

## Dealing with Volatility in the Price of Steel

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by Cody W. Wilson

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**An increasing global** demand for both structural steel and steel scrap has triggered significant domestic increases in the producer price of structural steel during the first half of 2008. As of June 2008, the mill price for wide-flange structural steel has increased 28% to just over \$1000 per ton. Other structural materials such as HSS and plate have experienced increases into the \$1100 to \$1200 per ton range. While there are many reasons for the volatility in steel pricing, this article looks at the difficulties involved and proposes a way, through advance planning, to avoid a catastrophe when the cost of steel turns out to be much more than initially bid.

Oftentimes companies do not appreciate the risks involved with fixed-price contracts until it's too late. In light of recent and dramatic increases in steel prices, when a contract is freely bargained for, it may be a good idea for steel contractors to consider a price escalation clause to protect against the volatility in the market. Fixed-price contracts can be financially dangerous when unexpected increases in steel change the assumptions on which the contract price is based. If the cost of steel increases, the cost to perform the contract will obviously increase. If this happens, when does a price change require a contract adjustment? If it is a fixed-price contract, that increased cost will be borne by the party promising to supply the steel. Very little can be done after the fact to undo a fixed-price contract. Courts will not rewrite contracts that were freely entered into by informed parties. Once a fixed-price contract is entered into, there is almost nothing that can be done to obtain relief from price escalations unless the costs increase is astronomically large.

Contracts in most states are ordinarily rescinded where there is original invalidity,



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fraud, failure of consideration or a material breach. Other basic grounds for contract rescission which may seem to offer potential relief in the context of steel price escalation include mistake of fact, impossibility, impracticability, frustration of purpose, and force majeure. These grounds are common in nature in that they rely upon the existence of circumstances that render performance difficult or burdensome. While every case must be assessed after careful consideration of all its facts, the facts will not typically justify rescission in the face of escalated steel prices.

Impossibility would likely fail to result in rescission, because steel does exist and the work is capable of being performed. Impracticability offers no greater prospects, because courts are reluctant to apply this doctrine, and when it is applied in the context of price escalation, it is usually done so where the contract is one for supply of goods, as opposed to performance of a service such as construction. Frustration of the purpose is unlikely to succeed in rendering a contract rescinded because the "frustrated event" must be the "purpose" of the contract – not a material element of the purpose, such as steel. Finally, force majeure would not likely result in the rescission of a contract because it is not a ground typically utilized by courts to protect contractors from the risks of contracting. >>

Ultimately, the approach which offers the best protection to a steel contractor is to be proactive with regard to future contracts by including a price escalation clause. This will protect the steel contractor from steel price increases by shifting the risk to the purchaser. Negotiation of a price escalation clause into your contract, however, is not always possible when the contract is won or lost with a public bid, as such bids require the bidder to be

responsive to the bid solicitation, which basically makes it a take-it-or-leave-it contract. Price escalation clauses may also be precluded when a strong corporate buyer yields excessive pressure on a weaker supplier to enter into a fixed-price contract. In situations where a fixed-priced contract is unavoidable, the only courses of action are to add a contingency to the bid or sale price, save for a rainy day, and/or just plain hope for the best.

Because of the volatility in the market, steel contractors may not be able to give fixed quotes to contractors or owners. To account for the actual costs of steel, a price escalation clause such as the one shown below may be considered:

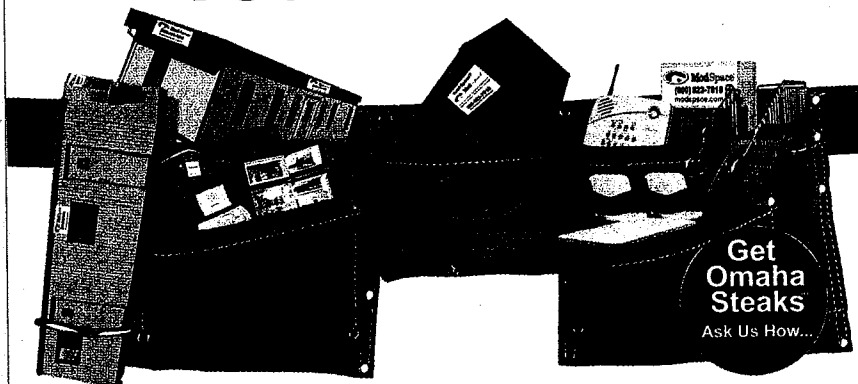
The Subcontract Price is based on the current prices and surcharges for the steel types and shapes necessary for the Project as posted and made publicly available by [MILL] on [DATE]. Notwithstanding anything herein to the contrary, any increases in the price of the steel ordered by the Subcontractor for the Project, or any additional surcharges imposed on the steel ordered by the Subcontractor of the Project, after [DATE], shall result in a corresponding dollar-for-dollar increase in the Subcontract Price.

In this example, the steel contractor is not absorbing the rise in the price of steel and is protected fully. Depending on the need and relationship with your owner or general contractor, variations of this clause can be executed which would allow the steel contractor to possibly absorb an agreed upon portion of the rise in the price of steel up to certain percentage.

While this is a turbulent time and this can be a difficult issue to navigate, it is worthwhile for steel contractors to be proactive and take steps to protect their future contracts. It may be that money spent on an experienced construction attorney in drafting a proper price escalation clause is small compared the potential financial disaster that could take place without this contractual protection.

Parties to fixed-priced contracts must be aware of the risks with such contracts. Where a contractor is free to bargain over the terms of its contract, price escalation clauses should be considered to reduce the risk from volatile markets for steel and other construction materials. Those already locked into a fixed-price contract need to realize that, unfortunately, courts do not usually offer relief. Understanding and implementing some of the precautions discussed in this article can help ensure a favorable outcome to the overall construction process. Through careful communication and attention to detail, your construction projects can be rewarding and productive instead of catastrophic. <<

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