Navigating Tariff Risks in Construction Contracts

by Rachel Burkhart and Kristina Maude

In recent months, changes to tariff laws have had a significant impact on the construction industry. With looming disruptions to global supply chains and material costs rising, there are a number of commercial and legal strategies that owners, contractors, and subcontractors can utilize to help manage the risk of tariffs.

A tariff is simply a tax or a duty paid on a particular class of imports or exports from a specific country. The U.S. Customs and Border Control collects the tariff during customs clearance at the destination port in the United States. Importers are responsible for calculating and paying the tariffs before goods are released.

This year, the United States has implemented reciprocal tariffs on select nations, a 10% tariff on all U.S. imports, a 50% tariff on steel and aluminum, and a 14.5% tariff on Canadian softwood lumber, to name a few. When tariffs have been implemented in the past, they have led to increased costs of construction materials, supply chain disruptions, project delays, and unpredictable pricing and budgets. The uncertain economic environment has been further exacerbated by shifting executive policies, negotiation of trade deals, and most recently, judicial rulings invalidating some of those tariffs.

The new tariff laws are far reaching and can impact everything from the cost of materials to the selection of suppliers. The following are some potential strategies for managing the risk of tariffs in drafting and negotiating construction contracts.

Strategies for Managing Risk of Tariffs in Construction Contracts

There are several contractual risk mitigation measures that may alleviate tariff-related risks on construction projects.

- **Openly discuss risk of tariffs and cost escalation in bid / RFP phase.** Contractors and owners should consider sharing information on how tariff-related costs have historically impacted project budgets. This knowledge helps both parties understand the risk of cost escalation throughout the course of a project and prepare for any potential price adjustments due to tariffs. Contractors can provide transparency

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regarding how tariffs are factored into their bids, which will facilitate any future change order discussions in the event costs change.

- **Consider impact of tariff risk when choosing project delivery model.** Generally speaking, hard bid and fixed priced contracts provide stronger protections to the owner in the event of material cost fluctuations mid-project, while cost plus fee and guaranteed maximum price contracts afford the contractor greater leeway for passing on cost increases to the owner. Choosing the right project delivery model at the outset can stave off significant disagreements and disputes later down the road.
- **Factor cost of tariffs into commercial terms.** To protect against unforeseen tariff increases, contractors may adjust their contract price or contingency to allow a buffer for any material cost escalations. If contractor pricing is challenging the financial viability of a project, then owners can negotiate cost sharing provisions and other mechanisms to better allocate the risk. Some potential contract provisions that provide vehicles for allocating the risk of tariffs include:
  - Materials Cost Escalation: A materials price escalation clause allows for an adjustment to the expected base price of specific materials upon the occurrence of certain conditions, such as a tariff increase.
  - Change in Law: A change in law provision could allow for an adjustment to the contract price or time allotted for the project in the event of a new or revised tariff law.
  - Force Majeure: A force majeure clause allows for an extension of time (and sometimes an adjustment in price) due to an unforeseen or uncontrollable event.
  - Alternative Materials Clause: This provision allows for the substitution of materials due to cost increases or supply chain disruptions.

- **Secure pricing with subcontractors.** Negotiating a fixed price with subcontractors and material suppliers can allow for greater certainty regarding the cost of material goods. This protects the owner and contractor from unforeseen price fluctuations. If fixed pricing is unavailable, contractors should pay close attention to the circumstances in which they can pass on cost increases from subcontractors to the owner.
- **Purchase materials in advance.** To avoid price escalations, contractors and owners can consider purchasing materials ahead of time. Buying early fixes the cost of materials, and it removes the risk of price fluctuations due to unexpected tariffs mid-project. On the other hand, if tariffs are later reduced or removed, or prices decrease, then early purchase could actually end up costing more. Contract provisions can be drafted to allocate the cost of ordering materials early, such as additional storage or laydown areas.
- **Consider leasing equipment and re-exporting after use.** Leasing and returning equipment to its country of origin after a project is complete can potentially avoid or reduce tariffs on imported machinery or tools.
- **Scrutinize declared value and country of origin.** Ensure that materials you intend to acquire correctly list the country of origin. Tariffs can depend on a variety of factors, including the value of the goods and the country of origin. Mistakes in customs declaration forms could lead to additional costs, so scrutinizing the declared value and country of origin is prudent.
- **Source materials from alternative suppliers.** Sourcing materials from alternative suppliers can result in cost savings. Contractors should beware, though, that alternative sources of materials may still be more costly, and that tariffs on foreign goods tend to increase the cost of similar domestic goods as well.

After decades of a relatively open global trade environment, tariffs pose a new challenge in the construction industry. Successfully navigating these economic pressures requires a proactive and informed approach. Construction companies and owners who stay informed and implement strategies to respond to the tariffs will be best positioned to mitigate the impact and cost of tariffs.