

ESSAYS IN HONOUR
OF
MICHAEL BOGDAN

OFFPRINT

Juristförlaget i Lund
2013

LARS GORTON

BENCHMARK CLAUSES – FUNCTIONS AND DRAFTING: SOME REMARKS

1. Background

Choosing a topic for a “Festschrift” in honour of Michael Bogdan is not an easy task for somebody who is not particularly knowledgeable in international private law. However, as Michael is also interested in matters related to the general law of contracts and international business law, I have decided as a contribution to discuss a topic which may have some relevance in that perspective. More specifically, I shall deal here with the use and drafting of so-called *benchmark clauses*.¹ Such clauses are found in particular types of contracts and they are designed and drafted to meet particular needs depending on the contractual environment related to the special types of contract involved.

“Benchmarking” emanates from economic terminology and has been described as the “search for industry best practices that lead to superior performance”.² This means that a contract party who has undertaken an obligation will not only have to perform in accordance with the specific contractual requirements at the time of conclusion of the agreement, but also as part of its commitment under the contract will have to maintain a performance level which compares to a best-defined standard during the contract, such as the best available practice in the particular trade concerned or the continuous achievement of a competitive price based on a defined quality level. In order to achieve this, the measured performance will be regularly checked in relation to a selection of peers, which will be decisive for the relevant continued quality of the contractual performance. The contract should thus also set out a mechanism for such measurement.

In a broader perspective, the questions raised below could be related to such catchwords as “best efforts” or “best execution” etc., but these expressions are not fully aimed at the same considerations as those covered by benchmark

¹ I wish particularly to thank the lawyers Dan Lindmark, Lund and Martin Pekkari, Stockholm for reading the manuscript and providing me with fruitful criticism and several guiding comments.

² See i.a. Camper, Founder of the benchmarking approach.

clauses.³ Benchmark clauses are often found in certain types of contracts such as IT contracts, outsourcing contracts and contracts involving the transfer of activities from the public sector to the private sector, e.g. transportation and health care, but may also be used in strategic sale and purchase contracts aiming at securing important service over a period of time⁴. One may say that this is a type of clause which serves its purpose in those types of contracts, where it is important that the performance of the obligations in relation to the price shall be maintained throughout the contract periods and where consequently there is need for continuously scrutinising and measuring the quality of performance.⁵

Some general remarks will be made below to evaluate benchmark clauses to a certain degree, in the light of a number of related contractual solutions, and some of the particular contractual parameters found in benchmark clauses will be discussed.

2. Contracts in a private law perspective

Below, some features will be taken into account, such as distinctions between different types of contract, between various types of contractual relations depending on the parties, the particular trade or business, the length of the contract and the geographical area involved in the contractual relations. Only B2B relations will be discussed.

Unlike French or German law, Scandinavian law has never undergone a fundamental restructuring of private law into a *Code Civil* or a *Bürgerliches*

³ There seems to be a difference between “best effort clauses” and benchmarking clauses in that the former type of clause is more related to a requirement put on the performing party to use “*best efforts*” in his execution of his obligations of a contract; see e.g. Gorton, Best efforts. *Journal of business law* 2002 p. 143 et seq. “Best execution” is a term which is used to describe requirements for the execution of orders with respect to certain financial assets. The aim is to ensure that orders are executed at the best terms that can reasonably be obtained. See for instance Hudson, *Securities law*, London 2008 at p.12. *The best there is?: An inquiry into best execution rules*. Ordeberg, Stockholm 2013 [diss.].

⁴ Some related clauses are often known as “preferred customer” clauses, intending that a competitor shall not be allowed better terms than the contract party. According to the ICC *Legal Handbook on Global sourcing contracts*, Paris 2007 on p. 7, “sourcing transactions are as diverse as the industries in which they occur, /but/ they share the common feature of a transfer by an enterprise of a vital, but not core business function to a service provider for whom the performance of such a function or process is a core competence”. On p. 28 et seq. there is a discussion of benchmark clauses and some related issues.

⁵ They may then invoke quantities, but probably more often price functions and quality as well. The more parameters involved, the more difficult the application of the clause.

Gezetsbuch (BGB).⁶ On the other hand, Scandinavian law is based more on legislation than English law, whereas for historical reasons common law has its basis in case law – to which is added the law of equity. Thus in English law there are comparatively fewer statutes, but on the other hand the existing statutes are often quite complex and detailed. The drafting technique with respect to legislation also differs between e.g. English law, Swedish law and German law.⁷

Continental legal thought and concepts have had an impact on Scandinavian law in several respects⁸, and during a period, above all certain principles in the BGB have played a role as models for Swedish legislation.⁹ Mainly after the Second World War Swedish law started to recognise more broadly influences from common law, to some extent due to the work carried out by common law lawyers in international organisations with respect to law harmonisation, but to an even larger extent due to the impact of drafters of commercial contracts, where English and American legal influences came to have a steadily growing importance.¹⁰ New contract types have come into being, and new contract clauses have been developed to meet new business requirements. The use of so-called boilerplates, particularly in B2B contracts, has spread outside common law, partly due to the increased importance of common law-inspired contract drafting technique.¹¹ The influence of Anglo-American law has generally brought lengthier, more detailed and often more complex contract drafting.

⁶ In Swedish law efforts were made during the 19th century to achieve a thorough law reform in the private law field, but these efforts did not succeed; as a result the Sale of Goods Act from 1905 (a more or less common Scandinavian legislative product) came to express general principles of obligatory law character and also came to be used as such directly or by analogy in obligatory relations. Thus the commentary by Almén on the sale of goods act, *Om köp och byte av lös egendom*, 4th ed. Stockholm 1960 has been regarded for many years as a basic work reaching outside its more narrow sales law area. In Swedish law, Rodhe, *Obligationsrätt*, Lund 1956 is the main legal work on obligatory law. General obligatory principles have also been treated by professor Hellner in among other things his *Speciell avtalsrätt. II. Kontraktetsrätt*. 3rd ed., andra häftet, allmänna ämnen, 1996, updated most recently by Annina Persson and Richard Hager in the 5th ed. 2011.

⁷ It should, be emphasised, however, that EU legislative measures have contributed to a steady increase of legislation in the Member States, as well as deteriorating legislative language and structure (at least partly due to endless compromises).

⁸ Although more so in Finland than in Sweden.

⁹ This is the case, for instance, in connection with the drafting of the Contract Act (*Lag (1915:218) om avtal och andra rättshandlingar på förmögenhetsrättens område*), where principles of offer and acceptance as well as authority were laid down. We also have to take into consideration the international work which has evolved in this field, in particular the Vienna Convention on International Sale of Goods (CISG) and particular parts of EU law.

¹⁰ Undoubtedly common law came to have an impact even earlier on certain types of contracts, not the least in the fields of maritime law and trade finance.

¹¹ Regarding boilerplates, see i.a. *Boilerplate clauses, international commercial contracts and the applicable law* (ed. by Giuditta Cordero-Moss), Cambridge 2011.

Another important feature of recent decades is the consequence of globalisation, which has steadily gained importance for business, initially in an economic perspective but subsequently also with respect to legal development.¹² Furthermore, law generally falls back on a number of concepts and ideas, which are not always very precise, but where national courts have gradually had to fill in by interpretation those general frames through case law. Thus, for instance, concepts such as *duty of care*, *culpa* (which has some correspondence with the question of negligence) and *reasonableness* have to be understood and applied with regard to the particular facts in an individual case and as recognised and applied by various courts.

Other expressions which are also of a less than precise nature are also in use, such as *good faith and fair dealing* and *best efforts*. In law there has been recognition of a distinction between the duty to achieve a specific result and a duty to apply best efforts in a contractual relation. This has also been adopted in e.g. the Unidroit Principles of Commercial Contracts and Principles of European Contract Law, respectively. Very often a contractual relation comprises a combination of the two types of undertakings. Thus Art. 5.4 in PICC sets out:

”(1) To the extent that an obligation of a party involves a duty to achieve a specific result, that party is bound to achieve that result.

(2) To the extent that an obligation of a party involves a duty of best efforts in the performance of an activity, that party is bound to make such efforts as would be made by a reasonable person of the same kind in the same circumstances.”¹³

¹² This is not the place to discuss this development broadly, but the effects of the development have to be recognised, e.g. the *Unidroit Principles of International Commercial Contracts* (PICC, 2. ed. Rome 2010) as well as the *Principles of European Contract Law* (PECL, The Hague 2000) and Draft Common Frames of Reference (DCFR). Furthermore, the development of international standard contracts also plays an important role in this regard etc.

¹³ In the comments to the Principles (2nd. Ed. 2004 p.132 et seq.), a couple of examples (illustrations) are mentioned, both for the specific result obligation and on the best efforts obligation, p. 133. In order to demonstrate the difficulty in establishing some degree of precision in general words, I wish to quote the latter part of the comment: “B...promises “to use our best efforts to expand the sales of the product” in the contract zone, without any stipulation that it must reach a minimum quantity. This provision creates an obligation of best efforts; it obliges B to take all the steps that a reasonable person, placed in similar circumstances (nature of the product, characteristics of the market, importance and experience of the firm, presence of competitors, etc.) would take to promote the sales (advertising, visits to customers, proper service, etc.). B does not promise the specific result of selling a certain number of items per year, but undertakes to do all that can be expected of it when acting as a reasonable person. See Art. 5.1.4(2)”. Mention could also be made of certain ICC documents, such as the Rules on Distributorship Agreements and Agency Agreements respectively, where principles of *good faith* and best efforts have been expressly stated. These various rules play different roles in the evolution of business law and have to be recognised as important models for contract draftsmen.

Furthermore, Art. 5.3 contains a rule on cooperation between the parties: ”Each party shall cooperate with the other party when such co-operation may reasonably be expected for that party’s obligations.”

3. Changed circumstances and the law

Contract law is often said to be based on two basic principles, namely *freedom of contract* and *sanctity of contract*.¹⁴ These principles exist side by side and form a basis of contract law, although they have both been limited gradually through a number of complementary principles which may differ somewhat between different legal systems. This is particularly so in B2C relations, but in B2B relations as well, both legislators and courts have gradually introduced new rules and principles limiting the effect of the two basic principles. On top of that, *contract interpretation* has been used to limit their effects.¹⁵

Among principles of a complementary nature, we can include force majeure, impossibility, abuse, frustration, good faith etc., but interpretation principles have also been used to adjust a contract.

It may be that certain contractual relations require more of these principles than others, or the upholding of only the two basic principles, and in these cases particular considerations may be needed when analysing contractual differences. Thus some contractual relations may require more flexibility than others in order to achieve efficiency, justice or other goals.¹⁶

4. Various clauses intended to catch and regulate changed circumstances: some examples

Benchmark clauses should therefore be seen in the light of contractual solutions where particular parameters are needed. Thus, over time, lawmaking bodies have over time sometimes adapted legislation to meet various needs arising with respect to contracts. Also courts have had to construe and fill in through a string of interpretation methods contracts and/or contractual provisions. A contract

¹⁴ This is the case in e.g. PICC Art. 1.1. regarding freedom of contract and Art. 1.3. regarding the binding character of a contract. In PECL these principles are not expressed in equally strong wording.

¹⁵ This is also a development which is mirrored in both the PICC and PECL.

¹⁶ See e.g. Grönfors, *Avtal och association*, Stockholm 1997 p. 9 and 64 et seq. where this situation is illustrated to some extent.

may set out in detail exact parameters related to the agreed performance¹⁷, but in some types of contract, the demands of performance will instead or also be related to new market conditions, new technical standards and/or new legislation requiring an adaptation to the new situation.¹⁸ Such contracts are often but not always long-term contracts.¹⁹ Various clauses have been developed gradually to meet the particular requirements of the particular contract type. Such clauses may have different aims; they may lead to the termination of the contract, or probably more often to a right of exit for one party, but they may also entail an automatic amendment to the contract. The clauses may be drafted rather precisely, setting out specific requirements as well as consequences, but they may also be drafted more openly as less precise renegotiation clauses. These clauses may be found under different headings in different types of contract, e.g. force majeure clauses tied to the concept of force majeure or impossibility in the law of obligations.²⁰ Particular clauses related to changed circumstances could embrace escalation clauses, index clauses, currency clauses, or hardship clauses inserted into the respective contract with different aims. There are other clauses such as war clauses and/or war risk clauses, and sometimes there are fuel cost clauses. In certain type of contracts there may be Material Adverse Change (MAC) clauses and change of interest clauses etc. All these various clauses are treated in literature related to the general law of contract but also in treaties covering particular contract types.

That type of clauses discussed here, namely benchmark clauses, are found in particular types of contracts in the last 10 to 20 years, and it is perhaps more correct to say that they aim at upholding a price and quality standard (where quality could also mean competitive price based on a defined quality of service) which meets the best requirements in the particular trade during the whole contract period.²¹ That means that there will have to be a mechanism in these clauses which will open them up for determination of the new requirements and their effects.

¹⁷ In construction contracts, shipbuilding contracts etc., there are often contractual provisions setting out that new technical developments may have to be taken into consideration in connection with the performance of the contract. New legal requirements will often be borne by the seller until the signing of the contract, and thereafter by the buyer. New technological standards may have to be agreed upon between the parties and the costs distributed between the parties by agreement.

¹⁸ Clauses to such effect are common in several categories of long-term contracts, e.g. construction contracts.

¹⁹ Certain requirements may need to be met, and this may be a reason for using some kind of benchmark clause.

²⁰ Cf. in English law the *doctrine of frustration*.

²¹ It is probably true to say that benchmark clauses generally aim at creating a basis for good quality at a low price, and perhaps the price element is what really matters. This also seems to be a consequence of legislation on public procurement.

5. Benchmark clauses

5.1. Certain business considerations

5.1.1. *Some general considerations*²²

In relation to the entering into of an agreement or the ceasing of a contractual relation with the prospect of extension or renewal, the buyer may in practice evaluate alternatives more extensively than during the contract period. That said, the follow-up of the agreed performance under an ongoing contractual relation will also be fundamentally important. In this sense a benchmark clause may offer the parties some protection during the contract period.²³

As in all contractual relations, the situation before or in connection with the conclusion of the contract will have to be taken into consideration, as well as the performance during the contract period. It will thus be important that the parties agree on both contractual requirements and consequences if the requirements are not met.

In order to make the observations brief, I have chosen to use mainly a seller-oriented perspective (service provider), or as the case may be, a buyer perspective.²⁴ The various risks arising for each of the parties have to be taken into consideration in the evaluation.

5.1.2. *Before the contract is concluded*

In the negotiation involving a benchmark clause, the parties will have to consider costs and quality in relation to the continued performance of their activities internally, by and in the business. For the seller it is necessary to consider the risks related to large investments, taking into regard not only price but also competence offered to the buyer. The seller has also to consider the risk for not being compensated for his development work in the light of comparative services in the market. For the buyer it is important to consider the risks involved in the outsourcing of the activity, including the loss of internal supervision and decision. These are important points for the parties (in particular the buyer) to consider before the outsourcing agreement is reached,

²² Benchmarking may also be used internally to establish comparisons between different divisions in a company or in a group of companies, but here, I have excluded these considerations.

²³ Sometimes a distinction is made between *internal* benchmarking, *competitive* benchmarking, *functional* benchmarking and *generic* benchmarking, depending on where and how the clause is intended to be used.

²⁴ Cf. seller/buyer perspective in sales contracts, ship owner/charterer perspective in charter parties etc.

and such considerations will then also be fundamentally important for the drafting and design of the outsourcing agreement.

5.1.3. During the contract period

Similar considerations will have to be made during the contract period, where the practical requirements of what has been agreed upon will have to be met. It will be necessary for the buyer to have a possibility to check and supervise the activities of the supplier in order to establish whether the cost and quality requirements are being met. Such checks and supervision may also lead the buyer to question the quality of the supplier's performance. If the buyer deems that the performance does not meet the agreed-upon requirements, he or she will have to consider possible alternatives. Both parties will often depend on a well-drafted contract setting a balance between them.

For this reason, the contract should be drafted in such a way that the buyer will be entitled to early termination as a last resort, but before that point is reached other practical solutions will be necessary. Sometimes the agreement does not allow for termination except under particular circumstances. The contract may also include a *break fee* clause, something which will also require the buyer to consider possibilities and consequences.

5.1.4. Before the expiry of the contract

Before the expiry of the contract costs and quality levels will have to be determined, and consideration will have to be given to continued internal operation or operation with the same or another supplier. One problem is of course that once the particular activities have been transferred to an independent body, it will be rather difficult to replace an independent operator with renewed internal operation. It may prove equally difficult to find a substitute supplier.

Again, of course, the problem will appear differently from the seller's point of view.

5.2. General purpose of benchmark clauses

Benchmark clauses are regularly found in certain so-called sourcing and outsourcing contracts (involving various types of service agreements), often with a duration of five to ten years (depending on the contract type) and often with a provision for extension, but these clauses are also found to an increasing extent in several other types of contracts.

Outsourcing contracts are based on several different parameters, such as the

duration of the arrangements, the required quality and service levels, charges, management liaison, change control and exit strategy etc.²⁵

The parties will then have to determine and agree on the parameters to be included in the benchmark clause. “Effective benchmark clauses and benchmark outcomes are characterised by a transparent process involving the client, service provider, and third-party advisor with data and comparative references agreed upfront.”²⁶ The standard of duty undertaken may be set out in particular and precise requirements with respect to number, weight, quality etc. may be stated, but sometimes the quality standard required is not easily defined, and contract drafters will have to find language to establish necessary parameters.

As already mentioned, benchmarking has been described as “the search for industry best practices that lead to superior performance” primarily in relation to the price. Benchmark clauses aim at achieving a best practice to be maintained throughout the contract period.

In this perspective benchmark clauses have certain features in common with best effort clauses, but the requirements set out in the benchmark clause are generally more specific than what follows from a best effort clause.

5.3. Some parameters in the design of benchmark clauses

When drafting the benchmark clause the parties will have to determine the particular items to be covered. It is necessary to set out in the clause those particularities which will form the basis of the performance, i.e. the different parameters needed to describe the requirements set out when the contract enters into force and during the contract period. A specific mechanism is needed to determine whether the contractual requirements are met, and if the contractual requirements are not met, to determine the consequences of such failure. This kind of review could be made continuously during the contract period, and the buyer would likely prefer this, but this is usually too costly so normally it will be carried out at specific intervals and not too often. In some cases the parties may have agreed on certain intervals.²⁷

²⁵ *Computer law* (ed. Chris Reed) 7th ed. London 2011 p. 235 et seq.

²⁶ See John Lytle, *Benchmarking clauses in outsourcing agreements*. Publication, www.mayerbrown.com.

²⁷ In view of the costs involved, benchmarking should only be used under special circumstances. There is a certain similarity with various construction contracts containing particular provisions for how to handle new contractual requirements, such as new legal requirements which need to be met or new technical developments which may have to be taken into consideration. The contractual solutions may then vary regarding whether the risk of new requirements is put on one or the other party. In this case, the contract may also contain a specific dispute resolution mechanism, or state that such disputes between the parties must be solved according to the general dispute resolution stipulated in the contract.

In order to check compliance, “checkpoints” are necessary, which allow the parties to perform appropriate reviews. If non-compliance is found the performing party will have to improve its performance and/or there may be a price reduction. It seems to be rare that the injured party will have a right to damages. There may also be a case of termination of the contract under particular circumstances, but again this seems to be rare.

The basic idea of the benchmark clause is thus that a certain standard of performance shall be met throughout the life of the contract. Such quality parameters will be covered by benchmark clauses (or for that matter, other clauses of similar purpose), whereby the quality standard (the highest degree) of the performance will have to be set and met during the contract period. There may also be a price factor tied to such contractual changes. Benchmark clauses are generally found in certain types of contracts, particularly where the performance shall meet the highest degree of requirements throughout the contract period.

Clauses involving performance generally set out a number of points and particularities, which may differ somewhat between different types of contracts. Benchmark clauses are special in the sense that they have come into use following the creation of new contract types or maybe rather contractual relations. The clause finally agreed upon may be aimed at financial parameters, the actual performance required and strategic considerations as well as price development. Most benchmark clauses seem to be turning around these parameters. Furthermore, benchmark clauses are established to set the stage for comparison of differences and similarities between competitors and to create a tool for measuring competitiveness in relation to leaders in the market. It is the general aim of the clause to create a basis for compliance with the best performers in the market.

Even if the benchmark clause could also serve to improve the knowledge the parties have when making future decisions regarding performance of the ongoing contract, and thus can have an impact on the extension or renewal of a contract, this additional knowledge is probably more often obtained through other mechanisms. The goal is to ensure that the development in the market will be followed, and the basic aim of the clause is to create a contractual basis for discussions or for an amendment with respect to the performance.

5.4. Benchmark clauses in relation to the general law of contract

5.4.1. *General observations*

The use of benchmark clauses will not mean a deviation from basic contract principles *per se*; rather, it will provide a predetermined model for adjustments of initial contract provisions.

With respect to their drafting, interpretation and application, benchmark clauses may present particular challenges. Therefore, it is also generally important to be aware of the relationships between contracting parties, and also to consider the particularities of the individual contract. These considerations will have to be reflected in the drafting of the contract and the particular benchmark clause.

When drafting a benchmark clause, the parties will thus need to consider certain items, such as time and frequency of benchmarking, the object of the benchmark and the comparative items. There is hardly a standard solution for benchmark clauses; they will need to be tailored to meet the individual requirements of the particular contractual relation. On the other hand there are also certain features which are common for most benchmark clauses. Certain items will then have to be contemplated in order to meet the specific needs of the parties. Several aspects will therefore have to be taken into account.

5.4.2. *Some factors to consider when drafting benchmark clauses*

In the discussions and negotiations of a benchmark clause a number of factors will be taken into account. The benchmark clause thus contains elements of other contractual terms among those mentioned above, such as index clauses, hardship clauses, adjustment clauses (in e.g. loan agreements), best effort clauses etc., but the benchmark clause will cover such items as the time and period of benchmarking, the scope and subject of benchmarking, the peer (the comparative group), the benchmarking agent, choice of and payment for benchmarking, structuring of benchmarking procedure, the calculation of price averages, the binding force of the outcome of the benchmark and the execution of the benchmark result. This means that a benchmark clause is a rather complex setup of contractual elements.

Contracts where benchmark clauses are found, may also be designed in different ways e.g. as a frame agreement with suborders, as a kind of subscription agreement or as a contract based on certain minimum quantities.

The price mechanism may be designed in different ways such as cost plus, price per unit, fix price for the whole contract, guaranteed minimums, investment costs for the service. The contract will normally be fairly long (5-10 years),

and in most cases there will be early termination provisions with or without exit fees. This means that if performance is regarded to be substandard there may be a right of termination. In practice this is a right which may prove to be hard to exercise, and the exit from a contract may not be even the desired option for the buyer.

5.4.3. Object of benchmarking

As in most other contracts, price and quality play fundamental roles in outsourcing contracts. Thus the “deal shape” forms a basis in connection with the drafting and the parties will have to determine the particular features which need to be taken into consideration in connection with benchmarking (including investments and transformation).

In these considerations the parties will also have to agree on those parts of the contract which should be covered by the benchmark and also how different parts of the contract would be affected by the benchmarking leading to an adjustment. It should be underlined that benchmarking rights and obligations are not substitutes for due diligence with respect to the terms of the particular deal, in particular where the price is involved. The contracting parties must consider how to draft the contract in order to achieve sufficient competition and competence over the contract period. In this respect it may prove to be better to have sufficiently specific contractual terms, but also sufficiently short contractual periods in order to check and determine the competitiveness (in relation to the price) of the services involved. The problem that may then arise is that the procedure is costly and time-consuming, so that too-frequent checkups will be counterproductive. Other practical consequences of applying such a mechanism would need to be considered as well.

It should also be noted that even if the price factor is important, the parties should consider whether there are other terms which should be benchmarked, such as the service level.

5.4.4. Objects of comparison

A further step will be to determine the object of comparison, namely the relevant external objects against which benchmarks shall be compared. This will also cover the minimum number of comparative objects to be used as well as the particular type of supplier which will serve as an object of comparison. The parties will also have to agree on whether the supplier’s own business should be included in the object of comparison. One is often confronted with the challenge of achieving a comparison “apples to apples”; this phrase captures a fundamental aspect of benchmarking.

5.4.5. Time and frequency of benchmarking

The contract should set out a time for when benchmarking shall occur, and also how often during the contract period benchmarking may be called for. In practice benchmarking is complex, expensive and often rather time-consuming. In most cases it will only be possible to request benchmarking some time into the contract period.

An important parameter may consist of requirements for contract improvement, where the service provider may have a duty at all times to meet any requirements that arise at different points during the contract period.

5.4.6. Information

Naturally, it is important for the parties also to decide on the information that should be made available in connection with benchmarking and whose duty it will be to present this information. It is also important that sufficient data is available from agreed sources, and that the vendor grants the benchmark staff sufficient information access rights so it will be possible to conduct the benchmarking procedure. This question may also involve confidentiality issues, which may need to be addressed and handled in the contract. For example, it should be possible to make certain data anonymous.

5.4.7. Termination rights?

Termination (exit) rights may not necessarily prove to be efficient remedies, but they may turn out to be a last resort to get out of a deal, when price adjustment no longer appears to be sufficient. This may be the case, when a benchmarking procedure concludes that a deal has become uncompetitive.

5.5. Benchmarking procedure

5.5.1. General steps

The benchmarking procedure undoubtedly covers a large number of parameters to be agreed upon by and between the parties. This will involve the procedure for determining benchmarks and the determination of an independent evaluator if that is what the parties wish (such as judges or experts).

Generally the parties will want an evaluator who is an experienced person with considerable knowledge of the trade in question.

5.5.2. The procedure and the report

The actual procedure will be based on analysis of data for the business and the objects of comparison. The review will often result in a preliminary

report followed by comments, and based upon this a final report will be completed.

When agreeing on the procedure, the parties need to consider whether the report shall be binding upon the parties or whether it will instead serve as a help for the parties to come to an agreement. The particular clause on procedure will have to set out certain time limits and deadlines which need to be followed and also the consequences if such time limits are not met. Similarly, the clause should set out who will be responsible for the costs of the benchmark procedure.

The contractual solution with respect to benchmark procedure could be in the form of arbitration, but less formal solutions seem more frequent. Such solutions are also found in a number of other contracts running over time, where the parties wish to maintain the contract but have a possibility to find a quicker solution to a certain new problem.²⁸ The question will then remain (unless it has been agreed precisely and clearly otherwise) whether the benchmark report will be binding on the parties or the effects will be binding in the event that the parties or either of them do not accept the report. The clause could of course contain a mechanism for appeal, but if no such appeal has been stipulated, this question will have to find a solution if and when the parties disagree. The design and drafting of the benchmark clause as regards the benchmark procedure may therefore result in several questions to answer. The benchmark report may be binding, but this does not seem to be the most common solution at the moment. If the clause allows for appeal, the mechanism for appeal should also be determined, including whether the appeal should be allowed only with respect to certain terms and conditions such as price, but also the grounds permitted for appeal as well as the (counter) evidence allowable etc.

If the report is only a guiding one, its value could be questioned if it is disputed by one of the parties.

5.5.3. Central elements in a benchmark clause

As is evident from the above, several items have to be contemplated in connection with the negotiations on and drafting of a benchmark clause. In the negotiations, the parties will have to take into consideration the consequences of certain events, which are regarded as crucial.

The first item concerns the evaluation of the contract in relation to the object of comparison; this object may be the general market or some specific condi-

²⁸ This may be the case in construction contracts, in offshore contracts and turnkey projects. With respect to Norwegian conditions related to the offshore industry see i.a. Kaasen. Kommentar till NF 92, Oslo 1994 p. 31 et seq. and p. 781 et seq.

tions agreed upon which are related to the particular object of comparison. If there is a divergence between the two, this may be the point where there is a right to start negotiations in good faith to find out whether there really is a difference, and whether this difference is sufficiently substantial to call for improvements, compensation and/or termination of the contract. The clause will normally set out certain requirements for measures which might be taken.

As mentioned above, a benchmark clause may set out a right of automatic adjustment, but this is not the most common solution. The more frequent solution seems to be that the buyer will be entitled to request a benchmarking procedure. There may also be a right for the supplier to request benchmarking under certain circumstances, mainly in cases where she deems that her company is performing better than has been agreed. One question to be discussed between the parties concerns whether the clause should have a buffer or a ceiling, and also whether this should be retroactive.

As mentioned previously, the parties should also agree on whether there should be a right of termination, and if both parties or only the buyer should have this right. A right of termination should probably apply only in cases where the parties cannot agree on benchmarking or the consequences of the procedure. In most cases the benchmark clause would probably not allow termination except under very particular circumstances, and this may also be combined with an early termination fee, when such a solution is required.

5.6. Interpretation and application of benchmark clauses

Like any contract for which the parties cannot agree on the meaning of a clause, contracts containing a benchmark clause will have to be interpreted. As has been shown above, benchmark clauses are often crucial for the contract, but they are also very often complex, and it goes without saying that the interpretation of these clause may be rather troublesome.

There are no particular rules for interpretation of benchmark clauses, but the same parameters will have to be applied as in other cases of contract interpretation. It must be emphasised, however, that the nature of benchmark clause is rather manifold and that the interpretation will have to consider several different parameters. The question could be raised whether the interpretation of benchmark clauses requires any particular methods. I believe that there is no general requirement for a particular interpretation method, but that interpretation will have to consider the particularities in the contractual relation.

There may therefore be a number of questions to consider related to the particularities of benchmarking and the effects of the benchmarking. Initially the drafting of the benchmark clause will have to depend on certain trade

practices related to the drafting and design of the clause and the parties will have to use some creativity in the drafting. There is undoubtedly a balance between the price and the quality involved and consideration must be given to the relative complexity of what the contract aims to achieve. One question to consider is whether it is possible to find relevant items of comparison in order to create a fair basis.

The parties will have to take into consideration that there is a natural adverse relation between the parties, while at the same time they must create cooperation. This may lead to some imbalance when looking at the conditions for benchmarking in connection with the negotiations and factual application of the clause during the contract period.

As to the time frame and intervals for benchmarking this will have to be determined between the parties. They have then to bear three aspects in mind: benchmarking after the conclusion of the contract; how close to the end of the contract that benchmarking should take place (benchmarking too late would probably not be efficient); and the time required to conduct benchmarking and the sharing of its costs and risks.

However the parties should also consider that benchmarking could form the basis for extending or renewing the contract.

6. Some final remarks

As we have seen, benchmarking clauses are rather common in particular types of contract. Benchmarking in contracts aims at securing best practices in contract performance in accordance with market conditions. The buyer will undoubtedly be interested in maintaining the competitiveness of the service provider's performance during the contract period. The service provider may be convinced that he will be able to achieve the goals agreed upon and that a long contract relation will be possible to maintain and beneficial as well. There seems to be difficulty in the drafting and evaluation of the clause when it comes to the precise specification of parameters to apply and how the agreed parameters will be applied in respect of the length of the contract period and the relative changes of the circumstances involved. Consequently the parties will have to evaluate and set the basis for the relation between them, and they will also have to consider the complexity of the contractual relation, which may lead to certain interpretation problems in the application of the clause.

The above indicates that it is not an easy task to negotiate and draft a useful benchmark clause and establish a mechanism which results in the identification of comparable parameters and which produces a meaningful result. This is

a question which will have to be considered and it will often involve the reliability of the benchmarker's judgment, unless the agreed basic data brought in by the buyer serves as the benchmark object. Will the parties be able to rely on the discretion of the benchmarker to determine the parameters to be compared and achieve necessary adjustments? In order to establish a reliable solution, the parties will have to select an appropriately qualified benchmarker. In the negotiations, it may become evident that negotiation of a detailed benchmarking procedure might not be worthwhile, as benchmarking rights are not invoked often and the simple benchmarking right may be sufficient as a lever to re-negotiate the terms of the contract.

Benchmarking clauses may not be perfect solutions to pricing and other market-related deal terms, but they will often have sufficient value for the buyer to be worth the effort to agree on as part of a long-term contract. In addition, if a benchmark clause is carefully structured so that it addresses the interests of both parties, it may prove to be a practical contractual tool to improve their relationship and create a better possibility to reach continuous improvements and innovation. If this is the case, benchmarking may provide for a win-win situation for both parties. If the seller has been too optimistic and is not successful in meeting the contractual requirements, the outcome may instead turn out to be a disaster for both parties.

