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Three Key Clauses to Know When Negotiating Tough Supply Contracts

11/8/2021

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Practices: Commercial, Competition & Trade

Suppliers of components to the automotive and electronics industries have long had to deal with brand name buyers with much more negotiating leverage. For the supplier, the weekly concern is monitoring the forecasts exchanged with its customer and making sure that the supplier's factories can fill the expected purchase orders. For sales employees, this is the heart of the relationship with the customer. However, in industries with large name brand buyers, there are at least three other clauses that often can surprise the supplier:

The Most-Favored Customer Clause: this clause requires the supplier to charge the same price to the customer that the supplier charges to all other customers. If the supplier needs to increase prices for the customer, then the supplier will need to be able to demonstrate how the products being supplied are actually different from those provided to other customers. Otherwise, the supplier can be found in breach of contract and owe damages to its customer.

The Step-In Rights Clause: this clause allows the customer to use the supplier's intellectual property (designs, patents, etc.) to fill its orders if the supplier is not able to do so. If a supplier is not able to avoid this clause in the contract, the supplier should negotiate for the right to reestablish control over the intellectual property and who has access to it, once the crisis that interrupted the supplier's supply chain has passed.

The Unilateral Modification Clause: this clause allows the customer to change the terms of the contract without the supplier's agreement. If a customer insists on such a clause, the supplier should remember that the effect of these clauses can be avoided. For example, if the supplier did not receive prior notice of a change in a contract term, this can be a reason to invalidate the unilateral change in terms.

Although these clauses will often not appear under their true names, suppliers should be wary of finding contract provisions that give the customer the same rights. When finding these kinds of clauses in a proposed contract, suppliers should take care in negotiating changes to them or creating internal procedures to help avoid their effects.