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Proactively Managing Tariff Impacts On Megaprojects

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President-elect Donald Trump's proposed tariffs in his second administration may have a profound impact on megaprojects — including large infrastructure developments like highways, bridges, tunnels, airports and railways, as well as large-scale energy projects like power plants, oil and gas facilities, and renewable energy installations.

Trump imposed significant tariffs on imported materials during his first term. For example, under Section 301 of the Trade Act of 1974, Trump implemented tariffs ranging from 7.5% to 25% on most Chinese goods.

Under Section 232 of the Trade Expansion Act of 1962, Trump also implemented tariffs on materials affecting the construction industry. These ranged from a 10% tariff on aluminum to a 25% tariff on steel, applied to imports from most countries.

In anticipation of his second administration, Trump has called for 25% duties on goods from Canada and Mexico and an additional 10% on goods from China, after previously calling for an additional 60% duties on China. He has also called for 100% duties on goods from the BRIC countries — Brazil, Russia, India, China, South Africa, Egypt, Ethiopia, Iran and the United Arab Emirates.

The effects of these tariffs may compound the complexity, duration and significant risks and challenges associated with planning, financing, construction and operation of megaprojects. It will be important for owners and contractors alike to understand and plan for the impact of tariffs on these large-scale projects.

Impact of Trump Tariffs on Construction Costs

Tariffs can lead to significant cost increases for construction materials, as Trump's 2018 tariffs on aluminum and steel have shown. Examples of materials that may be affected by Trump's new proposed tariffs include certain metals, coatings, plumbing components, HVAC parts, and electrical components such as transformers, circuit breakers and switchgear — especially if any of these items are sourced from China.

Cost increases to these materials or others could place a financial strain on the budgets of megaprojects.

Standard Construction Contract Clauses

The construction industry often uses standard form construction contracts — e.g., issued by the American Institute of Architects, ConsensusDocs or the International Federation of Consulting Engineers.

How these standard form contracts typically handle cost increases — if at all — and delays may not be suitable where tariffs are a cause of major changes to a project midstream.

Cost Increases

Cost escalation clauses — sometimes called price escalation clauses — seek to protect contracting parties against the risk of cost increases by providing an agreed method for adjusting a contract price when there has been a change in materials or labor costs.

Clauses related to cost escalation typically include an agreed benchmark or calculation based on a recognized price or commodity index, such as the Producer Price Index, which measures the average change over time in the selling prices received by domestic producers for their output.

Some clauses may provide that cost increases are only allowable for certain inputs — e.g., supply chain disruptions or surges in demand, not tariffs — may set a minimum percentage increase in the index before they become effective, may set a maximum limit for adjustments or a cap on the new total contract price, or may specify what substantiation is required to claim for any cost increases.

The clauses found in standard contract provisions may be inadequate in the context of significant cost increases due to tariffs imposed against foreign countries.

Schedule Commitments

Any cost increases can be problematic, but tariff-induced increased costs can also have second-order effects.

Cost increases arising from tariffs that lead to the need to change suppliers or inability to timely purchase materials, for example, have the potential to cause project delays. The potential consequences for parties involved in delayed projects may include liquidated damages, penalties, liability for prolongation costs and other contractual remedies.

Generally, delays in construction projects fall into two categories: excusable or nonexcusable. A standard form contract will typically define what events or occurrences constitute a delay, and when untimely performance is excusable.

Thus, it will be important for stakeholders to understand whether any project delays arising from cost increases and supply chain disruptions that flow from new or changed tariffs constitute excusable or nonexcusable delays.

A delay is often considered excusable when it is caused by factors that neither party can control. Excusable delays may relieve the contractor from damages or other penalties, and some may even qualify the contractor for additional compensation.

Typically, nonexcusable delays are those that the contractor had control over or could have predicted.

Whether delays caused by tariff impacts can be considered excusable will be dependent on the specific contract language, facts surrounding any delay and applicable law.

Practical Considerations for Parties Involved in Megaprojects

There are certain risk management strategies that stakeholders to megaprojects can take to address the risk of cost increases and delays.

To manage the risks associated with Trump's potential new tariffs, it is important to engage in proactive contract negotiation and drafting. Contract administrators should carefully review new contracts to understand and prepare for potential issues before they arise, rather than attempting to renegotiate provisions later.

It will also be important for operational managers on megaprojects to pay close attention to timing deadlines, and know when to notify other parties about cost overruns and performance delays.

Depending on the specific contract clause, facts surrounding the increases, and governing law, meeting notice deadlines — and providing adequate substantiation to the counterparty by those deadlines — may be essential to avoid problems, and ensure the validity of any claims for additional compensation or time extensions.

Project leaders should also consider how the choice of law governing a contract affects the relevant contract provisions. Jurisdictions may have significant differences in their legal approaches, so it is important to seek legal advice on how these apply.

In conclusion, the Trump administration's tariffs on construction and other materials may cause significant cost increases and delays in megaprojects. To proactively address these challenges, stakeholders should engage with contracting officers early to negotiate terms that account for potential cost overruns and schedule disruptions.

They should also review and ensure compliance with existing contract terms to maximize opportunities to control financial costs and ensure adequate time to complete these projects.

By acting proactively, parties can better manage risks and mitigate the impact of tariffs on their projects, ensuring smoother project execution and reducing the likelihood of contentious disputes.

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