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SOME OBSERVATIONS ON CONTRACT CONDITIONS FOR PROJECTS
IN DEVELOPING COUNTRIES * (1977)

by

Andrew Brown **

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** Mr. Brown is an Associate Director of Humphreys and Glasgow Limited, United Kingdom.

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Summary

This paper reviews problem areas which have arisen between Project Authorities and Contractors on some projects in developing countries, both in the pre-contract and contract stages. It is written from a Contractors view-point and sets out what a Contractor believes have been the principle restraints to the successful and prompt completion of Fertiliser and Chemical Process Plants. It is acknowledged that there will be a number of Project Authorities who could produce evidence of the failure of Contractors in meeting their full obligations on projects, but it is probable that a review of the causes of failure to complete projects on time or to meet guarantees might well result in an equal division of the responsibility for failures between Project Authorities and Contractors.

Responsibilities of Project Authority in Pre-Contract Stage

1. The first requirement must surely be that a decision to proceed with the Project should be made, before Contractors are invited to prepare bids. Yet how often are bids invited for projects in developing countries which are never implemented, or which are deferred year after year, for in some cases, up to ten years. The cost to a Contractor to prepare a detailed proposal for a plant and to have teams of engineers travelling to the site and for discussions with the Project Authority during the pre-contract period, can often amount to as much as US\$250,000.
2. Having reached a decision, backed up by the appropriate Government authorities where necessary, to proceed with the project, with reasonable certainty, it should be a normal requirement for a Project Authority to:-
 - a) Prequalify the Contractors to bid for the project
 - b) Draw up a comprehensive enquiry document
 - c) Select the site, and plan sources of main utilities as electricity and water
 - d) Negotiate in principle, the proposed main sources of financing required

- e) Invite proposals from pre-qualified Contractors, and carry out detailed assessment of these when received.
3. There have been cases of Invitation to Bid documents being sent out to as many as 14 or 15 Contractors, which can hardly be in anyone's best interests. The current World Bank or Asian Development Bank practice of limiting the number to 4 or 5, has much to commend it. Reference has already been made to the high cost to Contractors of preparing proposals and this coupled with the normal time lag between inviting tenders and project implementation (which appears to average in developing countries around two years), and the number of Contractors asked to bid, leads to Contractors taking a strong line in opposing the current demands for large bid bonds.
4. A Project Authority which does not have the staff to undertake these pre-contract requirements, should use the services of an experienced Consultant, and not, as is sometimes the case, expect Contractors to provide a free service in formulating the project requirements, site selection and reviewing various alternative schemes for economic viability. A fair assessment of Contractors bids without a comprehensive enquiry document, can become almost an impossible task.
5. Perhaps the most serious pre-contract problem in recent years has been that associated with the question of when does a Contract become effective. There are many examples of Contracts being signed between Project Authorities and Contractors, but which have not become effective for many months (and in some cases years). To become effective, it is generally necessary in developing countries for some or all of the following conditions precedent to be established:-
 - a) Approval of Contract by the Project Authorities Government, including issue of Import Licence
 - b) Approval of Contract by the Lenders
 - c) Completion of Financing arrangements
 - d) Opening of Letters of Credit or making Downpayment
 - e) Complementary Contract for local work to be Effective
6. There has been a trend in recent years for major fertiliser projects to be financed on a multi-lateral basis, with sometimes as many as seven Lenders, and the time required for all Lenders to approve a Contract can be considerable. Contractors are often asked to start engineering work following Contract signature and in advance of the Contract becoming effective, on the plea that they should understand the difficulties that Project Authorities have in obtaining Government and Financial approvals. Contractors will

soon finds that the interest charges due are a year in arrears as well. Project Authorities will generally blame their Government Ministries and plead for the Contractors understanding, but again this does not help, and there must be no doubt that the responsibility must clearly be with the Project Authority for ensuring that payments are properly made when due.

6. An article on the widespread delays in payments to Consultants, primarily due to the bureaucratic building of paperwork roadblocks between the clients money and the consultant invoices, appeared in a recent issue of the USA published journal "Overseas Projects". This refers to the inherent fault in the Letter of Credit system which often requires that non-fixed elements of the Contract Price should be provided for by Letters of Credit opened at later stages, that revalidating is periodically necessary, or that revolving types of L of C need frequent replenishment. Payment delays so often result from inadequate attention to the updating of the L of C. So important is this subject that the International Federation of Consulting Engineers published in May 1977 its booklet "Guide to the Use and Remuneration of Independent Consultants for Engineering Services", which recommends fairly strongly worded safeguards in Contracts.
7. Delay in making payments due to Sub-Contractors and Suppliers can often jeopardise the obtaining of back-up services required during the construction, testing and commissioning phases of a Contract. There are instances of accidents occurring after the Contractors staff had left site and un-informed sources had criticised the Contractor for leaving; yet in fact the Contractor had left because the Project Authority had refused to pay for the staff to stay on at the site.
8. In the light of the foregoing is it not surprising that many Contractors raise objections to the provision of Performance Bonds for substantial sums, throughout the Contract Period. Perhaps where large bonds are called for a 'quid pro quo' remedy might be considered in a Contract.

Expatriates - Terms and Conditions

1. The need to provide at the site, during Construction and Commissioning of the Plant, for the services of experienced expatriate staff, is without question. However the numbers to be provided, their responsibilities, and their terms and conditions, are frequently areas of differing views between a Project Authority and a Contractor. The numbers should be arrived at by mutual agreement, but be flexible enough to meet the Project needs. The responsibilities will generally be those associated with providing guidance and advisory services to the Project Authority, although there is a tendency in developing countries to attempt unjustifiably

to link expatriate services with responsibility for local contractors (even though there might be one expatriate and several hundred local contractors staff!)

2. It is obviously highly desirable that the Contractor should endeavour to send his most competent and experienced staff on expatriate assignments, but unless the terms and conditions of such assignments are equitable and acceptable to the Contractors staff, it will often not be possible to persuade the right people to go. It must be remembered that we cannot force people to go on these assignments, nor can we prevent staff from leaving the site and returning home if conditions are unacceptable. Hence we should, in the interests of all concerned, do our utmost to ensure that acceptable conditions are included in the Contract.
3. It has tended to become the norm in recent years, that all the local facilities required for expatriate staff, are directly provided by the Project Authority. This basis has much to commend itself since it can overcome problems associated with local regulations, import controls, availability of resources and such like. But what happens if the Project Authority is unable, or fails to provide the facilities required? It is in fact difficult to provide adequate remedies in a Contract which do not have possible serious consequences on the completion of the Project.
4. The principal areas where problems have arisen on terms and conditions are as follows:-
 - a) Provision of accommodation to an acceptable standard for both bachelor status expatriates, and those accompanied by their families. Generally, families should be provided for when the assignment is likely to extend beyond a period of 4 - 6 months.
 - b) Provision of household essentials including furniture, soft furnishings, refrigerator with deep freeze, cooker, washing machine and necessary cooking utensils, crockery, cutlery, air conditioners, etc.
 - c) Transportation both to and from the expatriates country to the site, and provision of a car at the site area for the expatriate and his family. For long assignments, arrangements need to be included for home leave trips, and in emergencies for return for medical attention or other domestic reasons.
 - d) The facility to be able to import, where the need arises, foodstuffs, drinks and cigarettes, without the burden of high duties being payable.
 - e) The provision of reasonable medical facilities for expatriates and their families at the site area.

- f) Local tax exemption should be provided, or arrangements made for any local taxation to be payable directly by the Project Authority. Generally when "Aid" funds are applied to a project it would be expected that the respective Authorities would reach an agreement on the taxation aspects to ensure that the "Aid" funds are not utilised for tax payments. Under this heading, the Project Authority must also be responsible for obtaining the necessary Work Permits, where required, for expatriates.
- g) The provision of local living allowances, in local currency, to defray all normal living costs relevant to that area.

In all areas listed above there are many examples of Project Authorities failing to provide the facilities required. Even more frequently, the provision of essential items has not been arranged in advance, so that the expatriate has had to survive in difficult circumstances awaiting deliveries. A remedy to be considered in a Contract is a clause providing that the Contractor may provide the facilities in the event of the Project Authority's default and all costs relating to such provision shall be payable to the Contractor.

There have been instances on local taxation where taxes have been assessed on expatriates, including liabilities in respect of accommodation, transport, schooling, etc., to an amount exceeding the expatriates actual salary!

- 5. If difficulties are anticipated by the Project Authority in providing the necessary facilities, then it is often possible to arrange that the Contractor or the individual expatriate can import the items concerned, providing the necessary duty-free import facility is arranged.

Conclusion

This paper is not intended to be just a critical review of Contractual problems with an emphasis on defaults by the Project Authority (there is in fact probably more time at this Seminar devoted to the defaults of the Contractors). It is a serious attempt to put over the fact that there will always be two parties to a Contract, and that a Contract should ideally be written to safeguard the interests of both parties equally. There can after all be no point in Project Authorities insisting on prohibitive bonding requirements or harsh Contract conditions, which will tend to limit the interest taken in the Project by the more competent Contractors. Surely a Project Authority should be looking for the Contractor with the right process, with good experience, and one who is competitive on price and performance, rather than one which is part of a major corporation or Government undertaking, or, a firm which is not able to obtain contracts under normal competitive bidding arrangements. There can be doubt that a properly balanced Contract will do much to aid the ultimate successful completion and operation of the Project.

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