

Steel Price Escalation Threatens NJ Contractors – A Proposed Two-Part Solution

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With the rising cost of steel since the Fall of 2003,¹ many New Jersey contractors obligated to provide and utilize steel on existing State of New Jersey and federal projects stand to suffer serious financial losses in the face of full contractual performance of existing contracts. Future public project contracts present similarly worrisome considerations for contractors. In today's steel market suppliers and fabricators of steel are increasingly reducing the amount of time for which they will honor quoted prices, or, in some cases, refusing to honor quoted prices or to supply quoted amounts. For contractors, the all-too-real result of steel price escalation *without administrative or legislative contractual relief* is financially crippling losses to the company or altogether collapse of the business.

As discussed below, *judicial contractual relief* – namely court-ordered contract rescission – offers a tenuous probability of success at best, and should not be considered as a safety net or likely solution. What is needed to preserve the financial viability of potentially thousands of New Jersey contractors is the execution of a two-part plan involving the inclusion of steel price adjustment clauses within contracts let by the State of New Jersey, and, the State's enactment of extraordinary contractual relief legislation.

We begin our analysis with consideration of which State of New Jersey or federal agencies have weighed in on the issue of steel price escalation, and, to what extent. On a retrospective basis – with respect to existing contracts – only the New Jersey Department of Transportation (“NJDOT”) has affirmatively addressed steel price escalation. All other State of New Jersey and

federal agencies have effectively taken the position of “contractor beware” as to existing contracts, in that the other agencies have failed to set forth an affirmative comment or position on steel price escalation.

NJDOT addressed steel price escalation with respect to existing contracts in a recently issued two-page “Corrective Action Notice” on June 11, 2004. The NJDOT memorandum states in relevant part:

The recent escalation of steel prices in the steel industry has caused concern and created uncertainty among contractors, steel fabricators and industry suppliers. Significant price increases have been reported for structural steel, reinforcing steel, sheet piling and other miscellaneous steel products. The rise of steel prices began in fall of 2003 and has continued into the beginning of 2004. A steel adjustment on existing contracts may be considered if a contractor can prove that his/her company has had to absorb a significant adverse financial impact based on steel price escalation after bid. The adverse financial impact must meet the test of the contractor being able to rescind the contract due to the increased steel costs. (emphasis supplied).

Under this Corrective Action Notice, NJDOT has indicated that it will entertain a contractor's claim for contractual relief, but only on a retrospective basis with respect to existing contracts, and the test for the granting of relief is whether or not that harm complained of rises to a level justifying contract rescission.

On a prospective basis – with respect to future contracts – no State of New Jersey or federal

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¹ Most observers believe the recent steel price escalation to be spurred by China's voracious demand and purchase of surplus steel stock; China has embarked upon an expansive infrastructure upgrade of its cities set as venues for the 2008 Olympic games.

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agency, including NJDOT, has made provision for contractual relief for steel price or other purchased materials escalations. Thus, with respect to future contracts, all of the New Jersey contracting agencies have adopted a “contractor beware” position.

Excepting NJDOT’s announcement that it will provide relief from post-bid steel price increases if the test for rescission is met, attempting to obtain court-ordered contract rescission is, at present, the only form of relief available to aggrieved contractors. Unfortunately for the contractor, satisfying the test for contract rescission – whether in a claim submitted to NJDOT, or, before a Court of law – is very difficult and infrequently occurs with success.

New Jersey state and federal Courts consider rescission an equitable remedy only available in limited circumstances. Further, a contractor requesting rescission must do so on the basis of established grounds for contract rescission. Even if the grounds for rescission exist, when the contractor has not acted within a reasonable time, or, when there has been substantial performance of the contract, the likelihood of court-ordered contract rescission is minimal. And, even when grounds for contract rescission do exist, the remedy is always subject to the court’s discretion based upon a balancing of facts and circumstances underlying the contract and the issue claimed by the contractor.

Contracts in New Jersey are ordinarily rescinded where there is original invalidity, fraud, failure of consideration, or, a material breach. Other basic grounds for contract rescission include mistake of fact, impossibility, impracticability, frustration of purpose, and *force majeure*. Mistake of fact, impossibility, impracticability, frustration of purpose, and *force majeure* may seem to offer potential relief in the context of steel price escalation. 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, we note that these grounds would not typically justify rescission in the face of escalated steel prices. Impossibility would likely fail to result in rescission, for, steel does exist and the work is capable of being performed. Impracticability offers no greater prospects, for, 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.

A better approach to the issue of steel price escalation, one which if executed offers relief with real and probable success, is a two-part plan incorporating administrative and legislative contractual relief.

With respect to administrative relief, the New Jersey contracting agencies should insert steel price adjustment clauses within future contracts that they let. We propose a clause such as follows:

A steel price adjustment on existing [contracting agency] contracts may be considered as a valid

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*One of **Hoffman Equipment Company’s** major achievements during its first year of representing Grove and Manitowoc was earning special recognition from Manitowoc as a Crane CARE “Elite” dealer. “Elite” status means that Hoffman has satisfied a detailed set of Manitowoc specifications relevant to total support of the manufacturer’s products. Hoffman Equipment has also established a full service branch on Long Island, NY at Holtsville. The company recently hired Doug Tully to be their General Parts Manager.*

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claim for additional compensation if a contractor can prove that it has had to absorb a material and significant adverse financial impact based upon extraordinary and unanticipated steel price escalations which accrued after the submission of the contractor's bid. Any such adverse steel price adjustment shall support a claim for additional appropriate compensation on such existing contracts, which shall facilitate the public good as a condition of being approved and paid by the [contracting agency].

We believe that a clause such as the one above would provide appropriate and equitable relief to a contractor who, without such contractual relief, has little prospect of successfully weathering the rise in steel costs. We propose the a clause such as above be inserted in all future contracts let by state and federal agencies until such a time that the steel market stabilizes.

The incorporation of a steel price adjustment clause is not only good news for the contractor. Project owners, and the public at large, stands to derive a benefit from this equitable solution. For, should a contractor be unable to make full performance on a contract due to increased steel costs after bid, the public contracting agency would be forced to let that portion of the work for bid, with the new bids reflecting the then existing cost of steel. Further, with this equitable solution, long delays in project completion and the exercise of litigation can be avoided.

With respect to legislative relief, we propose that the State enact emergency legislation that would permit public contracting agencies to grant warranted financial, and other forms of relief, in an emergency situation such as with the prospective collapse of a contractor's business due to steel price escalation, even though the contracting agencies would have no legal obligation to do so.

The concept of emergency legislation that we propose is not new or untested. Extraordinary contractual relief under Public Law 85-804, 50 U.S.C.A. Section 1431, has existed for federal contracting agencies since 1941. The legislation

was originally passed as part of the War Powers Act of 1941. Essentially, it enables the federal government, via statute, and later by Executive Order, to grant financial relief to contractors – even though such relief may be contrary to statute or common law – if the relief would “facilitate the prosecution of the war.” Public Law 85-804 was used during World War II, and then again during the Korean War. Since the Korean War, Public Law 85-804 is only effective during a national emergency declared by the President or Congress. With President Bush's declaration of national emergency on September 14, 2002, in response to the terrorist attacks, Public Law 85-804 is once again an effective and viable source of potential contractual relief for contractors involved in projects that touch upon national security.

While Public Law 85-804 is an extremely broad and flexible source of financial relief for federal contractors, extraordinary contractual relief is only available if legal relief within the contracting agency is lacking or inadequate.

While the genesis of Public Law 85-804 was the onset of World War II, and, therefore, is not directly applicable to the present situation regarding steel, we believe the concept incorporated into Public Law 85-804, i.e., that relief may be granted in extraordinary circumstances where not otherwise available under statutory or common law, could be advanced to the State of New Jersey as a means to address the current steel crisis.

Steel price escalation has created, and will continue to create serious financial loss for New Jersey contractors. With the State of New Jersey and federal contracting agencies doing little or nothing to address the issue, and the improbability of obtaining judicial relief in the form of court-ordered contract rescission, a two-part plan involving administrative and legislative contractual relief is the contractors best hope. State agencies should incorporate steel price adjustment clauses into all future public project contracts. Further, the State legislature should enact extraordinary contractual relief akin to Public Law 85-804. **AGC**