OCCASION

This publication has been made available to the public on the occasion of the 50th anniversary of the United Nations Industrial Development Organisation.

DISCLAIMER

FAIR USE POLICY

CONTACT

Please contact publications@unido.org for further information concerning UNIDO publications.

For more information about UNIDO, please visit us at www.unido.org

UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org

08797

Distr.
LIMITED

ID/WG.287/6
8 November 1978

ENGLISH

United Nations Industrial Development Organization

Expert Group Meeting on Industrial Financing
Vienna, Austria, 6 - 8 December 1978

THE RESPONSIBILITIES AND OBLIGATIONS OF PARTNERS IN INDUSTRIAL CO-OPERATION*

prepared by
the secretariat of UNIDO

* This document has been reproduced without formal editing.

id.78-7850

BACKGROUND PAPER 4(c)

THE RESPONSIBILITIES AND OBLIGATIONS OF PARTNERS IN INDUSTRIAL CO-OPERATION *

Introduction

1. In examining some of the basic concepts of the present framework, it appears fairly clear that they evolved out of the practice of commercial relations between nations at similar levels of development over a period of several hundred years, and more recently between colonial powers and their colonies. It seem therefore essential firstly to question some of the fundamental assumptions of today's world order, for example: that all countries can achieve their development objectives simultaneously; that all countries are in reality equal; that economic problems can be effectively regulated through the free market mechanism alone; that the existing world order cannot be changed without considerable adverse effects on the world economy. If we examine secondly the situation in the legal field, it appears that contractual laissez-faire has led more often than not to the perpetuation of inequalities between partners in industrial co-operation. Of equal importance is the need to reshape the thinking of contracting parties through gradual evolution, thereby taking into account the special requirements of industrial co-operation between partners of different levels of economic development and of different economic and legal systems.[1/]

The Main Inadequacies of the Current Framework

2. In examining the nature and scope of industrial co-operation arrangements through the review of interfirm contracts concluded between firms of developed and developing countries, it has been possible to discern firstly the following trends: (i) growing complexity; (ii) longer duration; (iii) increased obligation to provide results rather than only services, extended performance

---

1/ Deliberations of the meeting on Industrial Co-operation Contracts and Procedures for Solving Differences, Vienna, 14-16 November 1977.

* See Paper by A. Tiano: "Note for the Participants" of the above-mentioned meeting.

guarantees; (iv) the need for a gradual change in the mechanisms and procedures for solving differences; and above all (v) increased government involvement.

3. Secondly, it has been possible to identify the main objectives of developed and developing countries with regard to industrial co-operation. Partners from developing countries, the recipients, are primarily concerned with obtaining results rather than only services: it is important for them to acquire plants capable of functioning perfectly with domestic inputs and to ensure that they acquire the capacity to reproduce, adapt and further develop the technological know-how. Furthermore, it should be borne in mind that the nature of developing country partners is often different from those originating in developed countries: more often than not they are public enterprises or government agencies which have the obligation to safeguard national interests and whose success is measured not only in terms of profits but also of the overall industrialization achieved. The partners from developed countries do not usually have this obligation; their objective is profit maximization, while tending to reduce to a minimum their involvement or commitment to the overall development process of the host country. Additionally, they would require certain assurances and guarantees against non-commercial risks, such as nationalization, expropriation, etc. if industrial co-operation takes partly the form of a joint venture.

4. Thirdly, on the basis of the discussions at the Meeting on Industrial Co-operation Contracts and Procedures for Solving Differences, it has been possible to determine the main inadequacies of the current legal framework for international industrial co-operation contracts. These inadequacies may be grouped under three principal headings: (i) diffusion of the responsibilities of the foreign supplier; (ii) difficulties faced by foreign suppliers in carrying out their responsibilities and obligations.

(i) The diffusion by foreign suppliers of their responsibilities and obligations has been noticed for example to result from a concern to ensure that a supply contract is not put at risk because of difficulties occurring in the training of local personnel. The supplier consequently often favours the drafting of a number of separate contracts, whereas the

recipient would prefer a single global contract. In addition, it should be noted that performance tests may be carried out in such a way as to be advantageous to the supplier. For example, by splitting up trials so as to test individual production lines or machines rather than the plant as a whole; by reducing the duration of tests even if performances have been specified in contracts on an annual basis; by requesting that tests be carried out with the supplier's personnel and raw materials. Finally, suppliers' responsibilities and obligations can be considerably reduced through the limitation of penalties given the multiplicity of contractors and of their operations and through the increased use of hardship and force majeure clauses.

(ii) From the point of view of the foreign supplier, it must be recognized that he often faces considerable difficulties in carrying out his obligations for reasons beyond his control; for example, contracts must naturally exonerate the supplier from his liabilities when the recipient fails to perform stipulated functions, such as obtaining plan approvals and administrative authorizations, arranging for the supply of raw materials, etc. In general, however, it should be borne in mind that the supplier is often faced with constraints with regard to foreign exchange and constraints of a political, administrative, legal and institutional nature. In addition, problems often occur due to the use of subcontractors over which there may be insufficient control, due to the use of contractual forms exonerating the supplier from first degree liability, and due to extended use of penalty ceilings.

Conclusion

5. It is necessary to examine ways and means of overcoming industrial co-operation contracts and thereby to overcome the problems mentioned in paragraph 4 above. In particular, it would be necessary to study the drafting of special clauses ensuring that the foreign supplier provide overall results rather than only services, it being understood that such an obligation does not necessarily exclude the possibility of sharing responsibility regarding the different operations required to set up the plant. Similarly, it is intended to examine the problems related to the provision of appropriate performance tests and guarantees to protect the recipient partner, as well as those related to management. It would be necessary, for example, to look into the reasons why industrial plants set up through simple industrial co-operation arrangements are often immobilized or underutilized. Finally, with regard to remuneration and penalties, clauses should be designed to provide an incentive to suppliers to achieve stipulated performances and results.

The present and future role of Governments would be examined in order to determine the conditions under which Governments of both developed and developing countries might be willing to support such a set of general principles by including them in intergovernmental framework agreements. The objective is to explore how Governments of both parties would engage to a certain degree their responsibility with regard to the implementation of those general principles; this formula may go a step towards the view of those developing countries who consider that Governments of industrialized countries should bear legal responsibility for the activities of their nationals abroad.

It would be necessary to review technical assistant programmes as a modality of industrial co-operation and to develop the diffusion of information regarding specific industrial sectors; similarly, the role of international institutions in the provision of technical expert services for dispute settlement, of training programmes in international arbitration, and of course of a form of guarantees to partners in industrial co-operation, would be considered by UNIDO.

ANNEX

CLAUSES FOR INDUSTRIAL CO-OPERATION BETWEEN UNEQUAL PARTNERS*

A. Drafting of provisions concerning obligations of the supplier

1. Forms of contract, the obligation with regard to results, and complexity

In their analyses, experts try to break down the various elements of industrial co-operation and give them different names. A know-how contract is a contract for work and licensing is the leasing of an intellectual right. This approach is in our view not accidental, since it reflects the wish of the suppliers of technology (or "grantors") to separate their responsibilities and ensure that, for instance, a supply contract is not put at risk because of difficulty in training personnel. The supplier consequently favours the drafting of a number of separate contracts whereas the recipient (or "grantee") prefers a single global contract. The following question may therefore be asked:

(i) Is the formula of a framework contract accompanied by specific contracts an acceptable compromise?

(ii) Does it sufficiently stress the indivisibility of the contract and the interdependence of the operations?

2. The obligation to provide information and the obligation with regard to results

Results cannot be guaranteed unless information is obtained about the particular conditions of the beneficiary country, particularly if such conditions call for changes in existing technology. In this connexion it is surprising that the only preliminary studies recommended by the Guide on Drawing up International Contracts on Industrial Co-operation, paragraph 11, are concerned with protecting the technology supplier (for example, tax conditions). The following questions should be raised:

(i) In a contract involving an obligation with regard to results, concluded between a specialised firm and an authority of a developing country, is not a clause like

* See paper by A. Tiano: "Note for the participants" of the Meeting on Industrial Co-operation Contracts and Procedures for Solving Differences, Vienna, 14 - 16 November 1977.

"The supplier cannot be held liable for prejudicial results in the functioning of the process and in promised performance in the event of errors or imprecision in the information provided by the recipient in the preliminary negotiations" contrary to the spirit of the contract and the inequality of partners as regards technology?

(ii) If the supplier does not submit detailed questionnaires is he not in breach of his obligation to take due care?

(iii) Would it not be possible to develop the technique of letters of intent and preliminary arrangements (paragraph 13 of the Guide) by the inclusion in

3. The technical level of equipment and the complexity of contracts

In many contracts for the sale of equipment it is specified that the equipment must be of the most up-to-date kind. The authors of the Guide previously mentioned (paragraph 39) consider that industrial co-operation creates a "community of interests" in respect of the proper functioning of the plant covered by the contract and helps "to solve the problems of the liabilities assumed and guarantees offered by the supplier". This appears to imply an assumption that, in the technology supplier's mind, the main object of the contract is the operation of the plant, the products of which he will be able to purchase. This attitude seems to neglect the fact that compensation transactions and even technical assistance are often considered to be a necessary cost of which the main advantage is that they make it possible to sell the equipment. The recipient strengthens this trend by refusing to pay the true costs of the services, with the result that the supplier raises the price for the equipment so as to be able to reduce the price for know-how and technical assistance. The following might therefore be asked:

Would it not be a good idea, through realistic pricing and appropriate drafting, to ensure that the contract's main object is seen to be the transfer of technology while the sale of equipment is accessory?

4. Trials, the obligation with regard to results, and the national interest

Faced with the difficulties of industrial co-operation contracts, the technology supplier often attempts various ways of arranging trials in the most advantageous way for himself. Firstly, he may, for example, try to split them up so that what is tested is not the plant but the individual shop or production line, or even machine. Performances are assessed not in total hours but in direct hours or in terms of working stations. This fragmentation seems to make the obligation to produce results rather meaningless, since it hardly goes beyond the procedures for machine acceptance applied in any sale of equipment. Secondly, the supplier may try to reduce the duration of trials, even if performances are specified on an annual basis. Results ofsuch trials are then multiplied by a coefficient derived from statistical surveys in the supplier's plants. Thirdly, in some cases the supplier may request that trials be carried out by his personnel and with raw materials provided by him. A double-banked trial should preferably be adopted with the supplier's personnel being used to diagnose faults and not to take the place of the recipient's personnel. Lastly, the contract often stipulates that under-performances shall be compensated for by over-performance. This is satisfactory from the viewpoint of financial profitability but is unsatisfactory from the viewpoint of obligations to achieve macro-economic results (it is not immaterial whether 10 A's and 20 B's are consumed or 20 A's and 10 B's, if the B's are imports and the A's are domestic products).

5. Subcontracting and the obligation with regard to results

Few technology suppliers provide all the services covered by an industrial co-operation contract themselves; they use specialist manufactures, while often the supplier insists on the use of particular enterprises to take care of transport, civil engineering and assembly. This can give rise to real difficulties but also makes it possible to evade liabilities. The most common forms of evasion are to reduce to the minimum the control over subcontractors (for example, refusing to check whether the written instructions for assembly have been

followed), to find forms of contractual relationships exonerating the supplier from first-degree liability, and above all to extend the use of penalty ceilings.

(i) Would it not be in everybody's interest to devise selection procedures for subcontractors in which the two main parties would be involved (preparing lists, allowing justified rejections, etc.)? A unilateral choice by the supplier would entail an alteration of the contract (prices, deadlines) or clearly reduce the guarantees given. A unilateral choice by the recipient would raise penalty ceilings. Do the forms in which subcontractors are associated with a contract have any practical bearing on the sharing of liabilities and the rights of the parties to appeal?

(ii) Should not the subcontractors be associated with the negotiations?

6. Management contracts and obligations to produce results

The product-available contract (contrat produit en mains) is not the result of dogma but the pragmatic consequence of the under-utilization of factories built under older, simpler arrangements. However, it does impose considerable responsibilities on the supplier. He will have confronted many of the same difficulties in his own plants (change in supplier of raw materials, difficulties in finding skilled personnel and so on) and also in the setting up of branches around the world. The difference is that in the event of a setback in such circumstances he cannot blame anyone but himself, whereas in the present case he may be the victim of the shortcomings or carelessness of a partner, or even just think or claim that he is. Hence the temptation to go backwards and use legal artifices to turn an obligation to achieve results into an obligation to provide services.

In this connexion, the following questions may be asked:

(i) Would the tranefer of technology be facilitated by a development contract whose provisions were derived from a management contract?

(ii) Might it not be desirable to study (for instance, by systems analysis) the possibility of separating day-to day management from long-term management and handing over the former to the technology supplier for a predetermined period?

(iii) Do not management contracts or the rules for the organization of joint ventures give examples of allocating management actions to the partners or to their joint decisions?

(iv) What form of contract would safeguard everyone's dignity and make it possible to finalise matters rapidly after having ensured the transfer of know-how?

(v) Would it be possible to leave out of the management contract areas where there may be a conflict between the technology supplier's interest and the recipient's apprenticeship?

B. Drafting of provisions concerning obligations of the recipient

1. Obligation to perform services or carry out checks stipulated in the contract within the time limits indicated

The recipient must approve plans, obtain administrative authorisations, supply trainees, arrange for supplies of raw materials, in some cases provide services and always participate in testing. Contracts must naturally exonerate the technology supplier from his liabilities when the fault arises from the recipient's failure to perform stipulated acts.

(i) Is it not difficult to prove the consequences of an omission on the part of the recipient?

(ii) Should not provisions concerning acts to be performed by the recipient be made more precise if one wishes to oppose provisions restricting liability?

2. Forms of remuneration and the obligation with regard to results

Remuneration should be in a form such as to encourage the contractor to achieve the promised performances, and this is where payment by results, something which business has always favoured with regard to employees, could be re-introduced in contracts for work. However, the formula would move away both from the recommendations most favourable to the technology supplier: for example, the French Centre for Foreign Trade's "Isabelle" clause, the immediate payment recommendation made by the Commission Droit et vie des affaires of Liège University, and from the recommendations most favourable to the recipient (most-favoured-licensee clause). The former take no account of results and the latter take no account of differences in the difficulties of achieving them.

If the idea of a "profit-sharing" clause is accepted, its indicators must be defined - simple indicators (production, proportion of expenditure in the country and so on) or complex indicators (difference between actual trading account and forecast account, and so on).

3. Secrecy of know-how and national interest

In industrial co-operation between equal partners a technological lead of two or three years is considerable. The supplier of the know-how therefore prizes his secret highly and will pass it on to a partner only if he is certain that the partner will carefully protect it. It must be recognized that this aspect is less important in developing countries. Moreover, a unit which has been installed and operating for ten years in a developing country can serve as a stepping-stone on the way to industrialization. It would therefore seem desirable not to extend to North-South relations the provisions in know-how contracts prohibiting subcontracting or specifying secrecy for more than a few years.

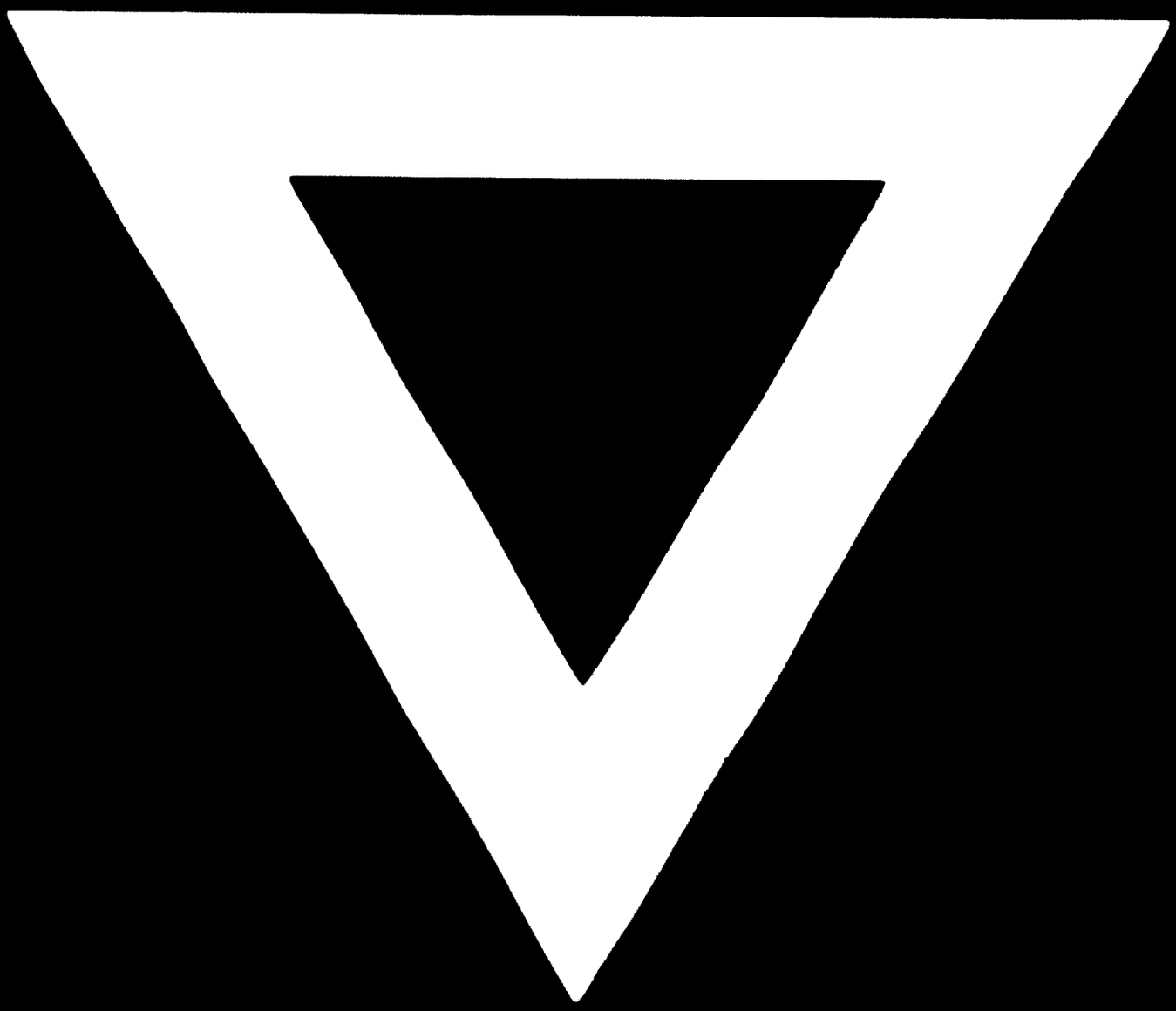
4. Improvements in technology and co-operation between equal partners

It is common in know-how contracts between equal partners to specify that innovations developed in the licensee's workshops should be passed on to the licensor free of charge. The adaptation of transferred technologies must also be encouraged such as the adaptation to a less skilled and cheaper labour force or to different climatic conditions. In this connexion, it may be asked whether these provisions on free exchange of information should not be given up in order to favour partnership arrangements between the technology supplier and the adapting recipient to promote subsequent transfers to other under-industrialized countries?

5. Mandatory distribution contracts between unequal partners

Sometimes industrial co-operation also covers marketing, and clauses regarding mandatory distribution through the network of the technology supplier in their countries are often inserted as accessory to other forms of co-operation. In many legislative systems, attempts have been made to protect the distributor against the supplier, who is more powerful in domestic commerce, to ensure that the former receives technical assistance from the latter and to protect him against over-strict control and abrupt cancellation of contract. Finally, efforts have been made in legislation to uphold rules of competition. This appears to be unsuitable for international industrial co-operation, as it is often argued that if the distributor (here, the technology supplier) sells products similar to those of the recipient, he commits an act of competition contrary to the contract. Furthermore, as contracts have often provided for the compulsory use of technology supplier's network by the recipient without defining relevant conditions, the trend to protect the distributor may give rise to inequity when the distributor is in fact more powerful.

I-80



80.02.04