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Principles of contract drafting

The aim of this presentation is not to review principles of certain clauses in a contract or structures of contracts, since this is done in other presentations, but to indicate some thoughts, forming a certain philosophy, a drafter should have when taking on the task of drafting a contract.

Also, it is ventured to suggest some methods and ideas by which s contract could be made to serve as a better tool to foretell and more reliably prevent later problems and possible disputes and to better help thereby the implementation of the project.

It has been considered advisable to first clarify certain legal notions in advance to ensure that the same meanings are assigned by everyone to all basic notions applied.

1. A brief review of some principles and and notions of civil laws

A contract is a legally enforceable joint act or manifestation of will of two or more parties resulting in an obligation to do /to supply or provide/ something or to refrain from doing something /such an obliged party is called the obligor/ and in a title or right to claim and demand such doing, such supply or provision or refraining /such party is called the obligee/.

As to contents, a contract can be unilateral /e.g. a gift, a donation or an indemnification, i.e. a compensation for damages/ or bilateral /e.g. a sales contract/.

The function of a contract is to bring about mutual obligations.

The purpose of a contract is to satisfy the lawful pecuniary demands of the parties.

When can an agreement be considered to be a contract? Irrespective of the name given it, an agreement is a contract if it is a legal act and if the intention of the parties is to accept legal obligations on both sides. A contract is a legal act and is to be considered valid and enforceable, if it has all prerequisites prescribed by the law.

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Laws vary as to when they consider a contract to be valid and enforceable, but the main prerequisites are:

- Two or more competent parties
- A legal subject matter
- An agreement with regard to all essential points
- A manifestation of mutual assent.

As to subjects of the contracts encountered in transfer of technology transactions, they may range from the simple transfer of rights, e.g. the right to use /a simple or straight licence agreement, where no transfer of know-how is required/, up to the supply of a complete plant.

A contract may have a single subject, but has usually more subjects, e.g. the grant of the right, the transfer of the technology /of the know-how/ by and through various channels of transfer /e.g. training, consultations etc./, the supply of engineering, the supply of equipment etc.

Main types of contracts and main types of obligations of the parties in the various contracts that may have a role in transfer of technology transactions are:

- Sales or purchase contracts between buyer or purchaser and seller or supplier /e.g. supply of equipment/, wherein the seller obligates himself to deliver the commodity and to transfer the title thereto, and the buyer obligates himself to accept the commodity and pay the price.
- Contracts for work and labour between client and supplier or contractor /e.g. supply of complete plants, contracts for erection, for engineering etc./, wherein the contractor undertakes to produce a result, and the party ordering it, agrees to accept it and pay the price.
- Rental contracts between lessee and lessor /e.g. rental of a building or of an instrument/, wherein the lessor obligates himself to allow the lessee the use of an object and the lessee to pay the rent.

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- Contracts for usufructuary lease between usufructuary lessee and lessor /e.g. lease of productive equipment/, whereby the lessor leses productive property for its use and for collection of the fruits or proceeds thereof, and the usufructuary lessee obligates himself to pay rent therefor.
- Licence agreements or contracts between licensee and licensor wherein the licensor provides a certain technical solution or technical information and the right for its use for the collection of the fruits and proceeds thereof, and the licensee obligates himself to take such licence and pay the agreed licence fees.
- Contracts for mandate /sometimes/ between mandatee and mandator, whereby the mandatee obligates himself to carry out some mandate for the mandator /e.g. represent him as a lawyer in a process or treat him as a physician/. The obligation of the mandatee refers to use his best professional skills without binding him to produce a result.

In most of the technology transfer transactions more than one of the above types of contractual obligations are involved.

The legal environment

Contracts are concluded between "persons". Such persons may be "natural persons", i.e. private individuals or citizens, or "legal persons", i.e. companies, organizations.

All these persons live in countries, states, in a social, economic and legal environment. States have laws that form a legal system which is based on the base law of the country, the constitution, codifying the generally accepted principles governing the country. Each country has a number of laws that can be divided into two groups. The first group includes laws that deal with the state itself and regulate or govern the relationship between the citizens and the state and that between the various institutions of the state, such as administrative law, criminal law, tax law, etc., which group is generally called public law.

The other group of laws is called private law or civil law and is primarily concerned and regulates the relationships between the

"persons" /natural or legal/. Such laws, branches of private law deal with the rights and obligations, duties of the persons, whose everyday lives, every step they take have to do with contracts. Such private or civil laws determine whether a promise made or an obligation taken is enforceable, they regulate and tell, what conduct is expected of them in certain situations, whether they are entitled to claim compensation for a damage or harm they suffered /law of contract, law of tort/, what is the nature and extent the persons enjoy over land and other property /law of property/.

All these national laws are of course valid only within the boundaries of the country or state, they are national laws.

But in transfer of technology and in trade in general we deal with international contracts concluded between persons belonging to different countries with different national laws.

Such different laws belong to different "law families" that can be grouped as follows:

- Romanistic law family
- Germanistic law family
- Nordic /Scandinavian/ law family

} Continental law family

- Common /Anglo-Saxon or English-American/ law family
- Socialist law family /disappearing/
- Religious or Islamic law family
- Hindu law family
- Other Far-Eastern law families.

For practical reasons, in our case the most important two families are the "continental law family" and the "common law family".

The basic difference between these two families is that continental private laws are entirely codified /also the socialist law family/, the law clearly states what is legal and what is not, and in the case of a dispute, the judge only has to interprete the law, for which reason they are also named "civil law family" /not identical with the notion "private or civil law"/, whilst the common law system is only partly codified and is largely a case-law or precedent law system based on prior judgements on similar cases. Such prior judgements bind the judges, whose new judgements will in turn also have the same effect on later judgements.

Consequently, it is of great importance to select the law governing the contract when it is concluded. By stating the law governing the contract, we also state how the contract should be interpreted and what rules should apply in a case of dispute.

No international private law exists that would regulate contracts between persons from different countries or states.

A civil law relationship may be of an absolute or relative nature.

Through civil relations of an absolute structure, civil law protects a static situation. It defines a protected circle, within which it intends to secure the freedom of action of a person entitled to the rights /obligee/ and intends to keep off everyone else. It is only the obligee that is designated in person. Everyone else - theoretically all other members of society - is obligated /obligor/. Obligated is everyone, who could get into a situateion to violate or infringe the rights of the obligee. The content of their obligation is a negative one, in that they are not permitted or supposed to hinder or disturb the obligee /the person entitled to the rights/ in exercising his rights. Thus, the obligee has an exclusivity within the circle protected by the law and anyone else may only enter into this circle by his permission or by direc authorization of the law itself. Such right of the obligee is called an absolute right, because his right and the statutory protection of such right is valid in general and against everybody else.

Types of the absolute rights are differentiated from each other by the contents of such protected circles, i.e. according to what is within such circle, according to what object and in what connectio does the obligee enjoy exclusivity. The most important absolute rights are: personal rights, rights of ownership, patent rights another industrial and intellectual property rights /models, copyrights etc./.

Civil relations of a relative structure are relations in which bot the obligee and the obligor are personally designated. This means that the right of the obligee is valid only in respect of one person, the obligated person or obligor. The obligation of the obligo is usually a positive obligation /the supplier has to supply/, but there are also negative obligations. All contracts create relative relations.

There is a strict connection between the relations of absolute and relative structure. One respect of such connection is that in the case of an infringement or violation of an absolute right, an obligation - usually one for compensation - comes into existence, i.e. the protection of absolute rights takes place via relative relation Another aspect of such connection is that the proper exercise of the absolute rights is usually performed by means of relative relations /licence agreements, sales contracts etc./.

Some basic principles of contract laws

- The parties have contractual freedom, meaning that within the frame of the law, they are free to shape their contracts in agreement at their discretion.
  This contractual freedom also means that most of the rules or provisions of the national laws are non-binding /of dispositive character/ thereby making the will and intention of the parties the first "law" to be considered.
- Exceptions from such contractual freedom are certain rules and provisions that cannot be overruled or changed or excluded by contractual provisions, e.g. the responsibility of a party for a guilty or unlawful conduct or act cannot be validly excluded or statutes of limitation cannot be validly changed.
- Provisions or rules of public laws cannot be changed by contractual provisions. E.g. the parties may not agree that no tax should be paid, contractual freedom only exists in this respect that they may agree that the other party should refund the amount of the tax payable by the first party.
- Another important basic principle of all laws concerning a contract is that the parties must meet their obligations /pacta sunt servanda/.

It is IMPORTANT to note that practically no legal system include special rules for "transfer of technology" and in general, for transactions with immaterial goods.

This means, that should any dispute arise from such a transaction and if the text of the contract is silent about the solution, the judge will have to apply rules for material goods and to decide,

whether rules on sale or on work and labour or on lease should be applied. This of course may only be an approximation, but will never really fit the situation.

Consequently, it is even more important than in the case of other contracts, to exactly specify rights and obligations in the contrac and provide for, as far as humanly possible, solutions for foreseeable situations. The importance of this aspect is even greater, when the contract is within the common law system.

It is intended therefore to call the attention to some more important principles to consider prior to drafting and to suggest some methods for drafting.

1. Some more principles to be considered

1.1 The role of the contract in the transaction

The contract has a double role:

- It should record the transaction as the parties' joint will and should thereby represent the first law a judge or board of arbitration has to consider in a litige.
- It should direct the parties in the fulfilment of the contract and not sleep in a drawer.

In order to meet these goals it must be clear, precise and yet concise, preventing possibilities for interpreting it in any other way as initially intended. Also, it should be readable and easily understandable

1.2 The contract should be correct and fair

This statement is valid for each and every contract, but particularly for those on technology transfer, being usually a longterm cooperation between the parties.

Correctness and fairness means that it should be balanced and should protect the lawful interests of both parties.

Success of the contract and of the entire project can only be expected if both of the parties have an interest in it and maintain that interest over the full validity of the contract.

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1.3 A contract is a homogenous entity

This means that its clauses and conditions are interrelated and consistent with each other. Thus, if we make a change in one of its clauses, it will necessarily also affect other clauses. E.g., if we change the date for providing starting data, this will also affect the date for supplying the design which in turn will affect clauses dealing with payment and penalties, erection, commissioning, start-up etc. There is a considerable similarity from this respect between drafting a contract, designing a closed-loop control system in a process control or with drafting a set of patent claims.

1.4 The roles of the parties are continuously reversed

Whilst at the "macro level" it is the transferor of the technology, who is in the role of the "obligor" /the obligated person/ and the transferee in the role of the "obligee" /the one entitled to demand the fulfilment of the obligation/, the roles are continuously reversed in the various clauses.

The great majority of the clauses reflect an obligation on the one side and a right to demand it on the other. E.g., if the transferor is obliged to provide a drawing, he only can do it and at the time set for it and in the quality required, if he had received the initial data necessary for it at the proper time set for it and if they were correct.

This is important to remember when drafting, because the action of one party not only influences that of the other party but may also release him from the consequences foreseen in th contract for his delay or defective supplies.

2. Some suggestions to follow prior to drafting

2.1 The contract and the aim of the project

The aim of the contract is the success of the project and the entire contract should serve this very purpose. If well draft ed, it should even spell it out in an appropriate way. Clarif first this aim for yourself in technical terms - it will also make it easier to arrive to the right warranty clauses.

2.2 Form a team

Contract drafting is a one-man job, but it should be assisted by or done within a team. This should include responsible experts whose knowledge and work is necessary in the fulfilment of the project, such as a process engineer, design engineer, procurement engineer, erection engineer, construction enginee utility expert/s/ /power, steam, water, sewage/, quality cont rol expert, patent agent or attorney, packaging expert, marketing expert, transportation, tax, insurance experts, an economist and - last but not least - a legal expert.

2.3 The contract should mirror the process of implementation

The drafter should consider the process of implementation of the contract and of the project, as if it had already been concluded. He should consider the sequence of events and thei preconditions. Thereby he will prevent considerable mistakes due to forgetfulness or omitting important elements and incor rect timings, and thus, damages.

2.4 Play the game "What-might-go-wrong?"

It is advised to play this game with each of the team members It should be aimed at to find out what troubles might occur, how they could be prevented, who should do what for such prevention, or, if it cannot be prevented and it occurs, who should do what and when and how and at whose expense.

2.5 Extend this game into the future

Consider that a transfer of technology contract is usually a longterm one covering many years. Since there might be considerable changes in the technical, commercial and political world, problems might occur. We should try to think of such possibilities and provide possible answers to them in the contract.

2.6 Clarify minimum requirements and conditions

When the main objective of the contract is clear and the process of implementation has been considered, the drafter shoul clarify the minimum requirements and conditions, i.e. the limits for all essential rights and obligations required to-

ensure success.

2.7 Drafting and the strategy and tactics of negotiations

By following the suggestion under 2.6, the drafter should also bear in mind the strategy of negotiations and also develop tactics to be followed.

3. Some suggestions for actual drafting

3.1 Avoid routine - Each contract - yours too - is unique and irreproducible

Each contract should be tailored to fit only and alone to the project to be covered. This means, that whilst it is useful to study other contracts concluded on similar cases or model form of contracts, textbooks etc., it is strongly advised: NEVER COPY!

3.2 Make your own draft

Indifferently, which party's draft will be considered as a basis for negotiations, it is suggested to always make your own draft under following these suggestions. It will give you a far better insight into the subject and will bring you into a better negotiating position - maybe in one that is level wit that of the transferor.

3.3 Select first the governing law and study it

Study what it says about the most essential rights and obligations /warranties etc./ involved. If there are no government regulations making it mandatory to apply the national law of the receiving country, it is useful to select a neutral law. /An unknown law means danger and risks for the transferor that usually induces him to increase the price/. It may be advisabl to have a codified law such as the Swiss law of contract /Schweizerisches Obligationenrecht/.

3.4 Prepare check-lists

It is advised to prepare two lists: one to list the problems to be dealt with in the contract /resulting from the review of process implementation and from the What-might-go-wrong games/, and as a second one, a list of chapters or sections and of the main clauses of the contract.

3.5 Define the subject/s/ of the contract

Define and declare the subject/s/ of the contract that could possibly be:

- a licence on the patent/s/ /if any/
- a licence on the know-how /if it has proprietary element:
- a licence on the trade mark/s/
- a licence on the model
- a licence on the software
- the transfer of the know-how /or technology/ in its various forms /written documentation with contents, consultations, training, survey of design, assistance in procurement of equipment, supervision of erection and commissioning/
- supply of equipment
- other possible services.

3.6 Prepare the glossary of definitions

The important goal, that the contract should be clear, exact and yet concise, excluding possibilities for an interpretation different from that intended, can only be realized by clear and exact definitions. The question, what should be defined, can be simply answered: EVERYTHING, each and every term and notion, even those ones that seem to be obvious, like notions "day", "tons" etc. /what sort of day, calendar or working, 24 hours, 8 hours, etc. and what tons, metric, short, long etc The question, where to define, can be answered: where it appears first. In more complex contracts with more similar notion it is advisable to prepare a glossary of definitions and place it in the beginning of the contract, with the clear indication that whenever the notions appear thereafter fully capitalized or with a capital initial, they will have the meaning as defined

Definitions must be carefully worded, checked and double-checked to prevent the three most frequent mistakes committed

- Ambiguity: the quality of word or phrase which gives at least two possible meanings, each of which may be quite definite, but only one of which intended in the given context.

  Example: The period from 15th June to 31st December, inc

this include or exclude the 15th day of June and/or the 31th of December? The words: the two limiting days included/excluded would make the definitions correct.

- /Excessive/ vagueness: Vagueness is that fuzziness which arises because the boundaries of meaning of a word or phrase are imprecise.
  Example: An "indivisible" licence. Does e.g. manufacturing of a part of the licensed product by an outside company mean a "division" of the licence, or not? Specify it
- The modifier whose reference word is unclear - or a misplaced modifier. A modifier is a word, phrase or clause that limits the meaning of another word, phrase or clau

  Example: The licensee agrees to pay on devices sold by licensee in the US or otherwise disposed of /as herein defined/ during the three preceeding calendar months X %.
  Correct: The licensee agrees to pay on devices sold by licensee in the US during the three preceeding calendar months or otherwise disposed of /as herein defined/, X %. It is clear that the words "or otherwise disposed of" are misplaced.

4. Checking

Checking the draft is and important part of drafting.

1.1 Checking by the drafter

It is advised that the drafter checks repeatedly the draft and checks it always from one single aspect only:

- Exactness, clarity and precisity of notions and definitions repeatedly, until uncertainty is reduced to a minimum tolerable and the text is clear.
- Consistency of terms
- Service and counterservice
- Chronology of the process of implementation
- Terms and dates
- Repetition of the what-might-go-wrong game
- Placement of annexes and their contents
- System of references in the text
- Structure of the agreement /titles of sub-divisions,

their logic, the decimals and sub-decimals, indentations etc./

- Checking against check-lists.

4.2 "Foreign revision"

Revision by the team members.

Conclusion

The method suggested is time demanding, but it is an "investment" that will be paid back by its advantages. Experience will here again help reducing it but it will always be more than that required by simple copying.