

LEGAL UPDATE

Who bears the risk of the price increase for raw materials?

Date: 23 November 2021

Introduction

Most entrepreneurs will not have escaped noticing the considerable increase in price of many raw materials and construction materials. Over the past few months, newspaper headlines have frequently commented on the price increases and concerns that companies will collapse as a result. Whether those concerns are realistic for certain companies depends, among other things, on which party has to pay for the price increases: the supplier or the buyer? Or should they share the burden?

In this Legal Update we will discuss a number of legal tenets that are related to the question of whether a supplier can pass on the costs of price increases - resulting from higher prices for raw materials and construction materials - to buyers. We will also discuss whether a supplier can legally refuse to deliver an order to a buyer because its own suppliers have increased the price of the raw materials and construction materials and the supplier therefore does not want to or cannot buy those materials. We will focus on B2B relationships and will not discuss the relationship between companies and consumers.

This Legal Update will only discuss the aforementioned questions based on Dutch law

The starting point for price increases: agreement and general terms and conditions

In assessing whether a supplier can pass on each price increase to buyers, we must first review what arrangements the parties have made about this in their agreement. The parties may have allocated the risk of price increases to one of the parties. For example, an agreement or the general terms and conditions that apply to such agreement may stipulate that the supplier is entitled to unilaterally increase prices. Subject to the conditions included in that clause, the supplier would, in principle, be able to pass on the increased prices to the buyer. Parties may also have contractually agreed on fixed prices which would mean that the supplier cannot, in principle, pass on price increases to a buyer under the agreement.

Currently, at a time when the prices of raw materials have increased substantially and may continue to increase, one might ask whether the original contractual clauses provide a risk allocation for such a situation, or whether the parties should depart from the risk allocation they set out in their agreement. In what follows, we will discuss a number of legal tenets under Dutch law that may be relevant if the parties fail to reach agreement on the risk allocation.

Contractual provision relating to price increases: apply, amend, or disregard?

Unforeseen circumstances

More specifically, the mandatory Article 6:258 of the Dutch Civil Code ("DCC") could be brought into play in some cases in order to depart from the contractual arrangements. This article can create the opportunity to amend or dissolve the contract before a court if unforeseen circumstances arise. The supplier may rely on unforeseen circumstances (Article 6:258 DCC) if the delivery of the raw materials has become extremely onerous, but not impossible. On the basis of this article, the supplier might ask the court to amend (or dissolve) the agreement (with retroactive force). Conversely, and also on the basis of Article 6:258 DCC, the buyer might ask the court to amend the agreement (with retroactive force) because the price increases passed on by the supplier on the basis of their contract are extremely onerous for the buyer.

A successful reliance on Article 6:258 DCC requires unforeseen circumstances (i.e. not accounted for in the agreement) that are such that the other party cannot expect the agreement to remain unchanged. Added to that, the circumstances should not, by virtue of the nature of the agreement or accepted practice, be for the account of the party relying on those circumstances.

There is an increased obligation to furnish facts and demonstrate them on the party that relies on unforeseen circumstances in connection with price increases in raw materials. This is because the court must exercise restraint in assessing any reliance on unforeseen circumstances. The party will have to assert and demonstrate that the price increases occurring now must be deemed not to have been accounted for in the agreement and should not (or not only) be for its account. That party must also provide sound substantiation of the actual financial loss caused by the price increases and make it clear that the other party is acting unreasonably by holding it to the original contractual terms. The extent to which the party has taken steps to limit that loss is a relevant factor in this. For example, whether a supplier has consulted its own suppliers about the cost prices to be charged, whether it buys the materials at the right time, or whether the buyer has consulted end customers about the prices to be charged. Based on the specific set of circumstances, the party must convince the court that the other party cannot expect the agreement to remain unchanged according to the principles of reasonableness and fairness.

The restrictive effect of the principles of reasonableness and fairness

Article 6:258 DCC is an elaboration of the restrictive effect of the principles of reasonableness and fairness. A party could argue that a certain price increase clause should be disregarded on account of the restrictive effect of the principles of reasonableness and fairness (Article 6:248(2) DCC). Jurists differ of opinion as to whether Article 6:258 DCC and Article 6:248(2) DCC co-exist or whether Article 6:258 DCC actually rules out reliance on Article 6:248(2) DCC. However, it is debatable how much a party would gain by relying on Article 6:248(2) DCC rather than on Article 6:258 DCC in this context in court proceedings. The fact is that in practice, declaring a clause inapplicable on the grounds of the restrictive effect of the principles of reasonableness and fairness and subsequently filling the resulting gap in the agreement would in fact amount to amending the agreement for that specific case. We will therefore leave this theoretical discussion aside for now.

Cost-increasing circumstances in the construction sector

The increase in prices of raw materials and construction materials are affecting a lot of building projects. The construction sector often applies back-to-back contracting. A client usually contracts with a main contractor, which then contracts with subcontractors, which in turn contract with suppliers. In construction, contracts are often concluded subject to the Uniform Administrative Conditions for the Execution of Works (UAV) or the Uniform Administrative Conditions for Integrated Contracts (UAV-GC), which means that, in principle, the parties are subject to certain arrangements on cost-increasing circumstances (see for example §47 UAV 2012). To the extent that these works contracts do not contain specific provisions on passing on price increases, the law provides Article 7:753 DCC, which is directory law. This article provides that a contractor may lodge a claim before the court to have the price (the contract sum) adjusted if cost-increasing circumstances arise which the contractor did not have to take into account. Like a reliance on unforeseen circumstances, the contractor or subcontractor will have to present sound arguments if it wants that article to apply. It would have to substantiate why it was not required to take into account the cost-increasing circumstances in that specific case *and*, more specifically, what the cost-increasing circumstances actually entail and how it is prejudiced by those circumstances. Moreover, Article 7:753(3) DCC provides that the contractor will only have this right if it informed the client of the necessity of a price increase as soon as possible, so that the client would have had the opportunity to amend, restrict or terminate the contract.

Non-performance by the supplier due to a price increase

If, due to steep price increases, a supplier no longer wants to purchase the raw materials, or is no longer financially able to purchase them, this may result in the supplier being unable to supply the orders submitted by its buyers. Here, too, a supplier has several options, legally speaking.

Unforeseen circumstances

Firstly, the supplier could apply to the court for it to dissolve the agreement with its buyer on the basis of unforeseen circumstances (see the discussion on Article 6:258 DCC above).

Force majeure

If the supplier actually encounters the situation where it is no longer able to supply the agreed orders and therefore fails to perform vis-à-vis the buyer, the supplier may try to invoke force majeure. After all, Article 6:75 DCC provides that failure to perform an agreement cannot be imputed to the debtor if it cannot be imputed to its fault and the debtor is not accountable for it by law, the legal act or accepted practice. Although, in most cases, the supplier will not be able to do anything about the increased prices of the raw materials, the question is: is this sufficient to render reliance on force majeure successful? After all, non-fulfilment must relate to the *performance itself*. The performance must have been prevented. In this case of increased prices for raw materials, a supplier could still supply the raw materials, but it would be more difficult for it to provide those materials at the agreed, fixed prices. The supplier has the obligation to furnish facts and demonstrate that its specific situation should be regarded as a force majeure event.

Conclusion

The increase in prices of raw materials and construction materials could have a great impact on existing agreements. The question of which of the contracting parties should ultimately bear the risk (and, by extension, the costs) depends on the specific set of circumstances. If a party wants to deviate from the provisions the parties had agreed, or dissolve the agreement, that party will be subject to an increased obligation to furnish facts and demonstrate them. The same applies to any reliance on force majeure.

These turbulent times call for clear arrangements. Given that several sectors have already encountered price increases, it would make sense for parties concluding agreements, and especially if they pertain to large projects with back-to-back contracting, to make clear arrangements about whether price increases for products such as raw materials and construction materials may be passed on to the buyer.

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