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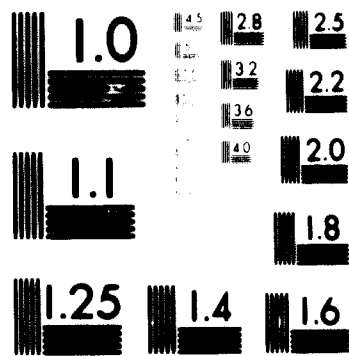
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United Nations Industrial Development Organization

**Technical Seminar on Contracting Methods and
Insurance Schemes for Fertilizer and Chemical
Process Industries**

Lahore, Pakistan, 25 - 29 November 1977

**CONTRACTING GUIDELINES
FOR FERTILIZER AND
CHEMICAL PLANTS.**

by

**NATIONAL FERTILIZER
CORPORATION OF PAKISTAN LIMITED**

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INTRODUCTION

BACKGROUND

The manner and method of the equitable transfer of technology from Developed States to Developing States has become one of paramount importance. The main thrust for tackling this problem at the international level, has been the call by Third World Nations, er bloc, for the establishment of a New International Economic Order, and at the Inter-governmental, regional and U. N. Organisational level, the holding of Seminars and discussions in an effort to develop the bargaining and contracting expertise of the Developing States and to reach a modus vivendi with suppliers.

With special regard to the Fertilizer and process industries the conclusions and recommendations of the Expert Group Meeting of the UNIDO/ESCAP Joint Priority Project was that an investigation on contract procedures for these types of Plants should be instituted. In particular, the First UNIDO Consultation Meeting on the Fertilizer Industry suggested the conduct of an investigation on the following:

Contract procedure intended to ensure the successful construction and operation of fertilizer plants and the suggested multilateral insurance scheme to provide protection to the interested parties concerned inclusive of consequential losses.

This aspect was also underlined by the UNIDO Consultation Meeting on the Petrochemical Industry.

As a direct consequence of this recommendation a Technical Seminar on contracting methods has been organised under the auspices of UNIDO in collaboration with the Board of Industrial Management, Government of Pakistan. The object of the Seminar is to evolve guidelines for contracting procedures of process plants through discussions on model contracts; case studies on

contracts implemented in Developing Countries and individual papers on such topics as Insurance Schemes for Plants, Arbitration procedures, etc.

The National Fertilizer Corporation Limited, which is responsible for Fertilizer Industry in the Public Sector has been asked to prepare a guideline for contracting, which shall form the basis of discussions in the seminar and hopefully serve as the basis for evolving a comprehensive guideline to contracting.

APPLICABILITY OF GUIDELINES

This guideline applies basically to the contracting techniques for the services and expertise needed for the installation of process plants by developing countries. As the services requiring procurement would vary according to the expertise of the Buyer, the guideline has been kept general so as to cater for any service or set of services being procured.

FORMAT OF GUIDELINE

Since it is not foreseen that contracts in the process industry would always encompass all services required to be procured in other words "turn-key" contracts, this guideline is not in the form of a model contract. The intention of this guideline is to assist with the aid of the notes in drawing up of a contract for any service being procured. Although the conditions of each Clause would vary in content according to the service being contracted - the list of Articles discussed in this guideline are themselves exhaustive, although other Articles may be needed to augment them depending on the requirements of the Contract.

THE CONTRACT DOCUMENT

PREAMBLE

The purpose of the contract document is to define "who" is entering into the Agreement, "why" they are entering into such Agreement, and "what" they are agreeing to. The Preamble to the contract must clearly state the "who" and the "why" of the Agreement. The "what" being defined and enumerated in the contents of the individual Articles and related Appendices.

In any contract the Parties to the contract must be clearly stated. The statements of Parties should include name, type of legal entity contracting, e.g., Company, Partnership and the location of his Registered or Head Office.

A bid received for the Project may be a joint effort of more than one Party. At the time of precontracting negotiations it may not be possible to determine the type of entity being negotiated with. This is because the bidders will not enter any agreement vis-a-vis themselves until they feel assured that the negotiation will end in success. However, it is suggested that prior to executing a contract an examination of the type of legal entity being contracted with is examined in detail so as to ensure that the Contractor's legal personality is not in conflict with his obligations under the Contract. A sub-Article should also be inserted in the Contract where the Contractor is a Partnership or where the members of the Contractor retain their separate legal entities which stipulates the joint and several liability of each member of the Contractor.

RECITALS

The background of the Contract may be stated including the business description of the Parties, the requirements of the Employer and the ability of the Contractor to fulfil those requirements.

DEFINITIONS

It is recommended that the definition of those terms which are frequently used and need consistent interpretation are defined immediately proceeding the Recitals of the Contract.

OBJECTION OF THE CONTRACT

As already mentioned in the notes to the Preamble, the Articles subsequent to it and Appendices thereof contain in detail "what" the Parties have actually agreed. To enable the interpretation of the Contract in the case of dispute it is considered necessary to broadly define what the Parties have agreed upon. In other words the essence of the Agreement is defined in the Article titled "Object of the Contract".

This Article crystallises the basic and underlying agreement entered into, and must have specific mention of the end product resulting from the services to be provided by the Contractor. These services may be enumerated in the Article but in each case be linked with the end product.

CONTRACTORS RESPONSIBILITIES/SCOPE OF SERVICE

The Contractor's responsibilities/scope of service must be very clearly and systematically defined in the Contract. Since the definition is usually in lengthy technical and procedural terms it is recommended that the detailed scope of service should be given in a separate Appendix for each broad responsibility of the Contractor or in one Appendix, broken into the necessary component responsibilities. In the main body of the Contract the broad responsibilities in brief, should be given.

While defining the broad responsibilities those should be broken up into activities to be performed by Contractor at its home office and/or at site. The activities should preferably be listed in chronological order. The commencement of each responsibility of Contractor should be linked to Effective/Execution Dates

of Contract. The satisfactory performance of a responsibility may, if required, be indicated by a well defined and verifiable act to be performed within a specific time limit.

This Article will tend to overlap with the Appendices containing details of Scope of Service. This is generally desirable to a reasonable extent so that ambiguity is totally avoided and both Parties to the Contract are aware of what is being sold. Those activities relevant and related to the Scope of Service/Works of the Contractor which are to be excluded from the Contractor's responsibilities must be specifically mentioned in the body of this Article and detailed in the Appendix relating to it.

CLIENT'S RESPONSIBILITY

It follows that whatever type of service(s) are being contracted for, other than, in a "turn-key" contract, the Client has to perform or provide certain services or inputs of his own to enable the Contractor to perform its responsibilities. While defining the Client's responsibilities the general guidelines given for the Article concerning Contractor's responsibilities should be followed.

The facilities, inputs, information and instructions to be supplied to Client as part of his responsibility may be linked to times/dates specified in the Contract, or if no such times/dates are specified, either to the actual performance of certain activities by Contractor within a specified period of Contractor's request for such inputs, provided that the period between request and provision of the inputs is reasonable and that timings of requests are linked to activities defined in the Works Schedule.

A useful method of ensuring completeness of Client's responsibilities avoiding ambiguity in scope of services is to

list together the responsibilities of both Client and Contractor and ensure that all service facilities, inputs and informations required for the performance of contract according to its object have been defined. This exercise also serves the purpose of checking for overlap of responsibilities.

CONTRACT PRICE

The type of price contracted for is determined either at the stage quotations are called for or at the time bid evaluation has been completed and the prospective Contractor selected. More often than not when the Contract is for more than one service the type of price so agreed for each service would differ. Therefore, the conditions of Article may have to deal for more than one price type.

Unless the contract is wholly lump-sum or reimbursable according to a fixed formula, each of the broad categories of service being offered by the Contractor should be linked to the respective price. Following the statement of price for the services the period validity of each price must be clearly defined. Period validity is normally a condition included in the Contractor's bid and may be defined either as a specific date or as a period linked to Contract Dates (Effective or Execution Date).

Recognizing the possibility of completion of the contract being extended beyond the specific price validity date or validity period, this Article may consider likely variations in price applicable after the price validity has expired. It is recommended this be done wherever possible through the incorporation of an escalation formula for each price linked to some international price index or set of indices.

TERMS OF PAYMENT

This Article must deal with all matters relating to payment and as such it should stipulate currency and exchange rate if needed,

bank through which payment is to be made or claimed, the schedule of payment and the documents to be presented by the Contractor to Bank (in case payment is being made through a Letter of Credit) at the time payment is claimed. Basically the terms of payment Article should provide for the following types of payments:

- i) Advance payments.
- ii) Running instalments.
- iii) Final payment/instalment.

Since the nature of these payments and their associated documents differ this Article should treat each type of payment separately, to avoid ambiguity. The mode of payment is basically of three types; direct remittance to Contractors account, through an irrevocable Letter of Credit or against suppliers credit, the mode of all payments being largely dependant upon the type of financing available to the Project.

GUARANTEES, TESTS AND PENALTIES

These notes apply to three Articles, entitled, Guarantees, Tests and Penalties.

It is the fundamental to the interest of the Client that the Contractor shall guarantee the successful performance of his obligations under the Contract. It is recommended that the Guarantee relate to the object of the Contract, i.e., the overall aim of the Agreement and to any time guarantees where the Parties are able to agree to them. Guarantees for individual services or Works can also be taken but they tend to result in extra cost and only lead to a slight and somewhat semantic advantage in case of dispute. As each service tends to be so interlinked with the object of the Contract that failure to perform one will tend to lead to failure to perform the agreement as a whole it is suggested that they need not be insisted upon.

The working of the Guarantees given must be unqualified as they confirm the viability of the bid and the Contractor's belief that the services he is offering will be in all cases sufficient to successfully carry through the Project.

Guarantees for performance of Processes, Equipment, Plant, etc., are based on technical criteria and specifications incorporated in the Contract itself or drawn from recognized international standards and as such, it is possible to assess the Contractor's performance in real terms.

Whether or not a performance guarantee is being met will be adjudged from tests which will be conducted within the framework of the Contract. This testing system will have to provide a step by step method by which the Employer is satisfied that the Contractor has satisfactorily performed his responsibilities.

Having defined the criteria and established a testing system, it is necessary to assess and quantify the loss to the Client should the guarantees fail to have been met. The quantification of these losses may be on an actual or specified basis. Where Employer is permitted under the Contract to claim reimbursement of a sum equivalent to the actual loss these damages may be described as unliquidated. Where loss is quantified in terms of a specified amount these may be regarded as liquidated damages. Guarantees which result in the former type of penalty being claimable can be called Absolute Guarantees, whereas Guarantees which result in the latter type of penalty are called Penaltiable Guarantees. However, in the case of Penaltiable Guarantees the Client should take care not to fix arbitrary sums if the laws of his country or the country whose law is governing the Contract are such that only recognize as legal those specified damages as are reasonable. What should and what should not be stipulated as an Absolute or Penaltiable Guarantee in a Contract will have to be decided in each case according to actual negotiations between the Parties. However, certain guidelines are suggested for consideration.

Absolute Guarantee should be considered for all services or acts of Contractor which will materially effect the successful mechanical or technical completion of the Project, including operating capacity, whereas Penaltiable Guarantees can be adopted in the case of increases in operating cost of the Plant or delay in Completion of the Project, or where time guarantee have not been met.

VARIATIONS

Variations both inside and outside the defined scope of Contractors' Responsibilities may result in substantial increase or decrease in the total cost of the Project. As such, the responsibility and ability of Contractor to perform such variations need to be taken into account when providing stipulations in the Contract in this connection. The types of variations can basically be defined as:

- a) those resulting in increase or decrease in the defined scope of Contractor's responsibilities. In considering variations of this type it is suggested that the Contractor be approached to accept a reasonable percentage increase or decrease in his defined responsibilities, in terms of total Contract price, which he should perform or accept without demur. At the same time every minor amendment or omission which does not materially effect the Contractor's obligations should not be considered a Variation. The Contractor should be entitled to give notice of those variations which will interfere with the performance of other obligations in the Agreement and these will have to be recognised by Client.
- b) Those variations relating to Work/Services outside the defined Contractor's responsibilities. Option to perform this type of variation should be left to Contractor's discretion. But once accepted the position of this type of variation assumes the same contractual position as variation (a).

The pricing and payment of these "extra services" may be as follows:

For type (a) variation a formula to which the increase or decrease in Contractor's responsibilities can be tied. For type (b) variation at the pricing may be done through a quotation for the work. This is because this type of variation is totally unforeseeable and no formula/method to assess the price can be envisaged at the Contract stage. Likewise where a decrease in the scope of Contractor's responsibility results in cost saving to the Client a manner of reimbursement to Client will have to be stipulated for if the need arises.

TAXES

Normally the Contractor because he is unaware of the Tax Structure where he is to perform his services is unwilling or unable to incorporate into his bid any item for tax due to the Client's country. At the same time the Tax Authorities of the Client will usually charge all remuneration/payments made under the Contract to tax as these will usually be deemed to have been received in the Client's country. It naturally follows that one of the Contractor's preconditions for entering into the contract is that the Client should undertake the satisfaction of all tax liabilities arising in Client's country. However, in view of the number of double taxation treaties, foreign tax credits laws and other tax exemptions available an Article simply sub-dividing the tax liabilities on the basis of tax payable in Client's country and tax payable in Contractor's country is in itself insufficient to deal with the particular aspects of "Taxes" as described above.

It is desirable that the Article firstly defines Tax liability and then allocates the benefits of any tax exemption alongwith the procedure interse the parties by which such exemptions can be claimed.

FORCE MAJEURE

Events occur which being so outside the control the Parties that they materially effect object of the Contract. These events broadly known as Force Majeure are not altogether unforeseeable, although the likelihood of their occurrence is remote. In such circumstances it is only fair where obligations are effected in substance by an act of Force Majeure the parties should be held responsible and it is desirable to incorporate in the contract an Article which:

- i) clearly defines those events which are to be regarded as Force Majeure.
- ii) states the method by which a party may reasonably claim the benefit of Force Majeure.
- iii) decides the effect of Force Majeure on the performance of the contract during the period of F. M. and in the case after the Force Majeurs has subsided.

CONCILIATION/ADJUDICATION/ARBITRATION

Obviously it is not feasible that all disputes likely to flow out of a contract can be foreseen and pre-empted by express stipulations in the contract document. In such circumstances it becomes necessary to devise a mechanism within the Contract by which contentious matters may be resolved without resort to arbitrary actions. This mechanism must clearly define two things:

- 1) The authority to decide.
- 2) The basis on which the authority will make its decision.

In giving authority to decide three options are generally open to the Parties. First a conciliation may be stipulated to be moved where dispute arises. Secondly a resort to the courts of a particular country may be given. However, resort to National courts has certain obvious drawbacks besides the cost of an action being brought in a national court tends to be prohibitive. Thirdly

Arbitrators or Experts may be appointed to settle the dispute. This appointment can be made either on a random basis by agreement between the parties or within the framework of some existing specified institution for arbitration.

Having selected the form it is necessary to provide that forum with the powers either to adjudicate the matters according to its own rules of decision or to provide the forum with a specified principle on which to base its award. A particular Law may be selected or broad principles of justice which will encompass the express provisions agreed upon by the Parties while keeping in view the spirit of the Contract.

It is suggested that in all cases the Parties agree that all these respective obligations under the Contract shall be valid and binding upon them during the period the dispute under this Article is unresolved.

TERMINATION

The likelihood of a party or both parties being unwilling or unable to fulfil their obligations under the Contract is not a remote possibility and it is reasonable that the parties should if the circumstances so permit be entitled to bring the Contract to an end. The termination of a Contract may be either by way of mutual agreement or through individual decision. Where it is the case of individual decision it is important to stipulate in the contract the exact nature of event by which the right to terminate would be available. Having defined the type of event that might result in termination it is necessary to provide the mechanics by which that termination is to become effective. This usually involves giving the defaulting party notice that termination is to occur within a specified number of days unless the other party is able to rectify its contractual breach. It follows that those obligations/rights of the parties flowing out of any termination should also be stipulated. The exact nature and extent of their obligations/rights are to be decided at the time of Contract.

SECRECY

In most contracts a certain amount of "secret" and "confidential" material will be disclosed to the Parties. Such materials will relate to those secret process, industrial data and technical specifications, as are not public facts.

Although it will be usual for the Contractor to be in the position to supply such information as part of his services under the contract the Client may in certain circumstances also have to provide some information/material which he is in a position to supply either because of his own expertise or because of some agreement with another party.

Where any party provides any "secret" material under an agreement a clause will basically be required to assure that the confidentiality of the material is retained. In this connection the type of material to be regarded as giving rise to the operation of this Article will have to be specified alongwith the period of time over which the obligation under this Article are to binding. Those documents or materials which shall become known in the Public domain through the ordinary course of time will be specifically excluded from the operation of the Articles.

EXECUTION DATE AND EFFECTIVE DATE

It will be noticed that many activities under the Contract are interlinked with Execution Date/Effective Date.

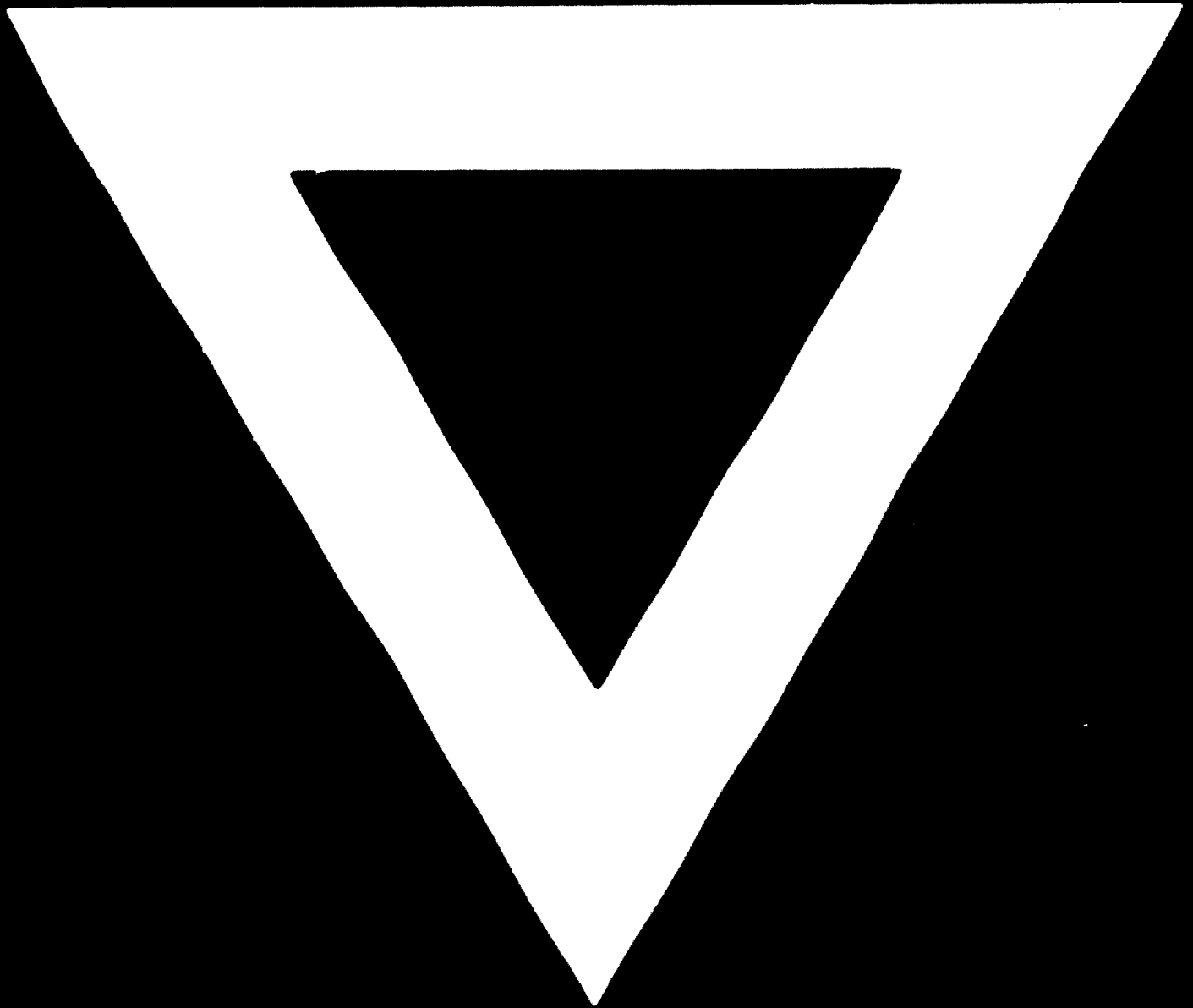
The necessity of two "contract dates" is primarily dependant on any conditions to be fulfilled by a party to all the remaining rights and responsibilities under the Contract becoming due for performance. At the same time a party who is to perform these conditions is naturally only willing to do so when he is assured that there is existence a legally binding document by which it will be able to enforce its rights under the Contract in case of non-failure of the other party to perform, hence the need for an Execution Date.

In most inter-national contracts the Contract will be regarded as executed on the date of signing the agreement but will only become effective on advance payments/opening letters of credit by Client.

GENERAL CONDITIONS

Those sub Articles which because of their contents being general and self-contained but which are not specifically related to a particular individual Article and where incorporation is necessary to supplement the other contractual terms should be placed in one Article at the end of the Contract document.

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