

PRICE ESCALATIONS – WHAT CAN YOU DO?

By: David A. Senter

With significant increases in the cost of raw materials over the past several years, including gas, steel and petroleum-based products, clients often ask whether fixed price contracts can be adjusted to account for significant, unexpected price increases. A Federal Court in North Carolina recently addressed that specific issue. The Court considered a case in which a general contractor and a structural steel supplier had entered into a fixed price contract for structural steel for a Fayetteville State University (“FSU”) project. During the course of the project, the price of steel increased substantially and the supplier sought a price adjustment from the general contractor. The general contractor refused and the supplier ceased work on the project. As a result, the general contractor was required to purchase steel materials from another supplier in an amount far in excess of the original supplier’s contract price.

The supplier’s only defense was that “its performance should be excused under the doctrines of frustration of purpose and impracticability.” Simply put, the supplier was looking for relief because it had to supply steel at a price which was much higher than it had estimated at the time it entered into its contract with the general contractor.

The Court noted that under the “impracticability” doctrine, a supplier may be excused from performance “if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made.” In order to succeed using this defense, a supplier must establish the following elements.

1. The supplier’s performance was impracticable;
2. The impracticability was due to the occurrence of some contingency which the parties expressly or impliedly agreed would discharge the supplier’s duty to perform;
3. The supplier did not assume the risk that the contingency would occur; and

4. The supplier seasonably notified the general contractor of the delay in delivery or that delivery would not occur at all.

Significantly, the Court noted that “increased cost alone will not satisfy the requirements of this defense.” However, under the Uniform Commercial Code (a set of laws governing the sale of goods) a “severe shortage of raw materials or of supplies due to a contingency such as a war, embargo, local crop failure, unforeseen shutdown of major sources of supply, or the like’ would be sufficient.” Even if one of these events occurs, a supplier cannot use this defense unless it has “employed all due measures to assure himself that his source will not fail.”

“Frustration of purpose” (which is like impracticability but is a creature of case law) excuses performance where a “fortuitous event supervenes to cause a failure of the consideration or a practically total destruction of the expected value of the performance.” This defense does not apply in circumstances where the “frustrating event was reasonably foreseeable” because one of the purposes of this doctrine is to grant relief where “the parties could not reasonably have protected themselves by the terms of the contract against contingencies which later arose.”

The FSU steel supplier contended that “market conditions caused an unprecedented and unforeseeable rise in steel prices during 2004 frustrating its purpose.” How many times have you heard that argument, thought about that argument, or actually made that argument? Unfortunately, the steel supplier did not produce “any facts which would indicate that the parties expressly or impliedly agreed that a significant rise in the price of steel would” excuse its performance.

PRICE ESCALATIONS – WHAT CAN YOU DO? (cont.)

Further the steel supplier could not establish “any reason behind the price increase, such as a shutdown of major supply sources or war.” Instead, it appeared that the price increase was merely the result of a fluctuation in the market and that was not sufficient to relieve the supplier of its fixed price contract obligation.

The Court went on to recognize that the supplier could have protected itself from a price increase by inserting a provision in the contract, such as a ceiling on the price. As you may know, some industry form documents contain such provisions. For example, “ConsensusDocs 200.1, Amendment No. 1, Potentially Time and Price Impacted Materials,” allows the contracting parties to set a baseline price for identified materials and provides a method by which price adjustments are calculated in the event of market fluctuations. Further, our Construction Practice Group has assisted clients in drafting their own price adjustment contract provisions. The most appropriate time for agreeing on such a provision is at the time the contract is entered into, not after the price has skyrocketed or taken a nose-dive.

In summary, absent contractual language to the contrary, fixed price contracts are not subject to adjustment merely because of market fluctuations in the price of raw materials. The party seeking relief from a contract price must show some unforeseen contingency such as “war, embargo, local crop failure, unforeseen shutdown of major sources of supply, or the like.” The risk/benefit of a contract provision allowing for adjustment in the event of price fluctuations should be carefully considered at the time the contract is entered into.

If you have questions, contact any member of the Construction Practice Group:

Eric Biesecker	ebiesecker@nexsenpruet.com
Henry Brown	hbrown@nexsenpruet.com
John Davidson	jdavidson@nexsenpruet.com
Walter Hannah	whannah@nexsenpruet.com
Harper Heckman	hheckman@nexsenpruet.com
Steve Hedges	shedges@nexsenpruet.com
Greg Higgins	ghiggins@nexsenpruet.com
Lawrence Melton	lmelton@nexsenpruet.com
Chris Ogiba	cogiba@nexsenpruet.com
David Parrish	dparrish@nexsenpruet.com
Randy Reavis	rreavis@nexsenpruet.com
David Senter	dsenter@nexsenpruet.com
Taylor Stukes	tstukes@nexsenpruet.com
Jack Taylor	jtaylor@nexsenpruet.com
Richard Wilson	rwilson@nexsenpruet.com



David Senter heads the Construction Practice Group of Nexsen Pruet. Since joining the firm in 1984, Mr. Senter has concentrated his practice in the areas of construction and surety, commercial litigation and commercial collections. He can be reached at 336.373.1600 or dsenter@nexsenpruet.com.