



Contract Management: FIDIC 2017 Red Book

Day 2-S1
Price Adjustments

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Price Adjustment

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Dinesh Shiwakoti

Doctor of Engineering (Civil)

Master of Laws (Construction, Arbitration, Adjudication)

FIDIC President's List Adjudicator

FIDIC Accredited International Trainer

Fellow, Chartered Institute of Arbitrator





FIDIC Red Book 2017: Price Adjustments

1. Price Adjustment-
FIDIC Principles

2. Price Adjustment-
ADB Regulations

3. Price Adjustment—
Changes in Cost

4. Price Adjustment—
Changes in Laws

1. FIDIC's Golden Principles and Price Adjustment

Abrahamson principles of “balanced” or “fair” risk/reward allocation, as refined by Dr Nael Bunni:

The allocation of risks to a Party to a Contract should be determined by:

- Which party can best control the risk and/or its associated consequences?
- Which party can best foresee the risk?
- Which party can best bear that risk? and
- Which Party ultimately most benefits or suffers when the risk eventuates?

- Construction contracts **typically have** Price Adjustment Clause.
- Aim is to provide for a **balanced allocation of risks** and rewards.
- Without such a provision, Contractor would have to **build allowance into its bid** – and Employer would have to **pay even if actual cost increases were less** than expected.
- If Contractor does not allow enough allowance, it might **run out of funds** and **stop work**.

Q: If a construction contract does not provision price adjustment clause, does it violate GP3?

The FIDIC Golden Principle 3 is as follows:

GP3: The Particular Conditions must not change the balance of risk/reward allocation provided for in the General Conditions.



2. Price Adjustment: ADB's Regulatory Requirements

Procurement Regulations for ADB Borrowers (2017)

[Appendix 3, Open Competitive Bidding Procedure]

Price Adjustment

47. The bidding documents shall clearly indicate whether price adjustments are allowed in the event of inflation or of changes that occur in major cost components of the contract, such as labor, equipment, and materials, over which the contractor has no control. The amount of price adjustment shall be based on changes in the cost of the major components of the contract. If used, the bidding documents shall provide the method of adjustment formula or formulas to be used. The comparison of bid prices shall be carried out on the basis of base price only.



Price Adjustment: Main Provisions

Changes in Cost

The relevant Clause is: Sub-Clauses 13.7

Changes in Laws

The relevant Clause is: Sub-Clauses 13.6



Contract Management: FIDIC 2017 Red Book

Price Adjustments
3. Changes in Cost



3. Price Adjustment: Changes in Cost:

- The relevant clause is **Sub-Clause 13.7 2017 Red Book**

Definitions:

Cost:

SC 1.1.19: "Cost" means all expenditure reasonably incurred (or to be incurred) by the Contractor in performing the Contract, whether on or off the Site, including taxes, overheads and similar charges, but does not include profit. Where the Contractor is entitled under a Sub-Clause of these Conditions to payment of Cost, it shall be added to the Contract Price.

Cost Plus Profit:

SC 1.1.20: "Cost Plus Profit" means Cost plus the applicable percentage for profit stated in the Contract Data (if not stated, five percent (5%)). Such percentage shall only be added to Cost, and Cost Plus Profit shall only be added to the Contract Price, where the Contractor is entitled under a Sub-Clause of these Conditions to payment of Cost Plus Profit.

Question:

Under Sub-Clause 13.7, when price adjustment is applicable, does the adjustment apply to

- "Cost", or
- "Cost Plus Profit"?



3. Price Adjustment: Changes in Cost

Relevant Clause is: Sub-Clause 13.7 [2017 Red Book]

The key consideration: inflation/deflation risk management mechanism

The key points are:

- This Sub-Clause **protects both Parties** from the consequences of **changes in the costs** of Labour, Goods and other inputs to the Works.
 - upward adjustment (protects the Contractor)
 - downward adjustment (protects the Employer)
- If **Schedule(s) of cost indexation** are not included in the Contract, this Sub-Clause shall not apply.

SC 13.7 (para 2): The amounts payable to the Contractor shall be adjusted for rises or falls in the cost of labour, Goods and other inputs to the Works, by the addition or deduction of the amounts calculated in accordance with the Schedule(s) of cost indexation.



3. Price Adjustment: Changes in Cost

Relevant Clause is: Sub-Clause 13.7 [2017 Red Book]

The key points are:

- If full compensation is not covered by the provisions of this Sub-Clause, the Accepted Contract Amount is deemed to have included amounts to cover the contingency of other rises and falls in costs.
- Increase or decrease is to be applied to each interim payment, for each currency in which the Contract Price is payable.
- Adjustment to be applied except for "work valued on the basis of Cost or current prices."

SC 13.7 (para 3): *No adjustment shall be applied to work valued on the basis of Cost or current prices.*



3. Price Adjustment: Changes in Cost

Relevant Clause is: Sub-Clause 13.7 [2017 Red Book]

The key points are:

- No adjustment shall be applied to work valued on the basis of Cost or current prices.
- Until a current cost index is available, use "a provisional index":
- If the source of the indices is in doubt, **GC is silent**—no express provision to resolve it.
[in 1999 Red/Pink Book: it shall be determined by the Engineer]
- A current index has not been defined in SC 13.7, but, in Guidance section, Schedule of Cost Indexation, mentioned as 49 days prior to the last date of the period of the IPC.

Note: Guidance section is not a part of the Contract, unless it is incorporated as a part of Particular Conditions Part B – Special Provisions

3. Price Adjustment: Changes in Cost

Relevant Clause is: Sub-Clause 13.7 [2017 Red Book]

The key points are:

- If the Works continue after the Time for Completion, due to the Contractor's fault, the indexation is
 - frozen at the rate 49 days before prior to expiry, or
 - the current index or price, in case of deflationwhichever is more favourable to the Employer



Price adjustment risks transferred to the Contractor, if Works completion are delayed due to the Contractor's fault.



3. Price Adjustment: Changes in Cost

Relevant Clause is: Sub-Clause 13.7 [2017 Red Book]

The key points are:

- Example formula for adjustment for change in cost [Guidance section, Schedule of Cost Indexation]

$$P_n = a + b \frac{L_n}{L_o} + c \frac{E_n}{E_o} + d \frac{M_n}{M_o} + \dots$$

- On adjusting weighting factors (coefficients)—GC is silent, but exists in Guidance section:
- Weighting factors (coefficients) can only be adjusted, if rendered unreasonable, unbalanced or inapplicable due to the volume of Variations. [in Guidance section, Schedule of Cost Indexation]

Note: Guidance section is not a part of the Contract, unless it is incorporated as a part of Particular Conditions Part B – Special Provisions



3. Price Adjustment: Changes in Cost

Relevant Clause is: Sub-Clause 13.7 [2017 Red Book]

– Example formula for adjustment for change in cost

[Guidance section, Schedule of Cost Indexation]:

$$P_n = a + b \frac{L_n}{L_o} + c \frac{E_n}{E_o} + d \frac{M_n}{M_o} + \dots$$

- The use of the suggested formula **does not guarantee** that Contractor will be **fully compensated** or that he will not be **over-compensated**.
- Much depends upon:
 - the choice of cost elements to be taken into account under “M” – diesel, cement, steel, etc.;
 - the weighting of the non-adjustable portion “a” – FIDIC fixes this at 0.10 but a different weighting can be given in the Particular Conditions or Table of Adjustment Data;
 - the weighting applied to the other cost elements – “b”, “c” & “d”;
 - the source and reliability of indices;
 - the timing of cost increases.



Case study: Price Adjustment for Changes in Cost

Contract Agreement was signed **1 January 2019** for a hydropower generation project in Northern Pakistan, based on FIDIC Redbook 2017 conditions.

- Market prices of materials (large part had to be imported from overseas), increased significantly, due to high inflation, supply chain disruption due to Covid-19, ongoing war in Ukraine, and local currency devaluation. The Contractor requested for price adjustment, but the Engineer replied that the **Price Adjustment Sub-Clause 13.7 is not applicable**, because the Contract does not include **"Schedule(s) of cost indexation"**.
- The Contractor disagreed, stating that the ongoing inflation is an **"Exceptional Event (Force Majeure Event)"** under Clause 18, and he will not be able to continue to perform the Contract, unless he is compensated for the inflation, so he will suspend the works.
- What would you do, if you were the Contractor?



3. Price Adjustment: Changes in Cost

Relevant Clause is: Sub-Clause 13.7 [2017 Red Book]

Unprecedented Inflation vs Exceptional Event (previously Force Majeure)

Sub-Clause 18.1 Definition of “Exceptional Event”

Exceptional Event means an exceptional event or circumstance which:

- (a) is beyond a Party's control;
- (b) the Party could not reasonably have provided against before entering into the Contract;
- (c) having arisen, such Party could not reasonably have avoided or overcome; and
- (d) is not substantially attributable to the other Party.

SC 18.1: *"Exceptional Event" means an exceptional event or circumstance which:*

- (i) is beyond a Party's control;*
- (ii) the Party could not reasonably have provided against before entering into the Contract;*
- (iii) having arisen, such Party could not reasonably have avoided or overcome; and*
- (iv) is not substantially attributable to the other Party.*



3. Price Adjustment: Changes in Cost

Relevant Clause is Sub-Clause 13.7 [2017 Red Book]

Unprecedented Inflation vs Exceptional Event (previously Force Majeure)

Sub-Clause 18.1 Kinds of “Exceptional Event”

Human-induced:

(a) war, hostilities; (b) rebellion, terrorism; (c) riot, commotion; (d) strike or lockout; (e) encounter munitions of war

Nature-induced:

(f) Natural catastrophes

SC 18.1: An Exceptional Event may comprise but is not limited to any of the following events or circumstances provided that conditions (i) to (iv) above are satisfied:

- (a) war, hostilities (whether war be declared or not), invasion, act of foreign enemies;*
- (b) rebellion, terrorism, revolution, insurrection, military or usurped power, or civil war;*
- (c) riot, commotion or disorder by persons other than the Contractor's Personnel and other employees of the Contractor and Subcontractors;*
- (d) strike or lockout not solely involving the Contractor's Personnel and other employees of the Contractor and Subcontractors;*
- (e) encountering munitions of war, explosive materials, ionising radiation or contamination by radio-activity, except as may be attributable to the Contractor's use of such munitions, explosives, radiation or radio-activity; or*
- (f) natural catastrophes such as earthquake, tsunami, volcanic activity, hurricane or typhoon.*



3. Price Adjustment: Changes in Cost

Relevant Clause is: Sub-Clause 13.7 [2017 Red Book]

Unprecedented Inflation vs Exceptional Event (previously Force Majeure)

Sub-Clause 18.4 Consequences of an “Exceptional Event”

If the Contractor is or will be **prevented from performing** any obligations under the Contract due to an Exceptional Event ... (SC18.2):

- Even if inflation is considered Exceptional Event, **inflation does not prevent** the Contractor from performing obligations, though it makes performance more onerous.
- Even if inflation prevented the Contractor from performing, it would only cover EOT but the Contractor cannot unilaterally suspend performance due to inflation, so unlikely to have entitlement even for EOT.
- Not entitled for Cost because *inflation is not similar to any of SC18.1 (a) to (e) type*.

SC 18.4: *If the Contractor is the affected Party and suffers delay and/or incurs Cost by reason of the Exceptional Event of which he/she gave a Notice under Sub-Clause 18.2 [Notice of an Exceptional Event], the Contractor shall be entitled subject to Sub-Clause 20.2 [Claims For Payment and/or EOT] to:*

(a) EOT; and/or

(b) if the Exceptional Event is of the kind described in sub-paragraphs (a) to (e) of Sub-Clause 18.1 [Exceptional Events] and, in the case of sub-paragraphs (b) to (e) of that Sub-Clause, occurs in the Country, payment of such Cost.



Case study: Price Adjustment for Changes in Cost

A Contract Commenced on 1 January 2019, for a hydropower generation project in Northern Pakistan, based on FIDIC Redbook 2017 conditions.

- Market prices of materials (large part had to be imported from overseas), increased significantly, due to high inflation, supply chain disruption due to Covid-19 and ongoing war in Ukraine, and local currency devaluation. The **Price Adjustment Sub-Clause 13.7 is not applicable**, because the Contract does not include “**Schedule(s) of cost indexation**”.
- The Contractor considered the ongoing spike in inflation as an **Exceptional Event** under Clause 18, and decided that it is **Physically Impossible** to perform his obligations under the Contract (**Frustration**), as the Engineer and the Contractor refused to make any price adjustment. So, the **Contractor gave notice of termination** of the Contract, under SC 16.2.1, SC18.5.
- Is the Contractor’s notice reasonable? What would you do, if you were the Contractor?



3. Price Adjustment: Changes in Cost

Relevant Clause is: Sub-Clause 13.7 [2017 Red Book]

When the Contract does not

- have Price Adjustment Clause, or
- provide compensation for full inflation cost:

remedies may exist at law.

- Seek legal advice to explore the remedies that may exist in applicable law.
- In extreme cases, there are examples of countries providing relief, by promulgating laws or legal instruments.



3. Price Adjustment: Changes in Cost

Legal principle of frustration (physical impossibility)

SC 1.4 Governing Law of Contract: Laws of Pakistan

Section 56 of the Contract Act, 1872, provides that an agreement to do an act impossible in itself is void. It states:

"A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promissor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful."

In order to claim frustration of the contract, the party is required to establish that the intervening act caused a physical impossibility and not a commercial impossibility

[Quinn Corporation v Cotton Export Corporation 2004 CLD 1040].

SC 1.4: *The Contract shall be governed by the law of the country (or other jurisdiction) stated in the Contract Data (if not stated, the law of the Country), excluding any conflict of law rules.*

3. Price Adjustment: Changes in Cost

Relevant Clause is Sub-Clause 13.7 [2017 Red Book]

FIDIC Contracts guidance on the effects of inflation and unavailability of goods and labour following the global COVID-19 pandemic and the war in Ukraine

https://www.fidic.org/sites/default/files/Guidance%20Memo%20-%20War%20memorandum_170323_final.pdf

The image shows the top left corner of a presentation slide. It features a small photograph of a construction site with a crane and a road. Below the photo is the FIDIC logo, which consists of a globe icon and the text 'FIDIC International Federation of Consulting Engineers The Global Voice of Consulting Engineers'. The main title of the slide is '3. Price Adjustment: Changes in Cost'. Below the title is a red heading 'Relevant Clause is Sub-Clause 13.7 [2017 Red Book]'. This is followed by a blue heading 'FIDIC Contracts guidance on the effects of inflation and unavailability of goods and labour following the global COVID-19 pandemic and the war in Ukraine'. Below this is a URL in blue text. The bottom left of the slide contains a quote in dark blue text, followed by a bulleted list of four points in dark blue text. At the bottom left, there is a dark blue box with the ADB logo. The background of the slide has a light blue and white geometric pattern.

FIDIC Contracts guidance on the effects of inflation and unavailability of goods and labour following the global COVID-19 pandemic and the war in Ukraine

FIDIC Guidance Memorandum

March 2023

“In line with its Golden Principles, FIDIC commends all members of the construction community to particularly keep in mind that FIDIC:

- promotes cooperation and trust between contracting Parties;
- does not support any Party taking undue advantage of its bargaining power;
- discourages adversarial attitudes and encourages dispute avoidance; and
- encourages timely and adequate payment in accordance with the Contract to maintain cashflow.”

Look beyond contract's 4-corners: Solutions to project difficulties may lie outside the four corners of any contract.

- The impact of the governing law of the Contract
- Decision(s) and recommendation(s) from governments/authorities



Contract Management: FIDIC 2017 Red Book

Price Adjustments
4. Changes in Laws



4. Price Adjustment: Changes in Laws

- The relevant clause is **Sub-Clause 13.6 2017 Red Book**

The definition of Laws:

Pink Book (& **1999 RB**): All national (or state) legislation, statutes, ordinances and other laws, and regulations and by-laws of any legally constituted public authority.

2017 RB: All national (or state **or provincial**) legislation, statutes, **acts, decrees, rules** ordinances, **orders, treaties, international law** and other laws, and regulations and by-laws of any legally constituted public authority.



4. Price Adjustment: Changes in Laws

Relevant Clause is: Sub-Clause 13.6 [2017 Red Book]

The key points are:

- The change of Law must be in the Country where the Site is located.
- Changes made after Base Date (28 days before the latest date for bid submission).
- No profit mark up allowed.

SC 13.6: "... the Contract Price shall be adjusted to take account of any increase or decrease in Cost resulting from a change in:".



4. Price Adjustment: Changes in Laws

Relevant Clause is: Sub-Clause 13.6 [2017 Red Book]

The key points are:

- **Contractor can claim for increase in Cost:** For any claim for **increase in Cost**, the Contractor is required to give Notice under Sub-Clause 20.2.
- **Employer can claim for decrease in Cost:** For any claim for **decrease in Cost**, the Employer is required to give Notice under Sub-Clause 20.2.
- **Variation as a result of any changes in Law:** As a result of any change in Laws, if any adjustment to the execution of the Works becomes necessary, this need to be handled under Variations [by Instruction: SC 13.3.1, or by RfP: SC 13.3.2]



Case study: Price Adjustment for Changes in Law

A Contract Commenced on 1 January 2019, for a highway construction project in the Project Country, based on **FIDIC Redbook 2017** conditions. Sub-Clause 13.7 of the Contract has provision for price adjustment, based on its "Schedule(s) of cost indexation".

- On 1 Jan 2022, the Country amended the labour law, increasing the minimum wage of unskilled worked by 25%.
- On 25 January 2022, the Contractor issued a **Notice** to the Engineer, with copy to the Employer, under Sub-Clause 20.2, claiming that it is **incurring increase in Cost**, as a result of the amended labour law, and sought relief under Sub-Clause 13.6.
- Does the Contractor have case? Why?

