

**Discussion on
Potential Claim No. 1
Raw Steel Market Price Fluctuations**

for the construction of

The Temporary Bypass Structure

at the

San Francisco Oakland Bay Bridge

For

**The State of California
Department of Transportation**

Contract No. 04-0120R4

By

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Job #215 Temporary Bypass Structure

Date: February 24, 2005

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Background:

C. C. Myers, Inc. submitted a bid for the project on December 3, 2003. Contract award was granted in March of 2004. The contract was immediately suspended until July of 2004, and again from September 2004 through March 2005.

C. C. Myers, Inc., on behalf of themselves and several of their subcontractors, had notified Caltrans in writing upon award of the contract of the events that were occurring in the steel industry causing prices for raw steel materials to become unstable. A request for an equitable adjustment of compensation was requested from Caltrans and a method utilizing an index was suggested. This request was subsequently denied, thus leading to the filing of the Notice of Potential Claim.

Situation:

Prices for steel raw materials have been escalating at unprecedented rates. Various levels of escalation have been occurring within the various steel commodities required for the project i.e.: plate, rolled sections, rebar, strand, pipe, etc.

Justification for Equitable Adjustment:

1. Bid Preparation:

C. C. Myers, Inc. prepared and submitted its bid for the project in good faith based on steel market conditions that had for the most part remained stable and predictable. Shortly after bid, unprecedented price escalations began, and continue to occur. The fact that the prosecution of the work was being delayed compounded the situation. Past practices with suppliers of steel raw materials and products have been to quote prices that were valid for long periods, several months at of time. Recent trends, beginning in early 2004 are that these same suppliers would only honor their quotations for as little as one week or even one day. Some suppliers would not even quote a price until shortly prior to product delivery. This practice has never occurred in the past. Discussion of these trends can be found in the Attachment A, which is an article from the June 5, 2004 edition of *Purchasing* magazine.

Discussion on: Potential Claim No. 1, Raw Steel Material Price Fluctuations

2. Indexing to Account for Price Fluctuations:

In our initial notification and request for an equitable adjustment of compensation, we suggested the use of a calculation method similar to that used by Caltrans to account for the fluctuations in the prices for asphalt oil. The basis for the use of this method is that they have recognized that they can provide protection for both their contractors and themselves against the risks associated with the purchase of materials that experience wide swings in price, when locked in by long term contracts. They have set precedent that this benefit exists and that it is not their intention to cause harm or allow windfalls to their contractors that are performing their work utilizing such materials. It was also shown that other state transportation agencies are implementing contract clauses that allow for raw steel materials to be included in the indexed adjustment programs as they recognized that this material pricing can be extremely unstable and there is benefit to both parties for doing so.

3. Scope of Payment:

Section 9-1.02 SCOPE OF PAYMENT of the Standard Specifications discusses the scope of payment for the work performed under the contract. Specifically, this section emphasizes that payment is for furnishing all labor, materials, tools, equipment and incidentals necessary to the completed work and for performing all work contemplated and embraced under the contract. The unpredictable and unprecedented events occurring in the steel market were certainly not contemplated or embraced under the contract. Therefore, this section does not preclude an equitable adjustment in compensation due to these conditions. It has been determined through arbitrations regarding similar events that have occurred that are beyond the control of either contracting party that the occurrence of these events are not contemplated or embraced under the contract and therefore, equitable adjustments in compensation are not precluded by Section 9-1.02 and thus, are warranted.

4. Cardinal Change:

The Cardinal Change doctrine, founded in government contract law, has evolved in response to this type of situation. The rule permits the contractor to disregard the provisions of the contract where there has been a change or series of changes so profound to change the very nature of the contract. Since the late 1930's, the law has developed significantly in this area, allowing government contractors to circumvent the often slavish formalism of government contract clauses where the nature of the contractual undertaking has been fundamentally changed. The doctrine's expansion makes it a powerful weapon against harsh contract clauses that would otherwise permit the owner to force the contractor to decide between breach and performance. The unpredictable and unprecedented

Discussion on: Potential Claim No. 1, Raw Steel Material Price Fluctuations

price increases occurring with the raw steel materials represents a Cardinal Change, thus warranting an equitable adjustment in compensation.

5. Commercial Impracticability

Contracts for the sale of goods in excess of \$500 are covered by the Uniform Commercial Code (the "Code"). Provisions under the Code provide that a contract has become "commercially impracticable". Commercial impracticability is addressed by the UCC § 2-615; MCL § 440.2615, which provides in relevant part as follows:

'Delay in delivery or nondelivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency, the nonoccurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.' As is certainly the case herein, the preparation and submission of the bid and subsequent awarding of the contract were all done with the basic assumption that profound changes in the steel market would not occur. We therefore contend that it has become impracticable to perform under the contract because the inputs, namely raw steel materials have become too expensive. This is due to the extreme fluctuation in the price of these materials that result from the international influences that caused the market to become unstable beginning in early 2004. In order for commercial impracticability to be applicable under the Code, it requires that the seller reasonably notify the buyer. This was accomplished with our early written notifications. Attachment B, which is an article from the July 12, 2004 edition of *Engineering News Record* describes how this commercial impracticability is being applied with other contracting agencies. Also, equitable adjustments have been by case law, a few are referenced herein:

Soletanche Rodio Nicholson (JV), ENGBCA Nos. 5796, 5891, BCA ¶ p.102176-102177

"The true distinction is not between difficulty and impossibility. A man may contract to do what is impossible, as well as what is difficult, and may be liable for failure to perform. The important question is whether an unanticipated circumstance has made performance of the promise vitally different from what should reasonably have been within the contemplation of the parties when they entered into the contract."

Brazier Lumber Co., ASBCA No. 18601, 76-2 BCA ¶ 12207

"...[C]onsideration must be given to several salient elements supporting the conclusion of extreme expense, injury or loss which bespeaks commercial senselessness in requiring further performance... In this context we have examined the entire period of actual performance which

Discussion on: Potential Claim No. 1, Raw Steel Material Price Fluctuations

greatly exceeded the period prescribed under this formally advertised production contract; the involvement of this contractor in extensive research development, the degree of experimental effort not within the contemplation of the parties to this contract; and the disproportionate outlay of expenditures in relation to the contract price."

Koppers Co. v. U.S. 405 F.2d 554, 566

"The doctrine of commercial impracticability does not impose the burden of continued experimentation until there is a certainty that success is not obtainable. There must, however, be a showing that the contractor could succeed only if excessive and unreasonable costs were to be expended."

Foster Wheeler Corporation v. United States, 513 F.2d 588, 598 (Ct.Cl. 1975)

Natus Corporation v. United States
Firestone Industrial Rubber Products, ASBCA Nos 16650, 17938, 74-1 BCA ¶10,516
Restatement, Second, Contracts § 266 (1981)

The United Nations Convention on Contracts for the International Sale of Goods (CISG) covers the international sale of goods. Specifically, CISG Article 79 provides that:

(1) A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

(2) If the party's failure is due to the failure by a third person whom he has engaged to perform the whole or a part of the contract, that party is exempt from liability only if:

(a) he is exempt under the preceding paragraph; and

(b) the person whom he has so engaged would be so exempt if the provisions of that paragraph were applied to him.

(3) The exemption provided by this article has effect for the period during which the impediment exists.

(4) The party who fails to perform must give notice to the other party of the impediment and its effect on his ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew

**Discussion on:
Potential Claim No. 1, Raw Steel Material Price Fluctuations**

or ought to have known of the impediment, he is liable for damages resulting from such non-receipt.

(5) Nothing in this article prevents either party from exercising any right other than to claim damages under this Convention.

As the contract provides for the implementation of international trade, (reference Section 5-1.018 FOREIGN FABRICATION of the Special Provisions) and international trade is actually being employed in the project, this code would certainly apply. The unstable conditions that exist with the price of raw steel materials is considered an impediment beyond our control and that we could not reasonably be expected to have taken said impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

6. Force Majeure:

Section 7-1.165 DAMAGE BY STORM, FLOOD, TSUNAMI OR EARTHQUAKE of the Standard Specifications provides relief from the financial burden that occurs as a result of acts that are out of the control of either party to the contract. This in essence constitutes a force majeure clause in the contract. The purpose of a force majeure clause is to relieve a party from termination of the agreement due to circumstances beyond its control that would make performance untenable or impossible. We believe that the conditions that exist with the steel raw material pricing constitute a force majeure and therefore relief is justified, just as it is under the similar conditions represented in Section 7-1.165.

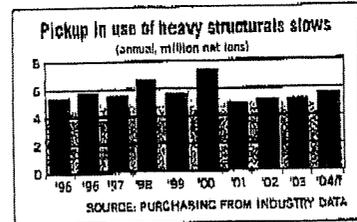
Closing:

We believe that an equitable adjustment in compensation is due as a result of the unpredictable and unprecedented volatility in the pricing of raw steel materials. We have provided several reasons outlined above why this is justified and within the State's contracting ability to provide such an adjustment. We have not gone into detail on the nature of the costs in this discussion, as this information was covered in our Notice of Potential Claim part B submitted previously. The exact value and impact to the project cannot yet be determined. Every aspect of the project involving steel products is affected, such as reinforcing steel, structural steel, prestressing steel, steel pile, stay in place deck forms, CIDH pile casings, micropiles, tiedown piles, electrical conductors/components, water pipes, column forms, falsework and shoring material. We are experiencing both price increases and project delays due to this problem.



metals

Tom Stundza, Executive Editor



WHAT'S HOT

It's 1974 all over again for contractors. The recent "unprecedented and unpredicted increase" in the cost of steel mill products has resulted in a "rapid and capricious rise" in the price of all fabricated steel materials used in construction, according to the American Institute of Steel Construction. So the national industrial trade organization recommends its members include "price escalation clauses" in new contracts as well as existing ones, if fabricators will agree. "The escalation clauses are needed to ensure that projects are completed without interruption and that the domestic construction industry remains vital and strong," says Louis Gurthel, AISC's president. Steel-price escalation clauses aren't unique, but they haven't been used since the energy crisis in 1974 when the Federal Highway Administration endorsed a material cost escalator for steel. That was the last time steel prices spiked beyond market supply/demand fundamentals. Surcharges on wide-flange beams and other structural steels have been different from normal base price increases because the surcharges are adjusted monthly on the whims of the steel mills. "They cannot be predicted or accommodated at the time a fabricator places a bid," Gurthel explains. "So while the surcharges are in effect, an easy and equitable method to evaluate bids is through a cost escalation clause in contracts."

Tom Stundza

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STEEL BEAMS

Buyers and contractors struggle to survive in 'abnormal' year

This was supposed to be a "big recovery" year for purchasing of steel beams and other structurals. But the unprecedented eruption in structural steel prices has slowed planned activity by building contractors involved in both private and public construction. That has put a brake on the purchasing growth-rate for construction steels.

As part of the 2004 overcharge of the steel-buying community, beams have risen to almost \$560/ton in April from \$300/ton a year earlier. That's almost an 87% inflationary jolt to the steel-buying system, and it may explain why analysts say beam buying may not arise as robustly from a three-year recession as they initially had forecast.

Supply isn't an issue: The average lead-time so far in 2004 is 4.2 weeks, compared with 5 weeks in 2003. Still, the steel mills have continued to play marketplace-pricing games with basis fees and scrap surcharges.

Demand isn't an issue, either: Most optimistic estimates put beam use this year at 5.6 million tons, a 12% gain over the average 5 million tons in 2001-03. Other forecasts aren't so bullish. In fact, the unprecedented doubling of structural steel prices over the last six months is crushing demand in some regions—along with the profit margins of distributors, fabricators and building contractors.

Since steel suppliers will only hold a quote for contractors for three days, some major construction jobs are being deferred. For example, the CSM Group, a construction-management firm in Galesburg, Mich., says customers are putting building projects on hold because of rising steel prices. "They're going to wait to see what happens," explains Curt Petersen, a project manager.

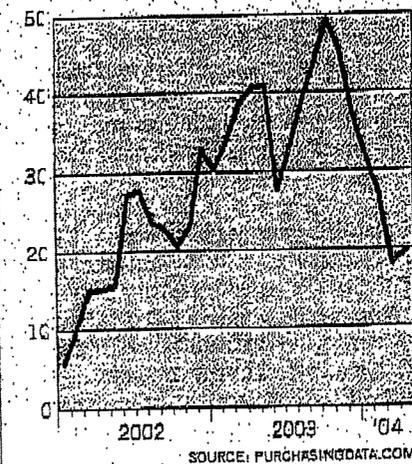
"Suppliers are saying steel is selling at market price right now," says Ken Simon-

son, chief economist at the Associated General Contractors of America trade group based in Alexandria, Va. "However, construction-grade market prices seems to rise day by day."

So builders accustomed to 90-day price protection windows for such steel products as structural beams and wide flange are finding that period cut to a week or less, forcing

Rates of expansion slows for steel structural deliveries

(monthly leadtimes, 12-month rate of change)



Mills are having trouble meeting delivery dates; demand is ahead of orders.

them to back off some business decisions. Thos. S. Byrne Ltd., a construction giant in Fort Worth, Texas, says prices quoted for steel by its suppliers are only good for seven to 14 days. And that is happening throughout the country, says John Avila Jr., president. "This is very, very abnormal."

The business pain inflicted by high prices has become acute and the uncertainty about future prices is making it almost impossible to plan more than 24 hours ahead. "My bid is only good for the day," said Ed Hinkley, owner and president of Fabricated Steel Services Inc. in Portage, Mich., a steel supplier to local manufacturers and building contractors. Fabricated Steel's bids used to be good for 30 days, but with steel prices rising so rapidly, Hinkley has had to allow for day-by-day changes to protect his firm financially.

"Fabrication contracts are killing us," agrees Kevin Larsen, corporate sales manager for Graham Steel Corp. in Kirkland, Wash. "The price of raw materials exceeds the price of a lot of our contracts these days." Graham Steel buys steel beams and reinforcing bar, then bends and welds it to the specifications of its customers, the contractors.

Prices have been rising so unpredictably that many fabricating companies have abandoned fixed contracts, and now are trying to add escalator clauses to adapt to the price of steel at the time of shipment. "You don't know what the prices of steel will be until a week and a half or so from delivery, and that's always a surprise," Larsen says. "It's something we've never seen in this industry. It affects the metal stud guys, the metal decking guys—anybody that has anything to do with steel and construction. We're all being affected by this market."

Prices stifle business planning.

The National Steel Bridge Alliance has petitioned the Federal Highway Administration to encourage state departments of transportation to permit material price escalation in steel bridge contracts. Steel bridge fabricators face devastating losses on previous bids, as well as intolerable risk on new bids, caused by spiking prices of plate steel, says Conn Abnee, the Alliance's executive director.

Current practice places steel bridge

fabricators in an untenable position, he says. "Fabricators must firmly bid the cost of making steel girders, forcing them to guess at the price of steel plate and rolled steel for months in advance of its order and delivery. If the price of plate steel rises steeply and unexpectedly, which describes current conditions, they must absorb huge losses that threaten their existence."

What wide-flange costs

January prices (Brimco structural beams)

- Purchasing: \$265/ton, 60¢ surcharge
- Nucor-Tamam Steel: \$270 sales letter, \$300 base and \$200 surcharge
- OMI-Chaparral Steel: \$420 sales letter, \$400 base and \$20 surcharge

April prices

- Purchasing: \$300/ton, buyers' survey
- Steel Dynamics Inc.: \$374 sales letter, \$420 base and \$120 surcharge
- OMI-Chaparral Steel: \$375 sales letter, \$400 base and \$75 surcharge
- Nucor-Tamam Steel: \$370 sales letter, \$350 base and \$120 surcharge

Material price escalation, which has precedent in the industry, would tend to insulate fabricators from abrupt price movements, Abnee explains. "We think we can work out a fair formula that shares the risk among all the contracting parties, rather than unfairly earmarking just one." Alliance members realize that bridge designers have the option to switch many of their new projects to concrete girders and many will, Abnee says. But that could lead to shortages of concrete and rebar, further boosting the volatility of bridge material pricing and damaging the long-term price stability needed for accurate bidding.

In a different sector of the steel supply chain, executives at Seattle-based structurals and plate distributor Seaport Steel Inc. are struggling to meet the needs of customers, some of whom are foundering. "We've seen a lot of people hurt very badly, where they're committed to jobs and they have no option but to complete their commitments, and suddenly they're hit with a 50% to 100% cost increase in raw materials," says Rodger Parr, director of purchasing and sales manager. "This is an unprecedented situation; there have never been increases

this large imposed this rapidly."

Across the country in Jacksonville, Fla., for developers in the very early planning stages of projects, steel prices also are a big question mark in their business plans, despite talk that the increase will level off. Auld & White Constructors' director of business development, Brian Franco, is finding it tough to negotiate steel supply for new projects with only a seven-day price lock-in from his steel supplier. And for builders with projects already under construction, the steel pricing crunch already is hurting the bottom line. "It's stretching our budgets real tight," reports Steve Arnold, vice president of design and construction at Flagler Development Co. "That means the profit margins go down and the contingencies get eaten up at the very beginning."

O'Neal Steel is one of the nation's largest construction-grade steel distributors. Prices have been changing so quickly that the company says it cannot change its base pricing for customers fast enough. So it is trying to pass the increases along through surcharges of its own on carbon steel products previously immune to such practices. Executives in the Birmingham, Ala., headquarters suggest the company is not necessarily benefiting from the higher prices, as the money needed to bring in the inventory is straining the company's cash flow.

One solution for some contractors is to buy all their steel for a project at once, and accept the cost of storing it in exchange for eliminating the risk. Fear of shortages and continuing price hikes have some customers buying ahead. Hinkley said that after one customer watched the price of the steel he needed for a construction project rise from \$71,000 to \$80,000 in three weeks, he decided to buy early to lock in a price. Of course, such early purchasing creates a false demand echo in the marketplace by artificially driving up steel costs even further.

So, some construction companies are looking at international markets for steel beams, which may explain why first quarter structural imports were 30% higher than a year ago.



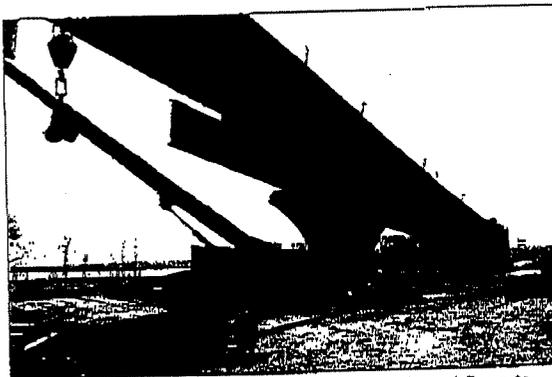
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CONTRACTS

Practical Attitude Prevails In Most Steel Price 'Deals'

Unlike most of their federal counterparts, state and private owners are quietly discussing relief plans on hundreds of projects to prevent steel fabricators and erectors from having to absorb all of the unexpectedly sharp price hikes in the material since last December, attorneys say.



▲ **Steel Trap.** Virginia does not want firms to fall on projects like the Woodrow Wilson Bridge.

"Everybody is cutting a deal," says David Dapper, an attorney with Wickwire Gavin LLP, Los Angeles. Such negotiations "are generally amicable, not adversarial," adds David Ratterman, a Louisville attorney who also advises the American Institute of Steel Construction. Both agree that costs related to project rebidding, delay and possible litigation far outweigh the steel's added cost. It has jumped from \$300 per ton in the first quarter of 2002 to \$493 a ton in the second quarter of 2003.

Steel fabrication and erection averages 10% to 20% of overall project costs. A 40% increase in the cost of material from a steel mill equates to only a 1% increase in the project cost, claims John Cross, AISC vice president.

Steel price hikes also are battering other specialty contractors, such as HVAC, electrical and mechanical firms. On April 30, the U.S. General Services Administration turned down a request by the Mechanical, Electrical, Sheet Metal Alliance, Rockville, Md., to reopen GSA contracts to provide relief. GSA officials say that doing so would violate federal purchasing rules.

Other owners are more flexible, but they do not want to publicize it. "Part of why you don't hear too much about it on the street is because owners who are renegotiating deals don't want to open

the floodgates," says Dapper.

The Virginia Dept. of Transportation is reviewing 34 requests for adjustments on existing projects, including the Woodrow Wilson Bridge. VDOT officials say they will not absorb the full increase, but they want to make sure contractors do not go out of business.

While some owners may take a pragmatic approach, contractors have some legal recourse when prices unexpectedly increase. According to Ratterman, commercial impracticability is a basic principle of U.S. law that "opens the window for negotiation." Part of the legal test involves whether the price increase was foreseeable.

While a judge may sympathize with a contractor's plight, some cases have been decided against firms because judges have ruled that "a contract is a contract and that's what a fixed-price contract protects," says Dapper. "The doctrine of impracticability can be easily abused, so courts are reluctant to apply it," says Renata Guidry, another Wickwire Gavin attorney. A contractor must exhaust all alternative means of performing promised work before determining that doing it would be "commercially senseless," she adds. ■

By Richard Korman

SAFETY

Big Apple Adds High-Rise Rules

New York City has adopted a law aimed at improving high-rise office building safety during emergency events. The legislation is based on recommendations for upgrades to structure, fire protection and emergency egress made in February 2003 by a task force formed by the Dept. of Buildings following the Sept. 11, 2001, attacks.

The law, signed on June 24 by Mayor Michael R. Bloomberg (R), goes into effect at the end of October. It deals with various safety issues, not only those related to Sept. 11, says Marilyn Davenport, senior vice president of the Real Estate Board of New York, and a task force member. For new construction, the requirements include a temporary ban on open-web steel joists for buildings over 75 ft tall, pending development of a national standard. The law also requires smoke-stop elevator vestibules. Air intakes must be at least 20 ft above grade.

The Dept. of Buildings has until Jan. 1, 2006, to develop standards for "impact-resistant construction." The law will require that all elevator and stair enclosures in new high-rise office buildings comply with those standards starting in July 2006.

Several requirements apply to existing structures. These include inspection of sprayed-on fireproofing in buildings being renovated and full sprinkler protection for office buildings 100 ft or taller. Owners of the estimated 200 to 400 unsprinklered buildings have 15 years to comply.

The Buildings Dept. and a mayoral commission are studying adoption of a model building code to replace the city's code, which many sources say is antiquated. "The law anticipates larger changes that will take place with the adoption of the International Building Code," says Rick Bell, executive director of the American Institute of Architects, New York Chapter. A framework for adoption of the code is expected by the end of the year. ■