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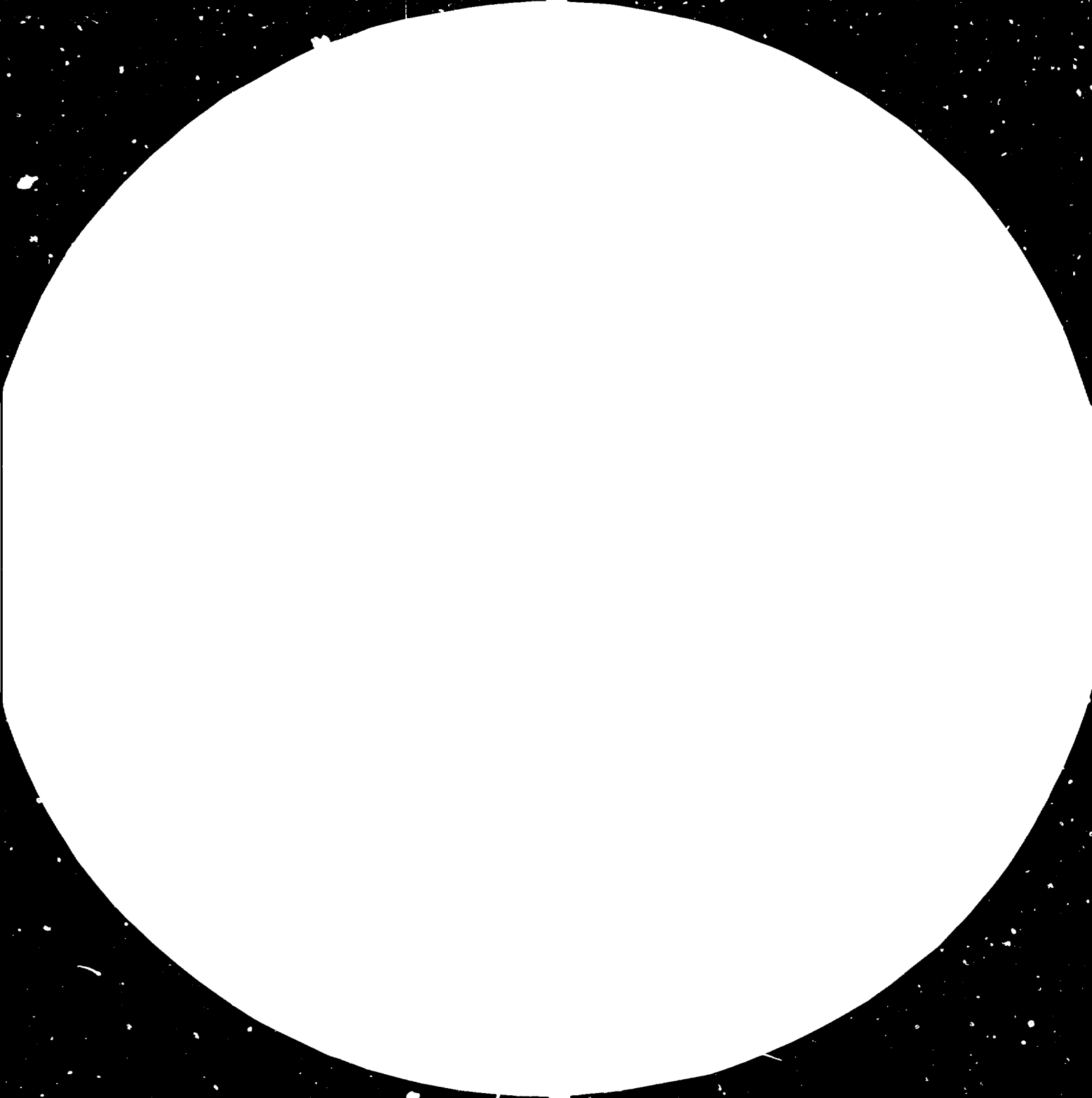
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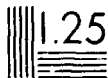
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Aspects of Industrial Collaboration  
Arrangements

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MANAGEMENT CONTRACTS IN DEVELOPING  
COUNTRIES:

AN ANALYSIS OF THEIR  
SUBSTANTIVE PROVISIONS \*

Prepared by  
United Nations Centre on  
Transnational Corporations

001337

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\* The paper has been prepared as a special contribution of the Secretariat of the United Nations Centre on Transnational Corporations for the Meeting of the Ad hoc UNCTAD/UNIDO Group of Experts on Trade and Trade-related Aspects of Industrial Collaboration Arrangements.  
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## PREFACE

1. The emergence of the management contract as a design for the relationship between a developing country Owner and a transnational corporation ("TNC") reflects at least three judgments made by the developing country:
  - (1) local ownership is to be preferred over foreign ownership, even if that ownership is not accompanied by control over operational activities;
  - (2) local technical and managerial skills are not sufficiently available to operate the project; and
  - (3) the project carries with it, at least for the short term, a valuable social economic cost benefit in and of itself, regardless of the nationality of the managers. These judgments appear with respect to management contracts of virtually all kinds.
  
2. While such judgments may embody a realistic appraisal by the developing country Owner of its present human resource capabilities, it would be inappropriate to anticipate an indefinite continuation of this arrangement. While separation of ownership and control is becoming a common phenomena for enterprises within industrialized countries, such separation is often viewed as undesirable when even operational control is vested in management organizations of a nationality other than that of the Owners. Ultimately, the developing country Owner may want to look toward fellow nationals for operational control and will thus place significant value on any management contract that accelerates the transfer of managerial and technical skills to host country nationals.
  
3. The United Nations Centre on Transnational Corporations ("UNCTC") has collected and analyzed thirty-five management contracts as part of its



programme for providing information and assistance on alternative contractual arrangements between TNCs and developing country Owners/Purchasers.

4. The UNCTC analysis undertaken indicates that management contracts deal with diverse subject matters ranging from mining operations to manufacturing or tourist projects. Moreover, management contracts seem to result from a wide variety of circumstances: turnkey construction contracts, technical assistance agreements, construction management and/or licensing agreements may involve management aspects and, to the extent they do, are appropriately to be analyzed as management contracts in order to evaluate their effectiveness for the developing country Owner. In other words, a management contract may be an integral part of a complete project development plan and either accompany a turnkey or technical assistance contract or be (probably less satisfactorily) a part of such contract. Alternatively a management contract may be entered into by an Owner independently from the initial project development plan as in the case of an Owner making the decision to adopt a management contract approach after the project facilities are in place. In the present report, the term "management contract" is accordingly being used as including those management contracts that are executed by Owners independently as an initial project as well as those that are included as an integral part of a complete development plan.

5. The present report is based upon the review of thirty-five management contracts. It consists of an introduction describing certain features, trends and problem areas of management contracts; this is followed by a descriptive analysis of the substantive provisions which are found in the majority of such contracts. Provisions dealing with subjects such as the extent of control retained by the Owner, duties to train and hire local staff, and project expenses are analyzed in order to identify critical areas that have an impact on the effectiveness of the management contract in meeting the Owner's expectations.

## INTRODUCTION

1. TNC willingness to assume the role of 'manager' rather than 'owner' in overseas operations is increasing. The management contract arrangement can thus be seen as a means by which TNCs can maintain their presence in foreign markets that may be less interested in, or attractive to, direct investment. Further, it is a means by which corporations can enter markets traditionally closed to foreign private capital, as in the socialist countries and the expanding public sectors of some developing countries. Overall, management agreements may allow TNCs to adapt their strategies to the changes in the international economic environment.<sup>1</sup>

2. Management contracts have been labelled as "a major development in the future of international business".<sup>2</sup> Clearly, they provide a framework within which the fundamental interests of both the TNC and developing countries can be reconciled.

3. The aim of a management contract is to transmit the contractor's corporate expertise to the project Owner's domestic staff so that over time it may choose to run the operation of its own accord. During the course of the defined contract period, the Manager's services may become unnecessary because, by its own efforts and presence, local managerial capability is likely to have improved to a point at which authority can be handed over to national staff. As will be discussed later,<sup>3</sup> the goal is often explicitly spelled out in the management contract by terms which prescribe -- in varying degrees -- the measures which the Manager is to take to work towards

absorbing trained locals into all phases of the project administration. Some contracts specify deadlines by which a certain number of host country nationals are to replace the expatriate staff; others provide additionally for means by which the Owner can periodically check on the progress made towards such replacement. In effect, the more rapidly and completely a management contractor meets these transfer expectations, the more successful -- from the standpoint of the Owner -- will be its performance under the agreement.<sup>4</sup>

#### Scope of the Management Assignment

4. Basically, the management contractor's assignment is to perform certain functional responsibilities related to the operation of the project as well as to make certain of its corporate resources and skills available to the enterprise during the contract period. The exact scope of the Manager's assignment will be set out, in varying degrees of detail, in the contract document.

5. Generally speaking, the management firm's duties are essentially the same as the administrative and technical functions a foreign company performs in running a subsidiary it has created by direct investment.<sup>5</sup> One writer has outlined the services that might be provided by a Manager as follows:

- i) General Management:
  - overall corporate planning;
  - organization and personnel planning.
- ii) Financial Administration:
  - financial analysis;
  - planning and budgeting;
  - borrowing;
  - control over liquid assets;
  - accounting.

- iii) Personnel Administration:
  - job descriptions;
  - recruitment;
  - promotion and job evaluation;
  - replacement of expatriate personnel by indigenous staff.
- iv) Production Management;
  - materials management;
  - purchasing;
  - maintenance;
  - quality control, including laboratory tests.
- v) Marketing<sup>6</sup>

Sales promotion, distribution, dealer relationships, and advertising might also be included among the Manager's duties.

6. A given contract might assign all or some of the above responsibilities to the management contractor. The Manager's duties might cover all phases of the project operation or might instead be limited to specific aspects, such as production, purchasing, or marketing. Further, parallel agreements to the main contract might call for specialized services falling outside of the typical management functions to be provided. Such technical services have been identified as: "special investigations, licensing, preparation of training materials, and actual selling of the local company's products."<sup>7</sup> Ordinarily, provision is made to remunerate the contractor separately for executing these additional duties.

7. The Manager typically deploys a whole range of skills and resources in order to carry out its assigned contract functions. These include personnel, technical procedures and processes as well as what have become known as its "corporate capabilities."<sup>8</sup>

8. The human resources, or personnel, provided by the management contractors commonly consist of a field staff, which acts directly on the project site throughout the contract period, and certain temporary staff - personnel who re-

main available at the home company headquarters for secondment to the project site. Such temporary staff might include specialists whose technical expertise is needed to carry out problem tasks, or reserve personnel needed to replace or add to the permanent field staff. In addition, the management firm directors will be supervising the assignment as a whole and will do so both from the corporate headquarters as well as by visiting the site from time to time.

9. Besides these back-up personnel services, the management company generally provides certain logistical back-stopping functions which support the field staff operation. Such functions derive essentially from its corporate status and thus have been described as the Manager's "corporate capabilities." Included in the scope of this term are the company's technological procedures, also books, manuals, etc., which will be useful to the project. In addition, some intangible corporate resources fall under this heading.

The purchaser of the management company's services will be able to take advantage of the corporation's access to funds, its ability to attract high caliber personnel for secondment to the project, its financial reputation, its access to world-wide procurement channels and marketing outlets, its product or service image and its ever-growing stock of research and development in products, industrial procedures, and managerial skills and techniques.

10. Most importantly, the purchasing project Owner is exposed to the organizational and management experience that is specific to the contractor's corporate condition. Transferring the ability to work together is a necessary accompaniment to the individual personal skills and technology transmitted under a management agreement if such resources are to be effectively and efficiently absorbed by the local enterprise. Such organizational abilities can be acquired

by host country nationals either through the explicit training efforts of the Manager or simply by local staff exposure to the contractor personnel's operations.

#### Management Contract Combinations

11. Under a pure management contract, the parent company provides management services to a foreign project without ownership.<sup>9</sup> Its reward is strictly related to its transmission of managerial know-how to the local venture. Frequently, however, management contracts are combined with some other form of agreement with the foreign Owner which might alter both the scope of the Manager's responsibilities as well as the nature of its reward. Such hybrid arrangements most frequently exist within the private sector rather than within the public sector.<sup>10</sup>

12. Although the emphasis of management agreements is primarily on project operation and the transfer of administrative skills, they include technical assistance provisions as well. Depending on the agreement, the Manager may be separately remunerated for its technical assistance services. Sometimes, however, management contracts will be combined with a separate technical assistance contract; each document then will relate to its respective type of service and will specify the Manager's remuneration.

13. Similarly, management contracts are often combined with licensing agreements in order to complement the transfer of the licensed technology with the expertise to use it. Likewise, management contracts may accompany contracts for the sale of capital goods which might need special instruction to facilitate their use. Combinations of independent construction and engineering agreements with management contracts have also been known to occur even though management contracts themselves may sometimes just include physical construction responsibilities within the scope of the Manager's assignment. Finally, hybrid

management contract and production-sharing arrangements have frequently been used, particularly in East-West trade.<sup>11</sup>

14. Management contracts have also been concluded in conjunction with joint venture agreements. Typically, such associations take place within the private sector. Through this type of mixed investment,<sup>12</sup> a company acquires foreign equity through, or in addition to, formally transferring its managerial skills to the project.

15. Whatever its motivation, the interest of the management contractor, in terms of returns and the period of such contract may not necessarily coincide with the development goals of the host country and the local partner, particularly in respect of rapid absorption and development of management skills. The principal terms and conditions of such contracts also require careful consideration and analysis in order to insure that rapid and effective transfer of management expertise takes place.

#### Global Trends in Management Contract Relationships

##### a. Trends

16. Management contracts and services are utilized in the public sector of developing countries and are increasingly used in the East-West context. They are common in the petroleum-related industries in the Middle East and may be increasingly utilized in several developing countries.

##### b. Sectors

17. Management agreements have found use in four major sectors: industrial; service industries/public utilities; tourism; and agricultural.

18. In the industrial sector, they are used, inter alia, to operate various primary resource mining projects, oil exploration and drilling ventures, refineries, heavy engineering and steel-making projects, aluminum plants and smelters, rubber and glass plants. They are also used to run enterprises

which manufacture agricultural implements, electronic equipment, textiles, chemicals and automobiles. Sugar refineries and pulp and paper mills **are** also operated through management agreements.

19. Management contracts have been operating in the service industries for the longest time and on the most competitive basis.<sup>13</sup> Management is provided -- often to host country public utilities -- in such areas as transportation, medical care, power supplies, forestry, telecommunications, port management, banking/finance, insurance, and others.

20. In the tourism industry, international hotel chains and often major airline companies with which they are affiliated **make** increasing use of management contracts to develop and operate local hotels and host country airlines.

21. Finally, the agricultural industry **uses** management agreements for such projects as livestock, irrigation schemes, and plantations.

c. Sources of Management Services

22. Companies in the same line of business as the local enterprise to be managed are the main source of management services. Manufacturing corporations, for example, **often are** willing to sell their managerial expertise to foreign project purchasers. Also, engineering consultancy firms may provide management services along with their preparatory studies, design work, and project supervision. Moreover, public sector agencies in some countries have offered their managerial expertise on a worldwide basis.<sup>14</sup>

23. The incentives for transnational corporations to sell their management services -- and the organizational framework within which they do so -- **are treated** in the next portion of this study.

Problems Arising Out of the Management Contract Relationship

24. Many of the difficulties that might **arise** in a management contract



relationship happen when the Manager's interests in the project conflict with the Owner's. Such conflicts usually occur when the Manager has a profit link to the enterprise or has some similar interest in its economic success, as when the venture plays a strategic part in its overall international operations. In such instances, the management contractor is likely to concentrate its efforts on making the project run efficiently and profitably even if this could lead to some divergence with the objectives of the Owner.

25. Such divergencies relate, for example, to the Manager's operating functions and its duties to train host country nationals for eventual assumption of management. Less emphasis may be given on training of local personnel as compared to meeting production targets and deadlines. Here it is important that the Manager's profit motive should not cause it to forego its training obligations in order to attend to its own operational goals.

26. A realistic assessment should also be made of the length of time required to complete the transfer of management to local personnel. Nevertheless, it has been observed that a Manager's ability to effectively reconcile its training responsibilities with operational demands is largely a matter of attitude.<sup>15</sup>

A Manager's failure to timely fulfill its training obligations may merely be a result of its reluctance to make the ultimate transfer of authority to the Owner's staff as well as of the primacy of its profit, or other interests in the project.

27. A related source of conflict between the Owner and Manager could be the way control of the project is distributed between the two parties. Ideally, the Owner will be able to follow the maxim that "experts should be kept on tap, not on top", both in negotiating a management agreement and in actually exercising the authority given it by the contract. This, however, is not always the case.

28. TNC management companies sometimes prefer to have as much control as possible for as long as possible. A Manager may successfully bargain to have terms included in the contract which effectively give it as much authority, as it might have over a wholly-owned subsidiary. Such terms might make an explicit across-the-board grant of authority to the Manager. Or instead, they might ostensibly distribute the project control between the two parties yet, because of open-ended phraseology or the way they interplay with other provisions, actually leave the Manager with an extensive amount of operating freedom. Specific examples of such arrangements are identified throughout this study.

29. Problems in this regard arise even where the contract clearly gives the Owner direct rights and areas of control, e.g., right of approval, mutual accord of parties, etc. This is because, at least at the initial stages of the relationship, the Owner might not have the technical capability or know-how to exercise such planning, controlling and evaluating functions as might be granted to it. Over a period of time, however, the Owner should be able to assume its rightful extent of control.

30. The fact that the Owner's capacities and needs may change in this manner during the course of the contract period is another important difficulty to be dealt with in management contract relationships. For example, the Owner may have an urgent short-term need for a profitably run project at the beginning of the term -- say, to assure enough revenue to meet the initial costs of development -- but not have enough well-qualified local personnel to run the project efficiently. Nor can it afford to strictly hold its Manager to training responsibilities which might interfere with the performance of the operation. Yet its long-term goal of developing local capacity for the eventual transfer of management will, at other times, make local hiring and training the project priority. And, as time goes on, the Owner may well have acquired the necessary skills to insist that the Manager adhere to its contractual responsibilities

in those areas. The contract should, therefore, be drafted in a flexible enough manner so as to be responsive to the changing needs and priorities of the Owner. Also, careful selection of the TNC to act as Manager is imperative in order to assure that it will be committed to dealing with such changes as they arise during the course of the contract term.

31. Owners have at times also been dissatisfied with the lack of project autonomy from the home offices of the Manager.<sup>16</sup> To the extent the venture's success is important to the management company's worldwide planning, in cases where there is an important feature of the arrangement, ultimate authority over the project may tend to be exercised by its senior officers charged with overseeing and coordinating the various aspects of the company's international operations. This may not always coincide with the interests of the enterprise which is being managed and with the exercise of local autonomy which is a critical aspect of management contracts.

32. Another problem faced by developing country Owners might be the unwillingness of some TNCs to sell their managerial expertise abroad without an accompanying acquisition of equity. Although, as has been discussed, TNC readiness to enter management contracts is on the rise, the Owner often may have to offer some incentives -- perhaps in the form of concessions -- to attract the corporate resources it needs. It may even risk abandonment by the Manager when such incentives cease to be available or of interest.

33. Incentives may take the form of procurement tie-ins whereby the Owner is required to purchase products or component parts from the management company. Similarly, the Manager may insist on a contractual guarantee of a portion of the project output or other source of supply. Contractual restrictions may be placed on sub-licensing and exporting by the Owner. It might even be stipulated that an excessive contractor's fee is to be paid in its home country currency, thereby draining local foreign exchange supplies.

34. Such provisions clearly work against the development needs of the Owner's host country. As a result, many host governments have established regulatory agencies and passed legislation for the purpose of screening and regulating management contracts so that they conform with the country's overall development strategy.<sup>17</sup> Approval of a particular agreement may be withheld if its terms are unfairly weighted in favor of the management company. Price controls on the cost of managerial services and special laws have also been designed to limit the import of unnecessary and excessive management skills. Some countries even have experts who keep abreast of the activities of foreign management companies within national boundaries.<sup>18</sup>

#### FOOTNOTES

1. Gabriel, Adaptation: The Name of the Game, Colum. J. World Bus. November - December, 1972, at 7-14.
2. Ellison, Management Contracts, Multinational Business, March 1976, at 28.
3. See discussion of Part V of this report.
4. Ellison, supra note 2, at 28.
5. P. Gabriel, THE INTERNATIONAL TRANSFER OF CORPORATE SKILLS, 24, (1967).
6. Westring, Aspects of International Management Contracts, in 1980 THE INTERNATIONAL CONTRACT - LAW AND FINANCE REVIEW, 402-3.
7. Id., at 403.
8. See generally, Gabriel, supra notes 1, 5; and Gabriel, New Concepts in Overall Investment, in THE ARTS OF TOP MANAGEMENT 100 (R. Mann, ed. 1971); Ellison, supra note 2.
9. M. Z. Brooke and J. Holly, International Management Contracts, (June 1980) (Unpublished paper in International Business Unit, University of Manchester), at 6.
10. Gabriel, supra note 5, at 23.
11. Westring, supra note 6, at 400.
12. Gabriel, supra note 5, at 34.
13. Brooke and Holly, supra note 9, at 25.
14. Westring, supra note 6, at 401.
15. Gabriel, supra note 5, at 153-4, 157-8.
16. Gabriel, supra note 5, at 143-44.
17. Westring, supra note 6, at 405-6; Neerso, Selected Aspects of Tanzania's Policies on Foreign Investment, 2 WORLD DEVELOPMENT 141 (1974).
18. Ellison, supra note 2, at 21.

I.  
PROVISIONS RELATING  
TO  
PRE-OPERATIONAL RESPONSIBILITIES

Overview

1. Owners and TNCs generally include sections in their management contracts pertaining to the pre-operating responsibilities of each party. If the Owner has a need for the company's expertise in the construction phase of a project, it will give the TNC a supervisory role.

Construction Phase

2. In each of the hotel contracts surveyed, the Owner is responsible for the actual construction of the facilities, but the facilities must conform with the specifications of the managing TNC. A typical provision stipulates:

Owner shall engage and retain at its own expense: architects, contractors and such engineers, designers, decorators, landscape architects and other specialists and consultants as shall be necessary and appropriate, each of whom and the contracts with whom shall be approved in advance by Manager. Said contracts shall provide that all plans, designs, specifications, drawings, layouts, etc. shall be submitted for approval to Owner and Manager prior to implementation.<sup>1</sup>

Another hotel contract lays out the rights and obligations in a similar manner, but does not require the Manager to approve the contractors in advance.<sup>2</sup> A third hotel contract gives the Owner more leeway by merely acknowledging the minimum standards employed by the Manager and stating that it will conform to these standards.<sup>3</sup>

3. Some of the hotel contracts stipulate that the Manager is to inspect the premises during or immediately after the construction period.<sup>4</sup> One of these states that the Owner shall take all measures to remedy any deficiency

indicated by the inspection and allows the Manager to accept responsibility for the hotel only on the condition that these deficiencies be remedied.<sup>5</sup>

Others do not provide for any inspection at all<sup>6</sup> or for an inspection by qualified personnel of the Manager only at the Owner's request.<sup>7</sup>

4. Industrial contracts in which the Manager is to take a supervisory role in the construction phase may broaden the Manager's responsibility in this area. The general form that most of these provisions take is to give the Manager the duty to supervise the construction without giving it the sole responsibility for this phase. Sometimes, the contract will state outright that the Manager assumes no responsibility for the construction of the plant.<sup>8</sup> More often, however, it will include as part of the Manager's duties the supervision of work done by other contractors in construction.<sup>9</sup> This type of contract will generally give the Manager the duty to prepare specifications, much like in the hotel contracts, but then to supervise and inspect the construction work while in progress.<sup>10</sup> There are some contracts, however, in which the Manager is given the full authority and responsibility for the construction phase.<sup>11</sup> In one of these, the Manager takes such responsibility in spite of the fact that a separate construction contract had been signed for the bulk of the work between the Owner and a third party.<sup>12</sup> Another provides that the Manager shall supply the staff to commission the plant.<sup>13</sup>

5. In some of the contracts, the Owner only goes so far as agreeing to provide technical assistance, in the construction phase. In one of these, the Manager will take full responsibility for the supervision of the project once operations begin,<sup>14</sup> while the others give the Owner full responsibility and authority for the project throughout.<sup>15</sup> In all cases, however, the Manager is to provide specifications on design, engineering, etc. as well as the staff to implement these specifications.

6. Some of the projects contemplated, especially in the mineral extraction area, will require the construction of ports, roads, power lines, or other infrastructural facilities. Most contracts do not specifically confer the duty to construct infrastructural facilities on either the Owner or the Manager. There is sometimes a "blanket" provision included such as the following:

Manager shall manage, direct and supervise the business and operations of the Project including the ... construction and operations of the project facilities and all other facilities that shall be used in connection with the exploration or exploitation of the Concession or with the mining and treatment thereof.<sup>16</sup>

Coupled with a subsequent provision which gives the Manager the obligation to plan and construct all necessary facilities, it appears that the Manager will decide upon and implement plans for construction of infrastructure.<sup>17</sup>

However, the Manager in this contract must also receive authorization from the Owner's Board of Directors to make investments over \$100,000 or enter into new contracts, and, will thus be unable to embark upon any major infrastructural construction without the concurrence of the Owner.<sup>18</sup>

7. Other contracts give the Manager more control over the planning and construction on infrastructure. For example:

The station shall construct, replace, repair, maintain and operate, satellite earth station together with such buildings, terminals, interconnection links, roads, warehouses and plants, as may be necessary, convenient, auxiliary, or complementary thereto, and Manager shall have all necessary authority for the performance of these functions.<sup>19</sup>

8. Another extraction contract allows the host government to finance roads, ports, and other items of infrastructure, with it being understood that the construction will conform to the specifications of the Owner and Manager.<sup>20</sup>

9. In one other extraction contract, the project is only being considered as part of a broader effort to promote new economic activities in an underdeveloped area of the country. The agreement therefore states that the govern-



ment will be responsible for financing and building the required infrastructure, but that the Manager will have an option to build this infrastructure itself and be compensated for it.<sup>21</sup> This contract may also give the Owner the responsibility to secure infrastructural facilities because it is a production -- sharing contract in which the Manager as well as the Owner is risking its equity capital. Of course, in contracts to which an agent of the host government is not a party, any kind of infrastructure will have to be included as part of the construction portion of the agreement.

#### Contracting and Procurement

10. Most contracts of all types give the Manager an important role in the selection of contractors and procurement of goods and services, but also include various restraints which can be exercised by the Owner. In contracts in which the Manager merely is to provide technical assistance, it usually also will merely provide assistance to the Owner in selecting contractors and purchasing goods and services.<sup>22</sup> One of this type of contract, however, gives the Manager slightly more responsibility in contracting out services:

... the General Manager (who is appointed by the Manager) shall make recommendations for the purpose of securing the approval of the Managing Director with respect to (i) selection of, and terms of contract with, contractors and subcontractors involving contracts for more than an amount to be determined from time to time by the Owner....<sup>23</sup>

This contract then goes on to provide that the Owner's representative can take any action he deems appropriate if no recommendation is made by the General Manager.

11. In contracts in which the Manager is to supervise during the pre-operation period, it is generally given more authority and responsibility in selecting contractors, goods, and services. In some cases, the Manager is given a wide berth in contracting and procurement. The relevant clauses of one such con-

tract read as follows:

... Manager's Powers shall include the following: (iv) Entering into contracts in the name of Owner for the construction of the Smelter, port facilities, roads, storage facilities, communications facilities, and other related facilities on a competitive bid basis ...

(v) Obtaining and purchasing such materials, supplies, equipment, and services as may be needed or required in connection with the Smelter, (etc.)<sup>24</sup>

This contract provides for relatively little control by the Owner over any possible excesses in contracting or procurement, except for the requirement of competitive bidding and a later provision (which exists in almost all management contracts) requiring periodic invoices of all expenses. A few contracts allow unlimited control to the Manager in signing contracts for goods and services, but only allow reimbursement for reasonable expenses within the guidelines established by the Board of Directors.<sup>25</sup> This may result in unforeseen obligations of the Owner to third parties and should be avoided.

12. Other contracts give the Owner more control over the contracting and procurement processes. Some stipulate that the Owner approve of all contracts made by the Manager;<sup>26</sup> many others require the approval of the Owner before any contract for services or supplies is signed with a value in excess of a specified amount.<sup>27</sup>

13. Since the Owner is primarily responsible for the construction stage in hotel projects, it will also have most of the responsibility in contracting and procurement. Since the Manager has a stake in assuring that the hotel facilities meet its worldwide standards, however, they have an interest in maintaining some degree of control over these matters. Thus, most hotel contracts give the Owner the duty to procure supplies and contract for services, but in accordance with the specifications of the Manager, who must also approve of all purchases and selections of contractors.<sup>28</sup> In one hotel contract, though,

the Manager only has the duty to present its standards, and review and recommend hotel purchase plans, without having veto power over the final selection of goods.<sup>29</sup>

#### Pre-Opening Programs and Training

14. Each of the complete hotel contracts allows for a pre-opening period, after all facilities have been constructed. This period is apparently desired due to the special nature of the hotel business, since any hotel must have a trained staff and clientele before it can commence operation. The contracts give the Managers varying levels of discretion and funding. Two of them require the managing company to submit a plan for an organization, services and sales program for the Owner's approval.<sup>30</sup> Another one allows for a pre-opening program as the Manager deems advisable or necessary.<sup>31</sup> A pre-opening fund is to be established for some contracts by the Owner, out of which the Manager may draw out reasonable expenses and be reimbursed for any drawings which exceed that amount.<sup>32</sup> Some of the hotel contracts include a test period before the formal opening so as to make sure that the hotel is running smoothly before its services are used by its customers.<sup>33</sup>

15. In the hotel contracts, training of the staff by the Manager is considered part and parcel of the pre-opening period. In many of the other contracts, in which training is also expected to play a major part, there is no specific provision for training of staff before the projects become operational.<sup>34</sup> Since one of the most important reasons that host countries utilize the services of managing companies is for the training of their nationals, and Managers may be reluctant to replace their own top staffers with host country nationals until the last possible moment, it would be necessary for host countries to provide a clause in their contracts saying that the Manager will begin to train its nationals during the pre-operating period.

There are some non-hotel contracts in which specific provisions are made for the training of local personnel prior to the start-up period at the request of the Owner<sup>35</sup> or for a completed training plan to be submitted within 90 days of the execution of the contract.<sup>36</sup>

#### Reimbursement and Compensation

16. As has been enumerated above, the pre-operations period is a time in which the Manager is performing various special functions, most of which are not producing revenue. Since a major reason why managing companies enter into management contracts (rather than, say, contributing all of the equity themselves) is to receive compensation for their services with a minimal exposure to risk, it is not surprising to see clauses in many of these contracts providing the Manager with different types of fees besides a percentage of revenue or profits. In some contracts, in which the scope of the Manager's services is different during the pre-operating period than during the operating period, the Manager's compensation will differ, but this is not always the case.<sup>37</sup>

17. Virtually every contract which has a pre-operating period provided for reimbursement of the Manager's expense during this time, including salaries paid to its employees, transportation costs, and overhead. (This was not done in contracts in which the Manager was to provide part or all of the equity.) This was done in some contracts out of a fund set up during the pre-operations period,<sup>38</sup> in some contracts on a periodic basis after expenses are itemized by the Manager during the pre-operations period,<sup>39</sup> and in some on a periodic basis once the project is in operation.<sup>40</sup> Several contracts provided for control by the Manager over the amount to be reimbursed, usually by means of a pre-operating budget which could only be exceeded with the approval of the Owner.<sup>41</sup>

18. In many contracts, there are special payments to be made to Managers over and above their reimbursable expenses. Sometimes, there is to be compensation

for feasibility studies done by the Manager.<sup>42</sup> At other times, there is to be a fixed management fee, either specified for the pre-operations period,<sup>43</sup> for technical services during the construction period,<sup>44</sup> or as a commitment fee in consideration for executing the agreement.<sup>45</sup>

FOOTNOTES

1. Contract 2, p. 6.
2. Contract 3, p. 2.
3. Contract 11, p. 13.
4. Contract 6, Oct. 15 Amendment, p. 2; Contract 3, p. 4.
5. Contract 3, p. 4; also see Contract 11, pp. 14-15.
6. Contract 2.
7. Contract 11, pp. 5-6.
8. Contract 15, p. 11.
9. Contract 22, p. 12.
10. Contract 29, p. 5; Contract 32, p. 3.
11. Contract 35, p. 4; Contract 23, p. 2.
12. Contract 35, p. 1.
13. Contract 4, p. 3.
14. Contract 13, p. 13-46.
15. Contract 28, p. 7; Contract 25, p. 15.
16. Contract 19, pp. 5-6.
17. Contract 19, p. 6; Contract 1, p. 4.
18. Contract 19, p. 4.
19. Contract 21, p. 5.
20. Contract 22, p. 16.
21. Contract 18, pp. 13-14.
22. Contract 4, p. 2; Contract 13, p. 13-46.
23. Contract 25, p. 16.
24. Contract 1, p. 4.
25. Contract 23, pp. 8-9.
26. Contract 32, p. 3; Contract 15, pp. 4-5; Contract 19, p. 5.

27. Contract 30, p. 4; Contract 22, pp. 21-22; Contract 10, p. 4; Contract 5; p. 7.
28. Contract 2, p. 6; Contract 3, p. 2.
29. Contract 11, pp. 7-8, 11-13.
30. Contract 6, p. 20; Contract 11, p. 17.
31. Contract 3, p. 4.
32. Contract 2, pp. 7-8; Contract 11, pp. 16-18.
33. Contract 2, p. 8; Contract 6, pp. 20-21.
34. Contract 7, p. 8; Contract 13, pp. 13-47; Contract 25, p. 8.
35. Contract 12, p. 39.
36. Contract 22, p. 39.
37. See Contract 11.
38. Contracts 2, 11.
39. Contracts 3, 11, 31.
40. Contracts 15, 22.
41. Contract 11, p. 17; Contract 17, p. 8.
42. Contract 22, p. 22.
43. Contract 34, p. 6; Contract 6, p. 19; Contract 19, p. 9; Contract 23, pp. 6-7.
44. Contract 13, p. 13-57.
45. Contract 3, p. 10.

## II.

### PROVISIONS RELATING TO THE OWNERS' CONTROL

#### Overview

1. It is difficult for any Owner, be it a private, semi-public, or public body, to maintain full control of a development project initiated, managed or supervised by a foreign management contractor. The Owner typically is obliged to enlist the aid of the Manager because it lacks the means of evaluating the feasibility and profitability of the project, access to international financing, and the technical expertise at all levels from management down to see the project through to successful completion. There is thus from the start a fundamental inequality between the Owner's and Manager's positions.
2. Despite inadequate control exercised by Owners in a number of cases, equitable and mutually beneficial contracts have been and continue to be negotiated between Owners in developing nations and foreign Managers. It is clear, however, that the importance of development projects both as a means of generating resources capable of aiding the overall development of the country or region, and, in narrower terms, as measured by the wealth that they produce, is too great to leave only to the good intentions of the Owner and the Manager at the start of the negotiation process. Progress has been made in narrowing the inequality of position between Owner and Manager in certain sectors, notably in some service industries such as tourism and in strategic mineral exploitation due to a combination of factors: growing Owner sophistication; competition among Managers to supply the needed services; worldwide demand for the goods or services the project will create. Such progress is important since a contract negotiated between equals is much more likely to be stable and beneficial to both parties and to instill in them the desire to derive maximum profit from their mutual association.



3. To this end, provisions detailing various aspects of Owner control of development projects are found in almost all management contracts. They differ from one another in degree of specificity, degree of duty or prohibition defining the acts of the Manager, and degree of encouragement given secondary and distinct development goals through the medium of the project itself. All share, however, the ultimate aim of allowing the Owner to exercise greater responsibility.

#### Express Control

4. Almost all of the management contracts examined for this survey include a general proviso or catch-all clause that all major policy decisions affecting the operation of the enterprise will be made by the Owner's Board of Directors and not by the Manager.

5.1.12 Operating Policies. Subject to the proviso that all major policy decisions shall be made by the Board of Directors of Manager, (shall) determine all operating policies including appearance and maintenance of airline facilities and aircraft, customer services and relations, and all phases of promotion.<sup>1</sup>

5. In one instance, the catch-all phrase is included in the recitation at the beginning of the contract,<sup>2</sup> but it is repeated in an express provision within the body of the contract.<sup>3</sup> Almost all others simply include a short express provision reserving all major policy decision-making to the Owner's Board.

6. The catch-all phrase is not a particularly effective tool for curbing excessive or overreaching activity on the part of a Manager. No specific prohibitions governing the Manager's activities are included, nor are such operative words as "major decisions" defined.

7. To cure the defects inherent in the catch all phrase, the majority of the contracts surveyed include an express enumerative provision denying the Manager specific powers:

SECTION 2.02. Manager shall not do any of the following acts or things unless specifically authorized by resolution of

the Board of Directors of Owner:

- (a) enter into any agreement for the borrowing of money, other than by way of a bank loan or overdraft not exceeding at any one time outstanding U.S. \$500,000 or its equivalent in (host country currency);
- (b) make any one investment in excess of U.S. \$100,000 or its equivalent in (host country currency) in respect of land, buildings, materials, equipment, securities or other property, provided, however, that this restriction shall not be applicable to purchases in the ordinary course of the business of Owner;
- (c) enter into any agreement for the issue or subscription for shares of Owner;
- (d) enter into any agreement for the production or sale by Owner of ferro-nickel or of any other product, or for the amendment of the Sales Agreement;
- (e) enter into any agreement by which funds of Owner are held in trust, or for the amendment of the Current Accounts Trust Agreement;
- (f) enter into any agreement to provide Owner with management services or for the amendment of this Agreement;
- (g) modify or conduct negotiations with respect to the modification of the Basic Agreement, the Supplementary Agreement, the World Bank Loan Agreement or the Owner Loan Agreement;
- (h) enter into any contract for the construction of any of the Project facilities or for the amendment of any such contract;
- (i) make application on behalf of Owner for any mineral concession or exploration permit or lease or otherwise acquire any mineral concession or exploration permit or rights in or to the same;
- (j) discontinue, pledge, lease, transfer or dispose of any part of the Owner business;
- (k) lend money or guarantee any indebtedness;
- (l) undertake any program of exploration or exploitation;
- (m) do any act of thing inconsistent with the obligations of Owner under the Basic Contract, the Supplementary Agreement, the Sales Agreement, the Current Accounts Trust Agreement, the World Bank Loan Agreement, the Owner Loan Agreement or any other agreement to which Owner is a party.

SECTION 2.03. Manager shall not have power to deal with any matter which under the Charter and By-laws of Owner or the laws of the (host country) is required to be dealt with at a meeting of stockholders.<sup>4</sup>

8. One of the contracts examined included a positively defined retention of major rights by the Owner rather than an express denial of rights to the Manager:

9. Rights Reserved by

the Project Company - In addition to the Project Company's right to approve the plans and budgets as provided in Section 4 above and without limiting all rights not delegated to Manager under this Agreement and notwithstanding any other provisions in this Agreement to the contrary, the Project Company hereby expressly reserves the power and authority to exercise through its Board of Directors the following rights:

9.1 To select its Managing Director.

9.2 To approve any borrowing of funds.

9.3 To approve all capital expenditures. The authority to make capital expenditures in emergency situations of no more than U.S. \$50,000 in the aggregate of or the equivalent thereof in any one fiscal year out of contingency funds provided for in the approved budgets, shall be delegated to Manager.

9.4 To review and approve the plans for construction and operation of any Associated Activity.

9.5 To exercise any and all rights not herein delegated to Manager.<sup>5</sup>

9. It seems, however, that a specific denial of powers to the Manager is a more effective tool in controlling potentially unauthorized actions on its part. Despite the language in the contract quoted above which attempts to delineate those powers delegated to the Manager by other provisions elsewhere in the contract, certain ambiguities remain and could conceivably create problems later in the contractual relationship. The Owner would seem better served by an express listing of those actions and powers specifically denied the Manager; a bright line test removes ambiguity and allows the Manager sufficient flexibility to operate the enterprise within the bounds set by the Owner.

10. In some contracts, usually dealing either with the exploitation of an unprocessed resource or with the introduction of a previously absent service industry, another means of enhancing Owner control is seen. A separate company is set up to manage the project, with both the Owner and Manager given seats on the governing board. As the Manager typically does not provide start-up capital, it is not a true joint venture. It does, however, offer some of the same advantages, giving the Owner a much greater say in the actual operation of the project. Coupled with a provision similar to those just discussed, this may provide one means of ensuring the Owner a greater degree of effective control. Reference can be made, for instance, to an agreement between a Government Owner and a Manager for the initiation of satellite communication service.

11. "It is contemplated that the Company will have a Board of seven Directors, three of whom, including the Chairman, will be appointed by the Government. Manager will appoint the other four, and one of these will also be the Managing Director of the Company. The Board will establish the policies of the Company, and the Managing Director will implement and give practical effect to such policies and manage the day to day affairs of the Company. First line staff members reporting to the Managing Director, as well as all other employees of the Company, will be nationals to the extent that such nationals possess the necessary technical and managerial skills required for effective Company operation. Where training is required, it will be provided by the Company as detailed in paragraph 51 of this Agreement."<sup>6</sup>

12. Such a solution may not be effective or appropriate in all situations, particularly where the Owner lacks requisite expertise. It is also likely that some Managers would decline to accept such a limitation on their free action, fearing that the Owner's domestic political and economic considerations

might hamper the profitable operation of the project. Still, it does offer some new possibilities deserving of further examination.

Express Manager Duties

13. Besides provisions detailing limitations on actions of the Manager, most management contracts also include clearly defined listings of affirmative duties of the Manager to be accomplished under the contract. If the clause is drafted with sufficient specificity so as to include all Manager duties that the Owner contemplates being undertaken for the project, an express listing of general duties is a useful tool. It helps lessen the level of ambiguity inherent in a contract governing a multi-faceted Owner-Manager relationship and provides a ready means of evaluating the work of the Manager.

GENERAL FUNCTIONS OF THE ADMINISTRATOR  
DURING FULL CONTRACT TERM

During the entire term of this Agreement, the Manager shall have the following general authorities, responsibilities and obligations:

1. To exercise directly, without contracting with or transferring to third parties (except as permitted by Clause Thirty-Three) the final management, supervision and administration of the Project, subject to the limitations contained in this Agreement and in the Articles of Incorporation of Owner.
2. To supervise the accounting and handling of the funds of Owner.
3. At each monthly meeting of the Executive Committee of Owner, to report concerning the operations, affairs and financial condition of Owner, and to submit monthly reports to the Board of Directors of Owner, as to the preceding month's operations of Owner, such report to be submitted within the first twenty (20) days following the end of the preceding month.
4. To maintain and operate the property of Owner.
5. To recommend the acquisition of properties, lands and rights necessary for development of the Project, including, among other rights, rights to use railways, ports and other installations owned by third parties.

6. To cause Owner to contract for and maintain insurance customarily maintained with respect to activities of the same character as the Project.
7. To provide for compliance with applicable laws and regulations concerning safety, environment, and otherwise, applicable to the operation of the Project.
8. To provide for the preparation and processing of patents, trademarks, trade names, copyrights, permits and other rights in the name of Owner, when the Administrator considers the same necessary or advisable in the interest of the Project.
9. To carry out activities necessary to deal with situations of emergency involving risks to persons or property or interfering with the normal conduct of the development and operation of the Project.<sup>7</sup>

14. Almost without exception, the listing of formal Manager duties is accompanied by formal reporting requirements imposed on the Manager. It is obliged to inform the Owner's Board at specified intervals on the development of the project.

(3) During the term of this Contract, the Management Company submit to the board of directors of the Owner:

- (a) Not later than the thirtieth (30th) day of each successive calendar month, a report, in a form approved by the board, on the conduct of the Enterprise during the preceding month:
- (b) Not later than sixty (60) days after the last day of March, June, September, and December in every year, a statement, in a form approved by the board, of the revenues and expenditures during the preceding quarter, together with such other documents as may be necessary or desirable to acquaint the board with the state of the Enterprise:
- (c) Not later than sixty (60) days preceding the last day of each financial year of the Enterprise, estimates, in a form approved by the board, of capital and revenue expenditure and estimated income of the Enterprise for the next ensuing financial year: and
- (d) Not later than ninety (90) days following the last day of each financial year of the Enterprise, a report, in a form approved by the board, on the conduct of the Enterprise, together with a balance sheet and profit and loss account of the Enterprise for the preceding financial year, together with a long form audit report and certificate, in a form mutually agreed upon by the board and the Manager.

(4) The Manager shall submit to the board semi-annual reports on world and local marketing conditions affecting the Enterprises's products.

(5) The Manager shall produce for the board or its duly authorized representative, whenever so requested, all correspondence and other documents relating to the Enterprise and shall provide the board with such copies or extracts thereof or therefrom, as the board from time to time requires.<sup>8</sup>

15. Similarly, many contracts require the Manager to develop the annual operating budget for the project and to submit it to the Owner for approval.

ARTICLE 6. At least thirty days before January 1 of any calendar year during an Effective Period, Manager shall furnish to the Board of Directors for its approval a proposed budget for the operations of Owner in such calendar year, and shall cause the directors to submit such budget to a General Meeting of Owner for approval of the shareholders. Manager shall make such revisions of the budget as the Board of Directors or the General Meeting may direct, and shall not, in the exercise of Manager's powers during the calendar year, undertake major departures from the budget without the prior approval of the Directors and the shareholders in General Meeting.<sup>9</sup>

16. The proviso prohibiting the Manager from altering a budget for the project that has been approved by the Owner is seen in most of the budgetary provisions. Normal procedure is for the Manager to request an additional appropriation or approval for increased expenditure from the Owner should conditions surrounding the project so require.<sup>10</sup>

17. A final concrete duty imposed on the Manager in most of the contracts examined is the duty to allow, and in some cases to prepare for on-site inspection of the project by the Owner, as well as inspection of operating records and other project-related documentation. Normally such provisions specify that inspection will be carried out during normal working hours and with as little disruption of project operations as possible.

21.9 Manager shall cooperate fully with the Owner in providing access for all directors and officers of the Owner or other persons on authorized business to visit and inspect at all reasonable times any of the Project areas, sites, works, facilities, and activities.<sup>11</sup>

18. All of the duties imposed by the Owner on the Manager that have been examined in this section are reasonably efficacious means of improving, if not guaranteeing, effective Owner control of the project. The combination of specific tasks created for the Manager with the Owner's budgetary control and inspection rights means that if the Owner has sufficient expertise and sufficient will to exercise the rights it has reserved for itself, it may enjoy a reasonable amount of control over the direction of the project.

#### Miscellaneous Control Provisions

19. A survey of management contracts reveals several discrete provisions that may in some circumstances serve to increase or solidify Owner control of the project, or perhaps more generally, are attempts to favor the Owner. One such provision which commonly appears in contracts governing production projects is an express grant to the Owner of an advisory role in setting programs of and goals for production, marketing techniques, price levels, etc. The Manager agrees to give weight to the desires of the Owner in these areas, subject always to the caveat that such wishes need be heeded only if the Manager judges them to be economical and in the best interest of the project's successful operation.

#### C. Determination of Production

The Manager shall determine the types, qualities and quantities of paper and pulp products to be produced by the Mill; provided, however, that the Manager shall give full weight to the desires of the Board of Directors of the Owner with respect thereto as long as such desires would not, in the judgment of the Manager, impair the efficient and effective functioning of the Mill.

#### D. Sales Administration

The Manager shall be responsible for developing, organizing and managing the sale of the products of the Mill; provided, however, that the Manager shall give full weight to the desires of the Board of Directors of the Owner with respect to the organization of the sales program of the Mill.<sup>12</sup>



20. The worth of such a provision rests primarily in the institutionalizing of Owner participation in the day-to-day management of the project. Although the perimeter of Owner control in this circumstance is clearly limited to the advisory, it is helpful to the extent that control extends further and in a more defined manner than was provided for in some of the more general provisions noted above (e.g., prohibition of certain Manager acts, etc.).

21. Two of the contracts<sup>13</sup> in this survey provide the Owner with unusually favorable termination rights, be they solely discretionary or at the end of a relatively brief time, certain. Liberal termination rights for the Owner are an unusually effective tool for increasing control; fear of an early termination would tend to increase the Manager's desire to meet the spirit as well as the letter of the contract. In addition, the Owner retains considerable flexibility and may find itself, assuming there is development of its resources, personnel, and expertise, with the opportunity of successfully managing the project itself.

FOOTNOTES

1. Contract 5, Article 5.1.12. See also: Contract 1, Article 2; Contract 6, Article 6(16); Contract 8, Article 3; Contract 9, Article 4(e); Contract 13, Article 2; Contract 15, Article 2(3)(a); Contract 16, Article 2; Contract 20, Article 3(3); Contract 23, Articles 2 & 2(i); Contract 25, Article 3; Contract 26, Article 11(a).
2. Contract 10, Recital.
3. Contract 10, Article 4.01.
4. Contract 19, Article 2(2)(a-m) and Article 2(3). See also: Contract 1, Article 2(c)(I-Xvii); Contract 2, Article 6(2); Contract 3, Article 4(4)(b-c); Contract 5, Article 5(1)(6); Contract 6, Articles 2(2) & 5(3); Contract 10, Article 2(3)(c)(i-xvii); Contract 22, Articles 6(1-3) and 24(1-8); Contract 30, Article 3(1); Contract 35, Articles 2(b)(ii) & 3(L); Contract 36, Article 16.
5. Contract 8, Article 9(1-5).
6. Contract 21, Clause 1. See also: Contract 22, Clause 1.
7. Contract 22, Clause 5(1-9). See also: Contract 1, Clause 2(b)(i-viii); Contract 5, Clause 5; Contract 7, Clause 5; Contract 21, Clause 32; Contract 22, Clauses 4(1)(a-L), 4(2)(a-c), 4(3)(a-i), & 4(4)(a-h); Contract 23, Clause 2(a-i); Contract 24, Clause 3-4; Contract 25, Clause 2(1)(a); Contract 27, Clause 2(3); Contract 29, Clause 4(1-9); Contract 30, Clause 2(2); Contract 31, Clause 2(1)(1-11); Contract 32, Clauses 1(1) & 3(3); Contract 33, Clause 3(2); Contract 34(1)(a)(i-viii); Contract 35, Clauses 2 & 3; Contract 36, Clause 2(a-b).
8. Contract 13, Clause 2(F)(3-5). See also: Contract 5, Clauses 5, (1)(1) & 5(1)(10); Contract 6, Clause 5(1); Contract 7, Clause 4(1.3); Contract 7, Clause 4(a-d); Contract 8, Clauses 12 & 20; Contract 9, Clauses 5(f) & 4(c); Contract 10, Clause 4(5); Contract 11, Clauses 11(4), 16(1) & 25(1); Contract 15, Clauses 2(6) & 5(18); Contract 16, Clauses 2(c) & 6(f); Contract 17, Clauses 6(b) & 9(c); Contract 19, Clause 5(1); Contract 20, Clauses 6(6)(a-g) & 7(1); Contract 22, Clause 3(1); Contract 25, Clause 2(1)(6); Contract 26, Clause 8(h)(1); Contract 30, Clauses 4 & 6; Contract 32, Clause 3(5); Contract 33, Clause 5(1-2); Contract 35 - 3(G)(2-5).
9. Contract 1, Clause 6. See also: Contract 2, Clause 7(4); Contract 6, Clause 6(1); Contract 30, Clause 9.
10. See, e.g., Contract 1, Clause 6; Contract 6, Clause 6; Contract 7, Clause 4(1.4); Contract 15, Clause 2(6); Contract 22, Clause 8(5).
11. Contract 8, Clause 21(9). See also: Contract 2, Clause 7(3); Contract 3, Clause 4(5); Contract 6, Clause 8(4); Contract 9, Clause 12(a-e); Contract 11, Clause 25(2); Contract 22, Clause 22.
12. Contract 35, Clause 3(c-d). See also: Contract 4, Clause 6; Contract 5, Clause 6(4); Contract 8, Clause 2(c); Contract 14, Clause 2(5); Contract 16, Clause 2(B); Contract 31, Clause 2(5).
13. Contract 1, Clause 18(B)(ii) and Contract 29, Clause 2(3-4).

### III.

#### PROVISIONS RELATING TO THE OWNER'S OBLIGATIONS TO MANAGEMENT

##### Overview

1. The general perspective from which to analyze the obligations of the Owner to Management is one that views these obligations at the beginning of performance of the contract and also anticipates how these obligations might change over the life of the contract given its provisions. From the Owner's point of view, contract provisions may be judged according to the degree of flexibility they allow the Owner in fulfillment of its responsibilities after it has secured the initial commitment of technology and know-how from the managing party. From the Manager's point of view, these same provisions may be judged according to the degree of practical control it will retain over the Owner's supply of services. In general, vagueness and omission may work in Management's favor at the beginning of the performance of the contract, but as the Owner receives more and more of Management's contracted expertise, it will be inclined to place less and less importance on meeting Management's requests for services arguably not covered by this vague language. This vagueness appears in the form of the following issues that can be seen in the contracts examined:

- use of general standards, such as "adequate," "necessary," "reasonable;"
- failure to provide standards;
- use of general industry or status-related standards;
- failure to stipulate which party has authority to determine a particular standard or the need for a particular service;
- failure to provide for other means of meeting a particular standard or service requirement;

-vagueness regarding time requirements;

-failure to require assurances of one party's ability to perform an obligation.

2. An Owner's obligation to assist Management in carrying out the terms of its contract can be divided into five categories: first, to provide housing, office facilities and transportation for management staff; second, to provide administrative, clerical, and security services; third, to represent the enterprise before the Owner's government and to obtain permits, licenses, and other forms of approval from the government; fourth, to keep financial records for the enterprise; finally, to provide Management with data, reports and documents.

3. It is sometimes helpful to classify the contracts according to their subject matter. The contracts reviewed can be divided into five general areas: (1) construction and engineering management; (2) hotel construction and management; (3) petroleum production assistance; (4) mining assistance; (5) management of completed production facilities.

A. Housing, Transportation, and Office Facilities

Construction and Engineering Management Contracts

4. Four different kinds of provisions are used in these contracts. One provision of one contract<sup>1</sup> merely requires the Owner to provide "quarters for field staff employees" without stating any standards.<sup>2</sup> A provision of another contract requiring the Owner to provide transportation also does not state any standards. In addition, provisions of three contracts<sup>3</sup> use general terms such as "suitable," "adequate," and "appropriate" to describe office facilities to be provided by the Owner. Third, one contract, in describing living quarters to be provided, couples these general terms with the requirement that "such living quarters shall be equivalent to the standard of living quarters normally available to persons of the same standing ..." in that industry.<sup>4</sup> Finally, two contracts stipulate standards verifiable by comparison within the enterprise

by requiring living quarters to be "commensurate with the salary, position, and requirements of the Field Staff."<sup>5</sup> It also supplies a list of minimum requirements. Another contract requires that housing and office facilities be "in accordance with the standards current in the Adviser's organization..."<sup>6</sup>

#### Hotel Construction and Management

5. These contracts contain five kinds of provisions. First, one contract requires the Owner to provide an automobile to Management without stipulating and standards for the car.<sup>7</sup> Second, one provision of one contract requires the Owner to provide "adequate" office space.<sup>8</sup> Third, two contracts contain provisions requiring the Owner to provide supplies, facilities or housing necessary to the performance of services by the management without stating which party would so determine what is "necessary."<sup>9</sup> Another contract, on the other hand, stipulates that the Owner shall provide "all services and payments ... deemed necessary by [management] ..." <sup>10</sup> Finally, another provision in the same contract requires that the General Manager receive living facilities customarily provided the General Manager of other management's first class hotels, and listed some of the services required.<sup>11</sup>

#### Management and Administration of Completed Production Facilities

6. One contract requires the Owner to provide certain members of the management staff with a private automobile without stipulating any other standards.<sup>12</sup> With regard to facilities, three different standards are used. One contract requires the Owner to provide office accommodation "required by [Management]" without stipulating which party is to decide what is "required."<sup>13</sup> This same contract also contains terms requiring the Owner to provide living quarters, the furnishings of which are described in detail.<sup>14</sup> Finally, one contract requires the Owner to provide living quarters which are equivalent to those "normally available to persons of the same standing in [that] industry."<sup>15</sup>

7. Almost every provision regarding housing and office facilities stipulates some quality standard with which the facilities provided by the Owner must comply. Only transportation provisions regularly lack such standards. Among the non-transportation provisions, one kind merely requires "adequate" or "suitable" facilities, a standard giving a great deal of discretion to the Owner.<sup>16</sup> This kind of provision, however, is used extensively only among the contracts for construction and engineering management and only to set standards for office facilities. The most stringent kind of provision from the Owner's point of view is also that used most frequently. It requires facilities described in a detailed listing within the contract or some other document.<sup>17</sup> Midway between these two extremes are provisions which set standards according to those generally seen in that industry.<sup>18</sup> This kind of provision, however perhaps because of the problem involved in agreement on and verification of standards in the industry, is seldom used. Most problematic are the provisions requiring facilities such as are necessary for management to carry out its obligations. Where management reserves the right to determine what is "necessary," these provisions give it almost absolute power to set standards.<sup>20</sup> Where no party is stipulated, these provisions will likely be no more helpful than the "adequate" provisions.<sup>21</sup>

B. Administrative, Clerical, and Security Services

Construction and Engineering Management

8. These contracts contain provisions regarding security services. One contract requires the Owner to provide "adequate" security forces.<sup>22</sup> Another stipulates that the Owner will provide "such security forces ... as the Management Company determines to be required."<sup>23</sup>

Hotel Construction and Management

9. All the contracts analyzed contain the same kind of general provision.

This provision requires the Owner to provide all administrative and clerical support services deemed necessary by the management.<sup>24</sup> This is coupled with a more detailed list of some of the required services. In addition, one contract states that this does not limit management's right to request unenumerated services.<sup>25</sup>

#### Management of Completed Production Facilities

10. Three out of four contracts contain general provisions requiring the Owner to provide support services. One contract requires the Owner to provide "such other assistance to [management] as [management] shall reasonably request."<sup>26</sup>

Two contracts not only require the Owner to pay for "all necessary facilities and services," but also place the acquisition of services and facilities in the hands of management.<sup>27</sup> In addition, two contracts stipulate that security forces are to be provided. One requires the Owner to provide any security deemed necessary by management.<sup>28</sup> The other states, "The Owner, with the assistance of the Management Company, shall make arrangements for adequate security forces to safeguard personnel and property...."<sup>29</sup>

11. In regard to security forces, the important issue is control over determination of what services are to be provided to management. Whereas two contracts allow management complete discretion (not even within the bounds of "reasonableness"),<sup>30</sup> two others, by requiring only "adequate" security, effectively give the Owner the right to determine what forces will be supplied.<sup>31</sup> The latter provision seems more likely to ensure the legitimate interests of both parties so long as the Owner is able to control, or obtain government assistance in controlling, the local security situation.

12. With the catch-all provision for administrative support, all but one of the contracts give management the effective right to obtain all services it desires. Either by requiring the Owner to provide services it deems necessary or to pay

for services obtained by management, these terms deny the Owners any control over the discretion of management. On the other hand, one contract provides at least a loose standard of "reasonableness" by which the Owner could limit management's use of this clause.<sup>32</sup> The effectiveness of this loose constraint would seem to depend on the Owner's ability to suggest alternate means of fulfilling management's requests for support when the Owner wants to avoid hiring more personnel or acquiring new equipment.

C. Representing the Enterprise Before The Owner's Government  
And Obtaining Permits, Licenses, And Other Forms of Approval  
From The Owner's Government

13. Most, but not all the contracts contain provisions stipulating certain matters concerning which the Owner is required to represent the enterprise before the government and for which the Owner guarantees government approval. The provisions differ not according to the particular subject matter of the contract involved, but rather regarding the extent to which Owner's obligations include more than mere representation; i.e., actual guarantee of approval for various matters.

1) Four contracts require the owner to designate an official to represent it in all matters relating to the contract.<sup>33</sup> The Owners, however, do not guarantee government approval of any particular matter.

2) Six contracts place general responsibility for ensuring the legality of the enterprise with the Owner.<sup>34</sup> Five of the contracts make the Owner solely and absolutely responsible for complying with all regulations in the particular field,<sup>35</sup> for making the agreement legally effective,<sup>36</sup> or for obtaining all government approval whatsoever.<sup>37</sup> One contract, however, requires only that the Owner "shall generally act as Government liaison so as to assist [Management] in obtaining all necessary Government approvals...."<sup>38</sup>

3) Five contracts require that either the Owner obtain or the Owner's government issue such items as permits and licenses necessary to performing the



operations of the enterprise.<sup>39</sup> Four of the contracts stipulate that management is to be provided with all such items as are "necessary" or "required."<sup>40</sup> Another contract requires the Owner to obtain those that "[Management] may from time to time request."<sup>41</sup>

4) Many, but not all, contracts require the Owner to make all arrangements for immigration papers, work permits, residence permits, and other permits necessary to the management's employees and dependents residing in the Owner's country.<sup>42</sup> Another contract also provides the "[Management] shall not be liable for any delay or failure to issue any permit visa...."<sup>43</sup>

14. The large number of contracts requiring the Owner to take the responsibility of acting as the enterprise's representative before the Owner's government attests to the logic and efficacy of such an arrangement. In addition, requiring the Owner to obtain government approval, permits, and papers, comply with regulations, or ensure that the contract becomes legally effective, as most of these contracts do, does not seem unduly burdensome for the Owner given the fact that many of the Owners in these contracts are public or quasi-public entities.<sup>44</sup> On the other hand, provisions that do not assign responsibility for some matters<sup>45</sup> or are couched in vague terms<sup>46</sup> may prove inadequate if Management relies on Owner's presumed ability to handle these matters while the Owner is not aware of the potential costs of seemingly minor delays. Therefore, those contracts that require the Owner to provide, for example, all permits "necessary" may not serve the situation where Management has made sure that the Owner is knowledgeable of government requirements yet has not taken steps to ensure the exact date by which these requirements will be handled. Assigning the Owner full liability for such delays may not be warranted in this context.

D. Financial Records

15. Four kinds of provisions require the Owner to keep financial records for

the enterprise, each differing in regard to the standards for judging the quality of the account kept. Not enough contracts contain these provisions to enable an industry-specific analysis.

1) One contract requires the Owner to keep books of accounts, "complete in every particular, as may be necessary or proper" to ascertain a fee due the Management under another provision of the contract.<sup>47</sup>

2) One contract requires the Owner to keep books of account "in accordance with generally accepted airline accounting standards and procedures."<sup>48</sup>

3) Two contracts require the Owners to keep accounts in accordance with procedures detailed in appendices attached to the contract.<sup>49</sup>

4) One contract requires the Owner to "obtain and pay for an annual audit performed by an internationally respected independent accounting firm acceptable to [Management]."<sup>50</sup> It then details management's present accounting system for reference.

#### E. Data, Reports, and Documents

16. Two different provisions regarding the Owner's duty to provide Management with data, records, and documents are seen in various combinations. Not enough contracts contain these provisions to enable an industry-specific analysis.

1) All the contracts containing provisions relating to data, reports, and documents stipulated that only materials "necessary," "pertinent," or "required" are to be provided.<sup>51</sup>

2) Two contracts require that these materials be provided within "a reasonable time"<sup>52</sup> or "without reasonable delay."<sup>53</sup>

17. These provisions leave much discretion with the Owner as to what materials are to be provided since management might not be aware of Owner's possession of some documents or data unless Owner wishes to provide time. Given this possibility, the requirements of provision within a reasonable time may be ineffective.

FOOTNOTES

1. Contract 17, p. 9.
2. Contract 17, p. 9.
3. Contract 17, p. 9; Contract 13, pp. 13-62; Contract 29, Sec. 8.4.
4. Contract 14, p. 18.
5. Contract 13, pp. 13-62.
6. Contract 28, schedule V.
7. Contract 6, p. 16.
8. Contract 33, p. 10.
9. Contract 33, p. 10; Contract 3, p. 7.
10. Contract 6, p. 17.
11. Id., pp. 29-30.
12. Contract 31, pp. 25-26.
13. Contract 35, pp. 23-24.
14. Id., pp. 24-25.
15. Contract 31, Sec. 6.08.
16. Contract 17, p. 9; Contract 13, pp. 13-62; Contract 29, Sec. 8.4; Contract 33, p. 10.
17. Contract 13, pp. 13-62; Contract 28, schedule V; Contract 6, pp. 29-30; Contract 25, pp. 24-25.
18. Contract 14, p. 18; Contract 31, Sec. 6.08.
19. Contract 33, p. 10; Contract 3, p. 7; Contract 6, p. 17; Contract 35, pp. 23-24.
20. Contract 6, p. 17.
21. Contract 33, p. 10; Contract 3, p. 7; Contract 35, pp. 23-24.
22. Contract 14, Sec. 6.05.
23. Contract 13, pp. 13-62.
24. Contract 33, p. 10; Contract 11, p. 7; Contract 6, p. 16.

25. Contract 6, p. 16.
26. Contract 32, Sec. 6.6.
27. Contract 35, p. 27; Contract 16, p. 23.
28. Contract 35, p. 27.
29. Contract 31, Sec. 6.05.
30. Contract 13, pp. 13-62; Contract 35, p. 27.
31. Contract 31, Sec. 6.05; Contract 14, Sec. 6.105.
32. Contract 32, Sec. 6.6.
33. Contract 31, Sec. 6.01; Contract 16, p. 21; Contract 13, pp. 13-46;  
Contract 14, Sec. 6.01.
34. Contract 5, p. 4; Contract 2, p. 23; Contract 11, p. 38; Contract 25, p. 24;  
Contract 32, Sec. 6.3.
35. Contract 5, p. 4.
36. Contract 11, p. 38; Contract 2, p. 23; Contract 3, p. 18.
37. Contract 25, p. 24.
38. Contract 32, Sec. 6.3.
39. Contract 35, p. 6; Contract 21, p. 9; Contract 18, p. 11; Contract 2, p. 24;  
Contract 3, p. 6.
40. Contract 21, p. 9; Contract 18, p. 11; Contract 2, p. 24; Contract 3, p..6.
41. Contract 35.
42. Contract 2, p. 25; Contract 35, p. 27; Contract 31, Sec. 6.07; Contract 32,  
Sec. 6.2; Contract 16, p. 24; Contract 14, p. 11; Contract 13, pp. 13-62;  
Contract 25, p. 24; Contract 33, p. 13.
43. Contract 33, p. 13.
44. See e.g., Contracts 35, 2, 31, 32, 13 and 14.
45. Contracts 13, 14, 16 and 31.
46. Contract 32.
47. Contract 24, pp. 13-37.
48. Contract 5, p. 13.

49. Contract 7, p. 19; Contract 9, art. XI(a).
50. Contract 3, p. 9.
51. Contract 29, Sec. 8.1; Contract 27, p. 20; Contract 28, cl. XV; Contract 25, p. 24.
52. Contract 29, Sec. 8.1.
53. Contract 25, p. 24.

IV.

PROVISIONS RELATING TO MANAGER'S FURNISHING

AND CONTROL OF HUMAN RESOURCES

A. Field Personnel and Home Support Staff

1. While all of the management contracts reviewed for this study require some form of field staff and on-site supervision, few of them include an enumeration of the Manager's support staff requirements, either at the home base or through affiliate companies. Such an enumeration may be critical for the Owner, particularly in terms of future payments which it may be required to make to the managing company for the use of 'extra' personnel and services which may seem to fall outside of the original contract provisions.
2. In the case of field staff, most of the contracts are very detailed in their descriptions of personnel requirements, both administrative and technical. A few, however, fail to delineate the qualifications, size, or positions to be filled by such staff, leaving such decisions to the Manager's discretion. For example, the phrasing in the following provision is extremely open-ended:

The Managing Partner shall employ or assign on a full or part-time basis, such personnel of Manager or its affiliates as may be required to assist in the performance of the Managing Partner's duties under this Agreement.<sup>1</sup>

3. In contrast, the majority of the contracts specifically outline the field employee needs of the project. Three basic constructions are used to do so. The first is a general provision on staffing accompanied by an attached exhibit listing the immediate project staff needs and allowing for more personnel to be seconded if the parties so agree at a later date.

Manager will second to Owner certain of the staff, a list containing this staff is attached hereto in Exhibit , and such other managerial and supervisory personnel as Manager, may in consultation with Owner deem necessary.<sup>2</sup>

4. This provision is detailed enough to forestall any problems of initial staffing requirements, yet flexible enough to encourage joint-determination of additional staffing needs as the contract term progresses.

5. Two other methods of construction are used. One form determines Manager staff requirements by title:

3.4.1. Initial Management Staff:

In order to fulfill its obligations hereunder, Manager shall make available to cause to be made available and subject to the approval of Owner, the services of the following management personnel:

- (a) Managing Director
- (b) Chief Engineer
- (c) Supervisor Quality Control
- (d) Manager Financial Services
- (e) Manager Employee Relations
- (f) Production Superintendent
- (g) Pit Superintendent
- (h) Pit General Foreman
- (i) Mill Superintendent
- (j) Mill General Foreman
- (k) Maintenance Superintendent
- (l) Maintenance General Foreman<sup>3</sup>

6. The other designates these staffing requirements by specialty:

(c) A staff as may be from time to time requested by Owner (including the General Manager referred to in Section 3) of capable and qualified individuals (and capable and qualified replacements therefor) to be engaged full-time in the Project. Such staff shall represent all appropriate disciplines such as (i) engineering and construction, (ii) engineering and maintenance, (iii) geology, (iv) metallurgy, (v) mine planning, (vi) mine and mill operation, (vii) smelter operation and (viii) administration, including personnel and training, accounting, shipping, receiving and warehousing and local purchasing.<sup>4</sup>

7. This second construction is considerably more flexible than the first and would be particularly applicable to contracts involving a multiplicity of services, or a range of services which will tend to fluctuate during the period of the contract.

8. Most contracts failed to specifically provide for any home or affiliate support staff services. In these contracts, it is left to the Owner and the Manager to determine whether rather weak, open-ended clauses, like the following, include full or part-time home staff, or affiliate staff obligations:

Manager shall select and assign qualified management personnel necessary to perform the services required pursuant to this agreement.<sup>5</sup>

9. Several of the contracts expressly provide for some outside or home support, but contain major ambiguities as to exactly what type of support is to be furnished and which party is to make the final determination as to the necessity for such support. For example, consider the following provisions:

In this respect it is recognized that Manager shall employ and assign independent consultants and experts in addition to operating and staff personnel ... and shall provide management and technical services within the Manager's organization as needed in support of the personnel employed on the project.<sup>6</sup>

and

In addition to the Field Staff, the Management Company shall supply such services of its executive personnel in its home office or at the offices of affiliated companies, for the support of the management staff by way of liaison, consultation and such other aspects of the operations ... as may be required to accomplish the objectives of the contract.<sup>7</sup>

10. Both of these provisions acknowledge the need for support services, yet both lack specificity. The first fails to distinguish any particular group or service required. The second, although using the "executive personnel" designation, is equally unsatisfactory. It would have been preferable if both contracts defined exactly what services were being indicated, i.e., informational, personnel recruitment, public relations, etc. Some indication of staff size, or at least a provision which left such a decision open for later mutual determination, would also have been advisable. A final problem with



both clauses is the interpretation of the wording "as needed" and "may be required," as neither party has been designated as the final decision-maker of these staffing requirements. Although this phrasing seems to leave the support staff decision as a negotiable point between Owner and Manager, in most cases such decisions would fall to the Manager since the Manager has the central control over its home and affiliate staffs and since, in a majority of these contracts, the Manager makes essential hiring and firing decisions. Thus, in order to avoid later, increased payments and/or a lack of organizational support for project personnel, a better drafted provision would resemble the following:

This scope of Manager's work specifically includes the provision of such technical, training, and management services (in project country) and such home office support services in (home country) as may be required by the Project Company. The home office support services shall include but need not be limited to:

- (1) Assurance that the position of Project Manager, Associate Project Manager, and Project Engineer will be filled by capable people
- (2) Selection and recruitment of expatriate personnel as required
- (3) Selection and shipment of machinery, equipment and supplies from foreign sources and the purchase of insurance therefore when required
- (4) Selection and shipment of seed, cuttings, animals, trees, etc., as required
- (5) Searching for and selecting technical and scientific information as applicable to the solution of Project problems and planning, and books, pamphlets, and other types of printed information required for the Project.
- (6) Expediting supplies, information, ideas, personnel, and all other possible aids to the achievement of an efficient, economic and successful project operation.

- (7) Providing advice and guidance with respect to the insuring of Project Personnel, equipment and supplies.<sup>8</sup>

11. This provision carefully outlines specific services which the Owner and Manager feel are essential to full project development. Although there is a large degree of flexibility incorporated within this provision, the types of services expected are clear. Notice, however, that the Manager is still left with the determination of what support is 'required' by the project.

12. Another more specific variation of this type of provision carefully enumerates the duties of the home staff.

Manager shall ... maintain a competent staff in (home country) fully conversant with conditions in (Project country) and the properties of the Company and capable of interviewing and selecting all categories of staff required by the Company. Representatives of the Home staff shall pay regular visits to (Project country) to ensure that they are fully conversant with (Project country's) conditions and to follow up on the effectiveness of recruiting.<sup>9</sup>

13. This provision leaves the Owner with greater control and flexibility in determining which home-staff services are provided within the scope of the present contract.

B. The General Manager

Generally

14. In most enterprises, the role of the General Manager is important for the success or failure of the project. He makes the difficult day to day decisions based on a combination of management skills, technical experience, and judgment. His personality and management style influence his subordinates, both those delegated from the Management Company staff and those hired within the country. The General Manager has the highest profile position within the local project group and may be most closely identified with the project by the local populace. He is likely to have significant contact with interested national and

local politicians, government officials and with the Owners. The General Manager's reports will influence how the project is viewed by his superiors. He is likely the most highly salaried employee on the project. Clearly the appointment of the General Manager is perhaps the most important appointment for a project.

15. In both appointment and termination, the interests of the Owner and the Management Company are not the same. Both the Owner and the Management Company want a person in whom they have confidence. While the Owner wants the best man available, the Management Company is primarily interested in providing a person who can get the job done and not antagonize the Owner or, to the extent the Management Company shares in profits, the person who can maximize those profits under the contractual arrangement. The Management Company probably has other projects under contract or bid and must allocate its potential general managers among them to maximize its own returns. Thus various Owners may unknowingly be competing with each other for scarce top management talent.

#### Appointment

16. Despite the importance of the General Manager, his appointment, his termination, the possible conflicts of interest between Owner and Management Company, and the complexity of these issues, more than half of the management contracts reviewed provided one simple solution -- the Management Company appoints and terminates the General Manager. The Owner has no say on the subject under the contract.

17. The remaining contracts reviewed do provide, however, a greater range of alternatives.

18. Before condemning this approach of giving great authority to the Management Company as simplistic overreaching, a few explanations for its use should

be considered. Within the terms of the contract, the Owner may have non-specific rights and powers vis-a-vis the Management Company which indirectly allow it the contractual leverage to veto an undesirable General Manager. The right may be as general as the right not to renew the agreement, to consult on the project generally, to refuse indemnification as to poorly selected employees, to claim a breach of contract, or to enforce an otherwise unimportant requirement having nothing to do with the General Manager. These rights counter-balance what otherwise appears to be the unrestricted control of the Manager over appointment of General Manager.

19. Outside the terms of the contract, the Owner may simply have confidence in the performance of the Management Company, its desire to maintain its reputation and to obtain future business. A more concrete explanation is the possibility of a side agreement, oral or written, as to who the General Manager will be. Thus, it is possible that the Owner has specified the General Manager despite the contract terms. However, none of the contracts reviewed explicitly gave the Owner this right.

20. Another method of determining the General Manager which precludes analysis of the relative influence of the parties in making the decision is to specify the General Manager in an exhibit to the agreement. As will be discussed with respect to provisions for the Manager's authority over hiring of personnel generally, it is not unusual for the Management Company to commit itself to using certain personnel listed in an exhibit.<sup>10</sup> The exhibit may have been presented to the Owner as a *fait accompli* or have been dictated by the Owner -- a less likely alternative unless the Owner is very familiar with the personnel from another project. The more common alternative to the unrestricted determination of the General Manager by the Management Company is

the appointment by the Management Company consistent with contractual standards or the nomination by the Management Company subject to approval by the Owner.

21. The contractual standards mechanism is vague and usually applies to the Management Company employees in general.

Field staff employed by the Consultant and assigned to the Mill shall be qualified and experienced in the functions they are assigned to discharge and shall meet the qualifications set forth in Appendix A.<sup>11</sup>

The following example is limited to top on-site management:

The home office support services shall include but need not be limited to:

- (1) Assurance that the position of Project Manager, Associate Project Manager, and Project Engineer will be filled by capable people ...<sup>12</sup>

These provisions, though weak and vague, give the Owner at least some basis for requesting information about the proposed General Manager and an opportunity to discuss, if not influence, the appointment in advance.

22. That right is conferred more formally in several contracts which allow the Management Company to nominate or appoint the General Manager but subject the nomination to confirmation by the Owner. The Owner may withhold confirmation either for good reason or for no reason, depending on the contract. This power is the maximum achieved by the Owner in any of the contracts reviewed. It falls short of the right to select the General Manager, but could be used to achieve much the same result, though in a time-consuming and perhaps unpleasant way, i.e., repeated rejections of the nominee. The standards provision reads:

... the appointment of the General Manager, Manager or Assistant Manager shall be conditional upon the approval of the Board (which approval shall not be unreasonably withheld.)<sup>13</sup>

23. Whether the absence of a 'reasonableness' requirement allows the Board to reject the nominee unreasonably depends on the law which regulates the contract.

24. Two examples falling outside this framework deserve mention. In one contract<sup>14</sup> the Management Company appointed the General Manager, but the Owner named his assistant. Since the contract provides for an extensive training program, this provision may only be another way of achieving that result. But it may also be a method of representing the Owner's interests in a real, day to day manner.

25. In a hotel contract the original contract called for a hotel construction inspector (not a General Manager) to be named by the Management Company, subject to the reasonable approval of the Owner and lenders. An amendment to the contract shifted the right to name the inspector to the Owner. This shift is particularly significant since the Owner wants a person independent of the Management Company to inspect the hotel construction.<sup>15</sup>

#### Termination

26. The Owner has greater powers to dismiss the General Manager than to appoint him, but almost half the contracts reviewed failed to confer this right. Indeed, they often did not provide for any method of termination that occurs. In the absence of any special regulation of the issue, the broad right to manage the project and name the General Manager appears to include the right to terminate him. In such an instance, the Owner would have still fewer rights to influence the appointment of a successor than in the initial negotiation, unless the termination indicated general difficulties with the project; in that case, the Owner might be in continuous, close contact with the Management Company.

27. Three other methods of regulating this situation were encountered in the

contracts reviewed: explicit grant of power to the Management Company; explicit grant of power to the Owner; explicit grant subject to consultation with or consent of the other party.

28. The first method, leaving termination solely to the Management Company, can be justified primarily by the belief that this is the Management Company's business (management) and it knows best. The Owner must hope that the contract includes enough incentives for the Management Company to exercise this right in the interest of the project.

29. Approximately 20% of the contracts gave the owner the right to have the General Manager removed. For example:

The board of directors shall have the right to propose to the Management Company that the construction manager or the general manager be replaced in the event of dissatisfaction with his performance in connection with the construction or operation of the plant or his conduct while in (host country).<sup>16</sup>

Another contract provides:

If the company requests for any reason that any personnel provided to it by (Management Company) ... be changed, such personnel shall be replaced by (Management Company).<sup>17</sup>

Another example allows termination by the Owner "On good cause shown ... in the event of dissatisfaction with his performance."<sup>18</sup> Certainly the Management Company will have an opportunity to dissuade the Owner from exercising this right. But Owner's power appears quite broad, not always being limited by the requirement that the dissatisfaction or reason be reasonable or documented. The Owner will be restrained by knowing that it cannot select the General Manager's successor and that the limited pool of possible successors may not hold an improvement over the person terminated. Still its power to terminate does provide additional leverage in a situation where the Owner might be thought to have no control over General Manager selection.

30. The requirement of consultation with or consent by the Owner to the termination of the General Manager appears in only one of the contracts.<sup>19</sup> The contract requires discussion with the Owner before any staff member is transferred from the project. Given the importance of the General Manager to the project and the Management Company's other interests, such consultation seems to be a minimum deterrent to a personnel change perhaps not in the best interest of the project.

31. One provision allocates the costs of terminating a technical staff member between the Consultant and the Owner, depending on the reason for termination. The contract also requires Owner's prior consent to remove or replace any technician or staff member.<sup>20</sup>

C. Other Personnel

Appointment

32. The contractual provisions regarding appointing and terminating management staff are also quite similar to those regulating hiring and terminating the General Manager. As a general rule, the Management Company has complete authority over hiring and terminating management staff, subject only to the indirect controls discussed in the case of designating the General Manager, i.e., option not to renew the agreement, linkage, etc. For example:

... the Management Company shall make all decisions relating to the organization, employment, supervision, discharge and administration of all personnel of the plant, and the maintenance of all records pertaining thereto.<sup>21</sup>

and

Manager as agent for owner will hire, supervise, direct the work of, discharge and determine the compensation and other benefits of all personnel working on the hotel.<sup>22</sup>

and



The Management Company shall have full and exclusive authority for the management of the Refinery and shall supervise all services connected with the operation of the Refinery including inter alia ... (7) hiring of personnel and payroll records ...<sup>23</sup>

33. Some of the contracts conferring hiring discretion on the Management Company do impose minimum standards on the process, on the employees, or both:

(Management Company shall) hire, promote, discharge and supervise the work of all employees of and consultants to the Airline, including the executive staff ... In the hiring of the executive staff or other operating and service employees, (Management Company) will use reasonable care to select qualified, competent and trustworthy employees.<sup>24</sup>

34. A hotel management agreement sets the identical requirements.<sup>25</sup> Another mechanism for selecting employees also parallels that for selecting the General Manager -- the Management Company proposes employees, and the Owner may accept or reject them:

In order to fulfill its obligations hereunder, (Management Company) shall make available or cause to be made available and subject to the approval of (Owner) the services of the following management personnel: (list of 12 top management positions follows).<sup>26</sup>

and

Field staff employed by the Consultant and assigned to the mill shall be qualified and experienced in the functions they are assigned to discharge and shall meet the qualifications set forth in Appendix A. With respect to each member of the Field Staff, the Consultant shall furnish to the Enterprise a certificate from a doctor stating that the person's health is satisfactory considering the person's proposed assignment and a curriculum vitae. Except for good cause shown in writing to Consultant by the Enterprise within ten (10) days of receipt of the curriculum vitae pertaining to such employee, the Consultant shall be permitted to employ any such member of the Field Staff and to assign such person to the Mill as and when Consultant deems appropriate.<sup>27</sup>

35. The third method of determining the staff, by specifying it in an exhibit to the contract, does not disclose whether the Owner plays a significant role

in the process. Certainly, the Management Company's discretion to make last minute decisions as to the staff is reduced.<sup>28</sup>

36. Two contracts include exhibits containing specific information on the staff to be supplied. One provides:

It is contemplated by the parties that the personnel set forth in Appendix A hereto shall constitute the Management Staff. It is further contemplated that such management staff will arrive pursuant to the schedule set forth in Appendix A and will remain in (the Host Country) for the periods indicated therein. It is understood, however, that the number of personnel, their duration of stay and times of arrival may be altered as provided in this Contract or by mutual agreement of the parties hereto.<sup>29</sup>

The other states:

(C) (1) It is contemplated that the construction Field Staff, as listed in Appendix A hereto, will be adequate to fulfill the obligations of the Management Company hereunder: provided however, that if, in the judgment of the Management Company the efficient and effective construction of the plant can be improved by hiring additional foreign personnel as members of the construction Field Staff it shall so notify the board of directors of the Enterprise in writing, giving its reasons thereof, and, upon authorization by the board of directors of the Enterprise, the Management Company may thereafter employ such additional personnel for the construction Field Staff.<sup>30</sup>

#### Termination

37. Termination of management staff is accomplished three ways -- at the Management Company's discretion, at the request of the Owner, and at the Management Company's direction after consultation with the Owner.

38. In the vast majority of the contracts reviewed, the Manager is given the explicit power to fire employees. Three examples have already been cited in connection with the Management Company's power to hire. Other examples include the following:

... Manager's powers shall include the following:  
(ii) Employing staff and other persons required

for the business of (Owner) as employees of (Owner) or of (Management Company) for the account of (Owner), determining their authority, duties and remuneration and discharging, suspending and dismissing such staff and other persons.<sup>31</sup>

and

The General Manager shall have authority to appoint, remove and replace the seconded staff and all personnel reporting to him, in accordance with sound and lawful practices.<sup>32</sup>

and

The selection, terms of employment and termination thereof, including rates of compensation and emoluments, and the supervision, direction, training and assignment of the duties of all Hotel employees shall be the duty and responsibility of (Management Company), ...<sup>33</sup>

39. Four contracts gave the Owner the explicit power to initiate termination of employees hired by the Management Company. One example restrains the Owner's power to circumstances where a specific standard has not been met:

The Board shall have the right to order (Management Company) to remove any management staff member, including the Management Director, whenever the Board considers that such person is incompetent or unsuitable for the performance of his assigned tasks. In such event, or in the event that management staff member is unable to continue to perform his duties hereunder, (Management Company) shall use its best efforts to provide a qualified replacement satisfactory to the Board without three months from the date of removal.<sup>34</sup>

40. The second example also refers only to personnel provided by the Management Company but sets no limiting standards on the exercise of this power:

If the (Owner) requests for any reason that any personnel provided to it by (Management Company) ... be changed, such personnel shall be replaced by (Management Company).<sup>35</sup>

41. A contract involving a developed non-market economy gives the Owner the power to terminate but only as to local personnel:

The employment and discharge of local personnel shall be carried out with the advice and consent of the Management Company by persons designated by (Owner).<sup>36</sup>

42. As part of a detailed mechanism for termination set forth in part here and in part below, one contract provides:

(Owner) may at any time (after) prior consultation with the (Management Company), request the removal of any Technician or Staff and in that event the (Management Company) will remove him and will select and propose a replacement with all the speed of which the (Management Company) is capable.<sup>37</sup>

43. The next paragraph of that contract continues to set forth the third standard mechanism in connection with personnel termination -- consultation with the Owner prior to exercise of the Management Company's discretion. The most detailed of these provisions encountered states:

(Management Company) may with the prior consent of (Owner) remove and replace any Technician or staff.

Without the consent of (Owner) the (Management Company) may also remove up to a maximum of six people, be they technicians or staff, during the continuance of this Agreement; and replacing them with the approval of (Owner).

If (Management Company) decides to remove Technicians and staff for disciplinary reasons and (Owner) agrees with such removal, the persons so removed will not count towards the six mentioned above.<sup>38</sup>

The contract goes on to regulate in detail the allocation of costs arising from dismissal of the employee.

44. A simpler contract merely states:

No personnel employed by or seconded to the (Owner) shall either be offered employment by or transfer to (the Management Company) except following discussion with the Managing Director.<sup>39</sup>

45. A final example merely gives the Owner the right to request that a management expert be retained on the project despite his replacement by a local employee as part of the training program:

Upon such replacement, the services of such Management Expert shall be terminated unless the Owner requests his retention for other duties.<sup>40</sup>

46. Two other contracts contain provisions designed to give the owner increased control over the personnel provided by the Management Company without relating to hiring and termination. Both require the personnel to devote their full time to the project:

During the term of this Agreement, all of (Management Company's) management staff assigned to (the project) shall be engaged exclusively, in the performance of the services assigned to them hereunder.<sup>41</sup>

D. Salaries

47. The great majority of the contracts reviewed provide a simple mechanism for setting personnel salaries, one which gives the Management Company complete or almost complete discretion on the subject. Nevertheless, some of the other contracts reviewed provide more imaginative methods of regulating this matter and give the Owner some influence in setting salaries, either in an ongoing way over the term of the contract or by negotiation of standards at the outset. None of the contracts gives the Owner the right to set salaries.

48. The basic grant of discretion to the Management Company takes several different forms. Most often it is together with other general powers regarding employees:

Manager as agent for Owner will hire, supervise, direct the work of, discharge, and determine the compensation and other benefits of all personnel working in the Hotel.<sup>42</sup>

or

(Management Company has authority) to recruit or dismiss all executive staff, foremen, employees or workmen; to determine wages, salaries, bonuses and gratuities ...<sup>43</sup>

or

(Management Company's) authority includes:) Employing staff and other persons required for the business of

(Owner) as employees of (Owner) or of (Management Company) for the account of Owner, determining their authority, duties and remuneration and discharging, suspending and dismissing such staff and other persons.<sup>44</sup>

49. In the following example, the authority is included in a still more general grant of authority:

The control and discretion by (Management Company) shall include the use of the Hotel for all customary purposes, terms of admittance, charges for rooms and commercial space, entertainment and amusement, food and beverages, labor policies (including wage rates, the hiring and discharging of employees), the maintenance of the bank accounts and holding of funds in its own name, and all phases of promotion and publicity relating to the Hotel.<sup>45</sup>

50. Two of the contracts settle the salary issue by specifying salaries in an exhibit attached to the agreement. This method precludes analysis of the relative powers of the parties.

The (Owner) shall pay the (Management Company) in United States Dollars as follows:

a. In respect of Field Staff Members assigned by (Management Company) to (project), the (Owner) shall pay to (Management Company) the rates set forth in Appendix A.<sup>46</sup>

The appendix referred to includes a quarterly inflation adjustment. The second example lists the salaries and then includes extensive regulation of other non-listed salaries.

(b) Salaries

(1) (Management Company) warrants that the salary scales listed in Appendix D are not in excess of (MC's) customary salary scales as related to (MC's) customary standards for the types of personnel and other parties under the contract. In the event (MC's) shall employ new personnel or retain independent consultants under this contract, the salaries for such personnel shall be reimbursable under this contract at rates commensurate with their past earnings, the responsibilities of their positions under this contract, and prevailing salary scales for expatriate personnel in the Host Country.

(2) The salaries of the field staff employees shall be deemed approved upon (MC's) certification at the time of first requesting reimbursement for each such employee that (i) the employee specified by name, classification and salary is receiving a base salary which is not in excess of the respective salary rate indicated in Appendix D; (ii) the employee's annual salary does not exceed the highest annual salary (exclusive of overseas differential) of comparable employees (as certified in the certification forwarded to (Owner) and (iii) such salary conform to (MC's) customary scale of payment for similar overseas services.

(3) Salaries not within the salary scales listed in Appendix D shall be submitted to (Owner) for individual prior written approval.

(4) Salaries are based on a \_\_\_ hour work week.

(5) Salaries of (MC's) home office senior staff personnel, or those of independent consultants retained by (MC) hereunder, while on brief visits to (Host Country) for supervisory or advisory services pursuant to paragraph 5 above shall be at the rates currently paid to such personnel in accordance with the customary salary scales of (MC) or the independent consultant except as limited in subparagraph (6) of this paragraph.

(6) Direct reimbursement for salaries of home office employee, including the salaries of home office senior staff personnel on brief visits to (Host Country) pursuant to paragraph (5) above, shall not exceed an aggregate of \$\_\_\_\_\_, unless the prior written approval of (Owner) is obtained before any such excess costs are incurred by (MC).

(7) A field staff employee who has successfully completed one year of service under the contract may, to the extent permitted by (Host Country) Law, be granted a \_\_\_\_\_% increase in his approved base salary in accordance with the established practice of (MC) or of the independent consultant involved, provided that his base salary as so increased is not in excess of the respective salary rate indicated in Appendix D, and provided that this salary increase will not be reimbursable for an employee whose initial salary rate under this contract was greater than the highest annual salary (exclusive of overseas differential, bonus, overtime, etc.) earned by such employee during any of the three years prior to sixty days before his assignment to this contract.

(8) In no event shall reimbursement for the base salary of any employee (overseas and home office personnel

exceed the annual rate of \$\_\_\_\_\_ (exclusive of overseas differential) nor shall reimbursement for the salary of any senior staff personnel exceed the annual rate of \$\_\_\_\_\_, without the prior written approval of (Owner).

(9) To the extent not normally included in (MC's) overhead, vacation and sick leave time shall be reimbursed for employees in accordance with the customary policy of (MC) or the independent consultant involved, for Expatriate personnel, but not to exceed the limitations contained in subparagraph (6) of this paragraph.<sup>47</sup>

51. This salary provision is by far the most thorough and extensive of all those encountered in the contracts reviewed. By contrast, it indicates the risks accepted by the Owner in the provisions granting practically unfettered power to the Management Company.

52. The more usual method of giving the Owner some control over the salaries paid is to require that the salaries meet a certain standard;

The (Owner) shall reimburse (Manager) for the amount of the actual cost to (MC) (or any affiliate) of all salaries, wages, and employee benefits (including expatriate benefits, and tax adjustments) of all personnel of (MC) (or any affiliate) performing services for the (Owner) pursuant to Sections 1.1 and 1.2 or training locals in plant management and operation pursuant to Section 1.4 together with travel and other expenses reasonably incurred by all the aforesaid personnel. The amount paid to and with respect to the employment of such loaned personnel shall be in accordance with the established policies of (MC) (or its affiliate) with regard to personnel performing comparable services in comparable locations or in normal standards or remuneration and employee benefits in the international fertilizer industry. The actual cost to (MC) (or its affiliate) of employee benefits, such as, but not limited to, savings, medical, group life and retirement plans, payroll deductions for the participation in such plans by such personnel whose services are loaned to the (Owner). The cost to (MC) (or its affiliate) of holidays, furlough, vacation, sickness and disability to the salaries and wages reimbursable under this Section shall be charged on a "when and as paid basis."<sup>48</sup>

53. A second example appears to give the Management Company a standard intended to ensure availability of desirable personnel while at the same time providing guidelines which serve the Owner:



(3) The terms and conditions of employment of personnel employed by or seconded to the Owner from time to time under the Agreement shall be competitive in the context of the world mining industry and shall be attractive enough to ensure the recruitment and retention of suitable personnel.

(4) Staff transferred or seconded from (Management Company) shall while serving the (Owner) enjoy terms and conditions of employment which shall not be less favorable than those applicable immediately prior to their secondment or transfer, nor shall any terms or conditions be changed to their detriment or made more restrictive at any time thereafter. At no time shall the terms and conditions of personnel seconded to the (Owner) be generally less favorable than the terms and conditions of personnel in comparable jobs employed directly by the (Owner).<sup>49</sup>

54. A third method of giving the Owner some control over salaries is to limit the terms of employment which the Management Company can offer without Owner's approval. For example:

Nothing herein shall be deemed to authorize the Management Company, without the express written consent of the Board of directors of the Enterprise, to perform any of the following acts:

\* \* \*

(4) Approval of employee or consultancy agreements of a term in excess of one (1) year, or providing for compensation to such employee a consultant in excess of U.S. \$10,000 a year, or the equivalent.<sup>50</sup>

This mechanism is also used in the lengthy example cited above involving the listing of individual salaries.

55. A non-specific method of controlling salaries results when the Management Company is required to submit extensive budgets and reports to the Owner.<sup>51</sup> Though most general, this method may give the Owner the greatest control over personnel salaries of all the methods encountered.

56. It appears, then, that while most contracts delegate all authority regarding personnel, including salaries, to the Management Company, some Owners have been able to negotiate a combination of standards, specific and general,

and procedures for consultation which allow the Owner to influence and in some cases dictate salaries. Such mechanisms may develop informally in situations where the contract gives full power to the Management Company. In the final analysis, some sort of consultation between Owner and Management Company appears to be good business.

FOOTNOTES

1. Contract 10, cl. 5.01, p. 5.
2. Contract 4, cl. 8, p. 3.
3. Contract 32, cl. 3.41, p. 9.
4. Contract 25, p. 9; see also Contract 22, cl. IV(3)(c).
5. Contract 33, cl. 4.1, p.5; see also Contract 1, p. 4.
6. Contract 30, p. 3.
7. Contract 35, p. 16; see also p. 27 and cl. B, and Contract 31, cl. 3.05 and Contract 14, cl. 3.05.
8. Contract 8, pp. 5-6; see also Contract 17, p. 3.
9. Contract 27, p. 22.
10. Contract 14, Article 1.01, 3.04.
11. Contract 16, Article 3(C).
12. Contract 8, para. 3(1).
13. Contract 27, Article 2(D).
14. Contract 18, Article 2.
15. Contract 6, Article 4(10); Amendment No. 2(3).
16. Contract 24, Article 3(B).
17. Contract 4, Article 1.3.
18. Contract 16, Article 3(E)(2).
19. Contract 27, Article 4(5).
20. Contract 28, cl. 13(C)(D).
21. Contract 13, Article 1(E).
22. Contract 3, Article 2, Sec. 2.
23. Contract 14, Article 2.01.
24. Contract 5, Article 5.1, 3.1.
25. Contract 6, Article 6(4).

26. Contract 32, Article 3.4.1.
27. Contract 16, Article 3(C)(D).
28. Contract 13, Article 3(C)(D). 29. Contract 14, Article 1.01.
30. Contract 13, Article 3(C)(1).
31. Contract 15, Article 3(B)(ii).
32. Contract 25, Article 3.01.
33. Contract 11, Article 21.1(a).
34. Contract 13, Article II(K)(4).
35. Contract 12, Article 1.3.
36. Contract 13, Article 2(e).
37. Contract 28, cl. 13(b).
38. Contract 28, cl. 13(c).
39. Contract 27, Article 4(5).
40. Contract 14, Article 2.04.
41. Contract 32, Article 3.4.5; Contract 14, Article 3.06.
42. Contract 3, Article 4, Sec. 2.
43. Contract 18, Article 2(6)(v).
44. Contract 15, Part II, Article 3(B)(ii).
45. Contract 2, Article 3.
46. Contract 16, Article 4(A)(1)(a).
47. Contract 17, Sec. 8(b).
48. Contract 12, Article 2.1A.
49. Contract 27, Article 4(3)(4).
50. Contract 32, Article 3.4.4.
51. Contract 8, para. 4, 5.

PROVISIONS RELATING TO TECHNOLOGY TRANSFEROverview

1. While a developing country Owner's immediate reason for entering into a management contract may be to ensure the efficient operation of an enterprise viewed as beneficial, the Owner's ultimate objective usually is to transfer the foreign Manager's expertise to its domestic staff so that local operational control will eventually result. Requirements both to hire local staff and to ensure adequate training programs are thus an important part of overall technology transfers and are each the subject of separate analyses in this report (see Provisions VI).
2. Ideally, however, provisions intended to implement the goal of accelerated technology transfer should be understood as going beyond local hiring and training requirements. While training a local middle management and operating staff are generally common features of a management contract, the Owner may want the contract to expressly address the broader goal of complete technology transfer. In the absence of such express provisions, it is unclear whether there will be an appropriate emphasis on this goal or whether it will be viewed a secondary by-product to more urgent day-to-day operational considerations.
3. Despite the increased awareness of the need and implications of technology transfer, it did not receive corresponding attention in the majority of the management contracts reviewed. At least three factors may be the cause of this apparent lack of emphasis on technology transfer by the management contract:

- ° An urgent need for the fruits of an immediately operational enterprise either for domestic consumption or for export to meet a pressing demand for foreign exchange;
- ° An immediate need to ensure a return on investment; and
- ° A preference to refer technology transfer provisions to other contractual forms such as the technical agreement rather than inserting them in a management contract.

4. Moreover, the developing country Owner may have been convinced that either the contract's training and hiring provisions or his power of ultimate control was adequate to ensure that the contract would result in transfer of technology.

"Goals" or "Purpose" Clauses

5. The great majority of the contracts reviewed did not emphasize technology transfer as a principal goal of the parties. To the extent technology transfer received any attention at all, it was usually limited to those provisions dealing with local training and local hiring. While an argument can be made that all management contracts by virtue of their inherent nature are effective vehicles for the transfer of technology, this argument is not persuasive in view of such developing country experiences with transnational corporations that may have operated within their boundaries for some time without achieving significant technology transfer.

6. As indicated in the provisions on hiring and training of local staff, several contracts fail to deal even tangentially with technology transfer, and leave any such concerns to local labor codes. Others could be said to

contain technology transfer provisions only insofar as they devoted a greater or lesser amount of attention to local hiring and training.

7. Ten of the contracts reviewed contained provisions relating to the transfer of technology that went beyond local hire/train requirements.<sup>1</sup> There was no common subject matter for these contracts, as they dealt with diverse areas such as agricultural, hotel, fertilizer, bauxite, cement, copper, asbestos, textiles, and manufacturing. Moreover, not all of these examples contained provisions favorable to the Owner as to local hiring and training. They did set forth, however, either in the preamble or in the scope of work, the basic principle that the parties intended that technology transfer be regarded as a goal of the contract. One such clause provided:

WHEREAS, Owner is desirous of obtaining from Manager the knowledge of the industry and the market, as well as the special expertise and management services which Owner requires in its plans to construct and operate, on a profitable basis, such a business.<sup>2</sup>

8. The most effective provisions dealing with transfer of technology as the goal or purpose of the contract were set forth in two contracts, one dealing with manufacturing<sup>3</sup> and, to a greater extent, one with asbestos production.<sup>4</sup>

Clauses Relating to Corporate and Technological Resources

9. In addition to the broad "goals" or "purpose" clauses, several of the contracts include provisions which were designed to incorporate the Owner's access to the Manager's technological expertise and that of its affiliates. Such access may be important in maintaining and increasing a project competitive visibility as well as ensuring technical expertise of personnel. Certain contracts contained only minimal reference to such technical assistance:

Manager shall make available to the Corporation at cost ... technical help and assistance ... and shall let it benefit by its experience and by the available information and know-how of Manager and its affiliates.<sup>5</sup>

10. This particular provision does not make clear whether later technological developments made by the managing company during the term of contract would be automatically included under the present agreement. Another contract takes into account this timing element but fails to designate which party determines what information is "appropriate" for use in the project:

Manager will make available to Owner appropriate information and developments resulting from Manager's own research and development activities in textiles.<sup>6</sup>

11. Two of the contracts contain specifically drafted, if broad, provisions for access to the Manager's technical support services:

Furnishing of Technical Information

The Management Company shall furnish to the Enterprise, without charge, such technical and other information at any time during the term of this Contract in its possession or in the possession of an affiliated company which is or might be of use or benefit, or, in any way, related to the operations of the Enterprise.<sup>7</sup>

and

(v) Advise on research and development;

(vi) Maintain contact, by visits or otherwise, with developments in mining and operating techniques in other parts of the world and with research and development activities elsewhere as shall be reasonably necessary for the development and efficient operation of the Company's business;

(vii) Provide or procure the provision of such further technical services to the Company to the extent that it is reasonably called upon so to do from time to time by the Managing Director on behalf of the Company.<sup>8</sup>

Although these provisions seem to be specific, their wording is somewhat ambiguous. The first contract has solved the payment and timing issue but still fails to designate which party decides whether the information "in any way relates" to the operation of the project. The flexibility in wording here, however, tends to work to the advantage of the Owner, as the Manager can only withhold such information after proving it to be wholly unrelated.



12. Likewise, the second contract has solved the timing and decision-making problems, but has introduced a new broad obligation on the part of the Manager to "maintain contact ... in other parts of the world ... as shall be reasonably necessary." Once again the wording is ambiguous. Which party decides what is "reasonably necessary" and how does the Managing company undertake to keep up with mining development techniques outside of its own organizational and affiliate structure?

13. It is important, therefore, in the drafting of these provisions dealing with technical support services, that both Owner and Manager agree to a specific time period and general criteria to determine what is "appropriate" technical expertise as well as whether this is an issue to be negotiated or left in the domain of one party.

14. Finally, several of the contracts, specifically those dealing with hotel management, included concise, well-drafted provisions which insured access, not only to technological expertise, but to group benefits and company services provided by the Management organizations world-wide.

Section 2. Group Services and Benefits. Manager shall provide or shall cause its affiliated companies to provide, in the operation of the Hotel and for the benefit of its guests, interhotel reservation, convention and business promotion, sales promotion, publicity, public relations, food and beverage, personnel, and other operational departmental supervision and control, and all other group benefits, services and facilities, including joint advertising programs to the extent appropriate furnished to other hotels owned or operated by Manager and its affiliated companies (herein called "Group Services and Benefits").

Neither Manager nor any affiliate of Manager shall charge or receive any profit for the rendition of Group Services and Benefits or for any services performed directly for the Hotel. Manager shall however be entitled to charge the operation of the Hotel and to be reimbursed for all costs incurred by it, including salaries of officers or employees, in the rendition of said services. If the Group Services and Benefits or other services are performed on behalf of

the Hotel and other hotels operated by Manager, and in the case of reservation, billing, and credit services, the charges therefor shall be on the same basis as to the other hotels prepared by Manager.

15. Only one of the contracts specifically denied the Owner access to previously available management services for world-wide inspecting and expediting of mineral resources.<sup>10</sup>

16. Financially, both Owner and Manager will be better off if support services are clearly delineated in contract provisions. This will lead to less confusion later on, as to expectations and additional payments. Such provisions should still contain some flexibility, however, since the needs of the project may change over time; also, crucial services may be left out by mistake.

FOOTNOTES

1. Contracts 8, 11, 12, 18, 23, 24, 25, 28, 32, and 34.
2. Contract 23, Preamble.
3. Contract 24, cl. 3 and 4.
4. Contract 32, Preamble, Article II, Articles 3.3, 3.4 and 3.6; Article 10.4.
5. Contract 18, p. 20.
6. Contract 34, p. 5.
7. Contract 35, p. 10.
8. Contract 27, pp. 3-4.
9. Contract 2, p. 15; see also Contract 6, pp. 25-26 and generally Article VI(2).
10. Contract 28, cl. 5.2, p. 16.

VI.

PROVISIONS RELATING TO LOCAL

HIRING AND TRAINING

Overview

1. Apart from restraints imposed by local labor laws and regulations -- including in some cases, requirements for indigenous hiring or limitations on expatriate employment -- an Owner usually has a wide range of powers over personnel hiring and administration. Under a management contract, however, the Owner usually relinquishes a certain measure of authority over such matters to the foreign Manager. An Owner's decision about how much of such control, if any, to give up should be based on the extent to which it is more concerned about immediate project results than with the development of the technical expertise of nationals.
2. That decision should be reflected in the operative terms of the management agreement. For instance, where the immediate efficient and successful operation of the venture is the Owner's preferred objective, the contract is likely to grant broad discretion over personnel matters to the Manager. On the other hand, where the Owner's interest in developing local capacity to run the project takes precedence, and where it has effectively asserted that interest during the contract negotiations, the agreement will tend to limit the Manager's authority with respect to staff matters by requiring a specified degree of local participation in the project.
3. A number of factors affect an Owner's decision to promote one objective over the other. Where the project has been an expensive one, the Owner may be more inclined to ensure a return on its investment by giving the foreign Manager unrestricted hiring powers than it would be to risk the operation's success by mandating the employment and training of unskilled national workers. The Owner of a project requiring complex technology and trained operators is

likely to recognize the necessity of turning over some or all of its authority regarding personnel to the Manager in the interest of both the project's welfare and safety on the operation site. Finally, where there is a serious shortage of experienced nationals, an Owner might tend to make pragmatic rather than unyielding local hiring and training demands.

4. On the other end of the spectrum, however, is the Owner whose top priorities include the long-term social and economic benefits **related** to the development of **national capabilities**.

Such an Owner may, in fact, be using the contract project primarily as a means to those ends. This is most likely to be true where the Owner is a government or a public corporation since such governmental entities **are presumed to have a special commitment in that respect**.

In such instances, the Owner will try to retain as much control as possible over personnel concerns so as to be able to assure a maximum amount of domestic employment and training.

5. Moreover, often even a private Owner who might otherwise be less intent upon local participation than upon realizing a return on its investment, may be bound by its country's foreign investment laws or other statutes mandating a specified percentage of indigenous hiring. In such cases, social and economic development goals are already set as priority considerations for the project by the host country government, and the private Owner then is legally obligated to insist that a local participation clause of some sort be embodied in the management contract.

6. Yet the extent to which an Owner's interest in employing nationals will be realized

also depends on the position taken by the foreign Manager during the contract negotiations. In some instances, the Owner will meet with little opposition to the inclusion of local hiring and/or clauses in the agreement. Where domestic labor costs make

it significantly more economical to hire indigenously than to bring in expatriate staff, the Manager will not object to being required to employ nationals. Furthermore, where the laws of the host country explicitly limit the use of foreign staff employees, the Manager will have choice but to acquiesce to the Owner's demands for local participation which are within those legal stipulations.

7. Usually, however, the Manager will resist the inclusion of a mandatory national hiring clause of any kind in the agreement and is not likely to be enthusiastic about carrying out obligations under any such provision ultimately incorporated in the contract. One general reason is that so long as there are few local personnel capable of performing the type of services it offers, the Manager's participation will continue to be crucial to the project and, as a consequence, it will be able to continue to receive the benefits of the agreement.

8. Moreover, unless there is a significant labor cost differential, those Managers who have a special interest in their projects' success are particularly opposed to the employment of nationals. In instances where, for example, use of the Manager's name or reputation is important -- such as in hotel management agreements with an international hotel company, or in manufacturing enterprises which use the Manager's trademark -- the management company will want to have authority over personnel matters to maintain strict quality control over the operations and thereby assure conformity with its internationally recognized standards of performance. Similarly, in management contracts that are part of a more comprehensive joint venture agreement -- whereby a foreign investor contracts to provide its managerial services in addition to its capital investment -- the managing investor is also likely to want full control over staff employment so that it can best guarantee the success of the venture and, consequently, the likelihood of an acceptable

return on its investment. Finally, where the Manager's reimbursement for its services is wholly or partially based on the output of the project, it will tend to prefer being free to employ only skilled staff members so as to maximize the undertaking's production level.

A. Local Hiring

9. A number of contracts analyzed for purposes of this report make no provision whatsoever for the mandatory hiring of host country nationals. As the following clause illustrates, such agreements give the foreign Manager general responsibility for personnel administration but make no requirements regarding the nationality of the persons hired:

Commencing immediately upon the signing of this Agreement Manager agrees, for and in consideration of the compensation hereinafter provided, and Owner hereby grants to Manager the sole and exclusive right, to supervise and direct the management and operation of Owner in accordance with international airline standards. In furtherance thereof and in the name of and on behalf of Owner, Manager, either directly or where appropriate through Owner's employees under Manager's supervision and direction, shall:

....

Hire, promote, discharge and supervise the work of all employees of and consultants to the Airline, including the executive staff (i.e., general manager, assistant managers and department heads). Such employees shall be on Owner's payroll and Manager shall not be liable to such employees for their wages or compensation, nor to Owner or others for any act of omission on the part of such employees, unless Manager has failed to use reasonable care to select qualified, competent and trustworthy employees.<sup>1</sup>

10. Notably, in the hotel management contracts reviewed, the Manager is granted "absolute control and discretion" over the labor policies of the hotel. At the same time the Owner has agreed not to interfere with the Manager's execution of its responsibilities respecting personnel matters. Thus, it cannot in any way influence the Manager's policies so as to encourage local hiring. For example, one hotel contract provides:

Manager as agent for Owner will hire, supervise, direct the work of, discharge, and determine the compensation and other benefits of all personnel working in the Hotel. Manager is to be the sole judge of the fitness and qualifications of such personnel and is vested with absolute discretion in the hiring, supervision, direction, discharging, and determination of the compensation and other benefits of such personnel during the course of their employment. It is expressly understood and agreed that all personnel are in the sole employ of the Owner and are not in the employ of Manager except as noted below. Manager is in no way liable to said personnel for their wages, compensation or other benefits, nor to Owner or others for any act or omission on the part of such personnel. Owner shall not interfere with or give orders or instructions to personnel employed on the hotel premises for any act of omission on the part of such personnel.<sup>2</sup>

11. The fact that a contract contains no local participation requirement might well mean that the Owner's predominant concern was that its undertaking be efficiently run or else that its bargaining strength or skills were no match for those of a Manager opposed to using resident workers. It is less obvious, however, that the parties might instead have simply concluded it was unnecessary to contractually bind the Manager to employ nationals. This might be the case where the Manager's intent to do so voluntarily, e.g., for a labor cost advantage, is without question, or where the host country laws to which the contract is subject sufficiently restrict the use of expatriate employees.

Samples of More Adequate Local Hiring Provisions

12. The rest of the instruments analyzed all make at least some provision for local participation; each agreement does so, however, in a different manner. Substantively, they vary in the amount of control the Owner retains over the use of nationals; structurally they differ in the way they provide for such control to be exercised. The contracts range, for example, from those which give the Manager absolute discretion over all personnel matters -- including the nationality of those it employs -- and then subject that discretion to various limitations (e.g., Owner approval, policy objectives, local preference in hiring, etc.), to those which require a specific request from the



Owner before foreign personnel can be used to supervise a staff otherwise composed of domestic workers.

13. Certain agreements make an initial grant of broad staff administration powers to the Manager. Yet the Owner often still retains some influence over such matters as a result of some form of restraint on the Manager's personnel duties. The contracts reviewed have utilized different devices to assure varying degrees of Owner authority over the otherwise broad hiring responsibilities assigned to the foreign Manager. One such technique is to subject the Manager's performance of all its contractual obligations, including duties with respect to personnel, to certain general requirements expressed in a 'catch all' clause. For instance, a Manager may be required to submit its work and employment plans for Owner approval or, alternatively, to carry out its employment duties in accordance with the recognized policy directives of the Owner, a board of directors, a joint committee, or local laws specifically restricting the employment of foreigners. Since most of the instruments employing this technique provide elsewhere in the agreement for training programs to be set up for nationals and/or specifically identify local hiring and training as an overall objective, the requisite Owner approval would presumably not be given unless the Manager arranges for a gradually increasing amount of local participation in the project. Such a 'catch all' clause might read:

With respect to the authorities, functions, duties and responsibilities of the Administrator set forth in Clauses Four and Five, it is understood that:

....

2. The administrator shall submit recommendations to the Board of Directors of Owner with respect to the following matters and the Board of Directors shall have the power to approve or reject such matters (subject to further approvals by shareholders where required by the Articles of Incorporation):

....

(h) personnel and remuneration policies and training and education programs;....<sup>3</sup>

14. Another common mechanism for limiting Manager discretion in employment matters is a statement in the agreement which clearly expresses local hiring as a contract goal. The Manager must then carry out its personnel responsibilities in the context of the objective. Such statements have been phrased with varying degrees of specificity. Some have done no more than express the local hiring requirement in general terms, either as a single policy statement or as one of the Manager's enumerated duties:

Owner and Manager recognize the value and necessity of utilizing citizens and firms of (host country) during the Development Period and Operational Period of this Agreement, and each shall strive to give priority in utilizing qualified citizens and firms of (host country).<sup>4</sup>

Other Agreements are more demanding and require generally that foreign staff be replaced by qualified domestic employees as they become available through training programs the Manager must administer:

The Manager shall select its employees, and determine the number thereof, to be used for operations hereunder. Manager shall, after consultation with the Government, prepare and carry out specialized training programs for all of its local employees engaged in operations hereunder with respect to applicable aspects of the petroleum industry. The Manager will undertake to replace gradually its expatriate staff by qualified nationals as they are available.<sup>5</sup>

15. Such terms will have some impact on the Manager's personnel policies. They are, however, so open-ended that implementation of the local hiring requirement is still, as a practical matter, left to the Manager's discretion. For instance, they do not specify the criteria for determining the level of proficiency a local candidate must have attained in order to be 'qualified' for the project staff, nor is it clear which party is to evaluate each candidate's qualifications.

Further, no timetable for the employment of stated percentages of nationals is prescribed. Thus, the Manager is free to set its own guidelines for replacing foreign staff with host country workers.

16. Other contracts reviewed are more exacting about the implementation of their stated policy of local participation. A tactic used in two contracts is to specify both the maximum number of foreign personnel to be sent to the project and the maximum duration of each expatriate's assignment. Replacement of foreign staff by qualified indigenous staff is to take place according to the schedule so that the project can ultimately be operated by an all-local management. The project Owner's approval must be given before any proposed alterations to such a schedule can be made. One agreement, for example, provides:

## ARTICLE II

### Scope of Operating Services to Be Provided by Management Company

Subject only to the over-all policies established by the board of directors of the Enterprise, and mindful of the objectives of the Joint Venture Agreement, the Management Company shall discharge the responsibilities hereunder enumerated, all of which are certified to be consistent with (host country) law:

#### (B) Training of Local Personnel

(1) The Management Company, without derogation of its<sup>1</sup> operating authority, shall provide and be responsible for the implementation of a training program for local personnel in order to ensure that upon expiration of this Contract local personnel can capably assume full responsibility<sup>1</sup> for ongoing operations.

....

(3) Local employees shall replace operating Field Staff, as that term is defined in Article III (A) hereof, as they have attained a level of efficiency which, in the reasonable judgment of the Management Company, enables them to perform the functions for which they have been trained. Upon such replacement, and upon giving of at least three (3) months prior written notice to the number of the operating

Field Staff, the services of such member of the operating Field Staff shall cease, unless the Enterprise requests his retention for other duties.

....

(E) Personnel Administration

Subject to such limitations as may appear in paragraph (K) hereof, the Management Company shall make all decisions relating to the organization, employment, supervision, discharge, and administration of all personnel of the Plant, and the maintenance of all records pertaining thereto. The employment and discharge of local personnel shall be carried out with the advice and consent of the Management Company by certain (Owner) designated persons.

....

ARTICLE III

Field Staff, Construction Manager, and  
General Manager

(A) The Management Company shall employ and carry on its payroll the non-local personnel comprising the Field Staff. The Field Staff shall comprise the minimum complement of foreign personnel required for the construction of the Plant (sometimes called the construction Field Staff) and for the operation of the Plant (sometimes called the operating Field Staff).

....

(C)(1) It is contemplated that the construction Field Staff, as listed in Appendix A hereto, will be adequate to fulfill the obligations of the Management Company hereunder; provided, however, that if, in the judgment of the Management Company, the efficient and effective construction of the Plant can be improved by hiring additional foreign personnel as members of the construction Field Staff, it shall so notify the board of directors of the Enterprise in writing, giving it reasons therefore, and upon authorization by the board of directors of the Enterprise, the Management Company may thereafter employ such additional personnel for the construction Field Staff.

(2) In anticipation of the start-up date the Field Staff shall be augmented by such personnel as, in the sole discretion of the general manager, may be required for the smooth and efficient operation of the Plant. It is contemplated that the operating Field Staff, as listed in Appendix B hereto, will be adequate to fulfill the obligations of the Management Company hereunder, provided, however, that if, in the judgment of the Management Company, the efficient and effective operation of the Plant can be improved by hiring additional foreign personnel as members of the operating Field Staff, it

shall so notify the board of directors of the Enterprise in writing, giving its reasons therefore, and upon authorization by the board of directors of the Enterprise, the Management Company may thereafter employ such additional personnel for the operating Field Staff.

(D) The members of the Field Staff will be assigned to Plant and will arrive in (host country) in accordance with the schedule set forth in Appendix A hereto and will remain in (host country) for the periods indicated therein. Certain of the Field Staff shall be placed at the Plant during its construction to familiarize themselves with it and with the operating conditions prevailing in (host country) and to provide technical assistance in connection with such construction. During the later stages of construction, such Field Staff shall initiate a training program for local employees and shall make all necessary arrangements to place the Plant on an operating basis. The Field Staff shall be increased as the Plant approaches completion so that the entire operating Field Staff shall be available for the commencement of operations. It is understood, however, that the number of members of the Field Staff, their times of arrival and duration of stay in (host country) may be altered as elsewhere provided in this Contract or by mutual agreement between the parties hereto.<sup>6</sup>

17. On their face, however, both contracts still expressly leave it to the foreign Manager to determine when a host country employee is qualified to replace a foreign staff member. Yet, in the above-cited contract the provision which expressly makes the Manager's judgment as to the qualifications of a local applicant determinative (Art. II(B)(3)) must be read in conjunction with the subsequent clause which requires that the employment and discharge of local personnel be the responsibility of appointees of the project Owner who are to obtain the 'advice and consent' of the management company (Art. II(E)). In effect, then, the evaluation of local worker aptitude is done by both parties to the agreement.

18. At this point it should be noted that, as the foregoing clauses illustrate, it is frequently the interplay of several provisions which governs the degree of local participation required by a contract. Consequently, an agreement should be scrutinized as a whole to discern if certain terms operate together in this respect. A 'catch-all' clause for instance may modify the impact of another

term which grants the Manager broad powers over personnel matters. The two provisions may be set forth in entirely different segments of the contract; such disparate locations may mislead the unwary interpreter of the agreement.

19. The terms of yet another group of instruments do not explicitly provide for local participation but do structurally regulate the Manager's use of expatriates in a way that results automatically in the employment of nationals. This can be done by putting an absolute limit on the number of foreigners the Manager can hire, thereby forcing it to complete the staff with nationals:

Manager shall make available to Owner in (host country) the services of qualified engineers and other personnel in such reasonable number as may in Owner's opinion be necessary to assist Owner to operate the Smelter in accordance with good industry practice as adapted to local conditions. The number of personnel shall not exceed the currently applicable number in the Immigration Quota set forth in Schedule G to the Master Agreement.<sup>7</sup>

Another method is the inclusion of a schedule, similar to those previously discussed, which sets a maximum number of expatriate employees as well as the maximum duration of each staff member's assignment in the host country. Replacement of such staff with nationals at the specified time is mandatory and any extensions of such a schedule desired by the Manager are subject to Owner approval. One contract for instance, provides:

In order to complete the Program of Work, Manager shall arrange to make available in (host country) the expatriate field staff personnel who may be either employees of Manager or affiliates, or employees of independent consultants retained by Manager for this purpose. The specific duties of such field staff and the timing and duration of their assignment shall be as set forth in Appendix B.<sup>8</sup>

Appendix B is an Organizational Chart of the project staff which indicates which positions are to be filled by expatriates as well as the date by which such positions must be filled by nationals. Another agreement, on the other hand, states:

ARTICLE III

Field Staff: Operations Manager

- A. The Consultant shall employ and carry on its payroll the foreign personnel comprising the Field Staff. It is contemplated that the minimum Field Staff, as listed in Appendix A hereto, will be adequate to fulfill the obligations of the Consultant hereunder; provided, however, that if, in the judgment of the Consultant, the efficient and effective operation of the Mill can be improved by employing additional foreign personnel as Field Staff, it shall so notify the Board Representative in writing, giving its reasons therefore, and may thereafter employ such additional Field Staff up to the maximum numbers set forth in Appendix A. If, in the judgment of the Consultant, the efficient and effective operations of the Mill can be improved by employing additional Field Staff in excess of the maximum numbers set forth in Appendix A, the Consultant shall notify the Project Committee in writing, giving its reasons therefore, and the Project Committee shall, within fifteen (15) days following receipt of such notice, have the right to approve the Consultant's recommendation. If the Project Committee fails to act within the fifteen (15) day period (or approves within the fifteen (15) day period), the Consultant may thereafter employ such additional Field Staff. If the Project Committee rejects the Consultant's recommendation the Consultant shall have the right to proceed under Paragraph C of Article VI.
- B. It is contemplated that Field Staff will arrive in (host country) generally in accordance with the schedule set forth in Appendix A hereto and will remain in (host country) for the periods indicated therein; provided, however, that the number of Field Staff (within the limits of Paragraph A), their times of arrival and duration of stay in (host country) may be altered as elsewhere provided in this Contract or as determined by the sole discretion of the Consultant.

....

ARTICLE VI

General Obligations of the Enterprise

....

If the Consultant should make a recommendation to the Project Committee or the Board and the Project Committee or the Board, as the case may be, rejects such recommendation, the Consultant, represented by the Operations Manager, shall have the right to request in writing an urgent meeting with the Board. Such meeting shall take place within seven (7) days of receipt by the Board Representative of Consultant's written request for such a meeting. At the meeting the Consultant and the Board shall use their best efforts to reach

agreement on the appropriate course of action to be taken with respect to the Consultant's recommendation. The decision of the Board which shall be made at the meeting (or at such other time as the Consultant and the Board shall mutually agree) shall be final. If the final decision of the Board is to reject, Consultant shall, at Consultant's option, have the right to terminate this Contract by giving written notice to the Enterprise within ten (10) days of the Board's final decision. Such termination shall be effective on the date specified in the written notice, which date shall be not less than thirty (30) days following the date of such notice.<sup>9</sup>

By virtue of strict application, these last devices clearly control the Manager's use of expatriate staff more than any of the preceding ones. The Manager does not judge the qualifications of local replacements; transfer is mandatory and is to occur automatically at the stated or agreed time. Moreover, the Manager cannot unilaterally order alterations of the expatriate personnel schedule; the Owner must agree before any changes can be made.

20. Perhaps the most effective measure used to assure local participation in the enterprise is the requirement that hiring preference be given to nationals. The agreements which use such a method permit use of expatriates only if qualified local candidates are unavailable. Yet the impact of such preference clauses is reduced in some contracts because they fail to prescribe standards for determining whether or not a particular national is sufficiently qualified. Either the contract neglects to indicate which party is to be the judge of the qualifications of local applicants ...

The management and technical services to be performed by Manager ... shall be performed by its Officers, including an Officer who shall be the supervisor of the operations of Owner in (host country) and shall be given the title of General Manager of Owner; provided, however, that the administrative and technical services that may be required to give effect to the directions and advice of Manager's Officers shall be performed by employees of Owner if qualified employees of Owner are available. If qualified employees of Owner are not available to perform the administrative services required to give effect to such directions and advice, such services shall be performed by Manager. If qualified employees of Owner are not available to perform the technical and engineering



services ... required to give effect to the directions and advice of Manager's Officers, Manager shall arrange for such services to be performed by its own qualified employees who are not its Officers or, if no such employees are available, by persons who are not employees of Owner or Manager.<sup>10</sup>

... or else it expressly leaves such judgments to the discretion of the Manager:

The Company shall have the obligation to organize and prepare regular and planned facilities for training and education in the country and/or abroad for local citizens with the aim of gradually replacing any foreign employees. Such training will include technical, engineering, management, business administration and marketing personnel. The Company shall make maximum use of local citizens consistent with the efficient operation of the Company. Accordingly, the Company may employ such foreign personnel as it may deem appropriate until qualified local personnel are trained and available.<sup>11</sup>

21. One contract, however, does safeguard its mandate that nationals be given priority in the employment scheme by making the Manager's personnel policies, including the criteria upon which they are based, subject to the approval of the board of directors of the Owner:

The Administrator and contractors and subcontractors of Owner or the Administrator shall, in hiring their personnel, give preference to local personnel in all job classifications, under equal conditions with respect to qualification.

The qualification and hiring of personnel shall be the responsibility of the Administrator, the contractors or subcontractors, but the Administrator shall inform the Board of Directors of Owner periodically concerning the criteria upon which the personnel policies are based. Such responsibility shall be exercised in a reasonable manner, and whenever in the judgment of the Board, the Administrator, a contractor or subcontractor has not so exercised its responsibility, the Board may require the party to furnish detailed explanations of the basis for its decision.

....

When in accordance with the provisions of this Clause, the unavailability of local personnel with the necessary qualifications is determined, Owner, the Administrator, and their respective contractors and subcontractors shall be authorized to hire foreign personnel....<sup>12</sup>

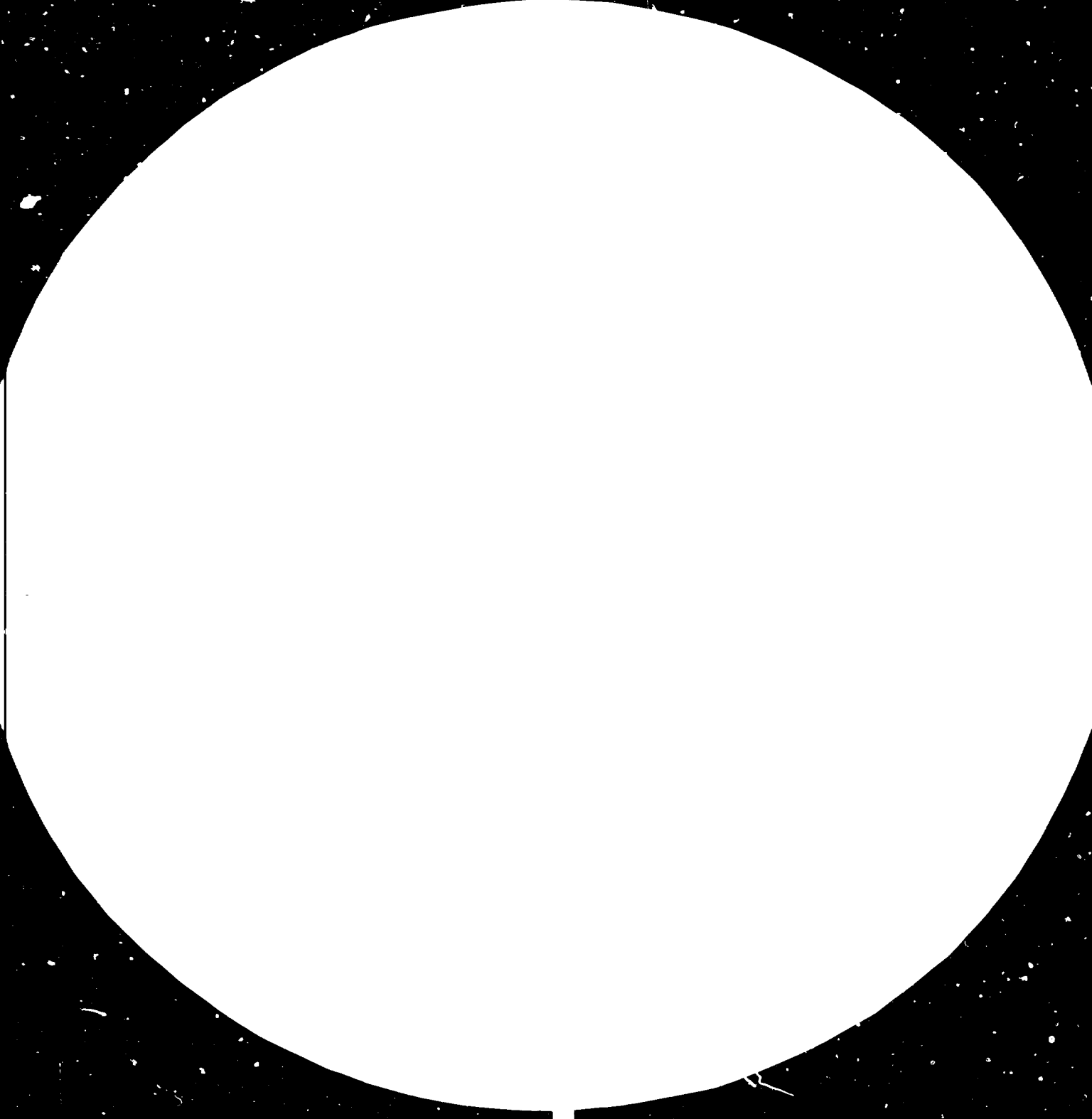
Such structural arrangements allow the Owner to ensure its interests with respect to local participation. Yet, because such arrangements is to permit both parties to share in the formulation of local hiring policy, the Owner is able to proceed in a flexible manner.

22. The final category of contracts to be discussed includes those which leave the Owner with full powers over the extent to which foreign management staff is used. The terms of such agreements imply that foreign management employees are to come in only upon the request of the Owner. A contract may regulate the use of even those expatriate workers brought in at the Owner's request by stating the objective that qualified nationals are to replace the approved foreigners on the staff as soon as possible so that when the contract term is over the Owner will be able to run the project without foreign assistance:

Manager shall furnish to Owner, during the term of this Agreement, in accordance with the then current and up-to-date standards and techniques of Manager:

....

- (b) A detailed program which shall provide expedited training for personnel with the required qualifications for training, selected and assigned for that purpose by Owner, with the objective that local personnel will replace Seconded Staff as soon as possible so that by the expiration of the term of this Agreement Owner can operate the Facilities without the assistance of Manager hereunder. Manager will, taking into consideration any recommendation Owner may make, determine the required qualifications for personnel to be trained, standards of such instruction and specific subjects to be taught.
- (c) A Staff as may be from time to time requested by Owner (including the General Manager ...) of capable and qualified individuals (and capable and qualified replacements therefore) to be engaged full-time in the Project. Such Staff shall represent all appropriate disciplines.... On the basis of information available as of the date of this Agreement, an estimate of the size and composition of such Staff may vary from time to time during the term of this Agreement depending upon Project requirements.... Manager will submit





2.8



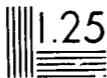
3.2



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to Owner for review the curriculum vitae of each individual proposed by Manager to be Seconded prior to making any employment arrangement with such individual. Owner shall indicate acceptance or non-acceptance of the Seconding of such individual, it being understood that in no event shall acceptance be unreasonably withheld. Owner shall give notice to Manager of such indication within twenty days (20) after receipt of such individual's curriculum vitae. If no notice shall have been given by Owner within such twenty-day period, the Seconding of such individual shall be deemed accepted.<sup>13</sup>

23. In some instances, once the request for foreign staff has been made, the Manager is left with complete discretion over hiring.<sup>14</sup> In others, the Owner must approve the curriculum vitae of an expatriate before he or she may join the management staff.<sup>15</sup> Yet, as the preceding clause illustrates, it may be required that such Owner approval not be withheld unreasonably. Finally, an agreement may oblige the Manager to include certain nominees of the Owner among the management staff it sends upon request to the project and to provide them with 'full and proper experience' within its organization. Such a requirement might read as follows:

Manager shall while the Agreement continues provide facilities for the secondment to Manager by Owner of such employees of Owner ... as Owner may from time to time nominate and whom Manager may agree to accept to its organization providing services to the Company in respect of metal marketing and recruiting. Manager shall not be entitled to refuse any such employees for secondment unless the secondment proposed shall be unreasonable having regard to the number of employees proposed to be seconded and their qualifications and experience for the purposes for which the employees are to be seconded and all other factors relative to the efficient conduct of the business of that part of Manager's organization concerned. During the period of secondment Owner ... shall bear the salary of the employees concerned, the cost of other benefits arising out of their employment and proper traveling subsistence and out-of-pocket expenses and Manager shall afford to each employee full and proper experience within the organization to which he is seconded and all facilities thereof.<sup>16</sup>

B. Local Training

24. Three of the contracts under review make no provision whatsoever for training

host country nationals. Nor do any of them contain local hiring requirements.<sup>17</sup> They simply give the Manager broad powers over personnel matters.

25. Several other agreements provide only for training of the project personnel in general without making a foreign/local distinction. Two of these are hotel contracts and contain no accompanying mandate for local hiring so that the training proviso may or may not affect host country nationals. Further, they call only for pre-operational training and leave the Manager with absolute discretion over labor policies during the operational stage:

#### Article 2

##### PRE-OPENING PROGRAM

Manager agrees to recruit and train at Owner's cost the initial staff of the Hotel through such training programs within and outside the Country, including ... training techniques as Manager shall deem advisable.

#### Article 4

##### OPERATION

##### Section 1. Operational Standards and Permits

... Manager shall have absolute discretion in the determination of room rates, food and beverage menu prices, and charges to guests for other services performed by Manager for the Hotel. Such absolute control and discretion shall extend to the use of the Hotel for all customary purposes; the terms of admittance to the Hotel for rooms, for commercial purposes, for privileges of entertainment; the labor policies of the Hotel; and all phases of publicity and promotion.<sup>18</sup>

Although the Managers in these instances will no doubt hire and train local workers for their lower-level staff positions, there is no contractual guarantee that host country nationals will be absorbed over time into the upper management hierarchy of the project.

26. The other contracts examined for this study do call for at least some measure of local training. Their effectiveness in doing so, however, varies

greatly. Substantive and structural differences in the ways they provide for such training can be identified.

#### Structural Variations

27. The contracts use a number of methods to require local training. Such a mandate might be found in the contract recitals:

WHEREAS, the Owner desires to engage the Management Company to supervise and provide the overall management of the operations of the said sugar refinery ... and for the training of local personnel therefore; ... 19

Or a special clause may set forth the requirement:

#### TRAINING AND EMPLOYMENT OF NATIONALS

On behalf of the Partnership, the Managing Partner shall continue to maintain a training and development programme to train and employ (host country) nationals in the operation and management of the Partnership.<sup>20</sup>

One contract incorporates the training provision of a related agreement:

(J) In the event that all or any part of the Smelter has been completed and may be operated during any Effective Period, Manager shall operate the Smelter in accordance with good industry practice, and to the extent possible the terms and conditions of the Long Term Tolling Contracts and the terms and conditions of the Master Agreement, including Article 28 thereof.<sup>21</sup>

28. The most commonly used structural method for requiring local training is to list it among the Manager's duties under the contract, as follows:

#### Scope of Operating Services to be Provided By The Management Company

Subject to the over-all policies established by the Board of Directors of the Enterprise, the Management Company shall discharge the following responsibilities:

....

#### B. Training and Replacement of Field Staff

1. The Management Company shall provide and be responsible for carrying out a training program for local personnel, both (host country) and in foreign paper mills, as rapidly as possible to the end that such local

personnel will be able efficiently to operate, maintain and administer the Mill. Such training of local personnel shall include on-the-job and in-service programs.<sup>22</sup>

#### Substantive Variations

29. Numerous factors affect the nature and scope of the Manager's training responsibilities. The contract may contain different specifications which define -- to a greater or lesser degree -- the manner by which the management contractor is to carry out its training duties. Such specifications touch upon a number of aspects of this duty -- impact of Owner policy, timetables, type of training, trainee selection, design and development of the training program. In essence, they represent the amount of control an Owner wants, or is able to have, over the Manager's performance in this area. A given contract may contain one or a combination of such specifications which themselves may be effectively or poorly drafted.

#### A. Catch-all Clauses

30. A very general way of defining the Manager's training activities is to subject its performance to the usually broad specifications of a 'catch-all' provision. For example, the Manager may be required to keep within the policies of the Owner's Board of Directors:

General Scope of Work - Subject to the policies established by the board of directors ... Manager thereby undertakes to furnish the Owner with such technical, training and management services as may be required to enable the Owner to accomplish its purposes.... These services shall include but need not be limited to the timely provision of all necessary technical training and managerial assistance in connection with:

....

(f) the training as outlined in the General Agreement of (host country) nationals to manage the operations of the project.<sup>23</sup>

31. The overall labor policies of the contractor may be required to be "in accordance with the applicable laws of (host country)."<sup>24</sup> Developing countries



increasingly have legislative requirements with respect to local hiring and training. Just how restrictive such a contract provision is will therefore depend on the content of the host country laws. A similar obligation is that the Manager is to be "mindful of the rights and interests of the (host country) Government"<sup>25</sup> in carrying out its duties, including training, under the contract. Finally, a very weak 'catch-all' clause might state that the project operations are to be conducted "in accordance with local character and traditions."<sup>26</sup> Since neither criteria nor a method for reviewing the extent to which the project is actually run in this manner are prescribed, such a clause is virtually ineffectual.

#### B. Timetables

32. Certain agreements specify how much training the Manager is to do as well as how long it is to take. Some contracts are more exacting in this respect than others. The amount of discretion and control the Manager has will vary depending on the language and structural arrangements contained in each agreement.

##### 1. General Phrasing

33. Some training provisions are phrased so broadly and leave the Manager with so much discretion that their effectiveness is questionable.

Manager undertakes to employ and train locals to the greatest extent feasible bearing in mind and having regard to the efficient operation of its facilities, provided that the criterion for employment and promotion shall always be that of competence and efficiency determined by management.<sup>27</sup>

##### 2. Replacement Schedules

34. Other agreements are more precise and put the Manager's training activities on a schedule. This is usually done indirectly by setting a deadline by which the Manager's foreign staff is to be replaced by trained locals.

35. Such replacement schedules may be specific or open-ended. An agreement may have a special replacement deadline or it might simply require replacement by the end of the contract term. For example:

Replacement of Management Staff

Manager shall train local personnel ... with the objective that such trainees will in the future be able to operate, maintain and administer the Mine and Mill efficiently. As part of this obligation each member of the management staff will be assigned a local counterpart. Such local counterparts/trainees who successfully complete Manager's training program shall replace members of the management staff as soon as in the judgment of Manager they shall have reached the level of efficiency required to perform the functions for which they have been trained. However, it is understood that all management staff shall, to the maximum extent feasible, be replaced by local personnel within ten years from the date of commencement of production.<sup>28</sup>

and:

Manager's Obligations

Manager shall furnish to Owner, during the term of this Agreement, in accordance with the then current and up-to-date standards and technologies of Manager:

....

(b) A detailed program which shall provide expedited training for personnel with the required qualifications for training selected and assigned for that purpose by Owner, with the objective that local personnel will replace Seconded Staff as soon as possible so that by the expiration of the term (10 years) of this Agreement Owner can operate the Facilities without the assistance of Manager hereunder.<sup>29</sup>

36. In some instances the replacement schedule is based on the estimated time it will take to train locals to take over the project management:

This list of Field Staff and the estimated duration of their employment are based on the Management Company's best estimate of the time required to train local replacements.<sup>30</sup>

As illustrated above, such estimates have been made by the Manager. The Owner would be well-advised to participate in setting such time limits.

37. Replacement schedules, and thus training completion deadlines, may be alterable. One contract states that such alterations may be made "as determined by the sole discretion of the Manager."<sup>31</sup> Others more equitably require "mutual agreement of the parties" before any change can be made.<sup>32</sup>

38. It should be noted that although an agreement has a set replacement schedule it might also contain language, such as the following, which implies that the Manager's efforts should be directed towards completing its training duties in advance of that deadline if possible.

1. The Management Company shall provide and be responsible for carrying out a training program for local personnel, both in (host country) and in foreign paper mills, as rapidly as possible to the end that such local personnel will be able efficiently to operate, maintain and administer the mill.

....

2. Local employees shall replace operating Field Staff as soon as, in the judgment of the Management Company, a local employee has reached the level of training and efficiency required to perform the functions for which he has been trained.<sup>33</sup>

Since these statements leave it up to the Manager's discretion whether or not it will perform ahead of schedule, their effectiveness is unclear.

39. Finally, a replacement timetable for training may be subject to certain ambiguous or subjective qualifications which might reduce its impact. For example, a clause might read:

The Management Company, without derogation of its operating authority, shall provide and be responsible for the implementation of a training program for local personnel in order to ensure that upon expiration of this Contract local personnel can capably assume full responsibility for ongoing operations.<sup>34</sup>

Another qualifying phrase might require replacement by locals "to the maximum extent feasible"<sup>35</sup> by a specified date. Such language clearly provides an "out"

for a Manager wishing to shirk its training responsibilities and prolong its authority over the project. On the other hand, the possibility that management's operational and training duties will be incompatible is a reality which the Owner should be mindful of. If accompanied by a few more checks on managerial discretion, qualifications like those illustrated above may provide the flexibility that is often needed to reconcile successful project operations with an Owner's development goals.

40. Finally, replacement objectives in management agreements may be phrased in an open-ended way, again probably leaving the Manager with too much discretion. As a result, the length of time the Manager will take to fulfill its training obligations may end up being its own decision rather than a matter regulated by the Owner. An open-ended replacement provision might read:

During the start-up period and continuing until local personnel have proved their operating competence, sufficient expatriate supervisory personnel, will be made available to assure that the plant is operated safely and efficiently. Each of these expatriate personnel will have the dual responsibility of putting the plant into operation at an efficient level and overseeing the training of his counterpart so that the responsibility for the operation of the plant can be turned over to locals as soon as practicable, consistent with safe and efficient operation.<sup>36</sup>

3. Quota of Expatriate Personnel Maximum Duration of Stay at Field Site

41. Another indirect method of timing the Manager's training activities is to set maximum quotas of foreign personnel that can be used on the project as well as maximum duration of their stay. This system forces the Manager to train locals in time to replace expatriates according to the schedule. A contract might read:

In order to complete the program of work, Managers shall arrange to make available in (host country) the expatriate field staff personnel who may be either employees of Manager or affiliates, or employees of independent consultants retained by Manager for this

purpose. The specific duties of such field staff and the timing and duration of their assignment shall be set forth in Appendix B.<sup>37</sup>

The referenced Appendix B is a organization chart of the positions to be filled by expatriate staff and indicating replacement deadlines. Presumably, the replacements will be made with trained host country nationals.

#### 4. Specific Training Schedule

42. One contract set out a specific timetable for Manager's training program:

It is assumed that the training of Manager's personnel will be spread over the years 1973, 1974, 1975 and the early part of 1976 commencing with Senior Management concentrated in 1973 while the training of foremen and supervisors will be mainly during late 1974 and 1975.<sup>38</sup>

#### C. Type of Training

43. A number of the contracts specify what type of training the Manager is to provide. An agreement might require one or more of the following kinds of training methods:

##### 1) In country/abroad

The Manager shall have the obligation to organize and prepare regular and planned facilities for training and education in the country and/or abroad for local citizens with the aim of gradually replacing any foreign employees. Such training will include technical, engineering, management, business administration and marketing personnel.<sup>39</sup>

Or,

The Management Company shall arrange, for the account of the Owner necessary training of local personnel both in (host country) and in foreign sugar mills.<sup>40</sup>

##### 2) On-the-job/Counterpart Trainees

Manager shall train local personnel of Owner.... As part of this obligation, each member of Management Staff will be assigned a local counterpart. Such local counterparts/trainees who successfully complete the training program shall replace members of the management staff....<sup>41</sup>

##### 3) Higher Education

It shall be the duty of Manager to ensure the

training of its local personnel both on the job and by attendance at training courses in (host country) or elsewhere and to provide selected local candidates with appointments for higher education in Petroleum Operations.42

4) Absorption into Manager's Organization

Manager shall while this Contract continues provide facilities for the secondment to Manager of such employees of Owner as Owner may from time to time nominate and whom Manager may agree to accept to its organization providing services to Company.... Manager shall not be entitled to refuse any such employees for secondment unless the secondment proposed shall be unreasonable having regard to the number of employees proposed to be seconded and all other factors relative to the efficient conduct of the business of the organization concerned. During the period of secondment ... Manager shall afford to each such employee full and proper experience within the organization to which he is seconded....43

5) Training by Equipment Suppliers

The Manager shall assist Owner in making arrangements for training Owner's personnel at the establishments of the Equipment Suppliers particularly during the manufacture of equipment to be installed at the works.44

D. Positions for Which Local Personnel are to be Trained

44. Ideally, a contract should provide specifically for the training of local personnel for management positions as well as for operational staff jobs. Only if local personnel is absorbed into the management hierarchy can the effective transfer of management to domestic personnel take place. The following are examples of clauses which explicitly call for training at all levels:

Manager will train the necessary number of local supervisory personnel in (host country) and in Manager's home plants to assume responsibilities in the operation of the plant. These persons together with expatriates furnished by Manager will initiate operation training programs in (host country) to train the approximately 750 locals who will be employed in the operation of the plant.45

and,

The Training Programme

As indicated above in 6.3. the detailed Programme of

training is to be agreed between Owner and the Manager but it is envisaged that in general the Programme for training may comprise:

- (a) Training for Senior Management to begin three years prior to plant start-up.
- (b) Training for maintenance personnel at management level, to include experience in the site workshops and visits to equipment suppliers, works under construction and working units overseas to the extent of up to 12 months split according to requirements.
- (c) Training for maintenance personnel of foreman and supervisor level, to include visiting equipment suppliers, works under construction and working units overseas to the extent of up to 6 to 9 months as necessary.
- (d) Training for Plant Unit Operations Managers to begin 18 months before start-up to include visits to equipment suppliers, works under construction and 12 to 15 months in operating steel-plants.
- (e) Training for Assistant Plant Unit Operations Managers to begin 12 months before start-up and to include 6 to 9 months in operating steel plants.
- (f) Training for those operations supervisors and foremen who require to train in operating plants to begin 9 months before start-up and to include 4 to 6 months in operating steel plants.
- (g) Training for Administration and Commercial Management as appropriate for periods of 3 months to 18 months.
- (h) Training key operators who require to train in operating plants to begin 4 to 6 months prior to start-up and to include 2 to 4 months in operating steel plants.<sup>46</sup>

#### E. Trainee Selection

45. The contracts provide for the selection of local trainees in several different ways. They vary essentially in the extent of Owner participation in the selection process.

##### 1. Selection by Manager

46. A contract might give the Manager final personnel hiring authority subject to a local hiring and training requirement. The Manager, therefore,

is left with the power to select the locals its hires and trains. The only check on this power might be a 'catch-all' clause making all of the Manager's activities subject to the policies of the Owner's Board of Directors which might affect the selection process:

Subject to the overall-policies established by the Board of Directors of the Owner, the Management Company shall discharge the following responsibilities:

A. General Responsibility for Management

1. The Management Company shall have full and exclusive authority and responsibility for the management of the mill and shall direct, manage, supervise, administer and develop all aspects of the operations carried on by, and all services connected with the operation of the Mill, including, inter alia: ... (g) obtaining of personnel and personnel administration; ...

B. Training and Replacement of Field Staff

1. The Management Company shall provide and be responsible for carrying out a training program for local personnel, ....<sup>47</sup>

47. An agreement might alternatively give the Manager express powers to select the locals it is to train:

Recognizing the wish of the Government to further its policy concerning employment and technical promotion, the Manager ... shall submit a program of progressive localization of specialists in order to promote, on the one hand, technical instruction of qualified local workmen and to ensure on the other hand the training and employment of locals chosen by the Manager from graduates of administrative, commercial or technical schools corresponding to various department of the Manager.<sup>48</sup>

2) Selection by Owner

48. Some contracts give the Owner final trainee selection powers but make its selection subject either to the requirement that it choose locals based on criteria set by the Manager or that the selected trainees be approved in the end by the Manager. For example:



Manager shall assist Owner in the recruiting of local personnel to be trained, including, as feasible, establishing employment criteria and listing procedures for local personnel who apply for the enrollment in the training program. Manager shall assist the (Owner's) Board to select any local personnel to be trained under this Agreement.<sup>49</sup>

and,

Manager shall assist and train at the manufacturing facilities of its affiliated companies in (its home country) and/or elsewhere technical personnel selected by Owner and approved by Manager in such reasonable numbers as Manager deems necessary.<sup>50</sup>

49. Related to the question of which party is to select trainees is the issue of who is to initiate the training program for the project. Most of the agreements already discussed specifically require the Manager to set up the local training program, presumably from the outset of the contract period. Some agreements, however, provide that the Manager is to train only upon the Owner's request:

Providing suitable persons with appropriate qualifications are available, Manager shall employ (host country) nationals or such other persons as Owner shall stipulate and if required by Owner shall establish a training programme for such personnel in accordance with instructions given to Manager from time to time by Owner.<sup>51</sup>

F. Design/Development of Training Program

50. Many of the contracts which assign training duties to the Manager make no specifications as to the exact nature of the training program, nor as to which party is to design the program. Presumably, in such instances, the Manager will assume that responsibility. Other contracts, however, provide for some input by the Owner into the development of the program. Such arrangements, of course, give the Owner more control over the Manager's performance in this area than those which leave it all up to the Manager.

51. The amount of Owner input and the method by which the Owner exerts its influence over the Manager's training activities vary from agreement to agreement. All the contracts allow the Manager to draw up the training program. One agreement, however, requires it to consult with the Owner prior to designing its plan:

The Manager shall select its employees and determine the number thereof, to be used for operations hereunder. Manager shall, after consultation with the Government, prepare and carry out specialized training programs for all of its local employees engaged in operations hereunder with respect to applicable aspects of the petroleum industry.<sup>52</sup>

Another contract expressly prescribes the contents of the plan the Manager is to develop:

Manager shall prepare and submit to the Owner's Board as soon as practicable after the signature of this Agreement but otherwise as reasonably requested by Owner a training program which sets forth recommendations for on-the-job training courses, the locations where training might be accomplished, the positions for which local personnel will be trained, the numbers of such personnel and the qualifications required for each position.<sup>53</sup>

Yet another agreement requires the Manager to take "into consideration any recommendation Owner may make,"<sup>54</sup> when developing its training plan.

52. In one instance, the training is to "be conducted according to programs to be agreed upon between Owner and Manager."<sup>55</sup>

53. Other contracts allow the Manager to initially design the program by itself but then require the plan to be submitted to the Owner for review and approval:

#### CLAUSE SIX

With respect to the authorities, functions, duties and responsibilities of the Manager ... it is understood that

....

2. The Manager shall submit recommendations to the Owner's Board of Directors with respect to the following matters and the Board of Directors shall have the power to approve or reject such matters....:

....

(h) personnel and remuneration policies and training and education programs.

CLAUSE TWENTY-FOUR

Without prejudice to other provisions of this Agreement ... the Manager shall be required to obtain the approval of Owner in order to accomplish any of the following:

...

7. To establish personnel and remuneration policies and programs for the training and instruction of personnel.<sup>56</sup>

54. In at least one agreement, once the training plan is submitted, both parties come to an agreement upon the final program format:

Manager shall prepare and submit to the Owner's Board ... a training program .... After discussing the recommended program and any additions or modifications thereto, Manager and the Board shall agree to a training program and thereafter, activities shall be conducted in accordance therewith.<sup>57</sup>

55. Some agreements specifically provide for later modifications of the training program once it has been set:

It is anticipated that from time to time as required by the needs of the Project, modifications of such program of training and instruction shall be effected, with the mutual accord of Owner and Manager in the interest of fulfillment of the objective to transfer management to local personnel by the expiration of this Agreement.<sup>58</sup>

Others provide for joint periodic reviews of the implementation of the programs:

Such training programs shall be presented to the Committee annually.<sup>59</sup>

and,

### General Conditions of the Training Program

4.4.1. Manager shall carry out such periodic examinations of trainees and the progress of the training program as it deems appropriate to determine the efficiency of the training program and to ascertain whether persons receiving training are taken advantage thereof. Manager shall submit to the Board a detailed quarterly report setting forth the results of such examinations and review and stating any conclusions drawn therefrom.

4.4.2. Manager shall promptly submit to the Board such other information and reports as the Board may from time to time reasonably request with respect to the implementation of the training program.<sup>60</sup>

### G. Commentary

56. The concept of flexibility is important in the drafting of management contracts. A successful contractual agreement is one which not only protects the interests of both parties but which also lends itself to the development of a good working relationship among all concerned. Incorporating rigid standards, replacement schedules or quotas in the contract may cause bad feeling from the start and ultimately result in the breakdown of the relationship. Terms which instead are firm, but open-ended such as those which require mutual accord respecting matters of stated interest to both parties, create a spirit of flexibility. Such arrangements permit the parties to negotiate together to resolve issues of inherent conflict and to tailor their approach for dealing with future circumstances which may have been unpredictable, such as the changing availability of qualified locals. Flexibility prevents the situation where a rigid contract term governs in a manner which disgruntles one or the other of the parties or which is not advantageous for the project in view of the circumstances prevailing at a particular time. Of course, however, such flexible mechanisms can operate effectively only where the parties are themselves intent upon resolving their differences. Where the parties are uncompromising, the use of devices

calling for a sharing of powers could lead to the stalemate which results in the termination of the contractual relationship.

#### FOOTNOTES

1. Contract 5, Article 5.1, 3.2.
2. Contract 3, Article 4(2); see also, Contract 3, Article 4(i); Contract 2, Article 3; Contract 6, Article 6(4); Article 5(3).
3. Contract 22, cl. 6(2)(h); see also, Contract 22, cl. 24(7); Contract 8, cl. 4(A)(2); (C)(1), cl. 6; Contract 11, Article 16; Contract 7, Article 2(B)(ii); Contract 19, Article 2; Contract 20, Article ; Contract 26, Article ; Contract 10, Article 4.01; Contract 13, Article 11.
4. Contract 11, Article 18; see also, Contract 7, Sec. 12(11), Contract 33, Article 3.4.
5. Contract 9, Article 15(b); see also Contract 12, Article 1.2(b).
6. Contract 13, Article 2, Article 3; see also Contract 14, Articles 1.01, 2.03, 3.02; see also Contract 1, Article 2(A), Article 3(J), and in accompanying "Master Agreement," Articles 27 and 29. See also Contract 34, Article 3.
7. Contract 15, Article 9(B)(i).
8. Contract 17, cl. 4, Appendix B.
9. Contract 16, Articles 3 and 6.
10. Contract 19, Article 3.03; see also Contract 18, Article 9; Contract 20, Article 6(9).
11. Contract 21, cl. 51; see also Contract 21, cl. 1.
12. Contract 22, cl. 16.
13. Contract 25, cl. 2.01(b)(c); see also Contract 24, cl. 4(a); Contract 26, cl. 2A; Contract 27, Article 3(3), Article 4(1)(2); Contract 28, Article
14. Contract 24, cl. 4(a).
15. Contract 25, Cl. 2.01(C); Contract 28, cl. 13(a)(ii).
16. Contract 27, Article 9; see also Contract 26, cl. 13.
17. Contracts 4, 5 and 29.
18. Contract 3, Article II, Article IV. See also, Contract 2, Article II, Sec. 5, Sec. 6; Contract 6, Article V(3).
19. Contract 14. See also, Contracts 31 and 32.
20. Contract 10, Article VI.

21. Contract 1, Article III(J).
22. Contract 15, Article III(B)(1). See also, Contracts 14, 15, 19, 20, 21, 22, 23, 25, 28, 33, 34, 35.
23. Contract 8, Para. 3. See also, Contract 35, Article III.
24. Contract 22, Cl. 16; Contract 35, Article III(I).
25. Contract 20, Articles VI.5, VI.9.
26. Contract 2, Article III.
27. Contract 1, Article III(J) and attached Master Agreement Article XX"III.
28. Contract 32, Article III.4.3.
29. Contract 25, Article II.01(b). See also, Contract III, Article II(B)(1); Contract 22, Cl. 17.
30. Contract 16, Appendix A; Contract 35, Appendix A.
31. Contract 16, Article III(B).
32. Contract 14, Article I.01(b); Contract 35, Article VI(D).
33. Contract 35, Article III(B)(1)(3). See also, Contract 25, Article II.01(b).
34. Contract 13, Article II(B)(1).
35. Contract 32, Article III.4.3.
36. Contract 34, Article I(111). See also, Contract 9, Article XVI; Contract 21, para. 51.
37. Contract 17, Para. 4, Appendix B. See also, Contract 15, Article IX(B)(1)(111).
38. Contract 28, Schedule 1, (c). See also, Contract 28, Schedule 1, 6.3.4.
39. Contract 21, Para. 51.
40. Contract 14, Article II.02. See also, Contract 20, Article VI.9.
41. Contract 32, Article III.4.3.
42. Contract 20, Article VI.9.
43. Contract 26, Article II. See also, Contract 27, Article IX.
44. Contract 28, Schedule 1, Sec. 6.3.2.
45. Contract 34, Para. 1(11).

46. Contract 28, Schedule 1, Article VI.3.4.
47. Contract 35, Article III(A)(B).
48. Contract 18, Article XI.
49. Contract 32, Article IV.3. See also, Contract 25, Article II.0.(b).
50. Contract 15, Article IX(B)(iii). See also, Contract 19, Sec. 3.02(d).
51. Contract 30, Para. 4(2). See also, Contract 24, Para. 4(5); Contract 26, Article II; Contract 27, Article IX.
52. Contract 9, Article XV(2)(b).
53. Contract 32, Article IV.2.
54. Contract 25, Article II.01(b).
55. Contract 20, Article VI.9; Contract 18, Article IX; Contract 32, Article IV.2.
56. Contract 22, cl. 6 and 24. See also, Contract 32, Article VI.2; Contract 18, Article IX.
57. Contract 32, Article IV.2.
58. Contract 22, Cl. 17.
59. Contract 20, Article VI.9.
60. Contract 32, Articles 4.4.1, 4.4.2. See also, Contract 33, Article V.



## VII.

### PROVISIONS RELATING TO

#### LOCAL PROCUREMENT

##### Overview

1. A variety of factors and considerations affect an Owner's decision about whether to vest the Manager with procurement responsibilities or to retain such responsibilities for itself. If the project is of such a nature that local suppliers may be able to provide significant portions of the goods and services necessary for its operation, the Owner may decide to retain procurement authority. On the other hand, if the goods and services requisite to the project are unavailable indigenously, the Owner may be willing to waive a certain degree of control over procurement. If the goods and services are of great sophistication, as they are likely to be in many of the high technology projects for which Managerial services are purchased, most of the procurement will have to be done outside the country.
2. Consistent with the Owner's objective of transferring the Manager's expertise to a domestic cadre may be the goal of using the procurement needs of the project to support or establish indigenous sub-contractors and supplies. In such cases, the Owner will likely place a greater emphasis upon channeling procurement flows to such target domestic firms. This can be done by either retaining procurement authority, subjecting Manager procurement decisions to **an approval process**, or by specifically providing that local purchasing is an objective of the contract. While the latter method is found in only a handful of the contracts, more evidence is needed to determine whether or not the former two methods yield results consistent with an Owner's interest in encouraging indigenous procurement.

3. Of course, the Manager may also have objectives that affect how control over procurement is distributed between itself and the Owner. For example, the Manager may regard control over procurement as an important element in its compensation scheme. In other words, if the Management company can also provide many of the goods and services for the venture, or if it has subsidiaries or affiliated companies that can serve a procurement role for the project, the Owner's indigenous procurement goal may be resisted. Likewise, any diminution in procurement authority for the Manager may induce it to seek a higher fee schedule for the specific services covered by the contract itself. On the other hand, if the Manager has no interest in who receives the supply contracts for the project, it may be willing to accommodate the Owner's objectives in this regard. Though if the Manager remains closely identified with the project, for example in a hotel management arrangement where the hotel bears the name of the Manager and will affect the worldwide reputation of the Manager, having control over procurement may be a very important consideration during the operation phase, and perhaps even during the construction phase.

#### Analysis

4. The provisions that articulate the duty of the Manager to use local products and services vary in their degree of specificity. It can be presumed that the more specific the provision, the more likely it is that the Manager will take such a duty seriously. The following analysis discusses the relevant contracts starting with the most general, and concluding with the most specific.

5. The most general requirement with regard to local procurement states as follows:

Manager recognizes the value and necessity of utilizing citizens and firms of (host country) in the work of Manager and the development and operation of the project and shall strive to give priority in utilizing qualified citizens and firms of (host country).1

Manifestly, this is a weak provision and offers no means of oversight or enforcement.

6. In another contract including a local procurement provision, the Manager, an international hotel company, retains a veto power. The provision giving the Manager ultimate procurement authority is a rare type of arrangement, and is perhaps a reflection of the Manager's concern for its reputation as a hotelier. Nevertheless, the contract states:

Equipment and Supplies. Manager will advise and assist in (a) the preparation of plans and specifications of, (b) the itemization of quantities of, and (c) the procurement of, the Furnishings and Equipment and other supplies for the Hotel. Owner shall approve or revise such plans and specifications, itemize such quantities to procure such Furnishings and Equipment and supplies without the prior written approval of Manager. Manager and Owner agree that, to the extent possible and consistent with operation of a first-class international hotel, Furnishings and Equipment and supplies will be procured in (host country).<sup>2</sup>

7. A third contract that has a relatively strong requirement for local procurement contains a strict preference provision for work and service from third parties, as well as a cargo set aside:

All the work and all service made or rendered by third party corporations to the Corporation for the latter's benefit in (host country) having a direct or indirect relation with the implementation of this Agreement, shall (the process and conditions of such work and services being otherwise equal) be entrusted to firms of (host country) nationality.

The above provisions shall apply insofar as there shall exist in (host country), at the time a firm is able to execute work or to render services of such nature. The Government reserves the right, in as much as it does not adversely affect the sale of bauxite, to have the exported tonnage loaded in a proportion which shall not exceed fifty percent on ships operating under the (host country) flag or an assimilated flag, or on ships chartered by the Government on the international shipping market, the above being, however, under the express condition that the freight tariffs practiced are lower or equal to those which are quoted at that particular time on the international shipping market for identical conditions for the freight and the shipping routes considered.<sup>3</sup>

The flaw of this provision lies in the fact that it neither lists the criteria for determining whether local firms are "able" to do the necessary work nor does it indicate which party is to make this determination. It is thus conceivable, then that the Manager could have very wide discretion in procurement matters.

8. Finally, there are two agreements that may be regarded as having specific and well-designed provisions. They reflect the Owner's interest in having the Manager assume a duty to pursue local procurement policies, without necessitating control by the Owner over the procurement process -- which in many cases would be counterproductive to the efficient use of the Manager's procurement expertise.

9. For example, one agreement contains separate provisions for local procurement of both services and products. The provisions not only require given equal circumstances, that preference be given to services and products of host country origin, but also that the Manager shall provide the Owner with the criteria upon which its procurement decisions are based:

#### CLAUSE EIGHTEEN

##### SERVICES OF (HOST COUNTRY) ORIGIN

In all stages of the Project, the Administrator and contractors and subcontractors of Owner or the Administrator shall give preference to the use of services of (host country) origin, within similar conditions of quality, experience, availability and cost to the same services of foreign origin.

The Administrator and such contractors and subcontractors shall state to Owner the qualification criteria utilized in choosing services.

The responsibility for applying the standards of this Clause Eighteen shall be in the Administrator, the contractor or subcontractor, as the case may be, but such responsibility must be exercised reasonably.

## CLAUSE NINETEEN

### USE OF PRODUCTS OF (HOST COUNTRY) ORIGIN

In all stages of the Projects, the Administrator and contractors and subcontractors of Owner or the Administrator shall give preference to the use of products of (host country) unless such products are not available on a competitive basis as to delivery, quality, quantity, availability and cost.

The responsibility for the selection of products shall be in the Administrator, contractor or subcontractor in the particular situation, but such responsibility shall be exercised reasonably in relation to the standards established by this Clause.<sup>4</sup>

While the provisions do reflect some balance in authority between the Owner and Manager, the Manager still retains broad discretion. The Manager is required to submit qualification criteria to the Owner for its service selection but no similar duty exists in the product clause. The contract is still basically a "best effort" approach.

10. The final contract deals with certain petroleum operations and is the most detailed of the five agreement provisions reviewed for this section. The agreement not only provides that indigenous subcontractors must be given preference, under equal circumstances, but also that even foreign subcontractors who utilize the maximum element of local equipment, goods, materials and supplies, in fulfillment of the subcontract are to be given preference. The provisions require, inter alia, that major contracts be let on a competitive basis, that an Owner Committee be kept informed of the details of bids and the reasons for selection, and also that tender offers must be published in local news organs:

For the purpose of Petroleum Operations hereunder, Contractor is authorized to use subcontractors selected by him, provided such selection except competitive bidding for tenders and provided further that preference shall be given to (host country) subcontractors having the requisite on price, performance and timing.

Major contracts, viz., those exceeding U.S. \$500,000, shall be awarded on the basis of competitive bidding

for tenders. Advertisements inviting tenders shall be published among other papers in the (host country) Trade Journal and three (3) daily newspapers having all (host country) circulation. In exceptional circumstances, the award of these tenders may be made on the basis of limited tenders or by wide consultation, provided that Contractor is able to satisfy the Committee that the price, quality and delivery so obtained is not inferior to that obtainable in a competitive manner. Limited tenders and wide consultation shall take (host country) parties into consideration.

The Committee shall be kept informed of details of bids and reasons for selection for its review. Goods, materials and supplies required by the Petroleum Operations whether used by Contractor or its subcontractors shall, whenever possible taking into account price, quality and delivery time, be ordered from (host country) suppliers or manufacturers and Contractor shall use every effort to maximize the share of (host country) supplies for the Petroleum Operations. In case subcontractors are employed from outside (host country), preference will be given by Contractor to those foreign subcontractors price and delivery time utilize to the maximum extent possible (host country) equipment, goods, materials and supplies, and this fact shall be made known to the subcontractors at the time of invitation of tenders.5

FOOTNOTES

1. Contract 33, Article 3.4.
2. Contract 6, Article iv, Section 7.
3. Contract 18, Article 9.
4. Contract 22, Clauses 18 and 19.
5. Contract 20, Article vi. 7, vi. 8.

VIII.

PROVISIONS RELATING TO  
PROJECT EXPENSES

Overview

1. Owner's primary obligation to Manager under pure management contracts is one of compensation and paying other project expenses. These obligations are construed both broadly and narrowly by the contracts under consideration. At the broad end of the spectrum are contracts which include within compensation, of the Manager, remuneration based on a basic management fee, an incentive fee, special fees for certain services defined to fall outside the scope of the basic management responsibilities, commitment fees, termination fees, and reimbursement for costs and expenses incurred by the Manager on behalf of the project. At the other end of the spectrum is a contract which includes only reimbursable costs within the definition of compensation.<sup>1</sup> Capital resources, including initial working capital for the early days of operation and often also including working capital for the on-going operation of the project, are also almost always included within Owner's responsibilities.

2. Any of several schemes are thus available for the compensation of Managers and other project expenses. These include: (a) basic fees, which are either fixed amounts determined in advance or a percentage of, for example, gross revenue and which may be paid only once or on a periodic basis; (b) incentive fees, otherwise known as contingent fees, which are based on profits, sales production or a similar category and which may either be in addition to the fixed fee or in place thereof; (c) fees for "special services" defined to fall outside the scope of services compensable under the basic fees; (d) commitment fees and termination fees; (e) advance fees for the procurement of, inter alia, equipment, materials and supplies, as well as overhead and support



staff expenses; and (f) payments for the reimbursement of itemized expenditures (note the difference from (e) above, wherein the Owner pays in advance for unitemized expenditures).

3. Various formulae exist for the computation of management fees. Most of the contracts under analysis include a basic fee along with an incentive fee. The basic fee may be either: a fixed fee worked out in advance between the partners and which may be a one-time only payment or a periodic payment; or, a fee usually calculated as a percentage of gross revenue or revenue. The incentive fee is usually calculated as a percentage of profits sales or production. Fees based on profit may be calculated on the basis of pre-tax or post-tax profits; those based on post-tax profits are more favorable to the Owners than the other possibilities, while those based on output or production are the least favorable to the Owners, with gross sales also being an inadvisable yardstick from this point of view, as those provide for a larger base from which to draw fees.

4. Other formulae also exist. For example, several of the contracts calculate this fee on the basis of a schedule geared to either the stage of the contract, such as whether it is at the preoperation or operation stage, or on levels of production.<sup>2</sup> Still others include the possibility of a percentage fee with a minimum fee floor.<sup>3</sup>

5. The basic fee and the incentive fee are compensation for designated activities and responsibilities. Other services, also expressly set forth in the contract, may be remunerated separately. Such special services may include marketing, preoperations assistance, recruitment and training of personnel. Payments for these services take a variety of forms, including: (1) cost reimbursement; (2) cost plus a fixed fee; (3) cost plus a percentage of revenues, sales or

profit; (4) fixed fees.

6. The compensation for additional services is an additional category of expense separate from both management fees and reimbursement of expenses incurred by the Manager. Contracts that include this category of expense are more favorable to the Manager than to the Owner from the point of view of the Owner's total outlay to the Manager under the contract, since the Manager divides its responsibilities into two categories: basic services compensable under the management fees, and special services compensable in addition to such fees. The Owner thus incurs expenses additional to those for services falling under the management fee. On the other hand, the Manager might want to raise the amount of the management fee to include such additional services if it feels such services to be outside the scope of duties normally required for the type of project involved. This is a matter of negotiation, but the basic point should be kept in mind: the more the Manager can separate out services from under the scope of duties compensable under the management fee, the more potential for it to gain.

7. Fees for equipment, supplies, support staff and overhead expenses, herein referred to as reimbursable expenses, may be provided for in one of at least two ways. The Owner may advance funds either directly to the Manager, or to a third party trustee, such as a bank, on either a revolving fund or letter of credit basis in an agreed initial amount replenishable periodically as funds are drawn down by the Manager; or, the Owner may reimburse the Manager for costs and expenses actually incurred by the Manager. The Manager clearly prefers the first, for it protects the Manager from non-payment or delayed payment on the one hand, and it means that the Manager's own funds are not tied up in such expenses and are thus free for other uses. The second is preferable to the Owner as it allows the Owner use of the funds for longer periods of time and it provides an additional measure of control over the Manager's expenses.

8. The contracts under analysis vary considerably with regard to the expenses that are reimbursable and those that are not. For example, while one contract holds that all expenses are the responsibility of the Manager, and a second requires the Manager to bear almost all costs and expenses,<sup>4</sup> most of the contracts allow the Manager reimbursement for most if not all of its operating expenses; advertising and sales promotional expenses; salaries, benefits and expenses of the field staff; and, inter alia, travel expenses connected to the project. Other expenses, such as the cost of procuring and maintaining insurance and inter-company transactions such as inter-hotel reservation facilities in hotel contracts, may or may not be reimbursable. Still other expenses, if paid at all by the Owner, may be reimbursed only on a pro-rated basis. These include charges for overhead expenses and support staff.

9. Reimbursement for the expenses of personnel and overhead may be done in any of several ways. A distinction almost always exists between field and home-country (support) staff. While most of the contracts herein reimburse the Managers for at least part of the salaries of support staff as well as for all direct expenses of those paying occasional visits and certain other indirect expenses, it is questionable whether such expenses should be paid separately and in addition to the basic management fee, or whether the management fee should be inclusive of such costs and expenses.

10. Remuneration for the costs and expenses of field staff may be done on the basis of either actual direct costs, salaries and benefits of such personnel, or on the basis of a lump-sum per period (month, week, hour) of work. An administrative charge to cover indirect or overhead expenses may be added to the first or included in the lump-sum figure of the second. Under the first choice, reimbursable salaries may be based on: the actual salary earned by a person elsewhere in the Manager's company for the same services; that salary

plus an incentive to go abroad; a salary level of the host country; or a salary level based on a schedule of rates developed by a third party, such as the Swiss Society of Architects and Engineers, as found in one of the contracts herein.<sup>5</sup> The lump-sum choice may also be refined by placing the Manager's field staff into categories and setting lump-sum rates for each category.

11. Another possibility with regard to the remuneration of field staff is for all such expenses to be part of the management fee. However, while this would provide certainty of expenditure level for the Owner, the Manager would undoubtedly increase the fixed fees and percentage fee bases for the management fee. Also, as long as a reasonable basis for remuneration is set and proper controls over expenditure, such as invoices and conformation with budgeted outlays, are met, then remuneration on the basis of actual direct costs could be advantageous to the Owner in that it allows for more supervision and oversight by the Owner and furthers the goal of eventual transferral of control from the Manager to the Owner; this last because the lump-sum method provides no rubric for understanding internal costs allocation, while the actual cost method requires line-by-line analysis of expenditures.

12. The indirect costs mentioned above include headquarter's administrative expenses (overhead) as well as a factor for risk and a profit on the services. These factors vary depending on the type of project involved, the size of the project, the term of the contract, and the location of the project.

13. The contracts herein differ markedly in their handling of overhead expenses. Certain ones include communication costs, such as telephone, telex and cable charges, along with duplication, design work, etc., within the scope of overhead for which separate payment is made, while others clearly label these as within the scope of the management fee.

14. Caution is advisable for Owners herein as it is possible for double payments for the same services to be hidden in the contract. For example, a payment may be added to the direct cost of salaries on the lump-sum payment to cover indirect costs, which may be defined by the contract to include overhead expenses, while an additional fee will be levied for certain activities such as communication costs that normally comprise administrative expenses falling within the area of overhead. Rebuttal can be made that indirect costs include less definable items than communication charges, such as corporate know-how and marketing services, and that charges for such factors are legitimately severable from the more predictable expenses of paperwork, etc. At the very least, however, an Owner should know the range of services to fall within each category of expense so that fairly obvious double payments do not arise.

#### Issues

15. A number of issues are implicit in the foregoing discussion. These include: (1) what the most equitable fee arrangement, including reimbursable costs, is for a particular project; (2) what an appropriate basis for fee payment is; (3) what an appropriate level or aggregate amount of payment for a service is; (4) whether services should be divisible or non-divisible with regard to payment under or in addition to the management fee; (5) whether certain expenses appropriately fall within the Manager's responsibility without compensation; (6) whether lump-sum or actual cost methods of remuneration are preferable; (7) how to retain control over expenditure levels; (8) how to monitor expenses of the Manager; (9) whether funds for reimbursable costs and expenses should be provided in advance in third-party accounts, or whether such payments should be made only after costs are incurred; and (1) how to prevent double payments. Several of these issues are discussed to some extent above. The following discussion elaborates on several others considered to be of special importance.

(1) Fee Arrangements (Issues 1, 2, 4, 9)

16. Several considerations need to be taken into account when structuring fee arrangements for a project. The first is the type of project involved. Three broad categories of contracts are represented herein, including hotel management contracts, technical assistance contracts and production-sharing contracts (this last not being considered in this section). Several types of technical assistance contracts are found, including sales and marketing arrangements, supply and construction contracts, and consultancy and operation agreements. The subject-matter of these technical assistance contracts also varies widely, from a farmlands project to aluminum smelters and a satellite earth station, among others.

17. Each of these types of contracts has its own inherent logic and progression with regard to benefits, risks and timetables, with each of these factors being a further consideration to be taken under advisement when considering fee arrangements for a project. Other considerations include who the Owner is (whether Government or private) and what the specific needs of the Owner are. For example: does it need foreign exchange; does it have an abundance or a scarcity of cash; and what goals are sought from the project? In addition, the identity of the Manager is also important as are its motives for entering the project and its needs. For example: Does it have an abundance of funds from which to draw, or is it on a tight budget requiring continual infusion of funds in order to meet costs and expenses; what are its specific advantages with regard to the project -- does it have corporate know-how and technological skills found nowhere else, or could the management of the project be undertaken by any of a variety of firms; if the latter, do the firms have an oligopoly; and if so, do they form an implicit cartel, as for example, with the ability to construct and operate aluminum smelters. A further consideration is what the market for the output or services of the project is, along with the outlook

for the market for the term of the contract. For example: is the market cyclical -- does it have expansions and troughs, or is it constant; is the price stable or mercurial; does the price or demand for the output or service depend on externalities, or are they centered within themselves?

18. Such factors as these must be accounted for when considering an appropriate fee arrangement. Nonetheless, certain statements can be made with regard to the various possibilities delineated earlier, including: fixed fees; basic fees set on a percentage of revenue, profit, sales production, or some other variable; incentive fees; and separate fees for special or additional services defined to fall outside the scope of the basic management fee.

19. Fixed fees provide certainty to the Owner in regard to total outlay for a service, but they also place all risks (as well as benefits) of profitability on the Owner. These fees are also inherently risky from the Manager's perspective, especially in times of inflation, as mistakes and misjudgments in the costs of services can be critical to the firm's profits.

20. The Manager need not maximize profit, sales, production or revenue to receive payment under the fixed fee scheme. To the extent that this is paid in advance, the Owner loses all control over the Manager's activity. Periodic payments on a pro-rated basis could provide some security in this regard.

21. A basic fee determined by a percentage of any of several variables, but usually by gross revenue or by revenue is a frequently used alternative to the fixed fee element of the basic management fee. Gross revenue is the broadest of the alternatives available, including profits (before or after taxes), sales, or production. Gross revenue comprises, inter alia, net sales, interest and dividends, royalties and net technical assistance, equity in earnings of associates, and other items of income, and is usually defined as the increase in the Owner's equity. This measurement thus provides the Manager with the broadest base from which to receive payment.

22. While the Manager clearly prefers this, benefits accruing to the Owner may be chimerical. Several factors normally seen in isolation must be considered in juxtaposition in order for this effect to be seen. For example, while basic fees set on a percentage of gross revenue provide the Manager with a stake in the project, such revenues are not profits and thus the Manager could stimulate revenues while net profits actually decrease (this is due to a variety of possibilities, such as profligate spending habits, intercompany transfer pricing techniques, and inefficient administrative habits raising overall cost).

23. The potential for this last problem to arise is mitigated if the basic management fee set on a percentage of gross revenue is coupled with an incentive fee based on profit. The Manager is hereby encouraged to maximize both total revenue and profit.

24. Several possibilities exist with regard to the basis used for the incentive fee. Profits were mentioned above. Managers, however, are likely to favor incentive fees based on sales.

25. Several reasons underlie this preference. First, sales are a broader basis from which to draw remuneration. Second, the firm could see a potential conflict between its objective to maximize profits and the Owner's social and political objectives for the project. For example, the Owner might require the Manager's training of local talent to take place in the Manager's home country, with the expenses of such training to come out of the operations of the enterprise, which would reduce profits available for compensation to the Manager. Such knowledge of the reason for the Manager's preference could help alleviate otherwise intractable difficulties herein.

26. Separate fees for the compensation of special services were discussed above. Suffice it to say here that such fees tend to increase the total



level of compensation awarded the Manager. The Owner should thus try to have as many services and costs as possible fall within the basic management fee.

27. Owners should be cognizant of the fact, when negotiating these points, that Manager's compensation for services is not necessarily limited to fees and reimbursable costs. Additional benefits derive from the sale of equipment, the acquisition of long-term purchase or supply agreements for raw materials or component parts, new markets, distribution franchises and experience for key personnel.<sup>6</sup> Such benefits depend on the type of project involved and not all will accrue to each Manager. Nonetheless, a knowledge of the motivations behind the Manager's interest as well as an understanding of its corporate structure will aid the Owner in its negotiating a fee package as these will provide insight into the indirect benefits to be gained by the Manager.

(2) Appropriate Levels of Expenditure for Certain Services  
(Overhead and Support Staff) (Issues 3, 7)

28. Cost assessment of international services is complicated due to a variety of reasons. These range from corporate activities such as home office support and transfer pricing practices to government-related policies such as multi-country taxation and foreign exchange controls; from insurance procurement to political and economic conditions (such as inflation); and, inter alia, from delays in payment to delays due to personnel problems. These and other difficulties make the assessment of true costs for direct services as well as indirect services such as overhead and seconded staff nearly impossible. One approach to this problem of inexactness and unpredictability is to set acceptable aggregate levels for payment. A number of the contracts herein combine fee schedules with clauses limiting the total amount to be expended for certain services. The question is how to arrive at a formula which is meaningful as well as appropriate to both parties. One approach is: first, to delineate as many of the variables involved as possible; second, to categorize the variables between

those whose costs are possible to assess with some degree of accuracy and those that are more unpredictable; third, to calculate the known variables as precisely as possible; and fourth, to approach the known yet ubiquitous variables on an individual basis, bringing to bear on each as much empirical support from past or other experience as possible, while putting on as many constraints as possible to limit the influence of each. As partial examples, costs may be indexed to inflation; personnel replacement cost variables may be controlled by requiring that such staff must work a minimum number of months in order for moving expenses for them and their dependents to be paid; certain intangible expenses could be borne by the Manager, or arbitrary limits might have to be set for such expenses.

29. The need herein is to keep the project or the Owner from being drained by unexpected expenses (or levels of expense) while the Manager is left unaffected or even in a profitable situation.

(3) Monitoring of Expenses (Issue 8)

30. The last sub-section posed the problem of potentially unlimited spending levels and suggested one approach to the containment of such spending within at least acceptable levels. At least two other factors require consideration in limiting such costs as well as in monitoring and revising such estimates over the life of the project: the annual budget and a method for accounting.

a. Budget

31. Oversight of the development of the annual budget is in the Owner's interest for obvious reasons. The contract sets forth broad categories of expenditures while the annual budget sets forth estimates on an itemized basis. Involvement in this process provides the Owner with detailed knowledge of the project and thus works toward the goal of eventual transferral of responsibilities from the Manager to the Owner. Secondly, as budgets are set and either

met or not met, a mechanism is set in place by which adjustments to spending levels can be made over time; empirical evidence develops that can be compared with the contract provisions and that can thus be used to amend such provisions over time. This depends, however, on the proper and thorough invoicing of costs to the extent possible; initially hidden or unpredictable costs for which arbitrary limits were set in the original contract might become more calculable once the project is put into operation. Inherent in both these reasons for Owner involvement in the preparation of the budget is more oversight of the Manager.

32. Several issues arise with regard to Owner involvement in the budget. The first is what the Owner's role is to be: observer, advisor, or participant (if the latter, the further question arises as to which party is the final authority). Second, and closely related to be parenthetical question of final authority over the budget, is whether the budget as approved is binding on the Manager: if so, whether sanctions against the Manager are provided with regard to overspending or major budget changes; if not, whether a process is required for budgetary changes including overspending.

b. Accounting Methods

33. Control over the budget and provisions for the calculation of fees have little supervisory meaning if a method is not provided with which to interpret the data. Definitions for items, such as gross profit, net profit, net income and cost of sales, along with other factors such as inventory valuation, depreciation and accrual versus cash-basis accounting, all affect the profitability of a project and all depend on accounting principles. These principles are not uniform throughout the world and even within highly regulated jurisdictions, such as the United States, a variety of accounting possibilities may be available with regard to particular items in financial statements. For example,

while generally accepted accounting principles in the U.S. do not recognize cash-basis accounting, at least five methods of inventory valuation, three methods of depreciation, and both broad and narrow definitions of net income, etc., are available. The specification of these and other accounting techniques directly affects income and profits, and thus structure the amounts to be paid to Managers under the various fee schedules. Owners must therefore assess the interconnections herein and negotiate for those definitions and techniques which are most useful for their purposes.

A. Examples of Provisions for Manager's Compensation

34. The contracts providing for basic management fees vary widely with regard to the bases used for such fees, ranging from fixed fees to percentages of: gross revenue, revenue, gross sales, gross operating profit or total price. For example, one contract<sup>7</sup> states simply that in addition to the reimbursement for costs:

Manager shall be compensated for its services hereunder by a fixed annual fee ...

(b) Manager's fixed annual fee is \_\_ based on an estimated \_\_ man-months of services by the field staff employees, payments and any adjustments to be made in accordance with Paragraph \_\_\_\_.

Another contract<sup>8</sup> couples other payments to the fixed fee as follows:

In consideration of the Services to be provided by the Adviser under this Agreement, Owner will pay ...

(i) A fixed sum of \_\_ as fixed fee;

(ii) Sums calculated at the unit rates per hour, day or month in the manner set out in Schedule II ...;

(iii) Sums, as variations due to increases in the cost of living of the amounts payable, calculated in accordance with Part 3 of Schedule III;

(iv) A bonus calculated on the saleable production obtained in the steel works prior to (date) inclusive, in accordance with Schedule III ...;

(v) All expenses....

Complications can arise very quickly under the second of these two methods which are disadvantageous from the Owner's point of view due to the uncertainty and unpredictable nature of the additional payments. On the other hand, such a method does provide for more participation in and oversight of the project by the Owner, which involvement can further the goal of eventual transferral of control from the Manager to the Owner. What is best for a particular project will thus depend on the circumstances of that project.

35. Other contracts use a percentage of one of several variables for the basic management fee. At least three<sup>9</sup> use "gross revenue," but differ in whether this is to act solely as the basic fee or whether it is to be coupled with another amount. For example, one contract<sup>10</sup> has it stand alone as follows:

Manager shall be entitled to charge ... and retain as its basic management fee an amount equal to \_\_\_\_\_% of the Total Revenue of the Hotel ....

The other two contracts, on the other hand, couple this with a percent of gross operating profit" as follows:<sup>11</sup>

Owner shall pay to Manager, as compensation for the services rendered by Manager during the period of this agreement ... an annual net management fee of \_\_\_\_\_% of "gross revenue," plus 20% of gross operating profit.

36. At least one contract<sup>12</sup> uses "revenue" rather than "gross revenue." Still other contracts use different bases, including "\_\_\_\_\_ % of gross sales value of finished product,"<sup>13</sup> "\_\_\_\_\_ % of aggregate net invoice value to customers of all goods and services sold and services undertaken....,"<sup>14</sup> "\_\_\_\_\_ % of gross price,"<sup>15</sup> and "fees calculated on purchase price...."<sup>16</sup>

37. One means of minimizing the income to the Manager while still providing sufficient incentive to retain its services is to have as narrow a basis as possible on which to calculate the basic management fee. In this regard, "gross revenue" is the broadest category (although definitional variations of other categories such as "revenue," "sales value," or "production" could equal

or exceed this). Note too that "sales value of finished products" is a broader category than "sales" or "gross price," since it includes all finished products and not simply those sold. "Net invoice value" and "gross price" are probably similar to each other in that both value are not diminished by the cost of goods sold, taxes and other expense items. The exact extent to which each of these is a broad or narrow base will depend on the scope provided for by the contract.

38. A slightly different approach to the basic management fee is provided in another of the contracts.<sup>17</sup> This states that:

In years when Net Profits of the Project Company are 50% of the Project Company's equity or less, the Project Company shall pay, as compensation for services (herein) to Manager an annual contract compensation in the amount of either (a) \$40,000 or (b) 10% of Net Profits, whichever is higher.

In years when Net Profits exceed 50% of the Project Company equity, the Project Company shall pay Manager contract compensation in the amount of 10% of Net Profits of the Project Company up to and including 50% of Project Company equity and 15% of Net Profits of the Project Company in excess of 50% of Project Company equity.

This provides a minimum amount that is advantageous to the Manager as well as a maximum (although not absolute in dollar terms) amount that will be paid as the management fee, which is desirable to the Owner.

39. The contracts also differ on whether the management fee's formula is static throughout the term of the contract or varies with the period or stage of the contract. For example, one contract<sup>18</sup> states:

The Enterprise shall pay to Manager a management fee in accordance with the following schedule:

(a) for each month during the construction phase ... a fee of \$10,000 ...;

(b) for each of the first six full calendar months following the start-up date in which the average daily production is equal to or greater than 60 metric tons of commercially saleable (product), a sum equal to \$200 mil-

multiplied by the average daily production in tons during such calendar month;

(d) for each financial year thereafter, a fee based on the net yearly profits of the plant before taxes (in accordance with a further schedule);

(e) In any event, a minimum fee of \$35,000 for the first financial year commencing after the start-up date, and a fee of \$60,000 for each financial year ... thereafter during the term of the contract.

40. Two sales and marketing contracts,<sup>19</sup> provide that commissions rather than management fees shall serve as remuneration. Two contracts<sup>20</sup> provide that the Manager will receive no remuneration for services other than for reimbursement costs, including overhead expenses.

41. Technical services fees are allowed in several of the contracts.<sup>21</sup>

These vary from statements that:<sup>22</sup>

Manager, in addition to (its) duties (herein set forth), may also perform any other duties and work for the Company which the directors of the Company may decide and which Manager agrees to undertake and shall receive such reasonable and proper remuneration for such work as shall from time to time be agreed upon ..., such remuneration being in addition to any remuneration provided for herein.

to declaration such as:<sup>23</sup>

The charges payable to Manager ... in respect of Special Technical Services ... shall consist of:

(i) such part of the direct labor costs ... as the time spent ... in the performance of the Special Technical Services bears to the time spent by them in performance of all services; provided that the direct labor costs ... shall ... (include) wages, salaries, bonuses (etc.);

(ii) such part of the other costs ... as shall equal 75% of the part of the direct labor costs determined under paragraph (i) ... (and certain indirect costs);

(iii) transportation, hotel and other traveling expense...;

(iv) the cost of materials and supplies purchased or used in the performance of Special Technical Services other than the usual offices and laboratory materials and supplies.

42. A large portion of the contracts also include incentive fees in addition to the basic management fees and technical services fees. These are usually provided for, as for example, "in addition, Manager is entitled to retain as an incentive fee \_\_\_% of Gross Operating Profit."<sup>24</sup> At least one contract<sup>25</sup> provides a more elaborate formula for the calculation of the incentive fee, stating that:

As an incentive fee, the Enterprise shall pay the Consultant ... an additional technical assistance fee based on the amount of paper produced at the Mill during each quarter ... The incentive fee shall be calculated for each such quarterly period as follows:

$$F = \left( \frac{\Sigma P}{30} - Y_i \right) \times \$ \text{ ---}$$

where:

F = fee for quarterly period ...  
ΣP = sum of saleable tons of paper produced ...  
Y<sub>i</sub> = goal for minimum production of saleable paper ...

This formula is based on production, not sales; the question is thus raised whether the goal for which an incentive is provided is total output or income, and whether the Manager has responsibility over sales. Production provides a broader base than sales from which to calculate the percentage and thus serves to detract from the total income going to the Owner. Note should be taken that certain contracts which do not formally provide for incentive fees do so implicitly, as for example, where the basic management fee is comprised of a percentage of both revenue and profit.<sup>26</sup>

43. All the fees described above are combined together in a variety of ways in the contracts. For example, a hotel management agreement provides:<sup>27</sup>

I. In consideration for the execution of this Agreement, Owner agrees to pay Manager a commitment fee, the sum of \_\_\_ plus \_\_\_ per guest rental room ...

II. In consideration for the Management of the hotel by Manager ... the Owner agrees to pay the Manager the following fees:



(1) A basic management fee calculated on the basis of 3.75% of gross revenue from total room sales, food and beverage sales, rentals, telephones and telex, and all other revenues excluding:

(a) any gratuities or service charges added to a customer's bill ...

(b) an amount equal to all credits or refunds made to customers, guests or patrons ...

(c) all sums and credits received in settlement of claims for loss or damage to merchandise ...

(d) all sales taxes, excise taxes, gross receipt taxes, admission taxes, entertainment taxes, tourist taxes or charges ...

(e) any and all income from the sale of furnishings, fittings, or equipment ...

(f) any compensation payments of claims against a third party ...

(2) An incentive management fee calculated on the basis of 9.50% of Gross Operating Profit (as hereinafter defined)....

Other contracts<sup>28</sup> combine a basic management fee with a termination fee, as for example:<sup>29</sup>

Upon termination of this contract, the Enterprise shall pay to the Management Company, as termination fee, the sum of \_\_\_\_\_ ...

Numerous combinations are possible for any one project. The choice of the most lucrative for the Owner will depend on the purpose of the project and the needs of the Manager as set out in an earlier section.

#### Compensation Methods

44. The contracts vary with regard to the manner of payment, place of payment, and timing of payment, as well as the specificity of provisions concerning this issue. The variations in the manner of payment range from simple statements such as that "the Owner shall pay to the Manager,"<sup>30</sup> to more elaborate ones requiring the establishment of special bank accounts with either sufficient funds to cover the fees and expenses,<sup>31</sup> revolving replenishable funds,<sup>32</sup> or irrevocable, confirmed, divisible letters of credit.<sup>33</sup> Different

methods of compensation for various types of payment may be found within the same contract. For example, one contract,<sup>34</sup> while providing extensive elaboration on fee schedules, simply states that "Owner shall pay to Manager fees ..." However, this same contract provides for the establishment by the Owner of "a special bank account, in its name and relating to the Project, from which ... reimbursements ... shall be made...."<sup>35</sup> Other contracts provide for more detail in regard to such special bank documents. For example, another contract states that:<sup>36</sup>

Owner agrees to maintain for the term of this Agreement a bank account in the United Kingdom or such other country as may be agreed by the parties in order to provide at all times for all of Manager's anticipated foreign currency requirements for a period of at least one year.

Another feature is found in a third contract, as follows:<sup>37</sup>

Owner shall provide in (its) Current Accounts Trust a revolving fund ... in which there shall be deposited sufficient funds to cover Reimbursable Costs incurred by Manager to the end that Manager shall not be required to use either its own funds or credit in the performance of any phase of the work required hereunder in the payment or discharge of any costs whatsoever.

Two other contracts present a different feature in almost identical language:<sup>38</sup>

A.1. Not less than 30 days prior to the departure ... of the Operations Manager for (country), as notified by the Management Country to the Enterprise, the Enterprise shall establish an irrevocable, confirmed and divisible letter of credit in favor of the Management Company at a United States bank acceptable to the Management Company, in the amount \_\_\_\_\_ which shall be utilized for the payment to the Management Company of the foreign exchange costs reimbursable to the Management Company ...

A.2. Simultaneously with the opening of the letter of credit provided ... above, the Enterprise shall deposit to the account of the Management Company at the Commercial Bank of \_\_\_\_\_ the sum of \_\_\_\_\_, which shall be utilized for the payment to the Management Company of local currency costs reimbursable to the Management Company ...

B.1. Not less than 30 days prior to the departure for (country) of the first field man ... the Enterprise shall

establish an irrevocable, confirmed and divisible letter of credit in favor of the Management Company at a United States Bank acceptable to the Management Company, in the amount of \_\_\_\_\_ which shall be utilized for the payment to the Management Company of the management fees and reimbursable costs by presenting to said bank an invoice of the Management Company ... itemizing the fees and reimbursable costs due and payable for the preceding month ... a copy of which shall be simultaneously made available to the Board.... The Enterprise shall replenish such letter of credit every three months ...

B.2. Simultaneously with the opening of the letter of credit ... above, the Enterprise shall deposit to the account of the Management Company at the Commercial Bank of \_\_\_\_\_ in the sum of \_\_\_\_\_ which shall be utilized for the payment to the Management Company of local currency costs reimbursable to the Management Company ...

(Note that the rather more complete text of B.1. is also to be found in A.1.)

45. Each of the bank accounts in the above example is to be opened and managed by the Owner or its trustee bank. This arrangement is changed in another of the contracts which provides that:<sup>39</sup>

Manager shall operate on behalf of Owner separate bank accounts outside (country)(and to any necessary extent within (country)) under such designation and upon such terms and conditions ... as may be mutually agreed by Manager and the Board through which all payments required to be made by or to the Company shall be passed.

46. On this last point of whether the Owner or Manager should have control over the bank account, setting aside for the moment the larger question whether such bank account is advisable from the Owner's point of view, the Owner's interests would seem to be best served by retaining such control. That issue of control also touches on whether the arrangement wherein an irrevocable, confirmed, and divisible letter of credit is advisable. An Issuer's control over the fund is lost by definition in such an arrangement since an irrevocable credit is exactly that: irrevocable. A third element with regard to this issue of control is the degree to which mutuality of consent is required as to the choice of the bank involved as well as on the terms and conditions under which payment is to be effected. Given that the Owner wishes to retain as much control over the project as possible, that party should **not** consent

to sole control on such a bank account to be in the Manager; even management authority by the Manager where the bank account is in the name of the Owner, as is the case above, is undesirable. Several reasons exist for this, including the fact that funds in such accounts represent advance expenditures by the Owner on behalf of the Manager. The extent to which the Manager does not obtain immediate, and thus advance, possession and usage of such funds depends upon the degree of control exercised over such funds by the Owner. The possibility of incorrect payments arises even where, as most of these contracts require,<sup>40</sup> guidelines requiring payment to be made only upon properly documented and verified invoices are set up. The Owner's interests are thus best preserved by its retention of control, both in name and in fact, over such funds.

47. The issue of control over funds so advanced leads to the question whether such funds should be advanced in the first place. The advance of such funds by the Owner means, first, that the Owner is to be responsible for the payments thereunder. An earlier section suggested that the Owner should be insulated or removed from such responsibility to the extent possible. The advancement of such funds is thus inadvisable from this standpoint. The alternative, as set forth in an earlier section, is for the fees and reimbursable costs to be funded from the operations of the project itself. This arrangement would provide an added incentive, even where an incentive fee itself is not provided for, in order for the Manager to manage the project to the best of its ability.

48. A second reason for the inadvisability of advance payments is that most of the Government Owners involved need to retain as much of their currencies as possible for other uses. An assumption here is that the Government wants, perhaps needs, the project to bring revenue to it specifically or the country generally. This goal is frustrated to an extent where the Owner must tie up funds in advance payments to such accounts as described above.

49. Where the decision is made to advance such payments, a proper system of verification for payment is needed. The contracts provide similar requirements in this regard; the key differences pertain to specificity, verification and the timing of payments. For example, one contract states:<sup>41</sup>

13. Manager shall submit to Owners during any period in which Manager is entitled to recover overhead expenses and receive a fee, quarterly invoices describing in reasonable detail the method of calculating the payment. For Reimbursable Costs, in a currency other than United States dollars, said expenditures shall for the purpose of such invoice be converted to the equivalent amount of United States dollars that would result if such foreign currency expenditures were converted into United States dollars at the buying rate for such currencies established by \_\_\_\_\_ Bank, New York ... on the business day immediately preceding the date on which the expenditure in currencies other than United States Dollars was paid. Payments for each invoice ... shall be made ... within fifteen days of the receipt of such invoice by Owner.

14. ...

(b) Prior to the Twentieth day of each month Manager shall notify Owners with adequate supporting detail, as to the amount of funds that Manager expects to expend or enter into firm contracts to expend on Reimbursable Costs during the succeeding six month period ... Owners shall cause the Trustee of the Owner's Current Accounts Trust to deposit such funds in the Manager's Revolving Fund and to make disbursements from such funds in accordance with directions from Manager which shall include invoices and appropriate supporting evidence that the amounts to be paid are due and owing. (Emphasis added)

These provisions are much more conducive to the Manager's interests than to the Owner's for several reasons. First, the Manager receives advance payment for future services and expenses. Not only is the Owner's money tied up in advance, but the Manager actually has advance use of it. Second, the Owner retains no oversight over the payment to the Manager from the fund; rather, disbursement is to be made solely "in accordance with directions from Manager..."

Third, no verification of invoices and other supporting evidence is provided for.

50. Other contracts require such fees and costs to be paid either on a pro-rated basis, as with fixed fees in one contract,<sup>42</sup> or only after costs and expenses are incurred.<sup>43</sup> The provision with regard to the fixed fee states that:

(a) Manager's fixed fee ... shall be payable monthly pro-rated on the basis of the actual months of services performed by the field staff employees; provided, however, that 10% of each monthly installment shall be withheld but shall become due and payable pursuant to (a designated schedule).

(b) The fee stipulated herein is based upon the estimate that the services to be performed will require approximately \_\_\_\_\_ man-months ... in the event that the total man-months ... are less ..., than the fee due and payable ... shall be decreased by \_\_\_\_\_.

Examples of provisions regarding subsequent reimbursement of costs and expenses include:<sup>44</sup>

Manager shall submit to Owner promptly at the end of each calendar month a statement showing all costs and expenses incurred together with supporting invoices and other relevant documentation ...

Another simply states that:<sup>45</sup>

The Engineer shall submit monthly invoices to the client in respect of all sums due.... Following verification of such invoices all sums properly due ... shall be paid ...

Another requires that:<sup>46</sup>

Manager shall render calendar monthly account statements to the Company of all costs and sums reimbursable to it ... (and) the Company shall settle the same within 21 days (note that all the contracts require time limitations, which periods vary from contract to contract) following their receipt.... Within 120 days following the end of each 12 month period ... Manager shall render to the Company a full reconciliation account duly certified if the Company so requires by a firm of independent accountants of recognized international standing whereupon financial adjustment shall be made ... for the year in question ...

51. The Owner should be as complete and specific as possible with regard to required invoices and supporting evidence. These will vary depending on the sector and industry involved; a knowledge of the business and commercial practices of the sector are thus required to set forth the requirements needed. Verification techniques are also necessary to serve as cross-checks herein; having independent accountants is advisable in this regard.

52. One hotel contract<sup>47</sup> provides a different manner to deal with certain expenses, although the method need not be limited to simply that category of expense in other contracts. The provision reads:

During each fiscal year, Manager will deduct each month from revenue 1/12 of the total amount of the estimated cost of replacements of or additions to Operating Equipment for the said fiscal year and will credit an equal amount to a book account.... All expenditures so made by Manager ... shall be charged against the (above) account and at the end of each fiscal year said account shall be closed and an adjustment made by crediting or charging revenue with the excess or deficit.

This type of provision protects the Owner from liability for such payments. This method, or a variation, could be used for fee payments reimbursable costs as well as for general overhead expenses. As stated above, this could provide added incentive to the Manager while removing the Owner from such liability and responsibility. The Owner would thus derive the benefits of the project income, etc., while not inheriting its liabilities. This would further the overall goal of revenue generation for the Owner, while not frustrating such hopes for income in the early periods, exactly when the Owner could least afford it, by requiring the Owner to advance funds for the project.

B. Examples of Provisions for Project Expenses--Excluding Compensation of Manager

Hotel Management Contracts

53. Four hotel management contracts<sup>48</sup> are included herein. While these are

fairly uniform, certain distinctions surface with regard to such factors as whether the Owner or Manager pays for various costs and expenses, or whether such costs and expenses are paid from the revenue of the project.

(A) Direct Payments By the Owner

54. All four contracts require the Owners to acquire and maintain full ownership of the hotel.<sup>49</sup> Typical in scope, if not in actual wording, of these provisions is the following:<sup>50</sup>

Owner warrants that it has, or will acquire, and throughout the Operating Term...., will maintain, full ownership of the Hotel (or if Owner's right and interest in the Hotel is derived through a lease, concession or other agreement, Owner shall keep and maintain said lease, concession or other agreement in full force and effect throughout said term) free and clear of any liens, encumbrances, covenants, charges, burdens or claims, except (a) such which do not materially and adversely ... affect the operation of the Hotel by Manager and (b) Mortgages ...

In addition, three of these contracts<sup>51</sup> require the Owner to pay and discharge ground rents, concession charges and other related rental expenses under almost identical provisions which read substantially as follows:<sup>52</sup>

Owner further covenants and agrees to pay and discharge any ground rents, or other rental payments, concession charges and any other charges payable by Owner in respect of the site or the building ...

The fourth contract<sup>53</sup> requires the Owner to be ultimately responsible but places the initial responsibility on the Manager as follows:

... Owner further agrees that throughout the term of this Agreement Manager shall have the right to pay, keep, observe and perform, for and on behalf of Owner: (a) all payments ... to be made ... under any lease, concession, or other agreement or security instrument in respect of the site, the Hotel or the Furnishings and Equipment ...

This provision is clearly preferable from the Owner's point of view as it places major responsibility on the Manager.

55. Three of the contracts also require in identical language<sup>54</sup> the Owner to pay for all legal actions, with regard to the quiet and peaceable operation



by the Manager, while the fourth makes no provision in that regard. The three contracts provide that: "Owner shall ... at its own expense, undertake and prosecute all appropriate actions, judicial or otherwise, required to assure such quiet and peaceable possession to Manager."

56. The four contracts are not uniform with regard to legal proceedings for other types of action. One contract requires the Manager to initiate certain proceedings but holds that the Owner will bear the expense of such legal action as follows:<sup>55</sup>

Manager shall institute in its own name or in the name of Owner, but in any event at the expense of Owner, any and all legal actions or proceedings to collect charges, rent or other income from the Hotel or to oust or dispossess guests, tenants or other persons ... or to cancel or terminate any lease, license, or concession agreement for the breach thereof:

On the other hand, another contract<sup>56</sup> holds that similar responsibilities fall within the scope of the management fee. This is clearly the preferable approach from the Owner's point of view as it places responsibility for both the initiation of proceedings and the expense of such proceedings on the Manager, with the Owner having no responsibility at all.

57. The contracts provide examples of two approaches to the payment of real estate taxes and similar assessments while retaining such payments as the Owner's responsibility. Three contracts contain almost identical language, as follows:<sup>57</sup>

Owner shall further pay all real estate taxes and assessments which may become a lien of the Hotel and which may be due and payable...., unless payment thereof is in good faith being contested by Owner and enforcement thereof is stayed.

The fourth contract requires the Manager to initially pay such assessments, but holds that the Owner is ultimately liable:<sup>58</sup>

Owner further agrees that throughout the term of this Agreement Manager shall have the right to pay ... for and on behalf of Owners ...

(b) all taxes, assessments and charges of every kind ... which may become a lien on the hotel...

This provision is broader in scope than that contained in the other three. It is preferable in that the Owner is not required to be initially liable; further it goes on to hold that such payments can come from the operations of the hotel. Another option, more preferable to the Owner, is for the assessment to be the responsibility of the Manager or made from the operations of the project with recourse to the Manager if such funds from the Project are insufficient. This would insulate the Owner from any responsibility or liability.

58. All four contracts contain substantially the same wording with regard to the provision and installation of furniture and equipment in requiring the Owner to bear all such expenses.<sup>59</sup> The contracts, however, differ with regard to which party is to bear the expenses of alterations, repairs and replacements of such furnishings and equipment. One, for example, places such responsibility on the Owner,<sup>60</sup> while others have the project itself bear such expenses.<sup>61</sup> The contracts also provide that "repairs, charges and replacements required by reason of any laws, ordinances or regulations of the government ... shall be paid for by Owner."<sup>62</sup> The Owner could require the Manager to be responsible for such repairs and replacements that are due to the Manager's negligence or other misconduct.<sup>63</sup>

59. All the contracts require the Owner to provide for initial inventories of food, beverages and other consumable items, as well as working capital throughout the term of the contract.<sup>64</sup> These contracts further require the Owner to bear all preopening and opening expenses.<sup>65</sup> They differ, however, as to whether funds should be set up in advance for such expenses or whether the

Manager should be reimbursed subsequent to such expenditures. For example, one contract<sup>66</sup> states that:

Owner shall provide a reserve fund ... for the costs and expenses of pre-operational staffing, training and organization, pre-opening operations, advertising, promotion, literature, travel and business entertainment ... recruitment ... and any other cost or expense in connection therewith.

Another contract, on the other hand, provides for the Owner to reimburse the Manager for expenses during such pre-opening period.<sup>67</sup> None of the contracts, however, requires such expenses to be borne by the Manager. Nonetheless, at least certain of the expenses categorized by these contracts as pre-operational and opening expenses to be borne by the Owner could be allocated to the Manager and defined to fall within the scope of the basic management fee.

60. Three of the contracts<sup>68</sup> are practically identical in their requirement that "Owner shall retain at its own expense architects, contractors, ... engineers, designers, decorators, ... and other specialists and consultants as shall be necessary and appropriate for constructing and equipping the hotel." The fourth contract words the requirement differently, but nonetheless requires payment to be made by the Owner.<sup>69</sup> At least one of the contracts requires the Manager to advise the Owner in its selection of such consultants, with such advice considered technical services to be compensated in addition to the basic fee.<sup>70</sup> Such services, however, should not be the basis for additional compensation as the Owner should have as much work as possible fall within the scope of the Manager's duties, compensable under the basic management fee.

61. Two of the contracts expressly hold that the hotel shall be operated at the expense of the Owner.<sup>71</sup> The other two apparently require such operating expenses to come directly from the revenue of the project.<sup>72</sup> Under the first type, the Manager acts in the name of and for the Owner. For example, one of the

contracts contains clauses such as the following in addition to the general statement that the Owners bear the expenses of operation:<sup>73</sup>

Manager shall purchase all food, beverages, operating supplies, and other materials and supplies in the name of, for the account of and at the expense of the Owner ...

The other clauses within that article use the same format with regard to the Manager's procurement "in the name and at the expense of the Owner," of, for example, licenses and permits, repairs, operating supplies, utilities and services, etc.

62. On the other hand, one of the other two contracts places such responsibilities on the Managers as part of the management service included in the basic management fee, as for example:<sup>74</sup>

Manager's management services shall include, but not be limited to ...

(c) The making of ordinary repairs and alterations ...

(d) The negotiation and execution of leases, licenses and concessions ...

63. The first approach is preferable to the Owner only where political conditions demand such visibility of the Owner's interests. From an economic point of view, the Owner usually would prefer to be shielded from such direct liability by having such expenses come out of the operation of the project and to be the ultimate responsibility of either the Manager or the project.

64. The contracts handle insurance payments differently. One places the responsibility for both the procurement and maintenance of insurance on the Owner, with the Manager having no responsibility at all, as follows:<sup>75</sup>

Owner shall, at its expense, at all times during the period of construction, furnishing, equipping and operation of the hotel, procure and maintain the following appropriate insurance ...

Another contract, on the other hand, allocates the responsibility for the procurement and maintenance of these types of insurance between the parties.<sup>76</sup>

(B) Reimbursable Payments By The Owner

65. Several approaches to reimbursement are found in the four contracts.

One<sup>77</sup> simply states that "Owner shall pay Manager the amount ... representing the out-of-pocket cost to Manager ... based upon Manager's experience in the rendering of such services ..." Another article<sup>78</sup> adds that "(i)f either party fails to make appropriate payments, the other party may do so and be reimbursed." This contract requires the Owner to advance funds to the Manager for pre-opening, etc., expenses.

66. Another contract takes a different approach to pre-opening, etc., expenses, requiring the Manager to initially bear such expenses subject to reimbursement as follows:<sup>79</sup>

Owner shall reimburse the Manager for all pre-opening travel and out-of-pocket expenses incurred during the period of construction and development of the hotel, the selection and installation of furniture, fixtures and equipment, the hiring and training of personnel ... and any other reasonable expenses or professional fees incurred by the Manager on behalf of the Owner.

This article goes on to state that:

Manager agrees to recruit and train at Owner's cost the initial staff of the Hotel ... within and outside the Country ... Manager further agrees to advertise and promote the business of the Hotel at Owner's cost ... Owner agrees to pay all pre-opening expenses, as well as expenses of pre-operational staffing, organization and any expenses of preopening operations, and for the cost of all promotion, literature, travel, and business entertainment ... All reimbursable expenses incurred by the Manager shall be itemized ...

To the extent that an Owner will allow any or all of such expenses to be reimbursable, an alternative approach is to have such expenses be reimbursed from the future operations of the hotel rather than directly from the Owner.

(c) Expenditures To Be Paid From the Project Or By The Manager

67. One contract<sup>80</sup> requires the costs and expenses of the hotel operations to be borne from the revenue generated from the enterprise as follows:

From the revenue shall be deducted the entire cost and expense of maintaining, conducting and supervising the operations of the Hotel, including, without limiting the generality of the foregoing, the following:

- (1) Manager's basic Management fee ...;
- (2) The cost of all food and beverages and Operating Supplies ... and the total payroll;
- (3) The cost of replacements of or additions to Operating Equipment and Uniforms;
- (4) The cost of Group Services and Benefits ...;
- (5) The cost of all other goods and services;
- (6) Out-of-pocket expenses incurred for the account of or in connection with the Hotel operations, including reasonable traveling expenses of employees and executives of Manager and its affiliates;
- (7) All costs and expenses of any advertising, business promotion or personnel training program of the Hotel, separate and distinct from other hotels of Manager or its affiliated companies;
- (8) All expenditures made by Manager for maintenance, repairs or decoration to keep the Hotel in good operating condition;
- (9) The cost of alterations, additions and improvements ...;
- (10) Premiums for insurance ... and losses incurred on or self-insured risks;
- (11) All taxes and public dues, other than income taxes ...;
- (12) (A scaled increase over years of the Percentage) of the cost of the originally ... installed Furnishings and Equipment ...

This contract elsewhere<sup>81</sup> provides that:

Manager shall have the right to make alterations, additions and improvements ... The cost ... shall be charged directly to current expenses or shall be capitalized on the books of account. The costs ... which are capitalized shall be amortized ... by charges to the Hotel's operating expense.

After all such payments are made, the Manager is required to pay to the Owner the "gross operating profit" (defined in the contract) in installments,<sup>82</sup> as

well as other "supplemental payments."<sup>83</sup> The Manager is provided certain other instructions, as follows:<sup>84</sup>

The supplemental payment to Owner ... and all proceeds from the sale of Furnishings and Equipment no longer needed for the operation of the Hotel shall be paid by Manager into a fund for Replacements of and Additions to Furnishings and Equipment ... Manager shall be entitled to withdraw from the fund so created any amounts required to make all replacements of, and additions to, Furnishings and Equipment deemed by it necessary or desirable, which Furnishings and Equipment shall be and become ... the property of Owner.

68. These provisions provide a useful guide for a method by which payment of fees to the Manager, costs of operation and profits to the Owner can be made. The Owner is insulated from expenditure outlays, while the Manager must look to the project operation for both its own fees and for reimbursement of its costs. As long as the Owner has and maintains proper supervisory and control mechanisms over cost levels and evidence of expenditure, then the Owner is freed from financial responsibilities and liabilities of the project.

#### (4) Supervisory Controls

69. Supervisory controls as used herein include the annual budget, proper accounting techniques and proper invoicing of costs and expenses. Budgetary considerations and proper accounting techniques fall outside the scope of this section but should nonetheless be considered carefully by the Owner. The proper invoicing of costs and expenses will be partially considered in a subsequent section.

#### Technical Services Contracts

70. A major difference exists between the technical services contracts and the hotel management contracts above. While the Owners of the hotel projects were invariably the respective Governments in those agreements, the Owners in the technical services contracts are either private -- or government -- owned Corporations. The government itself is thereby insulated from direct involvement in the contracts to be discussed below.

(A) Direct Payments By The Owner

71. The majority of provisions in the technical services contracts regarding project expenses require payment to be made by the Owner, either directly or by way of reimbursement to the Manager. This subsection concerns the payments to be made directly by the Owner.

72. The Owners in the present contracts either already own or warrant that they will acquire the plant, refinery, equipment or land which is to be built, operated or developed. Two contracts accomplish this with the simple declaration that "all necessary facilities and services required for the production operations of the Mill ... shall be provided and paid for by the Owner."<sup>85</sup> Another provides warranties that the Owner is the lessee of the necessary equipment as follows:<sup>86</sup>

Owner represents and warrants:

3.1.1 that it is the lessee of ... aircraft ...

3.2.2 that it possesses authorization ... to provide air transportation services ...

73. These contracts also require the Owner to provide the Project with working capital for its on-going operation under clauses such as the following:<sup>87</sup>

Owner shall provide such financial resources, in the form of working capital, as Manager may determine will be required for the day-to-day production operations of the Mill ...

Others simply state that "Owner shall provide working capital ..."<sup>88</sup>

74. These contracts also require the Owners to provide raw materials,<sup>89</sup> power and water,<sup>90</sup> as well as pay for all third-party consulting contracts.<sup>91</sup> As an example of the last, one contract states as follows:<sup>92</sup>

Owner shall pay:

(1) all payments, terms, covenants, conditions and obligations under any lease, concession or other contract ...

Other provisions of this contract give body to this requirement by stating,



for example, that "Manager shall enter into contracts in the name of Owner for the furnishing of electricity, gas, water, steam, telephones, cleaning ... (and for) all fuel, spare parts ..." <sup>93</sup> Another contract, however, provides a different approach to the payment of such third-party contracts in requiring that such payments be deducted from the fees paid the Manager as follows: <sup>94</sup>

In the event of Owner performing or engaging third parties to perform any services ... Owner shall be entitled to deduct from the fees otherwise payable to Manager hereunder such amount as shall be fair and reasonable in the circumstances of Manager being unable other than for reasons beyond its reasonable control to provide the service due to its resources being fully extended.

While limited to particular reasons in this contract, the technique of deducting payments from the management fee for such third-party contracts can serve as a balancing feature, especially in contracts requiring additional fees to be made for "special services" as developed in the first section above.

75. The contracts herein also require the Owner to pay for "all costs and expenses of maintaining and operating (the facility)," <sup>95</sup> "all duties, taxes, assessments and charges of every kind including income taxes, excise taxes, real estate taxes, and personal property taxes," <sup>96</sup> and office accommodations, including a range of facilities such as telephones, telex and cable services, duplication, and other office services and equipment. <sup>97</sup> (As will be discussed later, these are not always the expense of the Owner.)

76. The Owners are also usually required to pay the costs of personnel and their dependents, including travel and moving expenses, salaries and employee benefits, meals and lodging <sup>98</sup> and "such other costs as are approved" such as, for example, recruiting and training expenses. <sup>99</sup> At least one contract puts certain limitations on such expenses, as suggested in the first section above as follows: <sup>100</sup>

(If personnel are removed or replaced) at the request of the Owner ... because such person is notoriously inefficient, or otherwise is fully justified, or due to resignation, retirement, sickness or death, then the traveling and living expenses arising out of such removal shall be borne by Manager.

Other contracts place time limitation requirements for a minimum length of stay, as for example, six months or one year.<sup>101</sup>

77. The contracts differ in their requirements with regard to the quality of lodging to be furnished. One provides as follows:<sup>102</sup>

The Owner shall, at its own expense, provide suitable living quarters ... equivalent to the standard of living quarters normally available to persons of the same standing in the sugar industry.

Another<sup>103</sup> provides that "Owner shall provide ... first-rate, furnished, air-conditioned living quarters ..."

78. The Owner is often also required to provide and pay for the services of doctors, nurses and other medical care, as well as other accommodations, such as schools, stores and recreation facilities.<sup>104</sup> Few guidelines are provided with regard to these services as these requirements are usually set forth seriatim as, for example:<sup>105</sup>

Owner shall provide ...

(b) Adequate housing accommodations, schools, stores, and recreation facilities, together with appropriate furnishings, at or near the Property, for Staff and their dependents.

Terms such as "adequate" and "appropriate" are ambiguous and the resulting disagreements over the standards expected can involve substantial sums of money.

79. Certain of these requirements, especially those designating first-class accommodations, are arguably more appropriately the responsibility of the Manager, especially in countries with few resources and modest standards of living. The Owner arguably, should not be required to provide better facilities to the foreign staff than are available to the local citizens. Alternative

approaches include either having the Manager bear the additional costs or having such additional expenses come out of the operating revenue of the project. If this last approach is used, one should negotiate to have such expenses be deductions from the amounts available for calculating the basic management fee of the Manager.

80. General overhead expenses attributable to the project are also usually an expense item of the Owner. The contracts differ, however, in their methods to determine this amount. One contract provides as follows:<sup>106</sup>

In addition to the foregoing, Owner shall pay Manager an amount ... equal to those items of Reimbursable Costs specified in (a prior article) to reimburse Manager for the general overhead expenses of Manager.

The referenced prior article used as a basis for such reimbursement reads:

The cost to Manager of wages and salaries and all other compensation and benefits paid to any of its officers or personnel, (wherever) such payments are made ... including allowances for vacation, holiday and sick leave ... This item also includes all taxes, contributions and insurance ...

Another contract provides as follows:<sup>107</sup>

In addition to the foregoing, Owner shall ... pay Manager a monthly amount of seventeen thousand United States dollars. This amount is calculated to reimburse Manager for the general overhead expenses of the head office of Manager and not to result in profit to Manager.

A third contract provides that charges payable to the Manager include:<sup>108</sup>

Such parts of other costs of Manager as shall equal 75% of the part of the direct labor costs (detailed elsewhere), provided that the amount so determined shall be deemed to cover the indirect labor costs excluded (in the above referenced clause), telephone, telex and other common costs and all other overhead properly allocable ...

The earlier discussion on overhead expenses should be referred to in analyzing these and other such provisions. No uniformity exists among these contracts and seemingly arbitrary figures and percentages are set forth as compensation.

One may note that while the second of the three contracts ends by stating "and not to result in profit to Manager," no mechanism is available to the Owner to determine whether this is adhered to or not. A question exists whether such expenses should be recompensed at all, or whether they should comprise part of the basic management fee. Owners interests would be furthered by including them in the basic fee.

81. Most, if not all, insurance is also the expense of the Owner in the majority of contracts under consideration.<sup>109</sup> They differ, however, in that some require the Owner directly to procure and maintain such coverage<sup>110</sup> while others hold that the Manager is to take out such insurance at Owner's expense.<sup>111</sup> The contracts also differ in their degree of specificity. One<sup>112</sup> simply requires "insurance coverage for all goods imported (for the project);" another<sup>113</sup> merely requires "such insurance and bonds as may be reasonably required ... insuring the performance of its employees and officers ..." Others are somewhat more explicit regarding what insurance is to be provided. For example:<sup>114</sup>

Owner will (at its own expense and in the name and for the benefit of Owner, the Adviser and its sub-contractor and all other contractors and sub-contractors in any way connected with the Project) maintain ... a policy or policies of insurance against:

(i) All losses or damage to any property (including that of the Adviser and its sub-contractors) or injury to or death of any person (excluding Technicians and Staff and their property) that may arise out or as a consequence of the execution of the Project or the provision of the services;

(ii) Any expense or other consequential or special loss or damage sustained by Owner by reason of any negligence or deficiency in the provision of the Services by the Adviser or any of its sub-contractors; and

(iii) All claims, demands, proceedings, damages, losses, costs, charges and expenses in connection with the matters referred to in ... (i) and (ii) ...

This contract goes on to hold that:

In case Owner decides not to take out the insurance ... referred to in this Clause, Owner will indemnify and hold harmless the Adviser and its sub-contractors and their respective employees and the Technicians, against all such claims ... except for liability originated from bad faith.

A rationale for such insurance to be at the expense of Owner is that the insurance covers the Owner's, not the Manager's property. This rationale, however, does not envelope all the types of insurance above, ranging from insurance over property to insurance for actions by the Manager. To the extent that the Owner is willing to take out and maintain certain insurance, it should not be required to shoulder responsibility for all insurance.

(B) Reimbursable Payments By The Owner

82. As stated above, the contracts vary in their treatment of project expenses. What one contract holds to be the expense of one party is allocated to the opposite party in a second contract. Additionally, even where contracts agree that the Owner is the responsible party, they may differ in that one contract will require the Owner to make the payment directly, while another contract will require the Manager to be initially responsible for payment subject to subsequent reimbursement.

83. The contracts requiring reimbursement also vary with regard to the method used for repayment. Some<sup>115</sup> reimburse on the basis of itemized records and invoices; one<sup>116</sup> reimburses at least certain expenses on the basis of a one-time fixed fee, as follows:

Owner shall pay to Manager as reimbursement of Manager for any and all expenses incurred prior to the signing of this Agreement, a one-time fixed fee of ...

Note should be taken that this contract otherwise provides that the Owner is directly responsible for all costs and expenses of the project;<sup>117</sup>

and that even where the Manager enters into contractual obligations for expenditures such as fuel and utilities, it is always in the name of Owner.<sup>118</sup>

84. A third method is also contained in some of the contracts. At least two contracts reimburse certain costs with a fee based on a percentage of certain payments. For example, with regard to the reimbursement of recruitment expenses, one contract states:<sup>119</sup>

For services rendered herein Manager shall receive a recruiting fee being an amount equal to 15% of total emoluments payable with regard to the first year's services of each recruit who stays at least six months. (The clause then provides a definition of "total emoluments.")

85. The contracts also vary with regard to their degree of specificity. One contract<sup>120</sup> simply states that reimbursement is to be provided "for any and all expenses incurred prior to the signing of the Agreement." Others are much more explicit, as for example:<sup>121</sup>

Included in Reimbursable costs, without limiting the same, are:

(i) wages and salaries and all other compensation and benefits paid to the Manager's officers or personnel, including allowances for vacation, holiday and sick leave ... while such persons are engaged directly in the performance of work and services rendered herein ... (including) all taxes, contributions and insurance;

(ii) transportation and traveling expenses, living and country allowances or other disbursements (including) all costs of recruitment and moving of personnel along with dependents and returning to the original point of hire;

(iii) amounts for materials and supplies along with transportation of such;

(iv) premiums for insurance, fidelity and other surety bonds;

(v) all fees and expenses paid to technical consultants and attorneys;

(vi) cost of all taxes (save income taxes), levies, imports, duties or other excises;

(vii) costs and expenses of whatever kind ... incurred in complying with the provisions of any laws or regulations with regard to the payments to or for personnel or any government agency in (the country) or elsewhere;

(viii) cost of long-distance telephone, telexes, telegraph and other direct communication charges;

(ix) cost and expense of establishing, maintaining and operating in (the country) and elsewhere, offices, field offices, camps, medical and recreational facilities, shops, warehouses, (etc.) ... including rent, telephone, local taxes and ... furnishings, equipment, food stuffs and supplies;

(x) any and all costs of whatever nature and kind reasonably incurred (even though) not specifically enumerated herein provided they are within the scope of the budget ...

86. Various contracts treat these expenditures differently, with the items being allocated to one or other of the parties. The Owner's interest is furthered by having as many expenses as possible fall under the responsibility of the Manager, compensable under the basic management fee. To the extent that responsibility for certain items is attributed to the Owner, reimbursement would seem preferable to direct payment as this allows the Owner to retain its own funds as long as possible. The best approach, however, is to have such costs come from the operating revenue of the project, insulating the Owner from any responsibility. (The question, then is whether the formula for the basic management fee is to be based on a sum calculated before or after such expenses are deducted. The Owner's interest is to have as small a base as possible from which to pay the management fee which suggests that, for example, revenue, not gross revenue, be used as the basis, with the definition of revenue being gross revenue minus all costs. The Manager, of course, can be expected to oppose such attempts because, it would argue, this would at least theoretically represent a dual liability of incurring the initial payment as well as reducing its ultimate compensation.)

(C) Payments to Be Borne by the Manager

87. While the lists of payments to be made directly by the Owner or to be reimbursed to the Manager are long and fairly uniform, the lists of items which are the responsibility of the Manager are relatively short and vary from project to project. For example, one contract,<sup>122</sup> regarding the installation and operation of a satellite communication facility, requires the Manager "to make a lease payment to the government for each fiscal year of Manager's operations during which it has a net profit." This contract also requires the Manager to purchase all necessary equipment as well as to construct, replace, repair, maintain and operate the facilities. These provisions are unusual, yet are ones which can be of use in a number of other situations, especially where the Manager gains benefits in addition to the fee, such as access to raw materials and other supplies or markets.

88. Another contract<sup>123</sup> requires the Manager to bear certain expenses as, for example:

The costs of removing or replacing any Technician or Staff will be borne as follows:

(i) If the removal or replacement is made:

(A) At the request of Owner because the person concerned is notoriously inefficient, or because of any other fully justified reason, in the opinion of hotel parties; or

(B) By the Advisor (under particular circumstances);  
or

(C) Because of the resignation, retirement, sickness ... or death of the person concerned.

The traveling and living expenses arising out of such removal and replacement (including those of the families) will be borne by the advisor ...

This contract goes on to state:<sup>124</sup>



In addition, Owner will make available, at the expense of the Advisor, such services as the Advisor may reasonably request for the Technicians and Staff.

This contract further requires that:<sup>125</sup>

Telephone calls and cables, telegraphic and telex messages, postal charges, air freight, stationery and books will be charged at cost. The Advisor will not charge for any of these items which relate to the administration of domestic affairs of the Advisor, and where appropriate, will reimburse Owner with the cost of such items.

This contract also requires the Manager to take out certain insurance at its own expense.<sup>126</sup>

89. This contract requires the Owner to indemnify and hold harmless the Manager in the event the Owner decides not to take out insurance.<sup>127</sup> Another contract<sup>128</sup> provides for the converse, requiring "Manager ... to indemnify Owner against losses resulting from Manager's failure to obtain insurance coverage."

90. Almost all the contracts require the Owner to bear all expenses of travel and transportation of personnel and their families both to the project and their return to their original place of work or home. However, at least one contract<sup>129</sup> places such costs of repatriation at termination on the Manager. Still another contract provides:<sup>130</sup>

In the services to be provided under Article II, Manager will itself bear all costs (except as otherwise specified in paragraph (4) of this Article) save that the Company shall reimburse the Manager with:

(i) all costs (with regard to outside consultants) and

(ii) all reasonable traveling, subsistence and other out-of-pocket expenses properly incurred on the Company's business.

The exclusion from such expenses to be borne by the Manager as set forth in paragraph (4) are:

... reasonable and proper expenditures relating to losses or damages) actually suffered by or incurred by Manager in connection with or arising out of the performance of services for the Company ... which would not be compensated for by insurance ...

(D) Limitations on Recovery

91. An earlier section suggested that aggregate limits be set on certain reimbursable costs impossible to calculate with accuracy in advance. This is done by one of the contracts as follows:<sup>131</sup>

Owner shall reimburse Manager ...

(i) actual payroll ... including provision for vacation, bonuses, and fringe benefits such as U.S. Social Security, medical and hospitalization insurance, such allowances not to exceed 50% of annual salary;

(ii) 60% of the payroll of the field staff plus an additional 40% of the sum expended by Manager ... for compensation of (country) personnel employed, but said 40% not to exceed \$100,000 to cover Manager's support services and overhead charges.

Another contract<sup>132</sup> approaches this problem by providing that "Manager may enter contracts, at the expense of Owner, necessary for the operation, supply and maintenance of premises so long as they are for less than \$50,000; all expenses over \$50,000 must be consented to by Owner." While this is a hotel management contract, the techniques can be used in other types of contracts as well..

C. Special Considerations as to Currency Controls

92. As indicated earlier, at least two contracts<sup>133</sup> require the establishment of irrevocable, confirmed and divisible letters of credit with regard to foreign exchange, management fees and reimbursable costs. This method fully protects the Manager from the risks inherent in exchange fluctuations and in-country exchange laws: the amount to be paid is established thereby foregoing uncertainty for the Manager; the funds are in the currency of the Man-

ager, therefore convertability is not a problem for the Manager; and the funds are already outside the country, thus by-passing the possibility of changes in the exchange control laws of the country restricting the flow of such currency to the Manager. The Owner loses control over such funds to the extent that these statements are correct. This loss of control has several ramifications, including the fact that such money is lost to the country as it has now been taken outside the borders and thus is of little direct value to the country's development.

93. Other methods exist that are more advantageous to the Owner's needs. If a letter of credit arrangement is desired by the Manager, the Owner should negotiate for it being revocable rather than it being irrevocable; this would allow the Owner to retain some control over the money while providing the Manager with a fund in its own currency and perhaps in its own country. This still has the disadvantage, from the Owner's point of view, of (a) being an advance payment (b) from the Owner. An alternative to skirt these problems is to have expenses be reimbursed in the currency of the original payment, at a bank mutually chosen, to be paid only after the expenses are incurred but on a periodic basis such as monthly or quarterly, and to have such expenses come from the revenue of the project. None of the contracts incorporates all these elements; nonetheless, several elements are usually included in a contract that uses such a method. For example, while one contract requires payment to be made by the Owner, it goes on to state:<sup>134</sup>

All ... fees ... shall be paid ... in lawful money of the United States of America by cable credit to the account of Manager at the head office of \_\_\_\_\_ Bank, in New York City, U.S.A., in New York Clearing House Funds, or to such other account at such other bank as Manager shall specify from time to time ....

Another states that:<sup>135</sup>

The fees ... shall be paid by \_\_\_\_\_ to \_\_\_\_\_ in \_\_\_\_\_ United States dollars or other freely convertible currency in which the sale was made within 10 days after receipt of any payment ....

94. The most desirable option for the Owner, is to have payment in the currency generated by the project and in the country where the project is located. This is especially true where a country has a scarcity of foreign exchange earnings and needs the money to be used in the local economy. However, most Managers will try to forego such a requirement, for each wants payment in the currency in which it does most of its business. Also, many countries may have problems with access to foreign exchange. Contractual provisions should take this into account by allowing the Owner flexibility with regard to the currency of payment. Only one of the contracts analyzed allows this, as practically all require payments to be in United States dollars, or give the Manager the option of deciding in which currency to be paid.<sup>136</sup> The one allowing some flexibility provides that "payment ... shall be made in U.S. dollars ..., provided that to the extent that reimbursable costs are incurred in currencies other than U.S. dollars, Owner shall have the option to make payment in whole or in part ..., in each of such other currencies ...."<sup>137</sup>

95. Foreign exchange provisions are essential from the Manager's perspective in projects where payment is in the local currency. These take various forms, as for example:<sup>138</sup>

Owner shall at all times be entitled to obtain and shall make available to Manager at its request, such amounts of freely-convertible foreign exchange as the Manager might require to pay:

(1) All sums owing to foreign persons, natural or juridical, for work performed at the request of Owner ...;

(2) All expenditures payable in foreign currency;

(3) All expenses for wages and salaries to foreign employees ...

Another contract provides for foreign exchange remittances as follows:<sup>139</sup>

44. The parties recognize that because of the particular nature of its business the Company must be in a position to meet its continuing financial commitments on a regular basis. In this regard the Company shall be entitled to all the benefits of the foreign exchange provisions of the Act on Investment of Foreign Capital, as amended, and in accordance with any implementing regulations and instructions thereof, and in accordance with the Indonesian Foreign Exchange Law.

45. Upon appropriate and timely application by the Company, the Government agrees to take the necessary steps expeditiously so as to permit the Company both to utilize such foreign exchange as it may obtain as a result of its operations and to acquire foreign exchange for the payment of those items specified in the Act on Investment of Foreign Capital as well as the following:

a. Charges for the use of satellites.

b. Settlements with the Company's foreign connecting carriers for their participation in international telecommunications services rendered.

c. Charges for goods and services acquired abroad, including, but not limited to, equipment, facilities, spare parts, salaries and wages for foreign employees, fees, transportation, travel expenses, taxes, insurance and other expenses of like character.

d. Principal and interest on indebtedness at maturity dates.

46. In further implementation of the principle expressed in paragraph 44, and in order that the Company may be in a position to meet its recurrent foreign obligations on the most expeditious basis, the parties agree that the Company shall have the right, on a reporting basis and without having to make specific application in each case, to make remittances of such foreign exchange as it may obtain as a result of its operations for the payment of the items indicated under a, b and c of paragraph 45. The Company undertakes to report all such payments to the Government on such basis as may be mutually agreed upon.

47. The parties agree that the Company shall have the right to acquire foreign exchange for the foregoing purposes at a

realistic exchange rate representing a fair approximation of equivalent purchasing power of the respective currencies involved; provided, however, that such exchange rate (including any bonus or incentive payments or system and any related currency arrangements) shall not be less favorable to the Company than any exchange rate (including any such payments or system and any such arrangements) applicable to any other substantial foreign enterprise engaged in business in Indonesia with respect to exchange transactions of comparable kind and amount.

96. The repatriation of profits is related to the method of payment in the same way as the foreign exchange provisions are. Provisions allowing for payments to be made in, for example, U.S. dollars in banks outside the country where the project is, automatically provide for repatriation of profits. Contracts which do not provide for such methods of payment usually contain an article such as the following:<sup>140</sup>

Manager shall be entitled to receive the fees and reimbursements of costs which Owner is obligated to pay hereunder, in the form of United States dollars freely transferable to foreign countries.

This is open-ended and provides for no distinction of payments with regard to whether payment of reimbursable costs was originally in local or foreign currency. It also does not provide for retention of a percentage of profits or fees for use in the country.

FOOTNOTES

1. Contract 10, Article VIII.
2. See, e.g., Contract 34, Article 2; Contract 25, Article 5.
3. See, e.g., Contract 3, Article 5; Contract 8, Article 11.
4. See, respectively, Contract 21, Articles 12, 15, 21; Contract 27, Article V.
5. Contract 29, Article 9.1, Annex.
6. P. Gabriel, *The International Transfer of Corporate Skills* 100 (1967).
7. Contract 17, Article 7.
8. Contract 28, Article VII.
9. Contract 5, Article 7; Contract 6, Article VII; Contract 11, Article 22.
10. Contract 11, Article 22.
11. Contract 5, Article 7.2.
12. Contract 2, Article IV.
13. Contract 14, Article IV.
14. Contract 24, Article 5.
15. Contract 32, Article 7.
16. Contract 36, Article 10.
17. Contract 8, Article 11.
18. Contract 13, Article IV(C); see also Contract 1, Article 12; Contract 22, Article 7; Contract 25, Article 5; Contract 24, Article 2; Contract 25, Article V(C).
19. Contract 26, Article 8; Contract 27, Schedule I.
20. Contract 10, Article VIII; Contract 15, part IV.
21. See, e.g., Contract 19, Article IV; Contract 24, Article 7.
22. Contract 24, Article 7.
23. Contract 19, Article IV.04.
24. Contract 11, Article 22; see also Contract 2, Article IV.

25. Contract 16, Article IV.2.
26. See, e.g., Contract 6, Article VI.
27. Contract 3, Article 5.
28. See, e.g., Contract 13, Article IV.F; Contract 35, Article V.F; Contract 28, Schedule VII.
29. Contract 13, Article IV.F.
30. See, e.g., Contract 22, Article 7.2.
31. See, e.g., Contract 32, Article 8.1.
32. See, e.g., Contract 27, Article V; Contract 1, Article 14.
33. See, e.g., Contract 13, Article V; Contract 35, Article VI.
34. Contract 22, Articles 7.2, 7.3.
35. Id. Article 8.1.
36. Contract 32, Article VIII.
37. Contract 1, Article 14.
38. Contract 13, Article V; Contract 35, Article VI.
39. Contract 27, Article V.
40. See, e.g., Contract 1, Article 14.B; Contract 13, Article V; Contract 19, Article IV.05; Contract 27, Article V.5(b); Contract 29, Article 9.3; Contract 32, Article 7.4; Contract 33, Article 8.2; Contract 35, Article VI.
41. Contract 1, Articles 13, 14.B.
42. Contract 17, Article 9.
43. See, e.g., Contract 19, Article IV.05; Contract 27, Article V.5(b); Contract 29, Article 9.3; Contract 32, Article 7.4.
44. Contract 32, Article 7.4.
45. Contract 29, Articles 9.3, 9.4.
46. Contract 27, Article V.5(b).
47. Contract 2, Article V.
48. Contracts 2, 3, 6, 11.



49. Contract 2, Article 1; Contract 3, Article 1; Contract 6, Article II; Contract 11, Article 14.
50. Contract 3, Article 1 § 4.
51. Contracts 2, 3, 11.
52. Contract 3, Article 1 § 4.
53. Contract 6, Article II § 3.
54. Contract 2, Article 1 § 4; Contract 3, Article 1 § 4; Contract 11, Article 14.
55. Contract 6, Article 14.
56. Contract 11, Article 21(f).
57. Contract 2, Article 1 § 4, para. 2; Contract 3, Article 1 § 4; Contract 11, Article 14, para. 2.
58. Contract 6, Article II § 3(b).
59. Contract 2, Article I § 2; Contract 3, Article I § 2; Contract 6, Article II; Contract 11, Article 13.
60. Contract 6, Article VI § 8.
61. Contract 2, Article VI.
62. See, e.g., Contract 2, Article VI § 3; Contract 11, Article 24.
63. Certain of the technical assistance contracts, to be discussed below, contain such provisions.
64. Contract 2, Article VII § 1; Contract 3, Article I § 3; Contract 6, Article VIII; Contract 11, Article 23 § 4.
65. Contract 2, Article I § 5; Contract 3, Article 2; Contract 6, Articles IV, V; Contract 11, Article 17.
66. Contract 11, Article 17.
67. Contract 2, Article I § 5; see also Contract 6, Articles IV, V.
68. Contract 2, Article I § 2; Contract 3, Article 1 § 3; Contract 11, Article 13.
69. Contract 6, Article IV §§ 1, 2.
70. Id.
71. Contract 3, Article 4 § 1; Contract 6, Article VIII § 3.

72. Contract 2, Articles III, IV; Contract 11, Articles 20-22.
73. Contract 6, Article VI § 7.
74. Contract 11, Article 21.1(c)(d)(e).
75. Contract 11, Article 26.
76. Contract 2, Article VIII §§ 1, 2.
77. Contract 2, Article I § 3.
78. Contract 2, Article XI.
79. Contract 3, Article 2.
80. Contract 2, Article V § 2.B.
81. Id. Article VI § 2.
82. Id. Article IV § 3.
83. Id. Article IV § 4.
84. Id. Article V § 4.
85. Contract 14, Article 6.02; Contract 16, Article VI.D.
86. Contract 5, Article III.
87. Contract 16, Article VI.F; see also Contract 14, Article 6.
88. See, e.g., Contract 5, Article 5.1.9; Contract 35, Article VII.
89. See, e.g., Contract 14, Article 6.04; Contract 16, Article VI; Contract 35, Article VII.
90. See, e.g., Contract 16, Article VI, Contract 35, Article VII.
91. See, e.g., Contract 5, Articles 5.1.4, 5.1.5, 6.1.
92. Id. Article 6.1.
93. Id. Articles 5.1.4, 5.1.5.
94. Contract 26, Article 11.E(b).
95. See, e.g., Contract 5, Article 6.1.
96. Id.
97. Contract 16, Article VI.

98. See, e.g., Contract 4, Article 8; Contract 5, Article 5.1.3; Contract 24, Article 4(b); Contract 28, Schedule IV; Contract 29, Article 9.2; Contract 32, Article 7.2; Contract 34, Article 2(d).
99. See, e.g., Contract 32, Article 7.2; Contract 24, Article 4(b); Contract 28, Schedule II.
100. Contract 28, Article XIII(d).
101. See, e.g., Contract 27, Schedule III.12.
102. Contract 14, Article 6.08; see also Contract 35, Article VII.
103. Contract 16, Article VI.
104. See, e.g., Contract 16, Article VI; Contract 28, Articles VI, XIII(g); Contract 25, Article 8; Contract 35, Article VII.
105. Contract 25, Article 8.
106. Contract 1, Article 12.A.
107. Contract 15, Article 14.
108. Contract 19, Article IV.
109. See, e.g., Contract 6, Article VI.12; Contract 8, Article 19; Contract 13, Article 2.G; Contract 14, Article 6; Contract 22, Article 5; Contract 27, Schedule I(4); Contract 28, Article XIX; Contract 29, Article 8; Contract 36, Article 6.
110. See Contract 22, Article 5.
111. See Contract 27, Schedule I(4).
112. Contract 36, Article 6.
113. Contract 8, Article 19.
114. Contract 28, Article XIX.
115. See, e.g., Contract 15, Article 16; Contract 16, Article V.B.
116. Contract 5, Article 7.
117. Id. Article VI.2.
118. Id. Article V.
119. Contract 27, Schedule III.12; see also Contract 35, Article V.
120. Contract 5, Article 7.

121. Contract 1, Article 11.B; see also Contract 10, Article VIII.8.05; Contract 12, Article II; Contract 15, Article 13; Contract 16, Article IV; Contract 25, Article 6.
122. Contract 21, Article 12.
123. Contract 28, Article XIII(d).
124. Id. Article XIII(g).
125. Id. Schedule IV.
126. Id. Article XIX.
127. Id.
128. Contract 8, Article 19.
129. Contract 4, Article 8.
130. Contract 27, Article V.
131. Contract 13, Article IV; see also Contract 35, Article V.
132. Contract 3, Article IV § 4; see also Contract 17, Article 8.
133. Contract 13, Article V; Contract 35, Article VI.
134. Contract 34, Article 2(b).
135. Contract 32, Article 7.3.1.
136. See, e.g., Contract 10, Article VIII; Contract 16, Article IV.2; Contract 25, Article 7; Contract 32, Article 7.4.
137. Contract 15, Article 17.
138. Contract 22, Article 12.
139. Contract 21, Articles 44-47.
140. Contract 22, Article 13.

IX.

PROVISIONS RELATING TO  
PERFORMANCE CONTROL BY THE OWNER  
AND ALLOCATION OF LIABILITY

Overview

1. A significant weakness of the management contract form of project development is frequent failure to provide a practical means for protecting the Owner when the Manager's performance is less than satisfactory yet not so inadequate as to amount to breach of contract. Moreover, the majority of the contracts reviewed did not provide for the remedy of damages to the Owner except for exceptional breaches of duty by the Manager. Accordingly, there may be some cases in which a Manager has breached the contract by failing to meet the stated standard of care, yet the Owner will have no right to damages for breach of contract. The Owner's protection in the area of performance control is generally limited to provisions affecting his overall control (see Part II), those affecting his control over expatriate and national staff (Part IV), and those providing termination rights (Part XI). As indicated in those parts of this report dealing with the specific provisions referred to, however, many management contracts do not afford a meaningful input for an Owner concerned with the quality of operations.

2. If the Manager's performance proves unsatisfactory to the Owner, his basic remedies are (i) to seek to replace individual staff members of the management company or (ii) to terminate the management contract. As recourse to the termination remedy will likely result in costly delays, and the Manager may resist attempts by the Owner to evaluate individual staff members, these remedies may be more theoretical than practical.

3. The Manager will usually be concerned with obtaining protection from liability for damages arising from its activities under a management contract. This concern results in limitation of liability provisions in the contracts reviewed which are either expressed or non-expressed. Express limitations of liability usually take the form of an indemnification clause whereby the Owner agrees to "hold harmless" the Manager from liability. Non-express limitations, where the document is silent as to specific allocation of liability, are inherent in the Force Majeure clauses found in every contract, as well as in discussion of various duties, such as the purchase of insurance. While some patterns emerge, each allocation and limitation of liability is peculiar to the projects and parties themselves. From the Owner's perspective, the knowledge of those clauses which provide for the Manager's insulation from liability may be invaluable at the bargaining table as he negotiates for both a greater assurance of the quality of performance as well as a more meaningful damages remedy in the event of Manager's failure of performance.

#### Manager's Standard of Care

4. There are basically two types of standards observed in the instruments discussed. The best from the viewpoint of the Owner are:

Manager undertakes to perform its obligations under this Agreement in a prudent and sound manner and to apply the same degree of diligence it would apply if it were the sole Owner of the Property ... and to be mindful of the interests of Owner.

and

The consultant shall use its skill and knowledge in carrying out its responsibilities ... efficiently and in a proper and business-like manner to the best of its abilities in the best interests of the Enterprise.

From the perspective of the Owner, the first provision provides the most protection although the second provision may be adequate. The first is

preferable because it applies the best standard. The "best efforts" approach of the second clause leaves considerable room for argument when, despite such efforts, the project does not meet the Owner's expectations.

#### The Basic Indemnification Clause

5. The majority of agreements in this study contain the provision that the Manager will not be liable for personal injuries or property damage occurring in the course of its performance, and to the extent that liability is imposed, the Owner will indemnify the Manager.<sup>1</sup> This basic agreement does not include, at a minimum, liability attributable to the fraud, bad faith, or gross negligence of the Manager. Typical language expressing this indemnification reads:

[I]n the absence of fraud or gross negligence, Manager shall in no way be responsible for, and [Owner] will save Manager harmless from and against, any and all claims (and the costs and expenses of defending against them) ...<sup>2</sup>

6. The converse may be true as well, when bargaining powers substantially favor the Owner, as especially seen in one drilling contract, where the Manager agrees to indemnify the Owner, in this case a host-country government, for all damages toward third parties.<sup>3</sup> The Owner should note that although the Manager may have agreed to perform under the higher standard of care set forth above, it is the Owner, not the Manager, who bears the risk and is liable for performance which is below that standard, yet not so far below as to amount to gross negligence.

#### Variations and Exceptions to Basic Clause

##### A. Consequential damages

7. Additional protection for the Manager and weakness of protection for the Owner is afforded by the common provision that in no event (i.e., even if Manager is liable due to fraud or gross negligence) will Manager be liable for

special or consequential damages, such as loss of profits. The simplest form of this qualified limitation reads:

The liability in any event of [Manager] and its seconded staff shall be limited to the compensation of any direct damage suffered by [Owner]. Indirect damage, e.g. loss of profit or other consequential damage, shall not be compensated.<sup>4</sup>

Other contracts include this limitation, even where the Manager's basic liability is not restricted to instances of his willful conduct or gross negligence.<sup>5</sup>

B. Liability Ceilings

8. Managers may achieve additional protection by limiting the amount of money damages recoverable in the event the Manager is liable. One contract specifies a limitation of two hundred thousand (\$200,000) dollars,<sup>6</sup> while another specifies that the Manager's liability is not to exceed fifty (50%) per cent of the annual compensation under the contract.<sup>7</sup>

C. Ordinary Negligence

9. The Owners in several contracts succeed in imposing liability on Managers for instances of ordinary negligence in their performance.

1. Negligent Selection

10. In two of the contracts of this study, the Manager may be held accountable for damages arising from the act or failure to act of its Field Staff and general managers if the Manager can be shown to have been negligent in the selection of the offending personnel.<sup>8</sup> Similar ramifications may be seen in another, which imposes a duty on the Manager to select high calibre employees,<sup>9</sup> and another which requires that the Manager exercise reasonable care in the selection of its servants.<sup>10</sup>



## 2. Failure to Exercise Due Care

11. A standard less stringent than the basic indemnification exception for gross negligence of the Manager may be found in the contract for consulting services, wherein the Owner waives all claims against the Manager for liability "except in respect to bad faith, willful misconduct, fraud, or failure to exercise due diligence and care."<sup>11</sup>

12. In both marketing services contracts, the Manager's liability is limited to claims arising from the negligence of its staff, but one further provides that the Owner will be responsible for actions of the Manager's staff to the extent that such employees have been "seconded" to and are within the scope of Owner's employment.<sup>12</sup>

## 3. Mutual Indemnity

13. Both the Owner and the Manager may agree to indemnify the other against claims arising from their own negligence, to the extent the loss is uninsured. Each party further agrees to notify their respective insurance carriers of their mutual waiver of the right of subrogation.<sup>13</sup>

### D. Special Duties

14. The Owner may hold the Manager liable (as an exception to the general indemnity) to the extent that the loss incurred is the result of Manager's failure to perform a special duty. In one contract, the Owner's agreement to hold the Manager harmless (in absence of fraud, gross negligence, or willful wrongdoing) is conditioned upon Manager's acting prudently, economically and efficiently in the performance of its business, as well as upon Manager's not becoming a [host-country] resident.<sup>14</sup>

15. In an oil drilling contract, the Manager will not be indemnified if his performance of the project results in an environmental disaster, thereby

imposing a special duty to safeguard against such occurrence.<sup>15</sup> Similarly, the agreement between the "related" parties of another contract provides that they will share the costs of restraining and preventing infringement of their patents.<sup>16</sup>

E. Indemnification of Delegates

16. In specifying the extent of Owner's duty to indemnify the Manager, some contracts expressly provide that such indemnification extends to the Manager's agents, sub-agents, and others to whom authority to act has been delegated. Usually this extension is coupled with the Manager's duty to use reasonable care in selection of such delegates and a waiver of insulation from liability against the Manager's staff.<sup>17</sup>

F. Specification of Independent Contractor

17. A Manager may enunciate other insulation from liability by the specification that it is acting as an independent contractor to the project and is in no way a partner, joint venturer or employee of the Owner.<sup>18</sup> Status as an independent contractor may, however, impose liability on the Manager for its own conduct which can only be overcome by the Owner's specific agreement to indemnify the Manager.<sup>19</sup>

Insurance

18. The Manager is often in the best position to determine the insurance needs of a project and to purchase appropriate policies. Most contracts provide that the Owner is to reimburse the Manager for such expenditures along with other operating expense reimbursements. The duty to procure insurance, however, relates to the allocation of liability in several respects.

A. Failure to Purchase Insurance

19. Several contracts, while including money paid on claims as operating

costs, impose affirmative duties on the Manager to obtain comprehensive insurance coverage for the project.<sup>20</sup> Others, which contain specific Owner indemnification clauses, include this affirmative duty with the corresponding right of the Manager to look to the Owner for reimbursement.<sup>21</sup>

20. In a contract with a socialist bloc concern it is specified that the Manager's failure to insure all risks insurable at a reasonable cost will preclude the Owner's indemnification obligation to the Manager to the extent that the loss arises from such a risk.<sup>22</sup>

21. One contract specifies that the Manager will indemnify the Owner for any loss sustained as a result of the Manager's failure to provide adequate and appropriate coverage.<sup>23</sup> Another contains the interesting proviso that the Manager will purchase, at its own expense, insurance covering risk of damages caused by Owner's employees during their training, and that the Manager will hold the Owner harmless from such damages "except for liability arising from bad faith."<sup>24</sup>

B. Special Considerations for Hotel Management Contracts

22. Division of duties to purchase insurance may be seen as the primary means to allocate liability among the parties in a hotel management agreement. In two of these contracts, the hotel Owner is required to purchase public liability and indemnity insurance, property insurance, and all risk insurance normally carried by hotels similarly situated. The hotel Manager is required, at the expense of the Owner, to obtain public liability, elevator and theft insurance, employer's liability and workmen's compensation insurance, use and occupancy insurance and other policies necessitated by the operation of the hotel.<sup>25</sup>

23. The Owner in another hotel management contract, on the other hand, agrees

to purchase all types of insurance, and presumably, therefore, agrees to fully protect the Manager from liability in the hotel's operation.<sup>26</sup> Similarly, the Manager in a fourth contract agrees to provide comprehensive coverage, at Owner's expense, for all claims.<sup>27</sup>

C. Liability Following Insurance

24. In several contracts, it is stipulated that the Manager is liable for losses to the extent that it has obtained insurance to cover the loss.<sup>28</sup> Another contract limits such liability to workmen's compensation claims, although the Manager is given the affirmative duty to purchase comprehensive general liability insurance and all-risk aircraft hull insurance naming itself as co-insured.<sup>29</sup>

Guaranty and Warranty

25. Managers may also wish to specify that they do not promise any particular results from their services and expressly negate any warranties of performance, though such clauses are usually coupled with other limitation of liability clauses, especially provisions insulating the Manager from liability for consequential damages.<sup>30</sup>

## FOOTNOTES

1. Contract 1, Article 16; Contract 3, Article 7, § 2; Contract 4, § 10; Contract 5, Article XIV; Contract 10, Article X; Contract 13, Article II(L)(1); Contract 14, Article VI(6); Contract 15, Article 19; Contract 16, Article VII; Contract 19, Article V(2); Contract 23, § 4(e); Contract 26, § 11(F); Contract 27, Article VII(6); Contract 28, Article XIX; Contract 29, § 7; Contract 31, Article VI(6); Contract 32, Article IX(1); Contract 33, Article 10; Contract 34 § 3(a); Contract 35, Article III(m); Contract 36, § 16 (E)(iv).
2. Contract 1, Article 16.
3. Contract 9, Article XIII; See also, Contract 8, § 19 where Manager agrees to indemnify Owner for loss by its failure to obtain insurance and resulting from activities within its control (with the monetary limitation); Contract 28, Article XIX(c) where Manager assumes responsibility for damage caused by Owner's employees during their training program.
4. Contract 4, § 10, p. 5.
5. Contract 13, Article II(L)(3); Contract 27, Article VIII(6)(ii); Contract 32, Article IX(1); Contract 35, Article III(m)(3); Contract 36, § 16(E)(ii).
6. Contract 16, Article VIII(D).
7. Contract 8, § 19.
8. Contract 13, Article II(L)(2); Contract 35, Article III(m)(2).
9. Contract 23, § 4(a).
10. Contract 36, § 16(E)(i).
11. Contract 34, § 3(a).
12. Contract 26, § 11(F)(1)(a); Contract 27, Article VIII(6)(i) and (v).
13. Contract 32, Article IX(1).
14. Contract 19, Article V(2).
15. Contract 20, Article V(7); see also, Contract 7, Article V(1.2)(d).
16. Contract 24, § 13(b).
17. See Contract 27, Article VIII(1)); Contract 36, § 16(I).
18. Contract 23, § 4(c).
19. Contract 33, Articles 10 and 11.

20. Contract 7, Annex I, Article III(6) which treats insurance premiums and money paid on claims as operating costs to be reimbursed; Contract 8, § 19; Contract 20, Annexure C, Article II (1.7).
21. Contract 5, Article V; Contract 9, Annex "D"; Contract 10, Article IV(g)(2); Contract 13, Article II, (G); Contract 25, § 6.01(a); Contract 26, § 6; Contract 35, Article III(H); Contract 36, § 6.
22. Contract 13, Article II(L)(1).
23. Contract 8, § 19.
24. Contract 28, Article XIX(c).
25. Contract 2, §§ 1 and 2; Contract 3, Article VII, § 1, but see, Contract 3, Article VII, § 2 where Owner holds Manager harmless from liability for any cause arising out of Manager's duty, except where Manager is grossly negligent.
26. Contract 11, Article 26.
27. Contract 6, Article VI, § 12.
28. Contract 26, § 11(F)(i)(6); Contract 27, Article VIII(6)(i)(b); Contract 36, § 16(E)(i)(b).
29. Contract 5, Articles V and XIV.
30. Contract 16, Article VII(c); Contract 23, § 4(b); Contract 25, § 2.03.

X.

PROVISIONS RELATING TO  
DURATION AND EXTENSION OF CONTRACT PERIOD

Overview

1. In view of the ~~minimum~~ protection available to the Owner regarding general control (see Part II) and performance control and liability (Part IX), the duration of the contract and extension options should be carefully considered. Under the pure management contract (i.e. one not related to either equity or debt participation by the Manager or purchase of the facilities from the Manager), initial terms in excess of five years do not, as a rule, appear to be justified in view of the Owner's interests. Contracts of short duration are generally more suited to achieving the goal of accelerated technology transfer and foreign exchange savings through project indigenization.

2. This part of the report reviews and analyzes provisions of the management contracts in the study which set out the initial contract period, if a definite term has been specified, and any provisions which afford either Manager or Owner the right to renew or extend the operating term beyond the initial contract period. It should be noted that the analysis isolates provisions dealing with contract duration and extension from those provisions which allow either party to terminate the agreement, short of the originally agreed term, which are the subject of Part XI of this report. This discussion shall focus on both the length of the initial contract period and the structure of various provisions pertaining to duration and extension in the management contracts reviewed.

### Length of Contract Term

3. Ten of the contracts in the study include duration terms which are not quantifiable since the period of the contract is either delimited by an extraneous agreement or limited to the time necessary to complete a specific undertaking such as construction of a plant or refinery. More than half of the remaining management contracts provide initial contract terms of 7 years or less. And of these contracts, all but one provide for continuation of the contract term thereafter on a year to year basis unless the Manager notifies the Owner of its intention to terminate. Half of the management contracts with durations in excess of 7 years have initial terms of 20 years. Of this number, all but one are hotel management contracts. Each of these contracts provides the Manager with an option to extend the operating term for a certain number of successive periods. It is to be noted that the long term nature of these contracts is probably reflective of a distinctive bargaining advantage possessed by major hotel chains combined with a desire of the Owner to utilize the established market and reputation of the Manager. Once these industry specific contracts are divorced from the study, the majority of the remaining contracts have initial contract periods of 10 years or less.

### Structure of Provisions

4. Provisions dealing with management contract duration and extension in the study fall roughly into one of the following categories:

#### A. Tied to Duration of Extraneous Agreement

5. Seven of the contracts reviewed contain provisions linking duration of the management contract to the term of an extraneous agreement. One contract provides, "This Agreement shall, unless sooner terminated as provided in Articles 18 or 27 hereof, terminate on the same date as termination of the Voting Trust



Arrangements."<sup>1</sup> Another example recites that, "This Agreement unless sooner terminated, shall terminate when all provisions of the Sales Agreement, as the same may have been extended, shall have terminated."<sup>2</sup>

6. A variation within this category is found wherein contract duration, while linked to an extraneous agreements' duration, may not be terminated prior to a specified date. One example provides:

This Agreement shall come into force and effect on the date hereof unless some other date shall be agreed by the parties hereto and shall terminate on the date on which the Concession Agreement terminates ... by not less than one year's notice in writing to expire not earlier than the end of the third year of the term of the Agreement.<sup>3</sup>

B. Limited to the Time Necessary to Complete Performance of a Specific Undertaking

7. A second category within the management contracts reviewed limits the term of the contract to the time required for the Manager to complete performance of a specified undertaking such as construction of a plant. Within this category one provision stipulates:

The Period of Performance of this Agreement shall commence on the date that the last of the conditions precedent set forth in Article 12 is satisfied and shall end on the day all facilities in the ... Project are complete, ready for operation and open to the public.<sup>4</sup>

It is important to note, however, that this contract, which provides for construction of a tourist development also includes a provision for possible renewal which states, "The Period of Performance as specified in the preceding sentence may be extended by mutual written consent of the parties hereto."<sup>5</sup>

C. Limited to a Specified Term with Either No Provision for Renewal or Renewal Subject to Future Agreement

8. Approximately six of the contracts reviewed contain either no provision for renewal or specify that renewal is to be left to mutual agreement of the

parties. One such provision recites that, "The appointment of Manager shall be for a period of five years starting with the formation of the Owner Company."<sup>6</sup> The contract referred to contains no provisions pertaining to renewal or extensions. A variation within this category provides:

The Lease shall be for a term of twenty (20) years commencing with the date of first commercial operation .... Upon expiration of the term of the Lease all rights in the facilities subject to the Lease shall revert to the Government, unless the parties shall by mutual agreement extend or renew the Lease or make other arrangements.

9. Half of the contracts within this category provide for gradual replacement of Manager's personnel with the domestic cadre by the terminal date.

D. Specified Term with an Option to Extend or Renew the Operating Term

10. Seven of the contracts reviewed fit well within this category. Generally, they provide for a specified term and allow extensions of the operating term at the option of the Manager if certain requisites are met. One such contract provides:

This Agreement ... shall continue ... for an initial term of twenty (20) years from the commencement date defined below.... Manager shall have the option to renew this Agreement for three (3) successive terms of ten (10) years each.... Manager shall give a written notice of its intention to renew this Agreement not later than one-hundred eighty (180) days before expiration of the then current term.

Other contracts reviewed, in addition to requiring certain notice by the Manager, condition the exercise of the Manager's option to renew on the Manager not being in default of any provisions of the Agreement at the time of notice to exercise the option. Also many of the contracts in this class require the contract to have been extended for all prior periods. An example of one such provision recites:

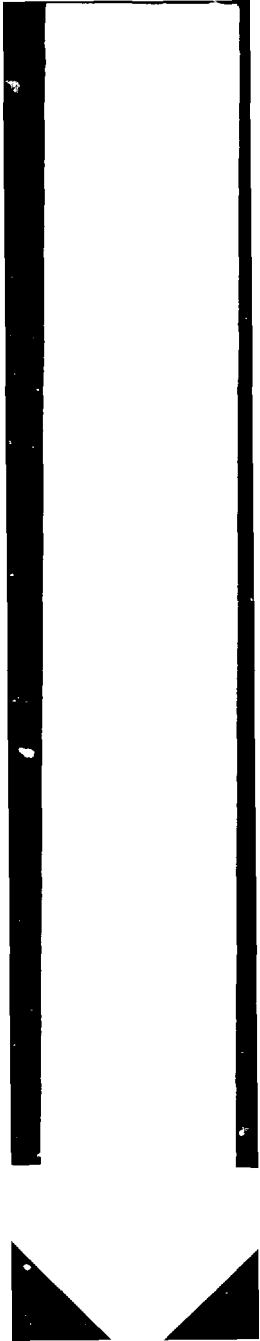
Manager shall have the right to extend the Operating Term for three (3) successive periods of ten (10) years each upon the following terms and conditions:

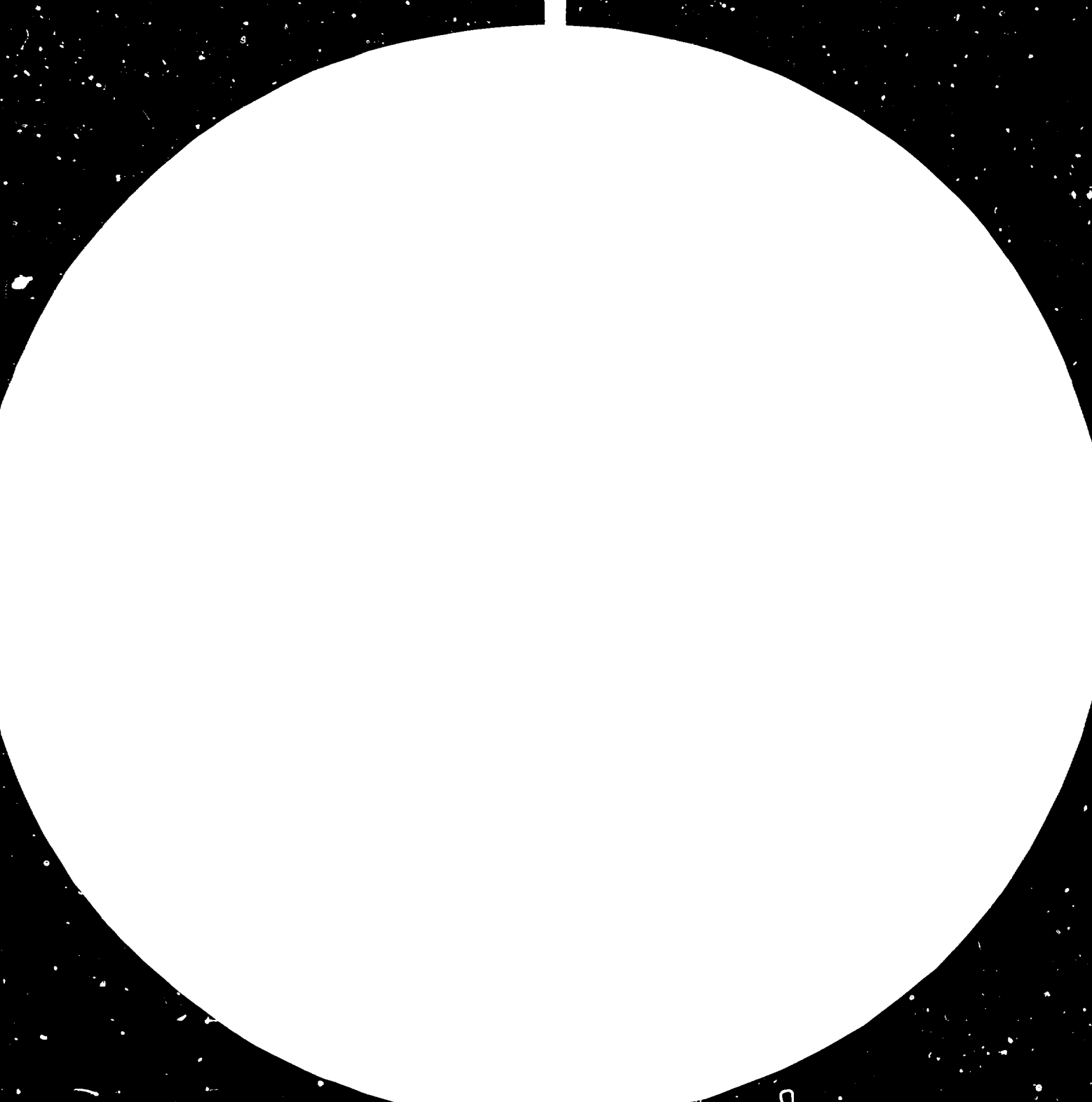
- (1) Manager is not in default pursuant to Article XII of this Agreement;
- (2) The Operating Term shall have been extended for all prior periods;
- (3) Manager shall have given notice to Owner of its election to extend the Operating Term on or before April 1 of the nineteenth (19th) full calendar year of the original term, and on or before April 1 of the last year of any extended term.<sup>9</sup>

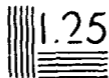
11. The contract provisions cited above purport to give the Manager an absolute option to extend the operating term provided it complies with the formal notice requirements and has not breached the agreement. A few contracts in the study limit the Manager's exercise of an option to circumstances where the Owner assents to such an extension. One form of management contract provides another limitation to exercise of the option to extend, in addition to the requirements that the Manager not be in breach and that all prior extensions shall have been granted. It states that the option is exercisable only if, "Owner has not, on or before April 1, of the nineteenth (19th) full calendar year after the Opening Date, given Manager notice that it does not wish to extend the Term of this Agreement."<sup>10</sup>

12. In the cited contractual provisions, the option to renew or extend is exercisable only by the Manager. One contract in the study did provide for an option exercisable only by the Owner. It provides that, "After the seven (7) year period referred to in Section 3.01, Manager, if so requested by the Owner shall continue to act as Manager under the terms and conditions of this Agreement for such period of time as may be agreed."<sup>11</sup>

13. Five of the seven contracts in this category have initial terms of 20 years with options to renew for several successive 10 year periods. Four of







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these are hotel management contracts. Only one of these contracts contains requirements that the Manager train local personnel.

E. Specific Term and Continuing Thereafter for Periods Unless Either Party Notifies the Other of its Intention To Terminate

14. Eight of the contracts reviewed provide for a specific contract term which is less than 10 years, and further provide that the management contract shall continue thereafter unless either party (Manager or Owner) notifies the other of its intention to terminate the contract. The notice requirement in all but two of these contracts is 6 months prior to the expiration of the then contract period. One contract provision within this category states that:

This Contract shall become effective upon execution hereof and shall continue in effect until seventy-two (72) months after the start-up date. It shall continue thereafter from year to year unless written notice of termination is given by either party at least six (6) months prior to the termination date specified in said notice.<sup>12</sup>

15. It is interesting to note that of all the contracts reviewed in this study, those contracts within this group as a whole have as one of their principal goals eventual change-over in personnel to the domestic labor force. Also, as noted, the initial contract terms tend to be short within this group, lending themselves to fulfillment of this objective. But, as previously stated, they also provide flexibility in that either party can permit the contract to remain in force after expiration of the initial contract period. Thereafter, either party is free to terminate the agreement by giving the requisite notice. From the viewpoint of the Owner, this may be the most advantageous of the contract provisions discussed.

F. Specific Term and Continuing Thereafter Until Owner Notifies Manager of its Intention to Terminate

16. One contract in the study contained a provision allowing the Owner to remove the Manager from his position after the initial contract period had

expired provided certain notice requirements are met. It is to be noted that the initial contract term covered a period of 25 years. It provided:

17. The Manager, as the same is or may hereafter be constituted,

shall be the Consultant and technical advisor to the Owner or its manufacturers, and ... shall continue and be such Consultant and technical advisor of the Owner for a period of twenty-five (25) years certain from that date, and thereafter until they shall be removed therefrom by Owner ... not less than twelve (12) months notice shall be given...<sup>13</sup>

G. Indefinite Term But Allowing Either Party to Terminate With Specified Notice Provided That Such Termination Shall Not Occur Before a Specified Date

18. A final category of provisions pertaining to duration and extension comprises those contracts which do not provide for a definite term per se (although their practical effect may be the same) but do not allow either party to exercise a contractual right to terminate until after a specified date. One management contract from this category provides, "This Agreement shall be deemed to have commenced on January 1, 1970 and shall continue in force until terminated by either Owner or Manager serving 12 months' notice in writing on the other expiring not earlier than 31st December, 1974."<sup>14</sup>



FOOTNOTES

1. Contract 1, Article 17.
2. Contract 19, Sec. 5.04. See also, Contract 12, Article IV; Contract 18, Article 14; Contract 27, cl. 11 and Contract 32, cl. 10.1.
3. Contract 30, cl. 10.
4. Contract 33, Article 6.1.
5. Contract 33, Article 6.1. See also, Contract 29, cl. 2.7.
6. Contract 4, cl. 2. See also, Contract 15, Article 20; Contract 22, cl. 2; Contract 25, cl. 10.
7. Contract 21, cl. 11.
8. Contract 3, Article 3. See also, Contract 34, cl. 7; Contract 5, Article 4.
9. Contract 2, Article XV.
10. Contract 6, cl. 2(c). See also, Contract 11, Article 32.
11. Contract 10, Article III, Sec. 3.02.
12. Contract 13, Article VIII(A). See also, Contract 14, Article VIII, Sec. 8.01; Contract 17, cl. 10; Contract 35, Article IX; Contract 31, Article VIII, Sec. 8.01; Contract 8, cl. 14; Contract 16, Article IX.
13. Contract 24, cl. 2.
14. Contract 36, cl. 13(A). See also, Contract 28, cl. XXII(a)(IV); Contract 26, cl. 9.A.(1).

XI.

PROVISIONS RELATING TO  
TERMINATION AND ASSIGNMENT

Overview

1. An important right of which the Owner should be assured in any pure management contract is that of terminating the Manager's services. Frequently, if the Manager performs with his best efforts and is not guilty of gross negligence but is nevertheless not performing according to the Owner's satisfaction, the Owner may be contractually bound to assume the risk of loss resulting from such inferior performance (see Part IX). Accordingly, the right to terminate the management contract in such cases may be the Owner's sole remedy.
2. Overemphasis on the protection available to Owners arising from flexible termination rights may, however, be misleading. Even affording the Owner the right to terminate the management contract at will, with no resultant liability to the Manager, will involve significant costs to the Owner. The probable lengthy shutdown of operations due to the time requirements for securing the services of a new Manager (letting of bids, review, selection and start-up) will be a disincentive to the Owner to exercise his termination rights except under the most pressing circumstances.
3. The majority of the contracts examined for this project contain some provision affecting termination of the contract as well as assignment of one party's rights and obligations under the contract. Within the topic of contract termination these provisions deal with: (1) permissible causes of termination, for each of the parties, with the varying notice requirements for each cause; (2) the effects of termination.

4. With respect to assignment, the provisions deal with the permissibility of either of the parties' attempts to assign to non-parties. The Owner will usually have an interest in preventing assignment without his consent and should assure that this is expressly provided for in the contract. Each of these areas is discussed at greater length and with reference to the relevant clauses in the contracts studied.

#### Permissible Causes of Termination

5. The permissible causes of contract termination by a party fall into the following sub-categories: (1) no causal action or omission by the other party; (2) breach of contract by the other party; (3) failure to make payments due under the contract by the other party; (4) Force Majeure outside the reasonable control of the affected party; (5) destruction, damage, or condemnation of an item or facility relating to the contract performance; (6) bankruptcy, liquidation or bankruptcy of a party; and (7) assorted miscellaneous causes.

6. Each of these sub-categories will be discussed in this section below. It should be noted at the outset, however, that the fifth and sixth sub-categories are often treated as instances of Force Majeure and are only here discussed separately to the extent that individual contracts analyzed treat them separately from Force Majeure.

A. No Causal Action or Omission by Other Party

7. A significant number of the contracts examined allow the termination of the contract by either party, with no prerequisite of action or omission by the other party.<sup>1</sup> All of these, however, require that the party wishing to terminate the agreement notify the other party or parties of its intention of a specified minimum number of months (or years) in advance. This period varies in the different contracts from three months to six months<sup>2</sup> to one year<sup>3</sup> and two years.<sup>4</sup> In one case, the contract's Term of Agreement clause sets both a minimum (12 months) and a maximum (18 months) period in which the terminating party must notify the other of its intention.<sup>5</sup>

8. Not surprisingly, all but one of these provisions allowing termination without cause at the discretion of the parties do not come into effect until the contract has continued for a specified period, ranging from two<sup>6</sup> years to ten<sup>7</sup> years, with an average of six to seven years required. The exception substitutes a "required period" of at least one month of negotiations between the parties with the aim of avoiding such termination.<sup>8</sup> The more usual prerequisite is that the contract must have been in effect for a stated number of years. One of these more usual provisions, no waiver, provides for an interesting prerequisite for termination without cause, as an alternative to its stated number of years in which the contract must have been in effect:

(1) The Agreement shall be deemed to have commenced (specified date) and shall continue in force until terminated as follows --

(1) by (either party) on two years' notice in writing which may not be served to expire before (ten years after commencement date), or (if after) when the stock has been repaid in full ...

9. This alternative means of determining the date starting from which either party may terminate the contract actually protects the government, rather than

the management company, since it will almost always be in the interest of the government rather than the management company to extend the period within which neither party may terminate without cause so long as the government or its agent has not yet recouped its investment.

10. Four of the contracts examined that specify requirements for termination without cause differ from the similar provisions in the other contracts examined in their explicit disparate treatment of the different parties to the contract with regard to termination rights and requirements.

11. Two of these deviant provisions clearly favor the operating company (and therefore the government), providing that only the operating company may terminate the contract without cause, albeit with more stringent prerequisites to be met than in the cases where both parties' rights to terminate without cause are identical. In the first case, the operating company must give one year notice, and obtain not only a resolution of its board of directors, but also approvals by various authorities, including banks, with interests in the project.<sup>10</sup> In the second case, the relevant contract provision itself purports to allow neither party the right to terminate without cause, but defines the following as a cause permitting the operating company to terminate at its option:

If (Government Operating Co.) at any time after the date of operation considers that, because of accelerated training and the then prevailing capability of the (its nationals) personnel working on the project, (Government Operating Co.) no longer requires the technical assistance of (Management Company). (Government Operating Company) may enter into consultation with (Management Company) with a view to a termination of this Agreement upon such terms and conditions as may be mutually agreed upon.<sup>11</sup>

12. The effect of this provision is, however, to enable the government operating company to terminate the contract absent any action or omission on the part of the management contract, such as breach, failure to make required payments, or entry into liquidation. It should be noted with regard to this provision, as in

the earlier case, that it does circumscribe the government party's right to terminate more severely than in the case where the parties' termination rights are coequal, requiring consultation and mutual agreement rather than a straightforward term of notice.

13. The other two deviant provisions dealing with the right to terminate the contract without cause are in diametric contrast to the two analyzed above, as they significantly favor the management company or its agent. The first of these is quite similar to the second of the above provisions, however, except that it reverses the parties:

Following the end of the third year as from the Effective Date, if in the opinion of the (Management Company) circumstances do not warrant continuation of the Petroleum Operations, (Management Company) may by giving written notice to that effect to (Government Company) and after consultation with (Government Company) relinquish its rights and be relieved of its obligations pursuant to this Contract, except such rights and obligations as related to the period prior to such relinquishment.<sup>12</sup>

14. It should be noted that the contract in which this appears also provides equal termination rights for both parties in the event of material breach.<sup>13</sup> On the other hand, the other provision favoring the management company is in stark contrast to all of the other provisions discussed, in that its treatment is so significantly one-sided. This surprising provision gives to the management company the right to resign at any time, with no limitation upon what constitutes a proper cause for termination, yet withholds any right to termination from the government -- unless the management company goes into liquidation<sup>14</sup> -- for a period of twenty-five years, and even then requires:

... extraordinary resolution of the Company passed at an extraordinary general meeting specially convened for that purpose, of which not less than twelve (12) calendar months notice shall be given and at which persons holding or representing by proxy or power of attorney constituting not less than three-fourths of the issued share capital of the Company at the time and having voting rights, shall be present.<sup>15</sup>

B. Breach of Contract

15. Many of the contracts examined for this project provide for the termination of the contract in the event of a breach of contract by one of the parties.<sup>16</sup>

16. The basic form that such provisions takes requires that the party seeking to terminate the contract notify the breaching party of its intention from anywhere from thirty to ninety days before the termination may take effect and permits the termination only in the event that the defaulting party does not cure its default within the notice period. This is illustrated by the following provision, which gives either party the right to termination in the event of:

... the failure by either party to perform, keep, or fulfill any of the other covenants, undertakings, obligations or conditions set forth in this Agreement and the continuance of any such default for a period of thirty (30) days after notice of such failure.<sup>17</sup>

17. Slight variations of this basic form include the following: required notice with the opportunity to cure within a "reasonable time" a notice which must be given within thirty days of the defaulting party's non-fulfillment of an essential obligation, allowing the defaulting party sixty days to cure its default,<sup>19</sup> required notice, but with no specification of how far in advance of termination it must be given nor of whether the defaulting party has an opportunity to cure,<sup>20</sup> and; a minimum thirty day notice period with a mandatory meeting of the parties, to attempt to resolve their differences,<sup>21</sup> within which a defaulting party may cure its breach if:

... such breach or default is of a character requiring, under objective circumstances, longer than 60 days for correction, (and) the breaching party is then engaged in, and pursues to conclusion, the diligent correction of the breach or default. Upon interruption of diligent corrective efforts undertaken in the latter situation, this Agreement shall terminate.<sup>22</sup>

18. A more significant variation upon the general basic provision for termination for breach or default requires the party seeking termination to either submit

the dispute solely to arbitration<sup>23</sup> or to a competent judicial forum.<sup>24</sup> Two of the three provisions examined with such requirements allow for a period following an arbitral determination that there has been a breach of the contract such as to justify its termination in which the defaulting party may cure its breach, in the same fashion as the above provisions which give the breaching party an opportunity to cure within the required notice period.<sup>25</sup>

19. Finally, two of the termination clauses studied manifest an even more extreme divergence from the general treatment by such provisions of the right to terminate due to a breach of the agreement. Both of these explicitly note the right of only one party to terminate the contract due to the other party's material breach. In one case, the government has the right, in the event of a material breach (as well as in other specified events) to summarily cancel the agreement "by order or decree," with no similar provision for the management company's cancellation of the contract in the event of the government's breach.<sup>26</sup> The second provision conversely allows only the management company the right to terminate the contract for the government operating company's failure:

... to keep, observe or perform any material covenant, agreement, term or provision of this Agreement to be kept, observed or performed by (Operating Company) and such default shall continue for a period of 90 days after notice thereof by (Management Company) to (Operating Company.)<sup>27</sup>

20. It must be noted, however, that a separate provision in the latter contract does allow the operating company the right to terminate in the event of "gross mismanagement" by the management company, which is, in effect, a breach.<sup>28</sup>

C. Failure to Make Payments Due

21. Although a party's failure to make payment due under the contract may well constitute a breach of the contract, various termination and default clauses studied separately state that such a failure gives the non-failing party the



right to terminate the contract, with proper notice.<sup>29</sup> In the majority of these cases, the party to whom fees or payments are due is the management company, but two clauses address themselves to the case in which the management company is delinquent in making required payments to another party, depending upon the requirements of the individual clause.<sup>30</sup> A party must be anywhere from ten days<sup>31</sup> to sixty days<sup>32</sup> late in making its payments before the other party's right to give notice of its termination of the contract. In one case, this period starts to run from the time of notice of the failure to pay,<sup>33</sup> but in the cases which explicitly deal with this point, it starts to run from the date the payments are due.<sup>34</sup> Once this requirement is met, if the party to whom the payments are owed elects to terminate the agreement, it may -- depending upon the provisions of the individual contract operation -- take effect immediately,<sup>35</sup> or within fifteen<sup>36</sup> or sixty<sup>37</sup> days, unless the delinquent party cures its default by making the required payments within the notice period. One particular clause varies notably from the others in that it sets a maximum rather than a minimum time period from the notice to terminate to the actual termination.<sup>38</sup>

22. A provision similar to the above two termination clauses studied (both involving the same government) provide in identical language for the management company's termination of the contract:

If by reason of any legislation or act of the government of the (named state) or because of any action of (other party) or any third party, the remittance of any money payable hereunder shall be prohibited or withheld for a period of six months from the date upon which such money shall have been due for payment.<sup>39</sup>

23. This achieves the result of broadening the management company's right to terminate the contract upon its failure to receive monies owed, to include those cases in which the government party, in particular, might be able to

interfere with the remittance of the payments owed to the management company.

D. Force Majeure Clause

(1) Definition

24. Of the more than thirty Force Majeure clauses analyzed, only four contain a general mention of Force Majeure without an accompanying enumeration of specific causes of failure, delay, or default in a party's performance of its contractual obligations constituting Force Majeure.<sup>40</sup> One of these simply referred to "Force Majeure" with no attempt at defining it.<sup>41</sup> And two others refer generally to "Force Majeure or other circumstances beyond the control of the [party]."<sup>42</sup> The fourth while still somewhat general goes further by establishing several prerequisites for Force Majeure:

For the purpose of this Agreement a failure shall be regarded as caused by Force Majeure only if the Force Majeure is outside the reasonable control of the party failing and is not caused by that party's fault and if the party failing has taken all proper precautions, due care and reasonable alternative measures with the object avoiding<sup>43</sup> the failure and of carrying out its obligations hereunder.

25. By far the greater number of the Force Majeure clauses examined approach the definition of Force Majeure through the enumeration of specific events or actions constituting instances of Force Majeure.<sup>44</sup> Of the clauses thus enumerating instances of Force Majeure, however, only three purport to be complete, inclusive lists.<sup>45</sup> The majority of the other enumerative clauses make it clear that they provide non-exhaustive lists of examples of Force Majeure in either or both of two ways. First, many qualify their enumerations of instances of Force Majeure by prefacing them with language such as "including but not limited to."<sup>46</sup> Second, others include within their enumerations of Force Majeure open-ended provisions such as the following:

The term "Force Majeure ... shall mean ... any other circumstance or situation, whether similar or different, which is reasonably beyond the control of the party claiming Force Majeure."<sup>47</sup>

A variation of the above specifically excludes the failing party's own or its agent's negligence from this encompassing provision, stating:

... Force Majeure shall include ... any other extraordinary event which the parties could not reasonably be expected to prevent or control but shall not include any event caused by the negligence of the party claiming Force Majeure or of its agents.<sup>48</sup>

And an even more interesting variation incorporates the following into the definition of Force Majeure:

Occurrences recognized as such by the principles of International Law or by the Laws of Civilized Nations....<sup>49</sup>

With a slightly different approach, some non-exhaustive enumerative Force Majeure clauses identify all instances of Force Majeure as, e.g., "any event beyond the control of the affected party and which could not be foreseen by such party...."<sup>50</sup> One Force Majeure clause does not even use the term "Force Majeure" but simply refers to "circumstances outside [the party's] reasonable control."<sup>51</sup>

26. The enumerated events or actions constituting examples of Force Majeure in the clauses analyzed are quite broad, but fall generally into the following categories: (1) acts of God, public enemies, or nature, (2) war and civil disorder, (3) labor difficulties, (4) acts of governments, (5) shortages or difficulties in obtaining materials, equipment, or transportation, and (6) miscellaneous.

## 2. Invocation of Force Majeure Not Leading to Termination

27. All parties to the contract may invoke the majority of the Force Majeure clauses examined, although in a few cases only the management company party to the Agreement may invoke Force Majeure<sup>52</sup> (at least initially) and in two, only the government operating company may invoke it.<sup>53</sup>

28. The effect of invoking most of the Force Majeure clauses studied for this project is to absolve the party invoking it of liability for all failure or delay in performing its obligations under the contract.

29. The greater number of clauses achieve this effect through a provision that a party invoking Force Majeure is not liable for failures due to the Force Majeure. A typical example of this approach is the following:

Neither the Government nor, [Management Company] shall be liable for the consequences of any failure to perform or default in performing any of its obligations under this Agreement if the failure is caused by Force Majeure.<sup>54</sup>

Two similar clauses refer to "responsibility" rather than to "liability," but with the same import:

[Party] shall have no responsibility to the extent and for the period that its obligations under this Agreement are affected by a Force Majeure incident.<sup>55</sup>

30. The effect of the above clauses is to implicitly excuse the relevant party from liability for its involuntary breach or default as a result of Force Majeure. Another group of clauses achieves this same result explicitly, using language such as the following:

non-performance or delay in performance by (both parties) or either of them of any obligation under this Agreement shall be excused if and to the extent that such non-performance or delay is caused by Force Majeure.<sup>56</sup>

31. In more direct recognition of what is, in turn, implicit in the above provision, three clauses recognize that the excused performance may only be temporary by speaking of "suspended" rather than "excused" obligations.<sup>57</sup>

32. Interestingly, while holding the government operation company free from any liability due to delays or failures caused by Force Majeure, one clause at the same time specifically obligates the government company to pay the costs of

extra expenses incurred by the management company due to the delay or failure.<sup>58</sup> Similarly, in one other case, although it is exempted from liability during the period in which performance is delayed, the government party must continue to pay the management company its normal fees and reimbursable expenses for up to a year of this period following the Force Majeure.<sup>59</sup> These two clauses are unique in explicitly indicating the parties' agreement to such an allocation of the risk of a Force Majeure event to the government party.

33. Another group of the Force Majeure clauses examined provides that parties who would otherwise be deemed in default of their obligations under the contract will not be considered in default if their failure or delay is the result of Force Majeure. A typical provision taking this approach is the following:

No party to this Agreement shall be considered in default in performance of its obligations hereunder to the extent that performance of such obligations, or any of them, is delayed by Force Majeure.<sup>60</sup>

34. Less typical but clearly within the group of clauses providing for no default for failures or delays due to Force Majeure is:

The failure or omission [sic] of any party hereto to perform such obligation shall not be treated as a failure or omission to comply with the Agreement...<sup>61</sup>

35. Finally, another clause bluntly prohibits the non-failing party to either cancel the contract or make any claims against the party unable to perform its contractual obligations due to Force Majeure:

Failure on the part of either party hereto to comply with any provisions hereof shall not be grounds for cancellation or give the injured party any claim for damages insofar as such failure arises from Force Majeure.<sup>62</sup>

36. The difference between the last clauses providing for no "default" and those noted above providing for no liability is that the former establish that there is actually no default in the event of Force Majeure, while the latter recognize that a breach or default may exist but excuse either (or one) party from liability for it.

37. The practical result of both of these groups of clauses is identical, of course, as there is functionally no difference between a no-default situation and excused-default one, but the parties drafting the Force Majeure clause may find one approach or the other preferable for less tangible reasons.

### 3. Termination

38. Several of the Force Majeure clauses examined for this project provide for termination of the entire agreement at the option of either of the parties if performance remains impossible due to Force Majeure for some stated period. Two such clauses allow termination within three months.<sup>63</sup> One, if the failure extends beyond six months;<sup>64</sup> another if it extends beyond a year<sup>65</sup> and a fifth if the period exceeds four years.<sup>66</sup> As an interesting and practical variant of the above, another of the clauses examined gives more flexibility to the parties, though it does have a set time period as a prerequisite for examination, providing that if the Force Majeure:

is not with the reasonable control of (either party) and continues, or is likely to continue for a period of more than one year, then either party shall have the right to terminate this Agreement.<sup>67</sup>

39. One clause among those examined stands out in four important respects relating to termination which must have special mention. First, it is the only clause in which only the management company party may terminate the agreement, provided that it meets the notice requirements of the clause:

If force majeure or other circumstances beyond the control of the (Management Company) prevents performance of this contract, the (Management Company) may terminate this contract by giving the owner notice in writing thereof, such termination to take effect upon the expiration of sixty (60) days after such notice unless the preventing circumstances cease to exist prior to the expiration of such sixty day (60 day) period.<sup>68</sup>

40. Secondly, it is noteworthy that in this clause the notice itself starts the clock running for the requisite period during which the effects of the Force Majeure must continue to make performance impossible before the contract may be terminated. This unique provision allows the government party with the

power to terminate the contract even greater flexibility than from the provision noted above that allows termination after the effects of the Force Majeure have either continued for a year or appear likely to do so.<sup>69</sup>

41. Third, although many Force Majeure clauses examined limit their applicability to the extent that the Force Majeure has made performance impossible, only this clause specifically distinguishes between a Force Majeure making performance of the contract completely impossible, therefore necessitating a provision for termination of this contract, and one only partially preventing performance:

... In the event that the force majeure or other circumstances beyond the control of the (Management Company) shall only partially prevent the (Management Company) from performing its obligations under this contract, it shall ... thereupon be excused from performance to the extent to prevented.<sup>70</sup>

42. Finally, it explicitly recognizes that the management company does not waive, "the fees and reimbursable costs incurred, up to and including the date of cancellation."<sup>71</sup>

43. Another clause examined also wants special note with regard to its treatment of termination of the contract following Force Majeure. Although this clause is similar to that just discussed in that it -- at least initially -- allows one party the right to terminate the contract, it is also the direct opposite, because this one party is the government company rather than the management company party.

44. It also differs from all the other clauses examined in that it distinguishes between Force Majeure incidents occurring prior to the date of plant operation and those occurring after this date.

45. Prior to the date of operation, the government company's right to terminate the agreement only arises after the delay caused by Force Majeure has lasted

for six months, but, uniquely termination is automatic after another six months of such delay. After the date of operation, in contrast, the government company's right to terminate the agreement arises immediately upon the occurrence of a Force Majeure incident, and the management company also obtains the right to terminate, albeit only after the necessity of a nine-month waiting period in which the force majeure delay must continue. Finally, the provisions in this unusual Force Majeure clause, among those studied for payments under Force Majeure terminations, are unusually detailed. Because of its unique approach to Force Majeure terminations, the relevant portion of this clause is here set forth in its entirety:

If prior to the Date of Operation any force Majeure incident prevents the continuation of the project and such incident continues in effect for a period of six months, then (Management Company) alone may upon notice to (Government Company) terminate this agreement. If such notice is not given by (Management Company) within 12 months from the commencement of such incident and if such incident continues to be in effect, this agreement shall be terminated effective at the expiration of such 12-month period. Upon any such termination, (Management Company) shall pay to (Government Company) within 30 days after such termination (i) all amounts then due and unpaid under this Agreement, (ii) all Termination Costs, and (iii) an amount in U.S. dollars equal to the aggregate of the fee that would otherwise have been payable to (Government Company) under this Agreement during the three-month period subsequent to the date of termination. If after the Date of Operation any force majeure incident prevents the continuation of the Project, then (Management Company) may at any time upon notice to (Government Company) terminate this agreement. If such notice is not given by (Management Company) within nine months from the commencement of such incident continues to be in effect, this agreement may thereafter also be terminated by (Government Company) upon notice to (Management Company). Upon any such termination by (Management Company) or (Government Company), as the case may be, (Management Company) shall pay to (Government Company) within 30 days after such termination (i) all amounts then due and unpaid under this agreement, and (ii) all Terminated Cost."<sup>72</sup>



E. Destruction, Damage or Condemnation

46. Three contracts provide for termination of the agreement in the event of damage to or destruction of something crucial to the performance of the contract. They all only allow termination by the party not responsible for repairing or replacing the damaged or destroyed item or facility, only after the responsible party has failed to undertake the necessary repair or replacement within ninety days.<sup>73</sup> In addition, one of these contract provisions also allows the party responsible for the repair or replacement the option of terminating the contract within ninety days of the event curing the damage or destruction, if "the cost of repairing, restoring, rebuilding and replacing the same shall exceed one hundred and twenty (120%) percent of the proceeds of the insurance collectable by (the responsible party)."<sup>74</sup>

47. The four contracts treating the issue of termination in the event of condemnation all relate to the management of hotels. These identically provide for the contract's termination immediately upon the condemnation or eminent domain of the hotel, with any award "fairly and equitably apportioned" between the parties. This treatment also applies if, in the judgment of the management company, the extent of the condemnation or eminent domain is such as to preclude using "the remaining portion as a hotel of type and class immediately preceding such taking or condemnation."<sup>75</sup>

F. Liquidation or Bankruptcy

48. A fair number of the contracts examined contain explicit provision for the termination of the contract in the event that one of the parties goes into liquidation or files for bankruptcy or otherwise demonstrates a lack of financial solvency. An example of such a provision is as follows:

If either of the parties to this agreement shall admit in writing its inability to pay its debts as they become due, or shall file a voluntary position in bankruptcy, or shall be adjudicated bankrupt or insolvent, or shall take any action or acquiesce in any action looking toward

its liquidation, dissolution or similar relief, then this agreement may be terminated at the option of the other party which option may be exercised by the giving of notice in accordance with the terms of section 21.5 of this agreement.<sup>76</sup>

#### G. Miscellaneous Causes for Termination

49. Various of the contracts examined provide for termination of the contract in such assorted cases as the following: incapacity or death of a party,<sup>77</sup> the making of materially false statements by one party to another,<sup>78</sup> sale, assignment, or abandonment of items or facilities necessary to perform the contract,<sup>79</sup> expropriation or nationalization, or effective deprivation by governmental action of operative power and benefits under the agreement,<sup>80</sup> governmental obstruction of performance of the contract for more than 6 months,<sup>81</sup> gross mismanagement or management below previous standards by the management company,<sup>82</sup> the failure of a party to maintain a minimum number of shares or a minimum bank balance or certain loans in good standing,<sup>83</sup> the operating company's revenue does not cover specified expenses for a specified period,<sup>84</sup> the operating company fails to follow the advice of the management company,<sup>85</sup> the management company intentionally extracts materials not authorized under the agreement,<sup>86</sup> the government requests the removal of more than a specified percentage of management company's employees in various categories,<sup>87</sup> and failure of successful renegotiation as provided under the contract.<sup>88</sup>

#### Effects of Termination

50. The effects, or results, of contract termination explicitly dealt with in the contracts examined for this study are as follows: (1) payments following termination, (2) the right to claim damages following termination, (3) continuing operation of the project. Each of these is discussed below.

A. Payments Following Termination

51. About a fourth of the contracts examined for the section of the project explicitly provide for some form of payments following the termination of the contract. These provide for one or more of the following categories of such payments: (1) termination costs, (2) liquidated damages, and (3) outstanding amounts owed to under the contract and (4) special.

52. Many contracts examined provide for the payment of any outstanding amounts under the contract upon its termination, most providing, e.g.:

Any termination of the engineer's appointment under this agreement shall not prejudice or affect the accrued rights or claims of either party to this agreement.<sup>89</sup>

53. In addition, a few express the same requirement more affirmatively, directing the payment following termination of the contract of "all amounts then due and unpaid"<sup>90</sup> under it.

54. Similarly, termination clauses may provide for one party's payment to another of monies to reimburse it for such things as "supplies and services with respect to which the (Party) has committed itself for fulfilling this Contract up to the date of termination."<sup>91</sup> One instance of this sort of provision deals with crops that have not yet been harvested at the time of the contract termination:

It is understood that (Management Company) will be reimbursed and compensated by the Project Company with respect to any growing crops and production in process ... the compensation will be based on the net profit of the project company as realized at the end of the fiscal year in which the termination takes place and prorated to the time (Management Company's) management responsibilities end pursuant to such termination; provided, however, that in the case of long-term crops such as trees and vines where marketable products will take a period of years to produce, the parties may enter into a separate agreement concerning the compensation payable to (Management Company) in the event of termination.<sup>92</sup>

55. One contract which requires the government party to pay all of the management company's termination cost, regardless of which party instituted the termination, and defines these costs is:

... any cost to (Management Company) related exclusively to termination of this agreement that would not have been incurred by (Management Company) except for such termination, unless any such cost is specifically excluded by this agreement. <sup>93</sup>

56. Another similarly provides for the reimbursement by the Project company to the management company of all reasonable termination costs, adding that these include costs for repatriation of the personnel of management company, with their personal belongings.<sup>94</sup> In contrast, the third contract explicitly providing for termination costs, provides only for those termination costs required for repatriation of the management company's personnel.<sup>95</sup>

57. An equal number of contracts examined manifest the parties' agreement upon a set sum for liquidated damages or termination fee to be paid by the party whose improper or defaulting performance lead to the termination by the other party.

58. One simply states the sum the parties have agreed upon as liquidated damages,<sup>96</sup> but the others provide for monthly installment payments and an exemption if the termination occurs within less than a stated period following the date of the commencement of the contract.<sup>97</sup>

B. The Right to Claim Damages Following Termination

59. Many of the contracts examined contain provisions safeguarding the parties' right to claim damages against one another following the termination of the contract.<sup>98</sup> One such provision states:

Termination of this agreement under this clause shall not affect (a) the affected party's rights to obtain monetary damages for the same breach.<sup>99</sup>

60. The statute of limitation of the applicable governing law of the contract of course places a limit upon the time in which the parties may bring claims

for damages against one another in each case, but one contract contains a provision requiring parties to submit all claims to one another within sixty days of learning of the facts giving rise to the claim, whether before or after contract termination.<sup>100</sup> This provision does allow both parties greater security against the possibility of longstanding potential claims suddenly being made, but also requires rapid and final decisions within an overall context that may change greatly.

C. Miscellaneous Effects

61. A handful of the contracts examined explicitly provide for the government or its company to take over operations previously performed by the management company, following the termination of the contract, using nearly identical language in all but one case:

Upon termination of this contract, the enterprise shall take over all operations of the mill, and the management company shall be relieved of any further responsibility under this contract, except for acts or omissions prior to such termination.<sup>101</sup>

62. In addition, one contract provides specifically for the treatment of the parties' share in the operating company upon termination of the contract<sup>102</sup> and another deals with the delivery and/or retention by the government operating company of documents and information relating to proprietary technology belonging to the management company.<sup>103</sup>

Assignment of Responsibility

A. Neither Party May Assign Without Prior Written Consent of the Other Party

63. More than half of all the management service contracts under study employ the above form of assignment. For example:

Neither the Owner nor the Manager shall assign or delegate or otherwise transfer its rights or obligations under this Agreement or any part thereof

to any other airline, agency, person, or organization without the prior written consent of the other party.<sup>104</sup>

The types of contracts which rely on this form are generally in the developmental and operational categories (steel production,<sup>105</sup> smelting,<sup>106</sup> pulp and paper production,<sup>107</sup> fertilizer production,<sup>108</sup> bulk cement terminal construction,<sup>109</sup> and sugar refining).<sup>110</sup> However, contracts dealing with technical and marketing advice, such as airline operations<sup>111</sup> and mineral marketing,<sup>112</sup> also use this form.

64. The advantages of requiring prior written consent of the other party are readily discernible. Consent of the other party equalizes the relative bargaining positions of the Manager and Owner. A consent requirement increases the amount of negotiation and participation by both parties. Increased negotiation creates more flexibility in the process because of greater participation. Each feeds on the other in a circular fashion. Flexibility benefits the Manager. Assignability allows a profit on the sale of the assignment to another company or subsidiary, the ability (often) to release itself from the bargain, and the ability to change its policy toward that industry quickly. For the Owner, a consent requirement assures it of effective participation in case of assignment. Although consent may be nominal due to a possible weakness in the Owner's bargaining power, the Owner's consent is required before assignment is effective. The following illustrates the weakness in the Owner's bargaining position. The Owner has an on-going operation recently established, a labor force, raw materials at its disposal, and leases to equipment owned by the management company. The Manager has the expertise and access to capital of which the operation has immediate need. If the management company requests consent to assign its service contract in exchange for speedy loan processing, the Owner will

justifiably feel its consent was coerced.

B. Management May Only Assign to a Subsidiary, Affiliate, or Controlled Corporation (With Notice, Without Notice)

65. Assignment only to a subsidiary or affiliate is an exception to the clause requiring prior written consent. As an illustration,

The Manager shall have the right ... to assign this Agreement ... to any subsidiary or affiliate ... except as herein provided. The Manager shall not assign this Agreement ... without the prior written consent of the first party.<sup>113</sup>

Nearly one-third of the management service contracts under study employ this exception. Notably, hotel management contracts, which operate as a franchise, include this clause. Marketing and technical service contracts comprise the bulk of contracts in this category.

66. This exception creates advantages for both Manager and Owner. The management company may shift business to a growing subsidiary and thereby shift income. Its overall operations are thus made more financially independent. Meanwhile, the parent maintains its reputation and it enhances the subsidiary's position by granting it a profitable contract. Likewise, the Owner has the opportunity to be managed by a company with a fresh approach to its operation. A second management company could give the Owner a basis of comparison and enable it to assess its business more objectively.

67. Ease is the main disadvantage of the exception from the Owner's point of view. The management company need merely give notice of its intent to assign. (Sometimes notice is not required.) A change in management and/or policy causes discontinuity, possible production setbacks and low morale among its staff. Though any assignment can cause discontinuity, the disadvantages in this clause stem from the low notice requirement and sole discretionary feature. The fact that the Owner has no recourse but to take a different bargain than

negotiated is a second disadvantage. The Owner has no guarantee that the subsidiary or affiliate has comparable ability, resources, prestige, reliability, standards, or contacts. The management company must make decisions with its best interests in mind, but it does not foreclose the responsibility of acting for the Owner's interests, too.

C. No Assignment Except with Written Consent Provided That Manager Will Remain Liable

68. Approximately one-fourth of the contracts require continued liability from the management company even after assignment. Generally, such clauses further qualify the prior written requirement, as in this example from a hotel management services contract:

The Manager shall have the right to assign without consent ... to any subsidiary or affiliate ... provided ... that the Manager shall continue to be liable under this Agreement to the same extent as though such assignment had not been made.<sup>114</sup>

The type of contracts which include such a clause fall into no recognizable pattern.

69. The main advantage of this provision inures to the Owner. The Owner is assured of two things from the Manager: that it is bound to uphold the original bargain and that it made a threshold judgment that its assignee's service will be of comparable quality. Moreover, continued liability enables the Owner recourse against the original party with whom it struck its bargain. This feature will allow a tribunal to find the intent of the original parties. While the same intent passes to the assignee theoretically, in practical terms, language and cultural barriers may render the words of the contract a mere recital of mutually misunderstood promises.

70. Continued liability from the Manager's viewpoint is undesirable. After assignment, it has no control or input regarding policy choices or daily plant



operations, yet it needs rights to an information flow as well as copies of assignee's report (if negotiated in the assignment agreement). Unfortunately, it probably has no binding authority over any matter. The original management company has an incentive to maintain an interest in the assigned work due to its continued liability, yet it has no right to impose its views on assignee's advice to the Owner.

D. Operation of Law: Assignment Only by Operation of Law

71. In the group of management service contracts under study, there was only a single example of the above type of clause. As shown, the clause contemplates no possibility of assignment outside of governmental intervention:

The Manager shall not have the right to sell, transfer, assign, mortgage or pledge its interest in this Agreement in whole or in part, except by operation of law.<sup>115</sup>

The operation of law type of assignment clause appears in a bauxite mining venture.<sup>116</sup>

72. The advantages allowing operation of law to determine an assignment are twofold. First, the assignment is automatic. Automaticity eliminates the possibility of one party dominating the assignment process. And second, by conforming to local laws (probably recently established and directed at the type of relationship management company and the Owner have), cultural and political tensions will be eased and goodwill cultivated. In the case of mining, developing countries are increasingly concerned with maintaining full control and sovereignty over their natural resources.

73. By contrast, the disadvantages of allowing operation of law to determine assignment are clear and convincing. Ideally, only the Owner and the Manager (the parties) should control the terms and conditions of assignment. The wishes of an outsider or third party should be immaterial. In addition, operation of

law may be based to some extent on political and policy changes which could disrupt the continuity and profitability of an on-going enterprise. Management service contracts in mining, as in the instant case, depend on long-range planning, remote sensing, forecasting, and therefore require a typically long-run arrangement of ten or more years.

E. Silent - By Design or Omission

74. Rarely does a contract bypass any mention of assignment by silence. Among the contracts under study, one omits assignment either by design or mistake. The contract concerns textile technology.<sup>117</sup>

76. The main advantage gained by making no mention of assignment is the opportunity for renegotiation. Because neither party expresses its intent regarding assignment, the resulting ambiguity is an area ripe for definition. This ambiguity is neither an advantage or disadvantage per se. It depends on the Owner's current bargaining position vis-a-vis the Manager. Silence can work to the disadvantage of both parties. If neither had any intent regarding assignment, a tribunal -- a third party -- would decide the issue based upon what is reasonable. Furthermore, if assignment, or any clause is omitted from a contract, the dominance of one company over the other as well as extraneous matter, such as political climate, would have an overriding role in the outcome at renegotiation time.

FOOTNOTES

1. Contract 8, Paragraph 14; Contract 13, Article VIII; Contract 14, Article VIII; Contract 16, Article IX; Contract 27, Article VI; Contract 28, cl. XXII; Contract 29, Paragraph 2; Contract 35, Article IX; Contract 36, Paragraph 13.
2. Contract 13, Article VIII; Contract 14, Article VIII; Contract 29, Paragraph 2; Contract 35, Article IX.
3. Contract 36, Paragraph 13.
4. Contract 27, Article VI.
5. Contract 8, Paragraph 14.
6. Contract 16, Article IX.
7. Contract 14, Article VIII; Contract 27, Article VI.
8. Contract 28, cl. XXII.
9. Contract 27, Article VI, emphasis added.
10. Contract 1, Article 18.
11. Contract 25, Paragraph 14.05.
12. Contract 7, Sec. XIII.
13. Id.
14. Contract 24, Paragraph (12).
15. Id., Paragraph (2).
16. Contract 2, Article XII; Contract 3, Article II; Contract 5, Article IX; Contract 6, Article IX; Contract 7, Sec. XIII; Contract 9, Article XIX; Contract 11, Article 29; Contract 22, cl. 28; Contract 23, Paragraph 6; Contract 25, Paragraph 9; Contract 28, cl. XXII; Contract 29, Paragraph 11; Contract 32, Article X; Contract 33, Paragraph 6.3; Contract 36, Paragraph 13.
17. Contract 2, Article XII; see also Contract 3, Article II; Contract 6, Article IX.
18. Contract 32, Article X.
19. Contract 28, cl. XXII.
20. Contract 20, Article II.

21. Contract 33, Paragraph 6.3.
22. Contract 22, cl. 28; see also Contract 23, Paragraph 6.
23. Contract 23, Paragraph 6; Contract 25, Paragraph 9.
24. Contract 7, Sec. XIII.
25. Contract 23, Paragraph 6; Contract 25, Paragraph 9.
26. Contract 9, Article XIX.
27. Contract 5, Article IX.
28. Id.
29. Contract 1, Article 18; Contract 2, Article XII; Contract 5, Article IX; Contract 11, Article 29; Contract 25, Paragraph 9; Contract 28, cl. XXII; Contract 34, Paragraph (e).
30. Contract 1, Article 18; Contract 2, Article XII.
31. Contract 34, Paragraph (e).
32. Contract 1, Article 18.
33. Contract 25, Paragraph 9.
34. Contract 2, Article XII; Contract 5, Article IX; Contract 11, Article 29; Contract 19, Sec. 5.05; Contract 28, cl. XXII; Contract 34, Paragraph (e).
35. Contract 28, cl. XXII.
36. Contract 2, Article XII.
37. Contract 1, Article 18; Contract 5, Article IX.
38. Contract 34, Paragraph (e).
39. Contract 1, Article 18; Contract 15, Article 21.
40. Contract 19, Sec. 5.03; Contract 21, Paragraph 19; Contract 31, Paragraph 8.02; Contract 35, Paragraph C.
41. Contract 21, Paragraph 54.
42. Contract 31, Paragraph 8.02; see also, Contract 35, Paragraph C.
43. Contract 19, Sec. 5.03.
44. Contract 1, Article 19; Contract 5, Article X, Contract 8, Paragraph 1.11; Contract 9, Article XX; Contract 10, Article XI; Contract 12, Article VII; Contract 14, Paragraph 8.02; Contract 15, Article 22; Contract 16, Paragraph B; Contract 17, Paragraph 13; Contract 18, Article 11; Contract 20, Article XIX; Contract 22, cl. 25; Contract 25, Paragraph 2.06; Contract 26, Para-

- graph H; Contract 27, Paragraph (8); Contract 28, cl. XXI; Contract 33, Paragraph 6.02; Contract 36, Paragraph (F).
45. Contract 1, Article 19; Contract 15, Article 22; Contract 33, Paragraph 6.2.
  46. Contract 16, Paragraph B and Contract 30. Paragraph 13; see also, Contract 1, Article 19; Contract 8, Paragraph 1.11; Contract 15, Article 22; Contract 17, Paragraph 13; Contract 20, Article XIX; Contract 22, cl. 25; Contract 25, Paragraph 2.06; Contract 27, Paragraph (8); Contract 28, cl. XXI; Contract 32, Paragraph 9.2; compare Contract 5, Article X.
  47. Contract 18, Article 11; see also, Contract 1, Article 19; Contract 5, Article X; Contract 8, Paragraph 1.11; Contract 9, Article XX; Contract 12, Article VII; Contract 14, Paragraph 8.02; Contract 15, Article 22; Contract 16, Paragraph B; Contract 17, Paragraph 13; Contract 18, Article 11; Contract 20, Article XIX; Contract 25, Paragraph 2.06.
  48. Contract 32, Paragraph 9.2; see also, Contract 5, Article X; Contract 8, Paragraph 1.11; Contract 19, Sec. 5.03.
  49. Contract 12, Article VII.
  50. Contract 18, Article 11; see also, Contract 1, Article 19, Contract 8, Paragraph 1.11; Contract 15, Article 22; Contract 22, cl. 25; Contract 24; Contract 26, Paragraph H; Contract 27, Paragraph (8); Contract 30, Paragraph 13; Contract 36, Paragraph (F).
  51. Contract 28, cl. XXI.
  52. Contract 5, Article X; Contract 14, Paragraph 8.02; Contract 31, Paragraph 8.02; Contract 33, Paragraph 6.2.
  53. Contract 25, Paragraph 2.06; Contract 35, Paragraph (C).
  54. Contract 21, Paragraph 54; see also, Contract 1, Article 19; Contract 5, Article X; Contract 15, Article 22; Contract 17, Paragraph 13; Contract 19, Sec. 5.03; Contract 21; Contract 24; Contract 35, Paragraph C.
  55. Contract 25, Paragraph 2.06; see also, Contract 28, cl. XXI.
  56. Contract 9, Article XX; see also, Contract 14, Paragraph 8.02; Contract 20, Article XIX; Contract 30, Paragraph 13; Contract 31, Paragraph 8.02.
  57. Contract 10, Article VII; Contract 16, Paragraph B; Contract 18, Article 11; see also, Contract 1, Article 19; Contract 15, Article 22.
  58. Contract 35, Paragraph C.
  59. Contract 5, Article X.

60. Contract 8, Paragraph 17; see also, Contract 22, cl. 25; Contract 26, Paragraph H; Contract 27, Paragraph (8); Contract 33, Paragraph 6.2; Contract 36, Paragraph (F).
61. Contract 12, Article VII; see also, Contract 25, Paragraph 2.06; Contract 28, cl. XXI.
62. Contract 32, Paragraph 9.2.
63. Contract 16, Paragraph B; Contract 28, cl. XXI.
64. Contract 33, Paragraph 6.2.
65. Contract 17, Paragraph 13.
66. Contract 32, Paragraph 9.2.
67. Contract 5, Article X, emphasis added.
68. Contract 14, Paragraph 8.02; Contract 31, Article VIII.
69. See text accompanying footnote 67; see e.g., Contract 8, Paragraph 17; Contract 9, Article XX; Contract 25, Paragraph 2.06.
70. Contract 14, Paragraph 8.02; Contract 31, Article VIII.
71. Id.
72. Contract 25, Paragraph 9.
73. Contract 3, Article 11; Contract 5, Article IX; Contract 6, Article IX.
74. Contract 3, Article 8.
75. Contract 2, Article X; Contract 3, Article 9; Contract 6, Article X; Contract 11, Article 28.
76. Contract 8, Paragraph 15.1; see also, Contract 2, Article XII; Contract 3, Article 11; Contract 5, Article IX; Contract 6, Article IX; Contract 11, Article 29; Contract 24, Paragraph (12); Contract 30, Paragraph 12; Contract 32, Article X.
77. Contract 23, Paragraph 6; Contract 29, Paragraph 11.
78. Contract 9; Contract 32, Article X.
79. Contract 2, Article XII; Contract 5, Article IX; Contract 6, Article IX; Contract 9, Article XIX.
80. Contract 5, Article IX; Contract 6, Article IX.

81. Contract 13, Article VIII; Contract 27, Article VI.
82. Contract 5, Article IX; Contract 27, Article VI.
83. See, Contract 3, Article 11; Contract 15, Article 21; Contract 19, Sec. 5.05; Contract 27, Article VI.
84. Contract 6, Article IX.
85. Contract 9, Article XIX.
86. Contract 25, Paragraph 9; Contract 27, Article VI.
87. Contract 9, XIX.
88. Contract 28, cl. XXII.
89. Contract 36, Paragraph 13.
90. Contract 29, Paragraph; see also, Contract 3, Article 11; Contract 5, Article IX; Contract 6, Article IX; Contract 22, cl. 28; Contract 25, Paragraph 9; Contract 28, cl. XXII; Contract 33, Paragraph 6.4; Contract 34, Paragraph (e).
91. Contract 25, Paragraph; see also, Contract 28, cl. XXII.
92. Contract 13, Article IV; see also, Contract 35, Article IX.
93. Contract 8, Paragraph 15.
94. Contract 25, Paragraph 9.
95. Contract 8, Paragraph 15; see also, Contract 33, Paragraph 6.4.
96. Contract 4, Paragraph 11.
97. Contract 5, Article IX.
98. Contract 13, Article IV; Contract 35, Article V.
99. Contract 2, Article XIII; Contract 3, Article 11; Contract 11, Article 29; Contract 13, Article VIII; Contract 16, Article IX; Contract 22, cl. 28; Contract 35, Article IX; see also Contract 5, Article IX; Contract 6, Article IX; Contract 28, cl. XXII; Contract 29, Paragraph 11.
100. Contract 22, cl. 28.
101. Contract 8, Paragraph 15.
102. Contract 35, Article IV; see also, Contract 13, Article VIII; Contract 14, Article VIII; Contract 16, Article IX; Contract 31, Article VIII; Contrast with Contract 8, Paragraph 15.

103. Contract 32, Article X.
104. Contract 4, Article XII.
105. Contract 28, cl. 26.
106. Contract 15, Article 27.
107. Contract 16, Article X.B.
108. Contract 12, Article IX.
109. Contract 17, Sec. 11.
110. Contract 14, Article IX, 9.03.
111. Contract 5, Article XII.
112. Contract 26, Section 11.C.
113. Contract 2, Article XVI, 1; see also, Contract 3, Article 19; Contract 6 Article XIII.
114. Id.
115. Contract 10, Article XII, 12.01.
116. Id.
117. Contract 34.



## XII.

### PROVISIONS RELATING TO

### DISPUTE RESOLUTION

#### Overview

1. Unless the parties to a contract specify otherwise in their agreement, the resolution of any disputes arising under, or in connection with, the contract must be through litigation in the proper judicial forum under the governing law of the contract. For **several** reasons, a large and growing number of parties to international commercial contracts do exercise their right to provide for arbitration to settle disputes arising under their contracts. The fact that only two of more than thirty management contracts available for examination in connection with this study did not provide for arbitration, illustrates this preference for arbitration as a method of dispute resolution.<sup>1</sup>
2. In spite of the wide use of arbitration clauses, the superiority of arbitration over judicial dispute resolution is not completely clear-cut, and parties considering arbitration should also be aware of at least one significant disadvantage in this choice -- the lack of mandatory enforcement mechanisms in the arbitration process. Enforcement of the arbitrators' interim rulings may well entail a separate suit of law. The effect of this would be to add to both the expense and complexity, as well as to the length, of the arbitration. Thus, the consensual and autonomous nature of arbitration which, in some contexts, provides advantages over judicial means of dispute resolution, may be a disadvantage in others. In addition, although the existence of two major international conventions,<sup>2</sup> as well as of numerous other international agreements and bilateral treaties, simplifies arbitration, there might be a further potential difficulty of obtaining recognition and enforcement of the award,

as this also requires a separate action at law, often in a jurisdiction other than that in which arbitration took place.

#### Agreements Designating Institutional Rules

##### A. Institutions

3. Institutions involved in the settlement of arbitration disputes include the following: the International Chamber of Commerce (ICC), the International Centre for the Settlement of Investment Disputes (ICSID), the Inter-American Commercial Arbitration Commission (IACAC), and the Stockholm Chamber of Commerce. Each of these institutions offers not only a forum for the settlement of disputes by means of arbitration, but also a complete and detailed set of procedures that may govern the proceedings. Of the representational sampling of arbitration clauses compared and analyzed for the purposes of this report, well over half designate the arbitral procedural rules of the ICC as governing any resulting arbitration proceedings.<sup>3</sup> In addition, two designate ICSID,<sup>4</sup> a third designates IACAC,<sup>5</sup> and a fourth designates the AAA.<sup>6</sup>

##### B. Incorporation of Institutional Rules

4. Although the clear preponderance of institutional arbitral clauses among those studied indicates the recognition on the part of many drafters or arbitral agreements of the value of arbitral institutions, it is worthy of note that only four do no more than incorporate the institutional rules by reference, as in the following example:

If any dispute or difference shall arise out of this Agreement, the parties shall endeavour to settle it amicably otherwise the matter shall be resolved under the rules of conciliation and arbitration of the International Chamber of Commerce.<sup>7</sup>

5. By far the greater number of the arbitral clauses examined which provide that any arbitration proceeding under them is to be governed by the rules of a specified arbitral institution actually combine with such a direct incorporation

by reference of institutional rules one or more of the following: (1) repetition of a provision or provisions in the institutional rules themselves, (2) the parties' exercise of various elections within the context of the institutional rules, and (3) specified variations from or additions to the institutional rules (see below).

1. Repetitions of the Institutional Rules

6. Instances of provisions in those arbitral clauses which explicitly repeat institutional rules include most notably: two requiring the arbitrators to decide according to law,<sup>8</sup> one directing that the arbitration costs be allocated by the arbitrators,<sup>9</sup> and another providing both that the arbitrators' decision must be by a majority of the tribunal and that default awards, with proper notice, are proper.<sup>10</sup>

2. Elections within the Context of the Institutional Rules

7. The parties to an agreement for arbitration within an institutional framework have the option of elections with regard to such factors as the number of arbitrators and the place, language, and governing law of the arbitration. In nearly all of the institutional clauses examined, the parties exercise some of these elections, but these elections are generally quite straightforward and do not merit particular mention.

8. A smaller number of the clauses, however, do demonstrate an interesting approach to the parties' election to select the place of arbitration. Under the approach in these clauses, the parties provide in the arbitration agreement that they will jointly agree on the place of arbitration at the time of the actual arbitration, but also designate a back-up situs in the agreement to be used in the event that they cannot agree upon the place of arbitration when the dispute arises:

The place of arbitration shall be such as may be agreed upon by the persons participating in the arbitration,

and in default of agreement shall be in Geneva in the Federal Republic of Switzerland.<sup>11</sup>

3. Variations from or Additions to Institutional Rules

9. The largest single area in which clauses examined demonstrate variances from the institutional rules expressly made applicable is the selection of arbitrators. This area is dealt within a separate section (see below), both because of its significance and because of the similarity of the treatment of this subject in both institutional and non-institutional arbitration clauses.

10. Three of the ICC arbitration clauses examined provide for ICC successor bodies to hold the same position with regard to any arbitration between the parties as the ICC would have. These clauses all use the following, identical language:

Should the International Chamber of Commerce be replaced by, or its functions substantially devolve upon or be transferred to any new international body of similar type and competence, the function of the Court of Arbitration of the International Chamber of Commerce provided by this Article shall be exercisable by the chief officer of such new international body without further agreement between the parties hereto.<sup>12</sup>

Interestingly, an IACAC arbitration clause expresses almost the opposite concern to that seen in the above provision, by specifying that arbitration under it is to be governed by the IACAC rules:

in effect on the date of execution of the Agreement unless the parties expressly agree to apply such Rules of Procedure of the Commission (IACAC) as may be in effect at the time of arbitration.<sup>13</sup>

11. Paralleling provisions that set time limits on the selection of arbitrators (see section below), the same IACAC clause quoted immediately above establishes a thirty day limit within which the arbitrators must agree upon the place of arbitration or have this decision taken from them to be made instead by the institution itself.<sup>14</sup> Similarly, although the ICC rules do provide that the arbitrators must make their award within six months of the signing of the terms

of reference, subject to extensions,<sup>15</sup> one ICC clause examined shortens this period considerably by providing that the arbitral panel must render its decision within four months of the designation of the third arbitrator, a time that may well be significantly earlier than the signing of the terms of reference.<sup>16</sup>

12. Finally, one unique clause examined sets up a two tier set of directions for arbitration. The first section of the single paragraph that constitutes this entire clause simply requires that any controversy arising between the parties concerning the contract be submitted for arbitration to ICSID. But then, the second portion of the clause goes on to provide for ad hoc arbitration (see section below) in the event that:

the Government is not a subscriber to the Convention [a prerequisite for ICSID arbitration] at such time necessary as aforesaid...<sup>17</sup>

#### C. Gaps in the Institutional Rules

13. Institutional arbitral rules often specify the governing law to be followed when their rules are silent with regard to a particular issue. The ICC provides that, in such a case, the rules the parties agree to will apply, with the further proviso that should the parties fail to agree, any rules the arbitrators agree to will apply, and finally, if the arbitrators also fail to agree, that the municipal governing law will apply.<sup>18</sup> ICSID applies a similar rule, but without providing for the parties' agreement on their own,<sup>19</sup> while both IACAC and the AAA defer more to the law of the place of arbitration, as seen by implication in their respective rules.<sup>20</sup>

#### Agreements Designating Non-Institutional International, Regional, or National Rules

14. In addition to institutions actually involved in the settlement of disputes through arbitration, various bodies have promulgated rules appertaining to arbitra-

tion which the parties to an agreement may refer to. Such bodies may be international, regional, or national.

15. The only present international non-institutional set of rules applicable to arbitration is that promulgated by the United Nations -- the UNICITRAL Arbitration Rules. None of the clauses examined makes reference to this set of rules.

16. Sets of arbitration rules have also been promulgated by various regional organizations, including the Economic Commission for Europe, the United Nations Economic Commission on Asia and the Pacific, the European Convention on International Commercial Arbitration of 1966, the Council of Europe, and the Council for Mutual Economic Assistance. Only the first of these, the Economic Commission for Europe, appears in a clause examined in connection with this study.<sup>21</sup> This clause is particularly noteworthy in that it states that any disputes arising out of the parties' agreement:

shall be settled exclusively by arbitration in accordance with the arbitration rules then obtaining.<sup>22</sup>

17. This is the only arbitration clause of all those studied that provides for arbitration as an exclusive means of dispute resolution; the significance of this arises from the fact that, absent such an explicit provision, even an affirmative statement of the parties' intent to submit all disputes to arbitration will not bar them from also, or alternatively, seeking judicial resolution of their dispute.<sup>23</sup>

18. Many states have, of course, laws governing arbitration within their jurisdictions, and the parties to an arbitral agreement may well elect that these laws should govern it, particularly if the country is their elected situs for the arbitration. Two of the clauses examined incorporate the Indian Arbitration Act as their governing procedural law,<sup>24</sup> and a third incorporates the Arbitration Act of 1950 of the United Kingdom.<sup>25</sup>

19. All of the clauses noted above as falling into the category of arbitral clauses referring to non-institutional but already existing bodies of rules also include the parties' explicit agreement to some ad hoc (as defined in the section immediately following) rules, such as with regard to the selection of the arbitrators. In addition, two of these clauses designate arbitral institutions as alternate selectors of arbitrators, thereby combining all three categories of arbitral agreements.<sup>26</sup>

Agreements Designating the Parties' Own Ad Hoc Rules

20. Four of the clauses examined for this study demonstrate the parties' formulation and explicit adoption of their own ad hoc arbitral rules.<sup>27</sup> Each of these clauses specifies explicitly the scope of the agreement, the number of arbitrators and procedures by which they are to be selected, and the final or binding effect upon the parties of any arbitration under the arbitral agreement. In addition, in designating the situs of the arbitration one makes an interesting provision to cover the possibility that public policy would prevent the validity of an award rendered in the designated:

Arbitration shall take place in Geneva, except in the case the circumstances of local public policy should make impossible the rendering of a valid award. In such event, the International Chamber of Commerce, and failing it, the arbitrators themselves, shall determine a locale in which such a possibility does not exist.<sup>28</sup>

21. Beyond the above, however, various -- and often possibly significant -- lacunae are apparent, e.g., in two cases the parties' failure to designate the place of arbitration,<sup>29</sup> and their failure in all but one case<sup>30</sup> to specify how the expense of the arbitrators are to be allocated. In recognition of this, two of the clauses explicitly designate sources for filling any gaps in their arbitral agreement. The first of these designates the arbitrators by simply stating: "The arbitrators shall establish the arbitration procedure."<sup>31</sup> The second also

makes the arbitrators responsible for filling any gaps in the agreed arbitral rules, but gives them more guidance providing:

The arbitrators shall have the power of 'amiables compositeurs' and shall have recourse to equity as suppletive law in the event that the sources of law applicable to the dispute are lacking or incomplete. In such event, they shall refer to the mutual intent of the parties, which is to arrive at a complete, intimate and trustful cooperation for the exploitation and valorization of the mineral resources which are the subject matter of this Agreement.<sup>32</sup>

22. In contrast, both of the other ad hoc arbitral clauses<sup>33</sup> examined only implicitly give the arbitrators the authority to fill in gaps in the procedures established by the parties. It must be noted, however, with regard to all four of these clauses that the extent to which an arbitral agreement may provide for ad hoc rules to govern any resulting arbitration depends upon the theory of arbitration accepted in the jurisdiction in which the arbitration takes place.

23. Closely related to the above, but somewhat different in effect, is the provision in one of these clauses for submission of any dispute that the arbitrators are unable to resolve to a specified national court of law:

In the event the arbitrators are unable to reach a decision, the dispute shall be referred to (Specified State) Courts of Law for settlement.<sup>34</sup>

24. The difference is that in this case the court of law is an alternate authority, rather than a supplemental one, for the rules to govern the resolution of the dispute.

#### Pre-Arbitration Attempts at Resolution of Disputes

25. About a third of the arbitration clauses examined for this study require or exhort the parties to the agreement to make various efforts towards resolution of any disputes before resorting to arbitration. These clauses typically specify efforts of "mutual conference"<sup>35</sup> or "good faith endeavor"<sup>36</sup> or limit arbitrable issues to those "which the parties have not been able to settle amicably."<sup>37</sup>



26. Most requirements of or recommendations for pre-arbitration attempts at resolution of disputes in the clauses analyzed are somewhat vague and general, as the examples above indicate, but two are noteworthy in that they also include more specific provisions with regard to efforts by the parties to settle their difference before going to arbitration. The first of these requires that the parties seek "amicable settlement in the spirit of the Agreement" for two months before they may institute arbitral proceedings.<sup>38</sup> The second goes further, requiring first that the parties attempt to settle their differences without outside help, then if this is not possible, that they attempt to do so through a specified conciliation procedure, and finally, only if formal conciliation has failed at the end of thirty days, that they resolve their dispute through arbitration. Further, the clause expressly provides that the achievement of conciliation at any time during arbitration proceedings will terminate the arbitration:

The Government and [Party] express their firm desire to examine, in the most objective and friendly spirit, all disputes whatsoever which might arise between them and having any connection whatsoever with this Agreement, in order to settle such disputes.

In the case, however, that a dispute should remain outstanding, the parties hereto agree to have recourse to a conciliation and, if need be, an arbitration procedure.

....

The conciliation procedure shall be implemented by two proxies, each party appointing one proxy, who shall attempt to bring about an agreement between the parties.

If within one month following the day on which either party shall have formally given notice of the dispute in writing the attempt at conciliation has not produced the desired result, then the dispute shall be settled by arbitration.

....

The proxies mentioned hereabove shall be convened to attend at all the proceedings of the arbitrators. They

may at any time terminate the arbitration proceedings by bringing about a conciliation.<sup>39</sup>

27. Finally, one other arbitration clause provides not only for the parties to meet before resorting to arbitration to resolve any disputes, but for them to meet regularly to discuss their ongoing business relationship and settling any problems as they arise:

Periodically (the parties) shall meet to discuss the conduct of the Petroleum Operations envisaged under this Contract and will make every effort to settle amicably any problem arising therefrom.<sup>40</sup>

#### Coverage of the Arbitration Agreement

28. With only slight differences in the wording and complexity of syntax, nearly all the arbitration clauses analyzed for this study provide for arbitration of all disputes between the parties in connection with the contract. The variations among these clauses range from a pithy reference to "any disputes arising"<sup>41</sup> to the lengthier "disputes and differences arising out of or relating to this Contract or the interpretation and performance of any of the clauses of this Contract"<sup>42</sup> to the even lengthier:

If at any time during the continuance of this Agreement or thereafter there shall be any question or dispute with respect to the construction, meaning or effect of this Agreement or arising out of this Agreement or concerning the rights or obligations hereunder, and involving two or more of the following persons: [seven persons listed], any of the parties to such question or dispute shall have the right to require the questions or dispute to be settled by arbitration as hereinafter provided.<sup>43</sup>

29. Three arbitration clauses outwardly vary from the majority in that they define two separate areas in which potential disputes may arise. One of these clauses, typical of all three, describes the first of these areas as "any controversy, disagreement or dispute ... in the performance, interpretation and application of this Agreement, which involves accounting matters" and,

the second, as "any controversy ... other than an accounting matter within the scope of the preceding paragraph."<sup>44</sup> The purpose of this distinction is to provide for the selection of an arbitrator with specialized qualifications in the event a dispute does involve accounting matters (see section on arbitrator selection procedures below). Since the clauses do provide for arbitration of disputes arising in both contexts -- accounting and all others -- their effective coverage is actually as broad as those discussed above.

30. The parties to an arbitration agreement may, however, provide for broader or narrower coverage than that seen above, and several of those examined vary markedly from the majority in the extent of their coverage. Because of their interest, each is discussed briefly in turn below, with relevant quotations, when appropriate.

31. The first variant clause not only asserts its coverage over "all disputes whatsoever which might arise between [the parties] and having any connection whatsoever with this Agreement..."<sup>45</sup> but also goes on, in great detail, to very explicitly assert its coverage over other agreements and relationships arising from the present one, as well as over persons not party to the agreement (e.g., suppliers contracting with one of the parties):

Conciliation and arbitration shall apply not only to disputes between the Government and [named party] in the strictest sense but also to all disputes which in any way are connected with this Agreement and with any legal instruments and legal relationships which might be a consequence thereof and which might involve two or more of the following persons or corporate entities:

The Government, [named party], the Corporation stockholders of the Corporation, suppliers or contractors who might have a connection with the persons or corporate entities above listed, in relation, directly or indirectly, with the matters which are contemplated under this Agreement, and the heirs and assigns, public or private, of the above-mentioned or corporate entities.

The above persons or corporate entities, other than the Government, [named party], and the Corporation, shall stipulate their acceptance of this conciliation and arbitration clause in order to be within its terms.

It is hereby provided that this clause shall apply without limitation to all disputes relating to this Agreement, to the authorizations herein provided, the exploitation, the operation and the dissolution of the Corporation.

....

The arbitrators shall have jurisdiction and shall pronounce on any principal or subsidiary question and on all pleas, including such pleas whereby a party to the dispute were to contest the validity or the scope of this Agreement and of any legal instruments or legal relationships arising therefrom, or the validity or the scope of this arbitration clause or of any agreement in connection therewith.<sup>46</sup>

32. Two more variant clauses limit the coverage of the arbitration clause. In the first case, involving a joint venture between a Government and a Corporation to form Operating Company, the arbitration agreement does not apply to Government. Thus, this arbitration clause only covers disputes between two of the three parties.<sup>47</sup> In the second case, the non-government party, Consultant, has the choice of submitting any disputes either to arbitration or to judicial litigation, so long as the government party is not a member of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.<sup>48</sup> With regard to this latter case, however, it should be reiterated that only an explicit indication in the arbitration agreement of the parties' intent to make arbitration the exclusive remedy will be effective, and further, that the normal language providing that any or all disputes are to be submitted to arbitration cannot achieve this result.<sup>49</sup> It is therefore not clear that this last provision does, in fact, limit the scope of the arbitration clause any further than would be the case had this limitation not been included in it.

33. One final arbitration clause offers an unusual and interesting departure from the normally broad scope of such clauses. This clause establishes

arbitration by the ICC in accordance with ICC rules, but limits the arbitration to two carefully defined situations. The first situation arises when one party notifies the other of the material breach and the other party does not remedy it within ninety days. The second situation is when one of the parties fails to make certain payments required under the contract within twenty-five days of notice that the amounts are due. In both of these cases, the ICC tribunal may only make an award calculated in accordance with the guidelines specified in the arbitration clause. Because of its unique and detailed approach, the relevant portions of this clause are here set forth:

9.02 If a party believes that a material breach has continued unremedied for a period of 90 days following notice to the other party specifying such breach, either party may apply to ICC for a decision as whether such material breach has occurred. Any failure by [First Party] to pay in accordance with this Agreement any amounts due [Second Party] or Staff will be deemed to be a material breach.... If a material breach is determined by ICC to have occurred, ICC shall make an award in favor of the non-breaching party terminating this Agreement and setting forth damages to the full extent (but not in excess) of the amounts specified in Sections 9.04 or 9.05, as the case may be, without reductions or offsets of any kind or type whatsoever....

9.03 Notwithstanding, and as an alternative remedy to, the provisions of Section 9.02, if [First Party] fails to pay in accordance with this Agreement any amount due [Second Party] or staff and such amount is not paid within 25 days after [Second Party] has given [First Party] notice of such failure to pay, [Second Party] may terminate this Agreement and the amounts specified in Section 9.05 shall be paid by [First Party] to [Second Party]. In the event of such termination, [Second Party] shall have the right to request ICC to determine the exact amount payable to [Second Party] specified in Section 9.05. Upon such determination by ICC, ICC shall make an award in favor of [Second Party] setting forth damages to the full extent (but not in excess) of the amount specified in Section 9.05 without

reductions or offsets of any kind or type whatsoever.

- 9.04 If this Agreement is terminated pursuant to Section 9.02 on account of a material breach by [Second Party], then [Second Party] shall pay to [First Party] within 30 days after termination, an amount in U.S. dollars equal to the aggregate fees that shall have been received by [Second Party] under this Agreement during the 18-month period preceding the date of termination.
- 9.05 If this Agreement is terminated pursuant to Section 9.02 on account of a material breach by [First Party] or if [Second Party] has terminated this Agreement pursuant to Section 9.03, then [First Party] shall pay to [Second Party] within 30 days after termination (i) all amounts then due and unpaid under this Agreement, (ii) all Termination Costs, and (iii) an amount in U.S. dollars equal to the aggregate of the fees paid or due to Second Party under this Agreement during 18-month period preceding the date of termination.

#### Procedures for Initiating Arbitration

34. The various arbitral institutions set forth in their rules the procedures by which a party to an arbitral agreement may institute arbitration proceedings. While the ICC<sup>50</sup> and ICSID<sup>51</sup> both require only that the initiating party file its request with them, IACAC<sup>52</sup> and AAA<sup>53</sup> require that the initiator directly notify the other party to the dispute of its request for arbitration in addition to filing a notice to them. Because they incorporate the applicable institutional rules by reference, most of the ICC arbitral clauses, as well as all of the other institutional clauses analyzed for this study need not -- and, in fact, do not -- make explicit mention of the procedures a party must follow in requesting arbitration.<sup>54</sup>

35. A significant minority of the ICC clauses studied do explicitly set forth the proper procedures by which a party may initiate arbitral proceedings. These expand the basic ICC procedures by requiring that a party seeking arbitra-

tion directly notify the other party involved. Although some of the clauses achieve this result by specifying that both the ICC and the other party must receive notices from the initiating party, others only explicitly require the initiator to notify the other party, and not the ICC. Of course, the effect is the same in both cases, as the ICC arbitral clauses all clearly assert their incorporation of the ICC Rule of Conciliation and Arbitration, which therefore govern all issues with regard to which the parties are silent, including notice of a party's request or arbitration to the ICC. One of the ICC clauses broadening the ICC notice of arbitration requirement is as follows:

An Interested Party may commence arbitration proceedings by (i) giving notice to the other Interested Parties (including in such notice a statement of the question or dispute and of the claim or contention of the party giving the notice), and (ii) cabling the Court of Arbitration, for the time being, or the International Chamber of Commerce, requesting the appointment of an arbitrator.<sup>55</sup>

36. At the other end of the spectrum, three of the four ad hoc arbitration clauses set forth explicit notice requirements for the institution of recognizing the principle of direct notice:

[E]ither party may serve upon the other a written notice stating that such party desires to have the controversy, disagreement or dispute reviewed by an arbitrator...<sup>56</sup>

#### Selection of Arbitrators

##### A. Importance

37. Not surprisingly, the non-institutional and ad hoc arbitration clauses analyzed for this study reveal the parties' recognition of the importance of procedures for the selection of arbitrators. This is undoubtedly because the parties are aware of how the choice of arbitrators may so readily affect the outcome of the arbitration and therefore wish to provide for the likelihood that when a dispute arises they may not be able to agree upon the number and method of selection of the arbitrator or arbitrators. Perhaps more surprising, however, is the fact that although institutional rules generally provide

detailed procedures for all facets of the selection of arbitrators,<sup>57</sup> more of the clauses analyzed for this study referencing such rules nonetheless also explicitly deal with at least two aspects of the selection of arbitrators -- the determination of how many there should be, and who is to select them in accordance with what procedures.

B. Selectors

38. All clauses examined which contained the parties' explicitly agreed upon selection procedures follow the same basic outline. When there is to be only one arbitrator, the parties will appoint him or her jointly, and failing their agreement, an alternate selector will designate the arbitrator. Similarly, the general procedure when the parties have agreed upon three arbitrators provides that the parties must each select one of the arbitrators, with provision for an alternate selector should they fail to do so, and then the two arbitrators together must select the third (who will be the chairman of the arbitral panel). Again provision is usually made for an alternate selector in case the original selectors agreement on the designation of their arbitrator. A typical clause reads:

The arbitration board shall consist of three members, each party hereto appointing one arbitrator. If one of the parties hereto fails to appoint an arbitrator, the other Party may, in the event that [First Party] so fails to appoint, request the President of [State] Supreme Court, and in the event that [Second Party] so fails to appoint, the President of the Supreme Court to make such appointment. The same procedure shall apply if, in the event that an arbitrator is prevented from acting or resigns, the party who has appointed such arbitrator fails to appoint a new arbitrator.

The two arbitrators shall elect a chairman. If no agreement is reached regarding such a chairman, one of the parties hereto or one of the two arbitrators shall be entitled to request the President of the International Chamber of Commerce in Paris to appoint such a chairman.<sup>58</sup>



39. As part of an arbitration clause that incorporates the ICC Rules of Arbitration, the foregoing provision demonstrates an important principle -- the principle that the parties may explicitly vary particular aspects of institutional rules that they have incorporated in the arbitral agreement. Thus, even though the provision in the clause cited the President of the Supreme Court of the specified state shall appoint the arbitrator should either of the parties fail to do so<sup>59</sup> conflicts with the ICC Rules which provide that the ICC Court should do this, it is a valid autonomous choice of the parties.

40. Conversely, it is entirely proper for the parties to an arbitration clause not otherwise making reference to the ICC -- or to another arbitral institutional body -- to name the institution as an alternate selector of the arbitrator or arbitrators. The following excerpt from an ad hoc arbitration clause (reproduced in full later below) illustrates this:

If the Second Party does not appoint its arbitrator as aforesaid, the First Party shall have the right to apply to the Court of Arbitration of the International Chamber of Commerce to appoint a second arbitrator.<sup>60</sup>

C. Time Requirements

41. Often included with the designation of who is to appoint the arbitrator or arbitrators such as in the clause last quoted, is some sort of time limit within which the parties, or their already designated arbitrators, must nominate the arbitrator or arbitrators. The purpose of time limits on the selection of arbitrators is to prevent delays, whether intentionally caused by a party or not, due to the failure to timely nominate arbitrators. Certainly the inclusion of some time limits for the appointment of the arbitrators would clarify those clauses lacking any such provision. A typical illustration of time limits in the arbitrator selection process is as follows:

Each party to this Agreement shall appoint an arbitrator within forty-five (45) days from the date of notification of the request for arbitration to the other party. The chairman of the arbitral panel shall be selected by agreement between the two arbitrators within fifteen (15) days of their appointment. If either party shall fail to nominate an arbitrator or if the two arbitrators fail to agree on the choice of the chairman within the specified period, the arbitrator or chairman, as the case may be, shall, at the request of the other party, be appointed in accordance with the Rules.<sup>61</sup>

Another clause achieving a similar result, but with regard to one rather than three arbitrators, is the following:

If within 5 days from the service of such notice [of arbitration], the parties cannot agree upon the selection of such an arbitrator, he shall be designated by the American Arbitration Association upon the written request of either party hereto.<sup>62</sup>

D. Number of Arbitrators

42. In most clauses examined for this study in which the parties specified the number of arbitrators, they chose three; in all others they chose one. Thus, of the clauses examined, none specified any number of arbitrators other than three or one.

43. One clause among those analyzed deals with the question of the appropriate number of arbitrators when two of the possible multiple parties to an arbitration share a common interest, providing:

Each of the parties shall, in the request for arbitration and in its reply to any request, designate an arbitrator, except that if both two named, related parties shall be a party to the arbitration, the arbitrator to be designated by them shall be a single arbitrator of their joint designation.<sup>63</sup>

44. Another interesting clause has a unique provision (among those analyzed) that actually changes the number of arbitrators from three to one if one of the parties fails to designate an arbitrator within fifteen days. This provision is in marked contrast to the usual procedure, noted above, in which

the responsibility of designating the arbitrator or arbitrators simply devolves upon another in the event of dilatoriness on the part of the selector first designated. Instead, this clause provides:

[E]ither party may service upon the other a written notice stating that such party desires to have the controversy, disagreement or dispute reviewed by a board of three (3) arbitrators and naming a person with whom such party has designated to act as arbitrator. Within fifteen (15) days after receipt of such notice, the other party shall designate a person to act as arbitrator and shall notify the party requesting arbitration of such designation and the name of the person so designated. The two (2) arbitrators designated as aforesaid shall promptly select a third arbitrator, then either arbitrator, on five (5) days written notice to the other, or both arbitrators shall apply to the International Arbitration Association to designate and appoint said third arbitrator ... If the party upon whom said written request for arbitration is served shall fail to designate its arbitrator within fifteen (15) days after receipt of such notice, then the arbitrator designated by the party requesting arbitration shall act as the sole arbitrator and shall be deemed to be the single, mutually approved arbitrator to resolve the controversy, disagreement, or dispute.<sup>64</sup>

E. Special Qualifications for Arbitrators

45. The parties may establish in their arbitration agreement any special qualifications arbitrators must possess. The most usual qualification in the clauses examined is expertise in the area relating to the contract or to potential disputes arising under it. In line with this, several clauses examined treat disputes (see above) and require arbitrators to be e.g.:

a person or a member or representative of a firm specializing in or familiar with accounting in the hotel industry.<sup>65</sup>

Similarly, another provision more broadly requires arbitrators "with expertise in the matter of issue."<sup>66</sup>

46. The arbitration clauses examined also include several other examples of special qualifications the parties may require of the arbitrators. In two clauses, for instance, the parties agree that an arbitrator must have, respectively, "no direct economic interest in the matter under dispute."<sup>67</sup> and "no economic

interest in the oil business."<sup>68</sup> The former clause also prohibits an arbitrator panel chairman who has "the same nationality as either of the parties."<sup>69</sup> And finally, a single contract among those analyzed contains the interesting qualification, unrelated to any of the above, that the arbitrator be a citizen of the country "which has diplomatic relations with both the [Arab host country] and the USA."<sup>70</sup>

#### Enforcement of Arbitral Award

47. Generally, for a party to an arbitration agreement to obtain enforcement of an award obtained under it, the award must be binding on the parties and final (not subject to appeal), and the subject matter of the award must be capable of settlement by arbitration in the country where enforcement is sought.

48. Nearly all arbitration clauses examined under this study address themselves explicitly to the question of the enforceability of any arbitral award made under them, in some or all of the three ways: (1) with a recital that the parties agree to abide by an award, (2) with a statement that the award is to be binding or final, and (3) with a statement that the award is enforceable in a court of competent jurisdiction. The following exemplifies all three of these:

Each party hereto agrees to abide by and perform any resulting arbitration award. The arbitration award, when issued, shall be final and shall be enforceable in any court of competent jurisdiction.<sup>71</sup>

Another similar, but more detailed, section of an arbitration clause provides:

Judgment upon the award rendered may be entered in any court having jurisdiction thereof or application may be made to such court for a judicial acceptance of the award and an order to enforcement as the case may be.<sup>72</sup>

49. A few of the arbitration clauses examined present slight variations from the above pattern. Two, for instance, embody the parties' agreement to waive any privileges or immunities they may have which would otherwise prevent enforcement of an award against them:

The parties ... hereby formally waive any rights to avail themselves, either during the arbitration proceedings or in respect of the enforcement of the award of any privilege or immunity for jurisdiction.<sup>73</sup>

A third arbitration clause examined explicitly provides for the validity of a default judgment, or award:

If a party, after due notice, fails to be present or to obtain an adjournment, the arbitration may proceed in the absence of such party and an award thus rendered shall have full force and effect.<sup>74</sup>

Finally, a fourth arbitral clause takes the unusual approach of essentially addressing the arbitrators, rather than the parties, directing them to structure the arbitral award in compliance with specific requirements relating to its enforceability:

The award will comply with the requirement necessary to make it considered as enforceable under the laws of the country of the domicile of the condemned party, and the courts of said domicile shall have jurisdiction to enforce and execute said award.<sup>75</sup>

FOOTNOTES

1. Contracts 10 and 24.
2. The 1927 Geneva Convention for the Execution of Foreign Arbitral Awards, and the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.
3. Contract 1, Article 20(A); Contract 2, Article XIV; Contract 4, Paragraph 13; Contract 6, Article XII, 1; Contract 11, Article 31; Contract 14, Article VII, 7.01; Contract 15, Article 28, cl. XXIX; Contract 32, Article XI, 11.1; Contract 33, Paragraph 16.5; Contract 34, Paragraph 4; Contract 35, Article X.
4. Contract 21, Paragraph 56; Contract 26, Paragraph 14.
5. Contract 22, cl. 26.
6. Contract 2, Article XIV; Contract 29, Article; see also both of the ICSID Contracts: Contract 26, Paragraph 14; Contract 21, Paragraph 56.
7. Contract 29, Article 10.
8. Contract 22, cl. 26; Contract 33, Paragraph 16.5; see also, Contract 35, Article X; Contract 32, Article XI.
9. Contract 16, Article VII.B.
10. Contract 22, cl. 26.
11. Contract 15, Article 23; see also Contract 19, Sec. 5.06; Contract 34, Paragraph 4.
12. Contract 19, Sec. 5.06; see also, Contract 15, Article 23, Contract 1, Article 20; compare with the reference to the ICC Rules "then in effect in Contract 34, Paragraph 4.
13. Contract 22, cl. 26.
14. Id.
15. Rules of Conciliation and Arbitration of the ICC, Article 18.
16. Contract 32, Article XI.
17. Contract 21, Paragraph 56.
18. Rules of Conciliation and Arbitration of the ICC, Article 11.
19. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Article 45.

20. IACAC Rules of Procedures, Article 2; AAA Commercial Arbitration Rules, Rule 3.
21. Contract 13, Article IX.
22. Id.
23. Id.
24. Contract 12, Article VIII; Contract 20, Article XX.
25. Contract 17, Paragraph 12.
26. Contract 13, Article IX; Contract 20, Article XX.
27. Contract 3, Article 16; Contract 7, Section XI; Contract 18, Article 13.
28. Contract 18, Article 13.
29. Contract 3, Article 16; Contract 7, Sec. XI.
30. Contract 3, Article 16.
31. Contract 9, Article XXI.
32. Contract 18, Article 13.
33. Contract 7, Section XI.
34. Contract 34, Paragraph 4.
35. Contract 24, cl. 9.02.
36. Contract 13, Article IX; see also, e.g., Contract 20, Article XX; Contract 18, Article 13; Contract 21, Paragraph 56.
37. Contract 4, Article 13.
38. Contract 18, Article 13.
39. Contract 7, Section XI.
40. Contract 4, Paragraph 13.
41. Contract 20, Article XX.
42. Contract 15, Article 23.
43. Contract 3, Article 16.
44. Contract 18, Article 13.
45. Id.

46. Contract 9, Article XXI.
47. Contract 16, Article VII.B.
48. Ehrenhaft, Effective International Commercial Arbitration, 9 Law & Pol'y Int'l Bus. 1191, 1195 (1977).
49. Contract 25, cl. 9.02.
50. Rules of Conciliation and Arbitration of the ICC, Article 3.
51. International Centre for Settlement of Investment Disputes Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings, Rule 1.
52. Rules of Procedure of the Inter-American Commercial Arbitration Commission, Article 3.
53. Commercial Arbitration Rules of the American Arbitration, Section 7(b).
54. Contract 2, Article XIV; Contract 4, Paragraph 13; Contract 5, Article XI; Contract 11, Article 31; Contract 12, Article VIII; Contract 14, Article VII, 7.01; Contract 16, Article VII.B, Article 21, Paragraph 56; Contract 25, cl. 9.02; Contract 26, Paragraph 14; Contract 28, cl. XXIX; Contract 32, Article XI; Contract 33, Paragraph 16.5; Contract 34, Paragraph 4; Contract 35, Article X.
55. Contract 19, Sec. 5.06(a); Contract 1, Article 20(a); Contract 6, Article XII.1; Contract 15, Article 23(a); Contract 16, Article VII(B); Contract 35, Article X.
56. Contract 3, Article 16; see also, Contract 9, Article XXI; Contract 13, Article IV; Contract 18, Article 13.
57. Within the ICC framework, for instance, if there is only one arbitrator, the parties may either agree upon someone to nominate for confirmation by the ICC Court of Arbitration, or they may leave the selection of the sole arbitrator to the ICC Court. If there are three arbitrators, however, the parties have the option not only of choosing to have each party nominate one arbitrator, but of also having those two arbitrators in turn nominate a third, to be chairman of the arbitral tribunal. In both of these cases, if the parties do not exercise their option to nominate the arbitrators, directly or through their previously appointed arbitrators, the ICC Court will do so. (Article 2.4 and 2.6.)
58. Contract 4, Paragraph 13; see also Contract 12, Article VII; Contract 13, Article IX; Contract 18, Article 13; Contract 20, Article XX; Contract 21, Paragraph 56.
59. Id.
60. Contract 9, Article XXI.



61. Contract 32, Article XI.
62. Contract 4, Paragraph 13.
63. Contract 22, cl. 26.
64. Contract 3, Article 16; see also Contract 6, Article XII.
65. Contract 30, cl. 16.
66. Contract 4, cl. 13.
67. Contract 19, Article XXI.
68. Contract 4, cl. 13; see also the Rules of Conciliation and Arbitration of the ICC, Article 6.
69. Contract 9, Article XXI.
70. Contract 11, Article 36.
71. Contract 35, Article X.
72. Contract 18, Article 13; see also Contract 22, cl. 26.
73. Contract 22, cl. 26.
74. Contract 28, cl. XXIX.
75. Although a detailed discussion of the various theories of arbitration is outside the scope of this analysis, generally: jurisdictions accepting the jurisdictional or hybrid theories are less likely, in some cases, to honor the parties' choice of governing substantive or procedural law, while those accepting the contractual, and especially the autonomous, theories are more likely to do so.



