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Protect Your Business Against New Tariffs on Construction Materials

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On November 25, 2024 President-elect Donald Trump suggested that he would implement significant tariffs on the United States' three largest trading partners - Canada, Mexico and China. On Truth Social, President-elect Trump stated, “On January 20th, as one of my many first Executive Orders, I will sign all necessary documents to charge Mexico and Canada a 25% Tariff on ALL products coming into the United States…[i]” Separately, Trump threatened an additional 10% tariff on all products from China.

These sweeping tariffs, should they take effect, are likely to have a profound effect on the construction industry. While China exported just 638,356 metric tons of finished steel to the United States in the first nine months of 2024, accounting for only 0.8% of China's total finished steel exports during that time,[ii] the United States currently imports about six million tons of steel from Canada annually, worth about $11 billion, according to the Canadian Steel Producers Association.[iii] In 2022, Mexico exported $4.77 billion in iron and steel to the United States.[iv]

The proposed 25% tariffs will also significantly increase the costs to import Canadian lumber. President Joe Biden reinstated tariffs on Canadian softwood lumber on November 24, 2021, and this past August, the U.S. Department of Commerce nearly doubled the average tariff rate on Canadian softwood lumber from 8.99% to 17.9%.[v] President-elect Donald Trump would boost that tariff by another 40%.

Owners, general contractors, subcontractors, and suppliers will recall that during his prior administration, President Trump in March 2018 ordered 25% tariffs on imported steel and 10% on imported aluminum from every country except Canada and Mexico.[vi] The effects of those tariffs proved hard to calculate given the Coronavirus pandemic’s decimation the construction industry, but were likely significant. Now, all members of the construction industry must review their forms and ensure they are protected to deal with potential slowdowns and price increases.

Hedging Against the Risks and Costs of New Tariffs

Tariffs can cause delays and create supply shortages. To prepare, contractors and subcontractors should draft their contracts with a specific eye towards the consequences of these proposed tariffs.

Escalation Clauses

Subcontractors and suppliers should negotiate their contacts to include an “escalation clause.” Such clauses allow contractors to protect themselves against drastic price fluctuations caused by external factors such as tariffs. These provisions can also be drafted to shift the burden of increased cost from the contractor to the customer. In addition, such a clause can be drafted in a way to permit cancellation of the contract if the parties do not agree to the increase in price. Most AIA contracts do not include escalation clauses in their templates, which are widely accessible and used on many projects. As such, it is recommended that any subcontractor or supplier that uses imported steel or soft lumber consult their contract or transactional attorney regarding escalation clauses and very likely seek to insert them. There is room for owners, subcontractors, and suppliers to negotiate to resolve this impending cost disruptions in a mutually agreeable manner.

An escalation clause can be structured in various ways, ranging from a direct adjustment tied to actual costs documented through purchase orders and invoices, to a predetermined formula referencing a recognized cost index. The financial burden of cost increases may fall entirely on the owner or be distributed among the owner, contractor, subcontractors, and suppliers. These clauses can also be tailored to apply only to significant cost surges or specific materials identified in the agreement.

Time Extensions

In current and future projects where contracts have already been signed, subcontractors should speak with counsel promptly to determine the appropriate avenues for a subcontractor to obtain a time extension on their project. Many contracts have strict notification deadlines, so waiting until the tariffs cause issues is likely not a viable option, so subcontractors should promptly advise of potential delays and obtain the necessary time extension before it is too late.

Supply bonds

Contractors can typically seek a supply bond from the supplier. In effect, the contractor, the supplier and surety will enter into a contract to guarantee the delivery of material at a set price. If the supplier defaults, the contractor can file a claim against the bond for the cost of the missing material. That said, these supply bonds can be costly and thus are typically used for larger or public construction projects.

Subcontractor Default Insurance

Owners and general contractors should consider 'subcontractor default insurance' Due to the higher tariffs, subcontractors may not be able to obtain the materials necessary to complete projects. This may lead to subcontractors walking off the project, leading to significant critical path delays. While subcontractor default insurance will not save the project from experiencing delays, it will help owners and general contractors recoup some of the financial losses owners and general contractors experience should subcontractors walk off projects due to delays or cost increases that chip away at the their expected profits.

Navigating FAR Clauses in Government Projects

Government contractors, subcontractors and vendors adversely affected by these proposed tariffs may seek to recover under Federal Acquisition Regulation (FAR) 52.229-3, which states: "The contract price shall be increased by the amount of any after-imposed Federal tax, provided the Contractor warrants in writing that no amount for such newly imposed Federal excise tax or duty or rate increase was included in the contract price, as a contingency reserve or otherwise." Generally, tariffs are classified as taxes[i] and, to be classified as a newly imposed tax, a tariff must be implemented after the date set for bid opening or, for a negotiated contract or modification after the effective date of the contract or modification. Thus, contractors should be aware of such clauses and speak to their attorney about their applicability.

If the government contract does not include the FAR 52.229-3 clause, the contract may include an economic price adjustment clause such as those found under 52.216-4. The issue with these clauses is they are capped at 10% increase upon the original unit price. A 25% tariff may thus leave a shortfall for the contractor. Given these various contract features and the risks they mitigate or fail to mitigate, it is vital that contractors speak with their attorneys to discuss all available avenues of relief under their contracts.

Conclusion

Tariffs, rising prices, and material shortages have long been familiar challenges in the construction industry. However, navigating these issues becomes increasingly complex in a volatile and unpredictable political landscape, complicating efforts to allocate and manage risk effectively. There are steps that contractors can now take to hedge their risk. Contractors should seek the advice of their attorney's and discuss potential modifications to contracts and available insurance coverage to do so.

Endnotes

[i] https://truthsocial.com/@realDonaldTrump/posts/113546215051155542
[ii] https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/metals/110524-us-elections-chinas-steel-markets-brace-for-potential-tariffs-policy-continuity
[iii] https://www.cbc.ca/news/canada/calgary/canada-us-steel-tariffs-1.7382869#:~:text=According%20to%20the%20Canadian%20Steel,worth%20about%20%248%20billion%20Cdn.
[iv] https://oec.world/en/profile/bilateral-product/iron-steel/reporter/mex
[v] https://www.cbc.ca/news/business/softwood-lumber-1.6262036
[vi] https://www.npr.org/2018/03/08/591744195/trump-expected-to-formally-order-tariffs-on-steel-aluminum-imports
[vii] https://taxpolicycenter.org/taxvox/what-tariff-and-who-pays-it

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