



Contract Risk for Escalation Costs

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Steel and other construction material tariffs necessitate careful evaluation and allocation of project cost and schedule risks. For example, when steel costs increased suddenly based solely on presidential executive orders, the building trades and owners saw drastic increases in costs, shop drawing review times and delivery dates. In many instances, contract documents failed to account for such risks.

Another factor that can significantly increase the price of material, and even the market price for labor, include catastrophic weather events. When bad weather occurs, contractors may no longer be able to obtain the material at originally budgeted pricing, or secure necessary labor forces to perform the work. Labor and material shortages domino into project delays, potential liquidated damages and claims.

Project participants should carefully evaluate and allocate by contract who bears responsibility for costs and schedule impacts. Prime contracts often contain provisions requiring the contractor to pay all taxes in effect at the time the contract is signed. Those provisions should be clarified to confirm who holds the risk of material price increases due to government policy changes and/or catastrophic weather events.

Reliance on a force majeure clause alone to identify and manage these risks is not the best practice. To avoid disputes regarding whether such an event has actually occurred, and the true measure of the resulting loss or impact, parties can include pricing assumptions and clarifications to assess and allocate risk of specific increases in material and labor costs. Such terms and provisions can easily be incorporated into guaranteed maximum price provisions and defined costs of work.

Since tariff and related costs are not within the control of the parties, best practices are typically upfront negotiation of cost allocations, similar to differing or changed conditions costs, to avoid including the price of potential risks in original contract values for events that may never actually be realized. Essentially, the parties' contract can identify the triggering events that require an equitable adjustment of time and price only if and when a defined event occurs. Defining the event triggers, and including guidelines and benchmarks for measuring adjustments, deserves significant preplanning and focus as part of the project budgeting and scheduling process prior to contract award. Alternatively, provisions may also detail the right of the owner to suspend work until prices level out; with reasonable payment to the contractor related to costs of suspension.

Contracting parties should review and understand their contract provisions, which govern their risk, including entitlement to compensation for material price increases, labor shortages, and project schedule impacts. It is equally important that the parties understand and follow all contract notice requirements to avoid waiver of rights and claims.

Contractors also need to evaluate and implement controls when securing prices from subcontractors and vendors. For example, bid documents should clearly indicate the duration that all bids and proposals are binding on the vendor or subcontractor to prevent withdrawal of prices before a final award from the contractor's customer. In particular, public bids in Ohio are typically subject to a 60-day owner evaluation period. Thus, prudent contractors will bind subcontractor and vendor pricing for a period not less than 60 days (plus such additional time as

may reasonably be necessary to confirm lower tier awards) and will also include the right to extend that period should the owner elect to delay the award deadline.

When faced with any defaulting supplier or subcontractor, a prudent contractor will document the default, provide notice and opportunity to cure, but also implement a Plan B in the event the default supplier/subcontractor cannot recover, to mitigate time and cost impacts.

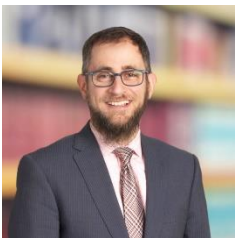


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