Mitigating the impact of tariffs on U.S. construction projects

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The U.S. recently imposed tariffs on imported steel and aluminum from China and nearly every other country in the world, except for Canada, Mexico, Argentina, Australia, Brazil, South Korea and the EU. In total, the U.S. has recently imposed $250 billion worth of tariffs on Chinese exports. Structural steel, in particular, is a critical long-term material for new commercial construction. These tariffs have caused significant concern within the construction industry with respect to the cost and availability of building materials, as well as the contracting parties’ relative risks and responsibilities over increased costs caused by tariffs.

Before the U.S.’ recent change in trade policy, interference from the government was seldom considered among the likely risks for a construction project (outside of the customary government involvement in entitlements, permits and inspections). As a result, few construction contracts address the circumstances of a “change-in-law,” such as the imposition of a new ordinance, tax or tariff. Indeed, most standard form contracts in the construction industry are silent as to a change-in-law.

Without guidance from the contract, the owner and general contractor are left to argue over which party assumed the risk of a new tariff. Many jump to the commonplace force majeure clauses for relief. However, for many such clauses, the party attempting to invoke its protections will face an uphill battle. First, force majeure clauses typically focus on the gross impracticability or impossibility of performance created by an unforeseen or unpredictable event. In most cases, however, tariffs do not render performance impossible—they only make performance more expensive. Further, the imposition of tariffs is arguably not an unpredictable event, especially in the current geopolitical environment. Indeed, many lump sum contracts expressly contemplate that the contractor bears the risk for fluctuations in material prices (without specifically mentioning tariffs), which renders the force majeure clause inapplicable to price fluctuations caused by newly imposed tariffs. Second, even if a force majeure clause could be snared by the imposition of tariffs, the relief to be afforded to the affected party is often limited by the clause itself. Many force majeure clauses limit the affected party to a simple extension of time for performance and do not provide for an increase in the contract sum. Under such a force majeure clause, the contractor would not be entitled to monetary relief from the owner for a cost increase caused by the new tariff.

Another place that the contracting parties may seek relief is under the common law. In many states, however, case law is limited on the allocation of risk for any change-in-law and the effect of such changes on building material prices.

Courts will sometimes look to doctrines like impossibility of performance or frustration of purpose to determine whether the tariff renders the parties’ contract unenforceable, or whether one of the parties should be held to its promised performance in spite of the unanticipated cost. Similar to the analysis for force majeure clauses, however, the imposition of a tariff does not necessarily make a material impossible to obtain—it only increases the cost of obtaining such material.

As a result, some courts have held that the contractor’s performance is not excused because of the increase in price. Other courts, in contrast, have chosen to “pencil in” an equitable formula for sharing the burden of the unexpected increases in material costs between the contractor and the owner. Still other courts have declared the contract void by imposition of an unexpected tariff, thus leaving the parties to either renegotiate the terms of an agreement or simply walk away.

Because there are a variety of approaches adopted by courts in different states, turning to the common law is an unpredictable proposition for contracting parties seeking to resolve a dispute over cost increases caused by tariffs.

In Colorado, the effect that a new tariff has on a construction contract is apparently an issue of first impression. Therefore, for projects in Colorado, the language of the parties’ contract, rather than the common law, is most likely to govern which party assumed the cost impact caused by such tariffs. It is important for both owners and contractors to carefully scrutinize their current agreements for: (1) the extent to which building materials may be affected by future tariffs for their projects; and (2) whether their contracts provide any guidance as to who bears the risk for potential increases in the costs of these materials due to tariffs or other changes in the law. Moving forward, construction parties would be wise to include change-in-law provisions in their contracts to account for the potential imposition of tariffs in the future, as well as other government actions that could affect the cost or time of performance.

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