

Finessing Price Review Clauses in Contracts

“The price is subject to review as costs increase” and “the parties must meet and agree on a revised price” are NOT enforceable price review clauses.

Price review clauses are used to adjust the price or cost of goods and or services supplied under a long-term contract.

Structure of a price review clause

Price review clauses commonly contain the following features:

1. Trigger event,
2. Procedure for arriving at the adjusted price,
3. Description of the factors or guidelines to be taken into account when adjusting the price,
4. Consequences if an agreement on price is not reached, and
5. Description as to how the adjusted price is to apply under the contract.

Price review clauses can be either:

- Non-prescriptive: a clause based on an agreement to negotiate in good faith an equitable revision to the price if market circumstances have changed; or
- Explicit and prescriptive: a clause requiring arbitration with adjustments only to be made with reference to pre-defined criteria).

Trigger events

A trigger event describes the circumstances in which a party can initiate a price review under the contract.

Events that are often used as triggers include:

1. A stated date (e.g. every second year),
2. A stated date to take account of CPI rises,
3. On the occurrence of external events constituting a change in the circumstances which existed between the parties, or
4. When one party believes that such an external event has occurred.

Factors to be taken into account when adjusting price

Price review clauses describe the way in which the price will be adjusted.

A process of negotiation coupled with ‘fair’ adjustment to the price leaves plenty of wiggle room and is unlikely to result in a prompt adjustment.

A review based on factors such as the state of the market or a basket of contracts and expert evidence as to the price based on that evidence can also be a time consuming exercise.

How adjusted price will apply

Price review clauses should clearly set out what price is to prevail while the outcome of a price review process is pending.

An objective process should be set out which provides an obligation on either:

1. The buyer to pay any incremental amounts due as a result of a higher price being agreed or determined, or
2. The seller to set-off any overpaid amounts by the buyer if a lower price is agreed or determined.

Procedure for arriving at adjusted price

Most price review mechanisms provide at the outset, for the parties to meet and seek to agree between themselves on a fair revised price. Failure to agree an outcome requires deadlock-breaking mechanisms, such as expert determination or arbitration. Deadlock-breaking mechanisms are required as agreements to agree are not legally enforceable and can result in the entire contract being ended for it being void (unenforceable) upon the grounds that its terms are too uncertain.

Negotiation

An obligation to negotiate in good faith without anything more is not capable of being enforced. However, if there is a method of resolution should agreement not be reached, for example by reference to third party to determine the price in accordance with certain criteria this is enforceable.

Expert determination juxtaposed arbitration

There are considerable differences between expert determination and arbitration. Expert determination is generally the relatively 'quick and dirty' option.

An expert may decide the issue on the basis of their own experience without hearing the parties, unless the agreement provides to the contrary.

Arbitration is different. An individual holds an inquiry and hears the respective cases of the parties and decide upon evidence laid before him.

A significant differentiator which arbitration offers to parties involved in a price review mechanism is the access to certain court procedures including, most importantly, the ability to obtain evidence through the issue of subpoenas.

When to use arbitration?

- Where information is in the possession of non-parties
- Where analysis of market prices or a limited basket of contract prices is required

When to use expert determination?

- Production costs are in the possession of the party providing the commodities

- Using an index based review
- Information is publicly available

To avoid costly and lengthy litigation ensure your price review clauses are clearly drafted and have a clear review mechanism.

Etienne Lawyers are experts in drafting, negotiating and litigating price review clauses in contracts. Call us to discuss your price review clauses. Your first consultation is free. Pick up the phone and speak to one of our experts today.