Focus | Construction/Real Property Law

Cost Escalation: COVID Aftershocks Rocking the Contractor World

BY BRYAN M. KELLY AND MATTHEW L. MOTES

Construction contracts, like other contracts, create a set of obligations and allocate risk between parties. Typically, the allocated risks are known and fall within a foreseeable range. For example, a steel supplier may bid a job accepting the risk that steel prices could fluctuate plus or minus 5–10 percent, decreasing or increasing its ultimate profit margin. But life is full of surprises, like the occasional world-changing pandemic. And currently, sharply inflated materials prices, especially prices for lumber, are plaguing the construction industry.

Diligent contractors routinely include contract provisions such as a traditional force majeure clause, which allocates the risk of loss if performance becomes impossible or impracticable, especially as a result of an event or effect that the parties could not have anticipated or controlled. However, relief under force majeure is limited to events or effects that can be neither anticipated nor controlled, like uncontrollable acts of nature (i.e., floods) and people (i.e., war). The recent hurricanes might fall under force majeure for performance required in the affected areas. But increased prices due to COVID-19 in 2021 generally do not—price increases can be anticipated and controlled. And even if a force-majeure-type clause provides some relief, it might not provide for cost escalation, as illustrated by the Federal Circuit Court of Appeals in a recent case denying cost escalation due to complications created by an Ebola outbreak.

Further undermining the concept of force majeure and non-contractual protection is Texas's treatment of impossibility and impracticability defenses (used interchangeably in this state), which can arise upon the occurrence of an event the non-occurrence of which was a basic assumption of a contract. Texas partially recognizes the concept but carves out economic impracticability as not a recognized defense. Indeed, to argue that stable material prices are a "basic assumption" of a contract is difficult when industry professionals know that material prices fluctuate daily and are sensitive to a variety of variables, including supply, demand, tariffs, regulations, availability, labor, and, as it turns out, pandemics.

Undeterred by the hardships it would cause, COVID-19 skyrocketed lumber prices in the past year. As of July 2, 2021, the national average cost of lumber per thousand board foot was $756.70, down from a high in May 2021 of $1,686.00. Compare this price to $351.00 last June. In one year, lumber prices increased almost *five*-fold.

And, these price increases are negatively affecting all parties. Owners with new projects must scale back designs or square footage. Subcontractors and suppliers must absorb overages to perform for the contract price or walk away from the project, breaching those contracts. If the subcontractors walk away, and the general contractor has not negotiated relief or allocated sufficient allowances and contingencies, then the general contractor can be left holding the bag.

So, if boiler-plate contractual provisions and common-law defenses will not protect parties to a construction contract, what will? Try a cost escalation provision. Such provision can be used up and down the contract chain.

A typical cost-escalation provision states that if material costs increase by more than a certain percentage due to events beyond a contractor's control, then the owner and contractor shall execute a change order for at least a portion of the increase. The question then becomes, "what is beyond a contractor or subcontractor's control?" The contractor and its subcontractor must take reasonable steps to mitigate against substantial cost increases. One of the best methods is to lock in material prices, even for future contracts, early and often. Subcontractors should work with their suppliers and the general contractor to pre-purchase materials, eliminating future variability. This approach is particularly viable when the owner is willing to provide funding for project materials up front. And doing so can be in the owner's best interest: it reduces (i) the owner's risk under the cost-escalation provision; (ii) the likelihood that suppliers or subcontractors walk out on the job; and (iii) the chance that the general contractor becomes disgruntled as its entire margin is consumed by the lumber mill.

Cost escalation and supply-chain interruptions will be part of the market for years to come. The best approach to minimize risk and build the best project possible is to negotiate specific contract provisions with all construction parties. **HN**

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DBA Trial Lawyer of the Year: Professor Cheryl Wattley

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For her work at OU, she received the DaVinci Institute Fellow Award for Innovative Teaching; the University of Oklahoma Regents' Award for Superior Professional and University Service and Public Outreach; the Oklahoma Bar Association's Ada Lois Sipuel Fisher Diversity Award (2012); and the Association of Black Lawyers' Ada Lois Sipuel Fisher Award (2012).

In January of 2014 Professor Wattley left the University of Oklahoma College of Law and undertook another teaching challenge by accepting a position in the newly formed UNT Dallas College of Law. As one of the pioneers in establishing this new institution, she worked—and continues to work—to create an environment of innovative teaching. Her work, and that of her students, have a great impact in the community at large. As the Director of Experiential Education, Professor Wattley has created legal clinics, not only within the law school's physical borders, but also in neighborhoods where legal services are not usually offered.

With the opening of two Community Lawyering Centers in the greater Dallas area and others envisioned, she is engaging her students in holistic lawyering with an understanding of the context of their clients' lives. She also created the Community Engagement Program which requires UNT Dallas College of Law students to give at least 75 hours of volunteer service in partnership with local non-profit agencies, government organizations and community programs. Through this outreach, UNT Dallas COL students have contributed tens of thousands of hours in service to the North Texas community. At the same time, they have been engaged in "hands-on" lawyering skills such problem solving, interviewing, counseling, and document drafting.

A cause close to Professor Wattley's heart is her pro bono work with Centurion Ministries—a non-profit organization dedicated to the vindication of the wrongly convicted—which recently led to the release of Benjamine Spencer after 34 years in the Texas penitentiary. She also helped achieve the exoneration of Kerry Max Cook, Richard Miles, and Mary Barbosa.

In her "free" time, Professor Wattley writes publications and authors books, which serve her ultimate goal in her career, as proclaimed in her young years: "to make sure that people are aware that the laws have changed." Examples of her authoring labor include the creation of a trial case file, published by the National Institute of Trial Advocacy, and her book *A Step Toward Brown v. Board of Education: Ada Lois Sipuel Fisher and Her Fight to End Segregation* which won the 2015 Oklahoma Book Award, Non-Fiction category.

Congratulations to Professor Cheryl Wattley, the Dallas Bar Association's 2021 Trial Lawyer of the Year. **HN**

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