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Expert group meeting on the selection of
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OFFERS AND QUOTATIONS FOR SUGAR PRODUCTION
EQUIPMENT AND COMPLETE PLANTS 1/

by

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SUMMARY

The purpose of a contract needs clear understanding and definition.

A check list for contract preparation is suggested.

Different approaches in calling for quotations are recognised.
Great care is needed with terminology.

Having defined the objectives it is then necessary to consider and define the following:-

Conditions for payment

Conditions for acceptance

Time scheduling

Future maintenance

Liabilities for taxation and other liabilities

Arbitration

Cost escalation and fluctuations in international financing

Bonus-penalty arrangements

Force-majeure

Need to identify possible low costing of immediate installation with high future cost of maintenance. This has special reference to service agreements and future availability of replacement parts.

A. Introduction

It needs to be made quite clear when seeking new plant or equipment as to just what is under consideration between the two parties. What does the customer want? Does he really know what he wants?

Then there are the occasions when sales representatives are endeavouring to solicit custom for plant equipment available on the market. It is in the interests of the manufacturer of the plant or equipment that he should make a sale.

It is in the best interests of good customer-vendor relationships that both parties should be satisfied.

B. Contracts

The laws of contract apply to this area in which there needs to be agreement between the two parties.

Where there is a significant sum of money concerned as with a new plant or a major new item of plant such as a new steam generator it is good practice for a specific agreement to be drawn up for signature by both parties.

When preparing such an agreement there are certain specific requirements which should be check-listed when the document is being prepared. This check-list includes the following items:-

1. Correct specification of the parties between whom the agreement is being arranged
2. Subject of the agreement
3. Objective to be achieved by the installation
4. Conditions for payment - lump sum, progress payments, details etc., place and currency of payment for international trading
5. Conditions for acceptance - terms, conditions

- for progress payments
6. Time schedule (may be included in 4 or 5)
 7. Future maintenance, liability for costs of servicing
 8. Liabilities for taxation, including customs and/or exise
 9. Other liabilities
 10. Arbitration if needed
 11. Wages or other cost escalations
 12. Fluctuations in rates of exchange for international dealing
 13. Bonus - penalty arrangements
 14. Force-majeure

Where small items are concerned it should be sufficient to place the order using a form suitably headed and recognised as the official order form of the sugar factory concerned. If detailed descriptive material is required a covering letter is usually adequate for small and medium sized items of equipment.

C. Quotations for Plant

When a feasibility study is under way and the decision has been made that it should be continued then a stage will be reached when it is necessary to obtain specific costing information.

Three general techniques may be recognised:-

- (a) calling for tenders
- (b) asking suppliers for specific quotations
- (c) being a recipient of approaches from interested manufacturers.

The options are also available for obtaining quotations in terms of whole plant, or turn-key contract, also known as a lump-sum contract; or for the supply of individual items of plant or groups of items:

Under certain circumstances it may be agreed to agree with a contractor for installation to be effected on a cost-plus basis. In such a contract the fee for services of the contractor on installation of fixed capital

facilities generally applies only to the profit portion of the contractor's reimbursement. The potential extent of liability should be ascertained as far as possible under these circumstances. This type of contract is to be avoided as far as possible but occasions do arise for any one of a number of reasons when it is necessary to resort to contracting under these conditions.

The most important first stage in calling for tenders or otherwise seeking to engage in a contract is for the prospective customer to know exactly what he wants, how and when he wants it and to be able to phrase his requirements succinctly in non-ambiguous terms.

Where a whole plant is concerned the specifications may run into a document as large as a book. Even for an individual item of equipment such as a steam generator or even a sugar boiling pan the documentation is quite extensive. Errors of omission are the more frequent in this type of documentation.

It is better practice just to prepare the specifications and have them reviewed by an expert, or have them prepared by an expert or firm of experts and then to call for tenders. It could be within the province of a firm of specialists preparing the specifications also to submit a tender at the appropriate time in competition with other possible interested contractors.

Terminology may be difficult where international contracting is concerned. Even with a commonly employed language such as English there are differences in meaning for example between certain American and British usage. Also there are terms (mostly American) which are in general use only in the country preparing the documentation.

One such term is that of "Battery-limit". In American usage this refers to the manufacturing area of a proposed plant including all process equipment. It does not include such areas as those provided for storage or administration buildings nor does it include utilities or auxiliary facilities unless so specified. It usually excludes site preparation and therefore may often be applied to the extension of existing plant.

D. Objectives.

The objectives to be achieved by the installation need to be specified in quantitative terms. This may also involve quality specifications.

The sugar industry has a terminology peculiar to its own activities and this terminology with respect to its correct definition needs to be understood by both parties.

At present there is no internationally accepted book of reference or glossary of terms hence the necessity for specific mutual understanding of the phraseology employed.

E. Conditions for Payment

Where large sums of money are involved and the transaction is international or occasionally multinational in character great care must be exercised in phrasing the conditions for payment.

As well as the items listed under general contract conditions there are also such matters as banking arrangements. These include methods of transfer of funds by letters of credit, bank cheque or other technique.

It must also be clearly understood by both parties in an international agreement that money can legally be transferred to the country which the contractor specified in the amounts and at the times agreed.

There may be occasions when the contractor prefers to keep all or portion of the funds within the customer's own country in order to pay wages for which he is responsible or for some other reason concerned with his business activities.

The availability of international currencies, fluctuations in rates of exchange are matters upon which agreement needs to be reached before a contract is finally signed. Who benefits or is penalised by interest payments also needs careful anticipatory thought.

F. Conditions for Acceptance

This subject will be considered in detail, as far as implementation is concerned, in the next chapter. At this stage it is necessary only to draw attention to the need for great care in drawing up these conditions.

G. Time Schedule

Where a large installation is concerned time scheduling is of paramount financial importance.

In the beet or cane sugar industries it takes on even greater importance because of the seasonal nature of operations. The delay of a month to coincide with the commencement of harvesting operations would be of very serious financial consequence whereas a similar delay which might occur 3 months before the commencement might have little in the way of serious financial consequence.

Any penalty which might be specified for delay should be graded in a manner appropriate to the magnitude of the estimated financial loss.

In the case of a separate sugar refinery the seasonal influence is likely to be of far less serious consequence and penalties for late completion would be unrelated to the time of the year.

For large installations such as for a whole plant, time scheduling should be set out in a step by step manner with payment and bonus - penalty arrangements agreed for each step.

H. Future Maintenance

There needs to be a clear understanding between the two parties as to their respective responsibilities for maintenance and service once the installation is complete.

The customer needs to be very careful in examining the requirements for spare or replacement parts. It is likely that certain parts can only

be supplied by one contractor. Whilst they may be available at the time the agreement is signed the customer may well find that twelve months after commencement of operations production of these particular parts has been discontinued by the contractor and can only be supplied at much greater expense than had been anticipated.

The general self-sufficiency of sugar cane factories provides a useful and important buffer against such problems. However this is a problem commonly experienced in many areas of present day technological society. One must anticipate as much as possible, be warned of the situation and be prepared to accept the consequences if and when they arise.

The important point at this stage is to be very much aware of any restrictive clauses included by the contractor which will make it difficult and expensive for the customer at such times as maintenance will be required.

Fabrication of replacement equipment is very common practice within the sugar industry. Care needs to be exercised to avoid infringement of patent rights when resorting to this practice. Many countries do not observe patent law of other countries but there are indirect ways of bringing pressure to bear in cases of willful and persistent infringement.

I. Liabilities for Taxation

Every country has its own taxation laws and system of operating those laws. When dealing with international contracts great care must be exercised in knowing the manner in which these laws influence payments.

There may well be special provisions relating to the payment of royalties on patents and a differentiation in treatment of such payments as compared with direct payments for equipment or services.

When preparing feasibility studies for a new plant installation it is necessary to take into account the effects of the laws of the country on customs or excise duties or both. Sugar is a commodity which governments of all countries consider to be a useful source of revenue. How this revenue is collected varies very widely from country to country. However the total liability is of paramount importance to the owner of the sugar factory and full cognisance should be taken of this effect when estimating profitability of the enterprise.

It is not until contract prices for equipment and manufacturing costs are added to taxation liabilities that the full financial picture can be obtained.

J. Other Liabilities

When drawing up a contract between customer and vendor it is necessary to assess relative areas of liability. This is important from such points of view as safety of personnel - both operating and visitors, environmental effects covering sight, sound and smell; provision of services, transport and related facilities, housing of stage and construction personnel, these and others of a more specialised character relating to local situation.

Insurance cover for accident compensation should be adequate and liability agreed upon beforehand.

Safety codes, regulations and restrictions should be defined. In developing countries these too may only be developing and the extent to which an international contractor is prepared to meet safety specifications needs careful understanding.

Society is becoming more conscious of environmental influences although in developing countries these may still be only of marginal concern. There should be a civic consciousness on the part of industrialists and contractors to observe the norms of society in this respect.

Who should clean up after a contractor has completed an installation? The larger the installation the more rubbish is there for disposal. The

responsibility should be clearly defined between and implemented by whatever party has accepted responsibility.

Services, transport and related facilities that are available needs to be carefully understood by the contractor and the liability written in to the agreement.

Sometimes in developing countries transport facilities may be completely inadequate. A clear understanding should be reached with the government and/or local authorities concerning provision of such facilities and whose financial liability it will be.

If the sugar factory owner agrees to accept liability for provision of transport facilities there should be a clear understanding with the government and/or local authorities as to their availability for public or other use and the extent and nature of compensation which might be forthcoming.

The self-sufficiency of the sugar industry means that less emphasis is usually paid to the provision of services but there needs to be no misunderstanding of liability in this respect.

There needs to be agreement as to whether the sugar industry provides housing and/or eating facilities for staff and persons working for contracting bodies and if so the quality, period of occupancy, compensation expected and other related matters need prior agreement.

K. Arbitration

Difficulties not infrequently arise when interpreting conditions of acceptance after completion of contract. In anticipation of such difficulties there is wisdom in making provision for appointment of a mutually agreed-upon arbitrator.

If the dispute is related to quality measurement then the sugar association or appropriate nationally recognized sugar body could most competently act in this way. In fact such a body might be specific in

the first place for conducting or supervising acceptance trials.

For matters of legal concern it is necessary to employ appropriately qualified persons. These may or may not be resident in the country of concern and the regular availability of availability or otherwise of suitably qualified legal personnel. As far as possible good-will should prevail with the avoidance of legal decisions which could well miss the spirit of the intention as far as matters of technological importance are concerned. A good terminal as well as progressive customer-vendor relationship is always of paramount importance.

1. Cost Escalation

Inflation is the common ailment in the financial circles of all countries in the latter half of the twentieth century. To estimate the future effects of inflation on costs of services and materials is often beyond the capability of the most competent economic forecaster.

A clause needs to be included in a contract, especially one of major financial consequence, to cover as far as possible the effects of inflation during the period of the contract. This is usually the liability of the customer but during any penalty period it should be the liability of the vendor.

How to measure inflation is also a difficult question to answer in relation to goods and services concerned with a construction contract. The basis for measurement in many countries refers to such factors as house rentals, costs of essential food items, community utilities and other items which may only indirectly affect the contractual liability.

This calls for careful thought, definition and phraseology at the time of preparing the contract and good will for its interpretation.

2. Fluctuations in International Rates of Exchange

International financing is difficult under any circumstances and a specialist should write clauses relating to these matters and only another

specialist in this field should be considered competent to assess the agreement.

N. Bonus-Penalty Arrangements

Time is money, and money not being used does not fulfill its function in an investment exercise. Therefore it is only financial common sense to write in to any agreement a clause covering penalties for failure on the part of the contractor to fulfill his contract or part thereof on time.

On the other hand it is equally reasonable to compensate the contractor correspondingly if he finishes his contract ahead of schedule especially if this enables the plant to be put into operation at an earlier date. This is most conveniently arranged in the form of bonus payments.

The bonus-penalty clauses may not be of a great deal of value either way if prospective production is not affected by rescheduling as could be the case with the seasonal nature of the sugar beet or cane factory.

There is also the possibility that delay in completion of a contract on schedule may be the fault of the customer. It should be recognised that under such circumstances payment of penalty would not be incurred by the contractor.

O. Force-Majeure

This is a term which is used for a clause in construction contracts which liberates the contractor from any obligations imposed on him because of such happenings as strikes, floods, catastrophes, national emergencies and similar unpredictable eventualities. Another term which has been used in some areas for this type of clause is "Act of God".

P. General

Great care should be exercised by customers to examine all aspects of contracts and implications of the various clauses especially with respect

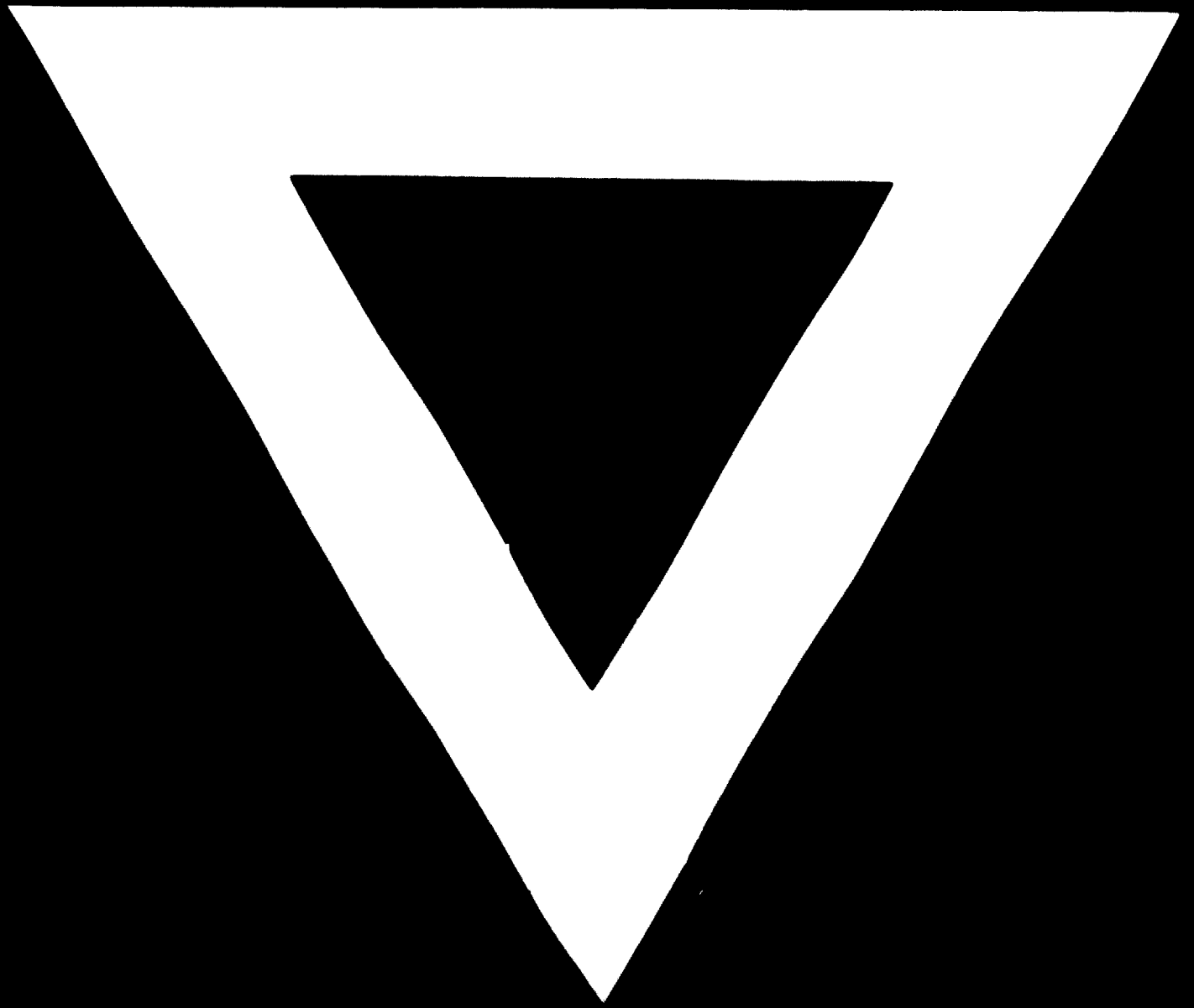
to financing arrangements and maintenance or service clauses. It is not unusual for a contractor to put his base tender price to a very narrow profit margin but write in financial and service arrangements to more than compensate.

When calling tenders the customer should indicate that the lowest or any particular tender need not necessarily be accepted. There should also be a requirement of a nominal deposit or enquiry fee (refundable in whole or in part) to minimise information hunting by persons or organisations not seriously interested in submitting a real tender.

Business principles and practices vary from country to country for a variety of reasons sometimes related to political differences and sometimes just to cultural background. These have in the past led to misunderstandings with both short term and long term consequences. One can only anticipate that there will be such difficulties when international agreements are negotiated and every endeavour should be made when preparing these agreements to explain clearly to each side their real financial and technological implications.

Questions:

1. What are the relative merits of calling publicly for tenders to be submitted for a contract compared with private negotiations with a particular contractor?
2. How does one cope best with problems of escalating costs?
3. In what ways can a customer best protect his interests when he is inadequately experienced in technology?



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