination of general points and specific actions for parties with different roles on projects.

Checklists have been produced for the following construction contract parties:

- Main Contractors
- Sub-contractors
- Clients

6.3. Each checklist highlights key actions dealing with commercial and contractual issues that may be triggered by the crisis. These issues are crucial and must be dealt with on a project-by-project basis to ensure that risk exposure is understood, and available mitigation steps are taken.

6.4. There are other steps that can be taken on a wider basis, through collaboration, that will support the industry getting through what could be a long and difficult period, based on lessons learned from the Covid-19 crisis:

- **Communicate clearly** – ensure that issues and problems are understood and that solutions are discussed.
- **Anticipate** – identify potential issues and plan ahead for their resolution.
- **Be flexible** – be prepared to change plans in response to events as they develop.
- **Problem solve** – consider a range of options to solve problems caused by the crisis.
- **Conduct business with respect** – play by the rules and expect others to as well.

UKRAINE CRISIS – MAIN CONTRACTOR CHECKLIST

This short checklist has been prepared to support construction contractors to consider and address issues arising from the current crisis in Ukraine, and potential impacts on their business

1. Commercial

- Client engagement – undertake work to understand any potential impacts of the crisis on your company’s clients. Impacts may include:
 - Finance issues where projects are funded by Russian or Ukrainian investors
 - Concerns over project viability where client budget may not support cost escalation due to crisis
- Supply chain awareness – undertake work to understand likely impacts of crisis on your company’s supply chain. Impacts may include:
 - Supply chain cost inflation
 - Inability to secure fixed prices, or have confidence in fixed price commitments
 - Inability to secure supply, including, steel and copper products and products relying on raw materials sourced from Russia, Ukraine and Belorussia
 - Requirements for alternative contract strategies to secure materials and manage inflation risk – e.g., does the contract permit product and materials substitution?
 - Current and potential exposure to sanction programmes – e.g., firms in Russian ownership/with Russian shareholdings
 - Supply chain insolvency – review supply chain resilience and safeguard credit/insolvency risks.
- Project progress, administration and communication – ensure that a full record set necessary for the management of the contract is maintained by all parties. A CLC guide can be accessed via this [link](#)
- Contractual – assess position of your client and sub-contract contracts in relation to any impacts of Ukraine crisis including consideration of:
 - Strategy – how will your organisation manage its contractual position with respect to clients and suppliers? Develop a plan for each project.
 - What the likely impacts are that will affect your ability to deliver the requirements of your contract – are all costs backed by fixed-price agreements? Has all work been procured?
 - What contractual measures are in place to address cost overruns?
 - What contractual mechanisms are in place to address delay?
 - Whether there are inflation recovery measures in place in your contracts. If so, confirm:
 - How are they applied up and down the supply chain?
 - Will they fully recover all cost impacts?
 - Bidding strategy for new projects, including approaches to inflation, price indexation and risk sharing

2. Employment

There are an estimated 37,530 people born in Ukraine living in the UK, as well as an estimated 73,000 who were born in Russia. Some of these individuals are likely to be working in the construction industry.

- Companies should be mindful of potential impacts on employees who may have family or other contacts that are affected by the crisis
- Companies may wish to provide wellbeing support to affected employees

3. Cyber

The National Cyber Security Centre has warned of an increased risk of cyber-attacks in the wake of the Ukraine crisis

- Review NCSC guidance for construction companies
<https://www.ncsc.gov.uk/guidance/cyber-security-for-construction-businesses>

UKRAINE CRISIS – SUB-CONTRACTOR CHECKLIST

This short checklist has been prepared to support sub-contractors to consider and address issues arising from the current crisis in Ukraine, and potential impacts on their business

1. Commercial

- Project pipeline and client relationships – undertake work to understand any potential impacts of the crisis on your company’s clients. Impacts may include:
 - Review pipeline, including live bids for risks to project progress including project viability and/or issues associated with client status/funding
 - Review contractor client resilience associated with exposure to Ukraine-related problems and safeguard client and contractor credit/insolvency risk
- Supply chain awareness – undertake work to understand likely impacts of crisis on your company’s supply chain. Impacts may include:
 - Supply chain cost inflation
 - Inability to secure fixed prices, or have confidence in fixed price commitments
 - Inability to secure supply, including, steel and copper products and products relying on raw materials sourced from Ukraine, Russia and Belorussia
 - Requirements for alternative contract strategies to secure materials and manage inflation risk – e.g., does the contract permit product and materials substitution?
 - Current and potential exposure to sanction programmes – e.g., firms in Russian ownership/with Russian shareholdings
 - Supply chain insolvency
- Project progress, administration and communication – ensure that a full record set necessary for the management of the contract is maintained by all parties. A CLC guide can be accessed via this [link](#)
- Contractual – assess position of your client and sub-contract contracts in relation to any impacts of Ukraine crisis including consideration of:
 - Contractual status – review all contract and supplier agreements for provisions associated with cost and time overrun. Develop a plan for each project.
 - Identify likely impacts that will affect your ability to deliver the requirements of your contract – are all costs backed by fixed-price agreements? Has all work been procured?
 - Identify the risk of suppliers defaulting on contract agreements – e.g., fixed price agreements
 - Whether there are inflation recovery measures in place in your contracts. If so, confirm:
 - How are they applied up and down the supply chain?
 - Will they fully recover all cost impacts?
 - Bidding strategy for new projects, including approaches to inflation, price indexation and risk sharing

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UKRAINE CRISIS – CLIENT CHECKLIST

This short checklist has been prepared to support construction clients to consider and address issues arising from the current crisis in Ukraine, and potential impacts on their business

1. Commercial

- Project status – undertake work to understand the status of your project/projects and areas of exposure to disruption
 - Funding arrangements including drawdown, reporting and guarantees
 - Scope, currency and adequacy of inflation and construction programme forecasts
 - Scope and effectiveness of change management procedures and reporting
 - Current contract status including access to fixed price guarantees and confidence in fixed price commitments
 - Status of material supply chain including exposure to risks associated products previously sourced from Ukraine, Russia and Belorussia
 - Current and potential exposure to sanctions – e.g., firms in Russian ownership/with Russian shareholdings
- Supply chain sanction review – undertake work to understand any potential impacts of trading restrictions on proposed or contracted parties. Impacts may include:
 - Ability of businesses to trade effectively if linked by funding to Russian or Ukrainian investors
- Supply chain financial resilience – undertake work to understand likely impacts of crisis on the project/programme supply chain. Impacts may include:
 - Supply chain cost inflation
 - Difficulties in securing fixed prices and installation dates aligned to contractual commitments
 - Difficulties to delivering work on site – ability to meet programme aligned to material availability
 - Risk of supply chain insolvency
- Contractual – assess position of contracts in relation to any impacts of Ukraine crisis including consideration of:
 - Development agreements, funding agreements etc – review measures to address issues associated with outturn cost and programme
 - Project contracts - what contractual measures are in place to address cost overruns and delay?
 - Project contracts - what contractual mechanisms does the main contractor have in place to manage impacts within the supply chain?
 - Strategy – how will your organisation manage its contractual position with respect to the wider supply chain?

- Project progress, administration and communication – ensure that a full record set necessary for the management of the contract is maintained by all parties. A CLC guide can be accessed via this [link](#)

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