



Rising raw material prices: remedies and solutions under Italian law

Over the last two years, unforeseeable events, such as the Covid 19 pandemic and the war in Ukraine, have led to an exceptional and unforeseeable increase in the cost of raw materials, electricity and components.

These price increases, naturally, have immediate repercussions on contracts that involve continuous, periodic or deferred performance: the contractual parties, in particular the one that has to supply or to produce, end up with commitments that were often made years earlier, in a completely different economic context, which become excessively onerous to fulfill. The situation is particularly uncertain in pending contracts where the parties had not originally provided for a mechanism for adjusting prices, or to renegotiate clauses in response to changing circumstances.

The following is a brief overview of the remedies provided by Italian law in these situations.

Ongoing contracts

Notwithstanding that Italian law does not allow one of the parties to unilaterally modify the prices indicated in an ongoing contract, in cases in which there is a supervening excessive burden, the party suffering the consequences of the excessive burden, which was unforeseeable, has two options: termination of the contract or renegotiation of the terms of the contract.

a.1 Termination of the contract

Although this option is often the least desirable for all parties, which likely would prefer to continue the contract (on fair terms) instead of pursuing termination, Italian law does provide for the possibility of termination of the agreement due to a supervening excessive burden. This case is expressly governed by the Italian Civil Code (Article 1467) and is applicable to cases in which one party's performance has become excessively onerous due to extraordinary and unforeseeable events, which certainly could a significant increase in the price of raw material, like metal or plastic raw materials, petrol, gas, or electricity.

Termination of a contract for a supervening excessive burden may only be declared in court, with a decision that has a "constitutive" value. That said, the party against whom termination is sought shall have the opportunity to avoid it by offering to modify the terms of the contract in an equitable manner.

a.2 Renegotiation

In these situations, parties may first attempt a renegotiation of the terms of the contract. In this scenario, the party suffering the consequences of the supervening excessive burden may propose to renegotiate the terms of the contract, in order to avoid termination altogether. This approach is based on the codified principle of good faith in the performance of contracts set forth in Article 1375 of the Italian Civil Code, which provides for "*an obligation of the parties to bargain in order to reach a new agreement aimed at restoring the balance of the contract within the limits of the normal level of risk*".

This principle supported by the majority position of Italian legal doctrine, and also conforms to UNIDROIT principles. In the event the parties are not able to agree on a price re-negotiation, the party that finds itself in serious difficulty may also appeal to the courts to order renegotiation. Over the last two years, this has led to a number of pronouncements (post-pandemic jurisprudence) rendered in the field of real estate leases,

confirming the parties' right – and, on the other side, obligation - to renegotiate contracts affected by inequitable events, in order to re-balance the parties' positions. To date, the case law has, however, focused on this specific area of contracts, and therefore it is not yet possible to predict to what extent this principle will apply in the wider, current context.

Recently, the Italian government introduced a law - Law no. 4 of 27 January 2022, referred to as the '*Decreto Sostegni-ter*' - which provides for the obligation to include price revision clauses in public procurement contracts. This is likely to provide a useful basis for the party suffering the consequences of a contractual imbalance caused by price increases to request the renegotiation of the contract.

Future Contracts

On the other hand, looking to future contracts of duration or which provide for continuous or periodic performance over a long period of time, what should parties bear in mind as they start to prepare their drafts? Considering the current uncertainty about many price indices, as well as the recent regulatory changes introduced for public procurement, we may see a trend towards the inclusion of price modification clauses even in contracts between private parties.

In this vein, there are two types of clauses that may prove useful: price revision clauses and hardship clauses. Neither of these instruments are new to the world of contracts, though recent events seem to have reminded many contractual parties of the importance of building some flexibility into the pricing terms in standard contracts.

First, a price revision clause is one that would allow parties, where appropriate in consideration of the type of contract and performance envisioned therein, to link the contract pricing terms to the cost of a specific public commodity. For example, perhaps a contract provides that Supplier will sell widgets to Buyer at a fixed price, however if the price of an underlying raw material necessary to make or transport the widgets experiences a certain increase (say, over 5%), the contractual price for the widget will be revised automatically. Then, there are a number of formulas that can be employed by the parties to determine to what extent the contractual price will change as a result of the cost of the underlying commodity.

Use of such clauses is conditioned on the Parties' ability to reference publicly available, neutral sources for the price of specific raw materials. An example of a useful resource here would be the World Bank Commodities Price Data, also referred to as the "Pink Sheet", which is regularly updated and contains the annual, quarterly and monthly averages for a wide range of raw materials and commodities. The contractual parties may, of course, decide to reference any number of industry, national or international publications, so long as such decision is mutual and expressly designated in the contract.

Alternatively, the parties may utilize a hardship clause. This is useful in the event that there are no public references for the prices of a relevant raw material, which would allow for automatic price revision. A hardship clause would provide for an obligation for the parties to renegotiate the terms of the contract, including the price, in the event unforeseeable conditions arise that could not have been avoided by the parties, and which result in a significant imbalance in contractual performance.

Conclusions

The last few years have provided many challenges for industries involved in all corners of the global supply chain economy, and parties to those contracts can find themselves in a difficult position due to continually rising production and transport costs. To facilitate the continuation of critical supply chains, it is necessary to provide these parties with some breathing room, to ensure they are able to complete their contractual obligations, without risking financial harm to their ongoing business operations. In Italy, but more broadly world-wide, contractual parties can find a safety net moving forward in clauses that build in some pricing flexibility, such as price revision clauses and/or hardship clauses.