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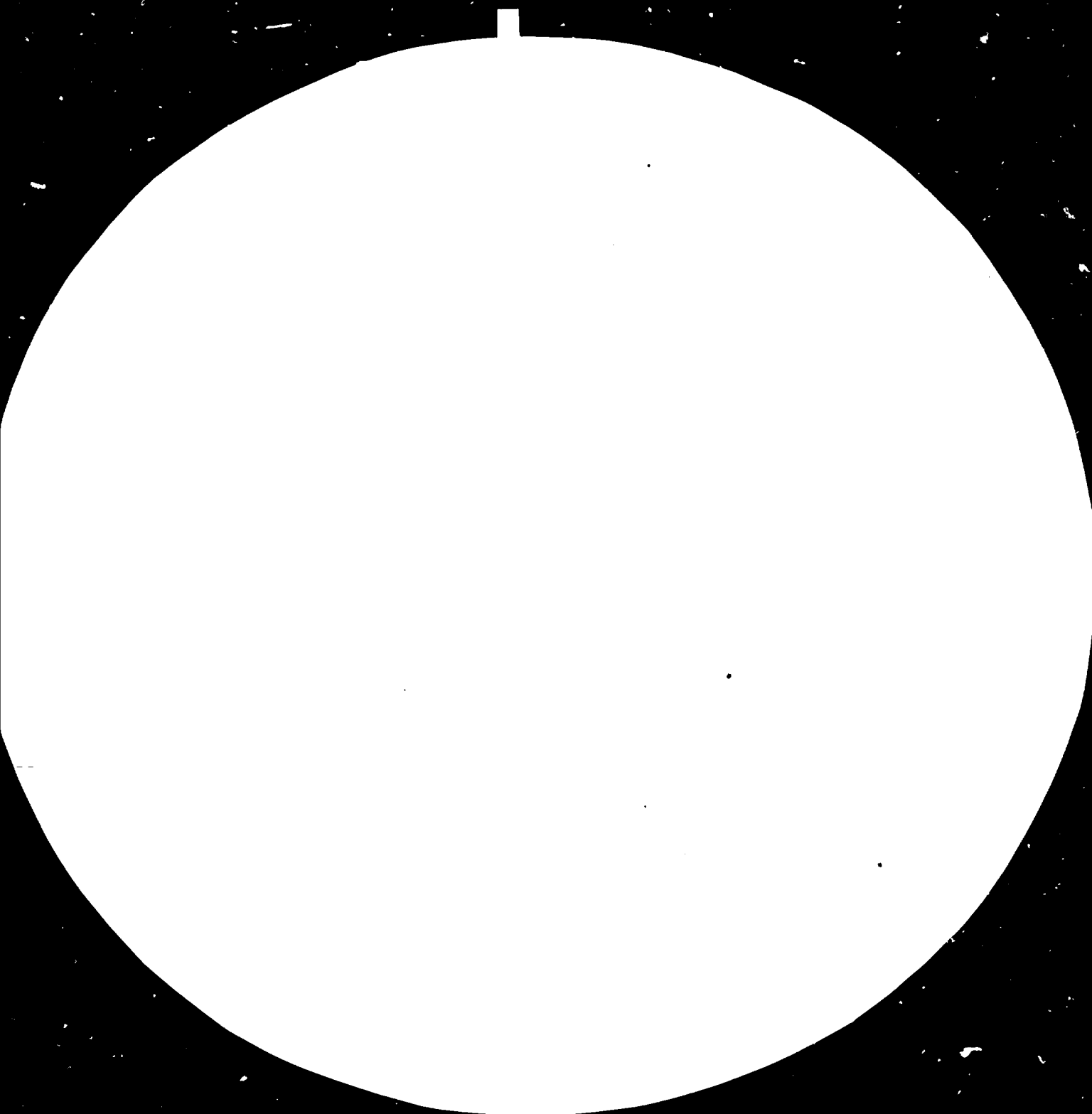
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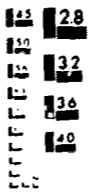
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NEWSLETTER

TECHNOLOGICAL INFORMATION EXCHANGE SYSTEM

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January 1986

Dear Reader,

On behalf of UNIDO and the TIES members, as expressed at the Tenth Meeting of Heads of Technology Transfer Registries, I should like to take this opportunity to thank Mr. G. S. Gouri for his great personal efforts and support in making the Technological Information Exchange System such an eminent example of effective co-operation among developing countries and to wish him a well deserved retirement from active service.

The Tenth TIES meeting, held in Cairo from 8-13 December 1985, was an opportunity to review the experience so far acquired from the TIES system. In this connection it was pointed out that the exchange of information and experience had been an important factor towards increasing the capabilities of national registries in the performance of their duties and in helping them to play a greater role in the technological development of their countries. It was also felt that informal contacts permitted the undertaking of bilateral co-operative action. The orientation of TIES towards computerized information exchange was welcomed and greater emphasis through the introduction of a software programme (CORIS) prepared by UNIDO for this purpose was expected. The TIES Newsletter was regarded as a major vehicle for the exchange of ideas and practical information, however a greater commitment of registries to contribute material to the Newsletter was needed. The training activities were selected as one of the priority areas of expansion of the TIES co-operative programme. For more detailed information of the proceedings of the meeting, you are free to request the report of the meeting quoting symbol No. ID/WG.454/6.

This issue will contain, apart from our regular features, an article based on real negotiation, focusing on the major issues involved. It will be our intention to publish a series of these articles to bring to the attention of our readers actual problems faced by developing countries while acquiring technology and their possible solutions.

K. Venkataraman
Special Technical Adviser
UNIDO Technology Programme

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Criteria for fixing royalty rates in Peru.
Venezuela - A Guide for Foreign Investment and Technology Licensing.
Foreign Investment Regulations of the Republic of Venezuela.
Guide on guarantee and warranty provisions in technology transfer transactions - structural aspects of guarantee clauses.
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Recent legislation

Criteria for fixing royalty rates in Peru

This article has been prepared by Adan Valdivieso Trillo, director of the Technology Directorate at the National Commission for Investment and Technology (CONITE) of Peru and is intended to provide the reader with the rationale of the evaluation of royalty rates to be allowed in Peru within the overall context of its national legislation.

A. General

In order to have a clearer idea of the main subject of this article it is necessary to establish the scope of technology contracts.

1. Scope

A technology contract may embody a variety of technological elements which could be classified under three main headings:

- (a) Items of industrial property;
- (b) Know-how;
- (c) Technical assistance.

(a) The items of industrial property are trade marks, patents, industrial models and designs and are protected by the rules applying to industrial property.

(b) Know-how includes confidential information about formulae, processes and techniques used in industry, ranging from chemical formulae to special manufacturing techniques, covering business secrets, confidential information, laboratory reports, engineering progress reports, pilot plant design, operating specifications, raw material specifications, quality control standards and methods, drawings and designs, models, moulds, guides and any other mutually agreed item.

(c) Contracts governing technical assistance relate to the following:

- Pre-investment consultancy;
- Plant construction and building;
- Basic engineering (equipment, process design, etc.);
- Detailed engineering, including specific assistance with regard to a production process, such as gas, water, electricity, etc.;
- Management of construction and building;
- Production supervision;
- Supervision of start-up;
- Equipment maintenance and repair;

- Administrative supervision;
- Marketing, including assistance with sales plans, market intelligence and direct sales assistance;
- Training in Peru and elsewhere.

2. Costs

A technology contract gives rise to two types of costs:

- The explicit cost, connected with the payment for the technology transferred, usually referred to as royalty;
- The implicit cost, arising from the payments that the licensee must make for the import of machinery, equipment and/or inputs needed to carry out the economic activity with the contracted technology.

CONITE does not monitor the implicit costs of the technology because such is not its role. It does, however refrain from accepting contracts which oblige the recipient to acquire capital goods, equipment, intermediate products and/or raw materials from a specific source. In practice such contracts are covered by the exception set out in Decision 24 (Art. 20, section a), whereby such purchases are to be made at current international market prices.

The royalty is paid direct by the recipient to the supplier of the technology. There are various types of royalty, the most common being:

- Fixed percentage on net sales;
- Levies on production;
- Single payment (generally used in the case of the purchase of initial technological information);
- Annual fixed payment of predetermined amounts to be paid at intervals in specified currencies;
- Fees to cover visits by technicians with payments by invoice.

A combination of two or more types of royalty may also be selected.

This report concentrates on the most common form of royalty payment, i.e. a fixed percentage on net sales, considering the contractual value of each element covered by the technology transfer (as set out in Art. 19 of Decision 24).

B. Normally accepted royalties

1. Background

- One of CONITE's on-going concerns has been to set standards for the better evaluation of technology contracts by putting forward criteria designed to achieve better contract negotiation.
- It is worth mentioning that the contracts originally signed before Decision 24 stipulated rather high royalties (exceeding 10 per cent of net sales), and in some instances as much as 20 per cent or its equivalent, with no provision for monitoring

or supervision. The implementation of decision 24 (in Legislative Decree 18900) in Peru marked the beginning of the registration and regulation of all current technology contracts.

- The various agencies therefore opted for a policy for reducing the agreed royalty levels in order, above all, to prevent a greater outflow of currency through the reduction of royalties in stages.
- Considering that most contracts laid down a royalty in the form of a levy on sales, these started to diminish in 1973 to average rates of 8 per cent or the equivalent thereof and, in 1975, to average rates of 6 per cent.

2. Action taken by CONITE

- It was in 1977 that CONITE began to function as the competent national agency, examining technology contracts from ITINTEC, following the trend set by ITINTEC and renegotiating royalties at average levels of 4 per cent on sales in an attempt to fix a general ceiling of 5 per cent.
- It was ITINTEC that started the deregulation of royalty rates by fixing a level of 1 per cent for trade mark licences.
- The figure of 1 per cent as a maximum rate for a licence to use a trade mark has gradually become the norm for CONITE, along with average rates for other technology elements that are generally not in excess of 4 per cent of net sales.
- Exceptional cases in which the above-mentioned royalty rates are exceeded are submitted to the Board for its decision.
- Participation in the Andean Group

In the Andean Group, through the active participation in the Andean Technology Information System (SAIT), information has been obtained regarding the royalties approved by the competent agencies, which normally do not exceed 5 per cent of net sales. In other countries outside the subregion, we have information that in India, for example, there is a ceiling of 5 per cent on net sales and a 5-year maximum life for contracts in any sector of the economy.

C. Criteria used in evaluation

The criteria used when evaluating contracts and negotiating royalties within the margins indicated above are set out in Art. 9 of the Decision of the Board of CONITE (No. 005-81-EPC/35), as follows:

- Compliance with current legal requirements, particularly the standards relating to the aforesaid Decision;
- Contractual conditions for each type of activity, national and international, and market characteristics when the contract was signed;
- Effects on technological development with regard to, for instance, the production process, degree of mastery by the licensing

company, use of local resources and services, etc.;

- Effects on the balance of payments and generation of income;
- Nature, lifetime and scope of the technology in question;
- Contribution to specific development plans affecting Peru and the subregion and effects on the environment.

Alongside all this, consideration is given to specific criteria, such as:

- Complexity of the technology;
- Use of national inputs;
- Use of imported inputs, in particular those purchased from the supplier of technology;
- Generation of employment;
- Effect of the inputs used on production costs;
- Profit made by the concessionary company;
- Importance of the technology in relation to the company's overall activity;
- Sales to be made on the foreign market;
- Percentage of royalties approved for competing products at national and subregional levels.

In the case of a contract extension, the following additional criteria are borne in mind:

- Age of the contract;
- Technological elements or inputs received in the last three (3) years;
- Innovations or changes made in the original processes or products;
- New products brought into manufacture in the last three (3) years;
- Expiry of the items of industrial property (patents, models or industrial designs).

Finally, mention should be made of the system of monitoring the execution of approved contracts, particularly when the elements that are covered by the contract are being effectively implemented. This gives a supplementary criterion for fixing royalties when evaluating extensions.

Conclusions

1. The technology elements which may be covered by a contract are as follows, either singly or together:
 - Items of industrial property;
 - Know-how;
 - Technical assistance.
2. Contracts in force prior to Decision 24 embodied royalties with margins in excess of 10 per cent of net sales or the equivalent thereof.

3. Since the competent agencies have been functioning, there has been a downward trend in agreed royalty levels.
4. CONITE is implementing standards to arrive at a better evaluation of contracts in order to achieve proper royalty negotiation.
5. As a result of the downswing in royalties and the evaluation criteria, CONITE is setting 1 per cent for trade mark licensing and 4 per cent for other items as being acceptable as normal margins.
6. Within the Andean Group, the competent national agencies have also decided to accept as standard the margins indicated above and the participating countries are tending to standardize the royalties for equivalent technology via the information exchange channel offered by Sistema Andino de Información Tecnológica (SAIT).

Venezuela - A Guide for Foreign Investment and Technology Licensing

The TIES Newsletter has recently obtained a copy of the above mentioned document, from which we give you hereunder a short extract concerning the licensing of technology. Complete copies of the Guide may be obtained from Superintendencia de Inversiones Extranjeras (SIEEX), Centro Comercial Ciudad Tamanaco, Mezzanina 2, Nivel C-2, Oficina M-6, Caracas, Venezuela.

Following the extract from the Guide, we have reprinted the relevant parts of the recent Regulation Governing the Treatment of Foreign Capital and Trademarks, Licenses and Royalties in Venezuela.

Technology licensing

The norms for technology licensing in Venezuela were established by Decisions 24 and 84, and by National Decrees 746 (of 1975) and 656 (of 1985). For the purposes of these Regulations technology is defined in the broadest sense as intangible knowledge and includes all forms of industrial property (patents, trade marks, designs, etc.), know-how assistance and services, regardless of how it is conveyed.

Basic licensing rules - authorization and registration

All contracts or other agreements for the transfer of technology, in any form and regardless of whether royalties or fees are permitted, or have been agreed upon to be paid for the technology, must be approved and registered by Superintendencia de Inversiones Extranjeras (SIEEX) or the Ministry of Energy and Mines in their respective area of competence. Any such agreement which is not duly registered has no legal validity in Venezuela and cannot be defended in the national courts.

Regarding the choice of technology, for the most part there is no intention on the part of SIEEX

to influence the selection of technology, or its utilization once chosen by the national licensee. At the same time, it is considered in the national interest that only the essential elements of a technology package be contracted from abroad, and that they be complemented with technological capabilities found within the country, such as in the areas of plant design and construction. Likewise, there are naturally certain considerations, such as employment effects, environmental contamination and others which may influence the approval of a technology or process, just as they may determine the options for locating a particular project. In general, however, while these factors are taken into consideration by SIEEX and by the other governmental agencies concerned with technology transfer, such as the Technology Division at the Ministry of Development, there are a series of rules that must be applied concerning the private entrepreneurial choice of technology alternatives.

Term of contract

As a general rule, the maximum term for a technology agreement is fifteen years. However, reserve or confidentiality may be for longer if, in the opinion of SIEEX, such terms are justified for the particular technology under contract.

Likewise, technology agreements may be renewed for up to similar terms upon approval. SIEEX is, of course, concerned that an effective transfer of the licensed technology takes place, that is that the licensee firm is assimilating the foreign technology, but it does not interfere with freely negotiated pragmatic business decisions.

Restrictions for foreign companies

The only barrier in regard to technology licensing for foreign companies in Venezuela is in the case of technology flow between a foreign company and its parent or other affiliate abroad. In this situation the foreign company in Venezuela is prohibited from paying royalties or fees to the parent or affiliate abroad, or from making deductions for the technology or services received. However this does not affect the right to register and protect industrial property. This prohibition does not extend to specific and occasional assistance or services, even though these may be provided by the parent company and for which the Venezuelan subsidiary may have to pay compensation. The only requirement in this instance is that the company must notify SIEEX of the respective compensation within thirty (30) days of its payment.

Specific services, including among others, technical assistance contracts for up to 90 days and for reasonable amounts, may be hired by national, mixed or foreign companies with the prior approval of SIEEX. In all other cases, that is foreign companies contracting technology from non-affiliated licensors, both mixed and national companies regardless of the technology source, there is no barrier to freely contracting the technology which appears most suitable and to paying a fair compensation for that technology.

Royalties and fees

There are no particular requirements for defining the formulas which may be adopted when calculating royalty levels or fees, whether as a percentage of gross or net sales, or on a per unit basis or some other appropriate method of calculation. In general terms, these matters are

left by SIEX to the determination of the licensor and the licensee. However, SIEX is responsible for ensuring that the sums contracted for are reasonable and fair with respect to the value of the technology. The Law does prohibit payments for certain specific items. For example, royalties or other payments are not allowed for those patents which have expired, or for technologies which have become public knowledge. In these cases, technical assistance agreements are often approved to facilitate the utilization of the basic technology. Accordingly, in its evaluation of proposed technology agreements, SIEX takes these factors into consideration, but within reasonable limits which are internationally comparable, SIEX does not attempt to impose royalty levels once the parties have reached a freely negotiated agreement.

Prohibited contractual conditions

Both Decision 24 and Decree 746 define a series of conditions which may be imposed by a licensor on the licensee. These prohibited conditions are basically of three types. The first is with respect to what is usually referred to as "tying-in" provisions whereby the licensee is obligated to purchase raw materials or intermediate goods only from the licensor, utilize only the licensor's personnel, pay for additional technologies which are not required or employed, and others of a similar nature. Of course, this does not mean that the licensee is prohibited from purchasing needed inputs from the licensor or from calling on the expertise of personnel of the licensor. These kinds of commercial relations or ties are only prohibited when they are unduly and unnecessarily imposed by the licensor. However, this restriction is not, for example, intended to interfere with the licensor's legitimate interest in protecting the quality of the products made under the licence.

The second area of prohibited conditions involves commercial restrictions, such as prohibition to export the product made from the technology, price fixing, and others of this kind. In this area some exceptions may be allowed, as with the prohibition on exports, for example. In this case, when valid commercial or other reasons exist certain potential export markets may be excluded for the licensee, but in no case may this encompass the Andean Group market to which exports are officially encouraged. At the same time, it may be in the mutual interest of the parties concerned to have the licensor act as the commercial agent for the exports of the licensee to certain world markets; this sort of relationship is possible, providing it does not imply an obligation on the part of the licensee to sell a major portion of the products to the licensor.

Finally, the third area of prohibited contractual obligations for the licensee is in regard to the use of the technology once the contractual relations between the parties are terminated. Naturally this does not mean that the ex-licensee may utilize industrial properties of the ex-licensor, provided these have been legally registered in Venezuela, but it does signify that the ex-licensor may not prohibit the ex-licensee from using the knowledge and skills gained to continue to produce similar products, or to provide like services, though of course under a distinct trade mark commercial name. In other words, what is prohibited is the type of pledge not to compete, rather than condoning any form of infringement practices. In this regard, Venezuela fully respects the proprietary nature of industrial properties and know-how, and it is considered to be in the best interests of both parties concerned and of the nation that technology contracts are faithfully fulfilled.

Foreign Investment Regulations of the Republic of Venezuela (Decree 656) dated 12 June 1985

The following articles have been extracted from the Regulations. The translation is not official, for further details please refer to Spanish text published in Gaceta Oficial, No. 33.270 of 23 July 1985, Caracas, Venezuela.

Regulations Governing the Common Treatment of Foreign Capital and Trademarks, Patents, Licenses and Royalties Approved by Decisions Nos. 24, 37, 37A, 70, 103, 109 and 169 of the Commission of the Cartagena Agreement

CHAPTER I

Preliminary Provisions

Article 1. Foreign investment and contracts on trademarks, patents, licences and royalties and the use of foreign credit, will be governed by the provisions contained in Decisions Nos. 24, 37, 37A, 70, 103, 109 and 169 of the Cartagena Agreement Commission, and whatever other Decision on said subjects ordered by said Commission, by this Regulation and by the national legislation relating to it. Excepted from these rules are the Foreign Investments made through contracts referred to in Article 126 of the Constitution and those destined to the National Defense. Foreign investment and technology contracts regarding the sectors of tourism, agriculture, agro-industry and building construction shall be governed by that established in Article 76 of this Decree, and foreign investment made in the hydrocarbon sector, by the corresponding special law. ...

CHAPTER XI

Importation of Technology and the Use and the Exploitation of Patents and Trademarks

Article 61. All contracts foreign, mixed or national companies propose to execute for the importation of technology and use and exploitation of patents and trademarks, whatever their modalities, must be authorized and registered by the Superintendency of Foreign Investment.

Article 62. All documents containing minutes, contracts or agreements of any nature, to be carried out within the national territory, whether or not they provide for payment or counter-services, are subject to authorization and registration as per the foregoing Article. Specifically subject to said authorization and registration are those relating to the following items:

1. Concession of the use or authorization for the exploitation of trademarks and distribution of products identified by trademarks owned by foreigners.
2. Concession of the use or authorization for the exploitation of invention patents, improvements, industrial models and drawings.

3. The supply of technical know-how through plans, diagrams, models, instructives, instructions, formulas, specifications and training of personnel and other modalities.
4. The supply of basic or detailed engineering for the execution of installations, the manufacture of products and the execution of industrial and construction projects.
5. Technical assistance, whatever the form and the management area in which it is provided.
6. Services for the management and operation of companies in general.

Article 63. The acts and contracts referred to in the foregoing Articles, must contain the information and documents required by the Superintendency of Foreign Investment regarding the following matters:

1. Identification of the contracting parties, with the express indication of their nationality and domicile, as well as that of the intermediaries, whichever the the case may be.
2. Breakdown and description of the technological contribution and identification of the patents or trademarks object of the contract.
3. Identification of the modalities and conditions of the technology transfer, the guarantees applicable to the case and the treatment the parties intend to give the improvements developed during the life of the contract.
4. Contractual value of each of the elements involved in the technology transfer regarding the effects of the authorization, expressed in a manner similar to that provided for in the registration of the direct foreign investment, in Decision 24 of the Cartagena Agreement Commission and this Regulation.
5. Determination of the period of validity, which may not exceed fifteen years.
6. Conditions of payment, currency and country of destination.
7. Clauses conducive to an effective transfer of technology.
8. Determination of the period of reserve or confidentiality of the technical information revealed. Said period may not exceed a period equal to that of the validity of the contract, to be counted as of its date of maturity, in the judgement of the Superintendency of Foreign Investment.

Article 64. With the aim of fulfilling the obligations set forth in Articles 20 and 25 of Decision 24 of the Cartagena Agreement Commission, the Superintendency of Foreign Investment is hereby authorized to define other restrictive clauses, the presence of which in contracts referred to in Articles 61 and 62 of this Regulation would prohibit the contracts' registration.

Article 65. Technical assistance contracts must contain the obligation of the supplier to train the national personnel required for the best use of the technological services contracted and to further the promotion of the activities for the development and for the technological research in this country.

Article 66. National, mixed and foreign companies shall not require the prior authorization

of the Superintendency of Foreign Investment in order to obtain occasional specific services against remuneration but there shall subsist the obligation to notify the Superintendency of Foreign Investment of the payment of the respective countervalue, in the thirty days following its having been made.

Sole Paragraph: Occasional specific service will be considered any service required, for the purpose of attending to or resolving unforeseen situations arising during the activities of the company.

Article 67. The national, mixed and foreign companies may contract specific services or others than those occasionally provided for in the foregoing Article, after being so authorized by the Superintendency of Foreign Investment. Said services may only be remunerated by fees or tariffs on a basis of calculation other than the volume of production or sale, or any other kind of establishment of royalty.

Article 68. The technological contributions resulting from the acts, agreements and accords described in Articles 61 and 62 of this Regulation shall give the right to payment of royalties, after being so authorized by the Superintendency of Foreign Investment, but may not be calculated as capital contribution of the owner or of the supplier of the technology to the receiving company.

Such considerations may be paid to those providing same without need of prior authorization, provided it is so done within the terms provided in the respective contract and after the corresponding taxes are paid or withheld. The company shall be obliged to notify these payments to the aforementioned Body within thirty days of their execution.

When these contributions are supplied to a foreign company by its parent company or by another branch or subsidiary of the same parent company, the payment of royalties or other remunerations shall not be authorized nor shall any tax deduction be accepted therefor.

Sole Paragraph: Technological contributions are considered to be all supplies, sales, lease or cession referring to trademarks, patents or industrial models; instruments, models, documents or instructions as to processes or manufacturing methods; assistance as to technical or administrative procedures under the modality of qualified personnel and any other goods or services of a similar nature which the Superintendency of Foreign Investment, in its opinion, qualifies as such.

Article 69. The Superintendency of Foreign Investment may supervise the execution of the contracts under the terms approved and thus, the contracting parties, if so required, must report periodically as to their activities relating to same, and specifically, as to whether the process, patent or trademark is effectively being exploited in accordance with the appropriate economic conditions and the terms and conditions authorized and registered.

In case of breach of the terms and conditions of the agreement approved, the Superintendency of Foreign Investment may suspend or cancel the registration of the agreement, in accordance with the gravity of the violation, by means of a reasoned Resolution.

Article 70. No payment will be permitted for royalties, nor for other payments resulting from the

use of trademarks, procedures, patents or industrial models, for a period greater than that of the industrial property rights which are granted by the respective law. In the case of a judicial or administrative controversy regarding trademarks, procedures, processes, patents or industrial models, royalty payments or the deposit which corresponds to such a payment, the resolution shall be in conformity with what is decided by the administrative or judicial authority handling the conflict.

Article 71. The payments of remunerations agreed to in the agreements or contracts referred to in Articles 61 and 62 of these Regulations will be suspended until they are registered with the Superintendency of Foreign Investment. The modifications to the contracts shall not come into force until authorized.

Technology acquisition and TAS

Guide on guarantee and warranty provisions in technology transfer transactions

Further to the articles on individual guarantee and warranty provisions taken from the above paper, we are pleased to present hereunder abstracts of a chapter on structural aspects of guarantee clauses.

Comments and discussions on this subject will be welcomed by the UNIDO Secretariat. Such contributions should be forwarded to UNIDO's TIES Newsletter Editor and may, if desired, be published.

Structural aspects of guarantee clauses

The object of the guarantee provision is to set a standard against which the effective performance has to be compared in order to determine whether the promise has been met.

The substantive elements of a guarantee provision will, of course, depend on the specific type of contract and technology and the subject matter of the clause. However, there are a number of structural elements which recur independently of the content of the individual provision. These will be discussed briefly in this section.

1. Clarity and completeness

Guarantee provisions should be formulated in an unmistakable phraseology, and whenever possible, be substantiated by numbers, listings, mathematical formulae and drawings. Ambiguous terms should therefore be avoided or be properly defined in a definition section. The standard should be related to local operating conditions. Taking the operating conditions of the technology supplier's plant or country as a point of reference can create great difficulties. It is also important that both parties have a clear understanding of each others objectives and of the meaning and scope of the guarantee provisions.

Therefore, in order to avoid ambiguities or lack of contractual provisions, the following precautions should be taken:

- Clear and descriptive phraseology;
- A separate section on definitions for expressions which are used throughout the contract, i.e. a glossary of terms;
- "Recital" or "Whereas" clauses stating the purpose of the contract.

2. Time element

Delays in production start-up and appearance of the product at the market place, especially if the market is cyclic as, for example, fertilizers, may have a great effect on the overall profitability of the project. It is therefore important to clearly state the commissioning date of the plant in the contract. Furthermore, delivery dates of machinery and documents, time schedules for training etc. should be clearly spelled out. In addition, time is an important factor when asserting and enforcing claims.

Delayed start-up of commercial production results in no income while expenses continue. Such expenses consist for example in running interest on spent capital, such as equipment stocked, raw materials and salaries for hired but unemployed personnel. These effects should be taken into consideration when drafting the provisions of consequences in case of non-fulfilment.

3. Burden of risk

Liability clauses will only apply when the clause clearly stipulates who has to bear the risk and for what period of time. Thus, arrival of equipment at the recipient's site may terminate the burden of risk unless it is clearly specified that the risk is only passed over to the recipient after inspection, after the acceptance test run or even after the performance test run.

4. Burden of proof

In case of non-fulfilment of the contract or when a dispute arises, it is often unclear who has to prove a certain fact. While this can be a complex legal subject which in some cases is dependent on the applicable law of the contract, in general, it is the party who initiates a claim who has the burden of proof. From the recipient's point of view, it is of course preferable that the supplier has to show that the requirements are met, but often the recipient will have the burden of proof for defects. In any case it is important to include in the contract who has to bear the burden of proof and more important which requirements have to be met. This applies for example to time limits, notification requirements and to the means and procedure of proof such as the number of necessary samples, testing institution and procedures, etc.

5. Consequences and remedies in case of non-fulfilment

Each guarantee provision may contain an agreement on sanctions in case of non-fulfilment. Thus the type and scope of the sanctions may be closely geared to the type and scope of the guarantee. For example, it may provide for the replacement of the defective parts or for the reimbursement of costs, rectification or adjustment of the process. On the other hand certain aspects of non-fulfilment such as delays may be dealt with within a more general clause which is not geared to the type and scope of guarantee because the issue of legal consequences has some common elements independent of the specific provisions.

In this connection one must differentiate between absolute guarantees and guarantees liable to penalty. For example, it is possible to request a guarantee from the supplier to carry out modifications/repairs until the specified production capacity is achieved (absolute guarantee). It is also possible to specify in a contract that the supplier has to pay liquidated damages if the production is for example less than 100 per cent but more than 95 per cent of the specified production capacity (guarantee liable to penalty). In some cases the two types of guarantees may also be combined by, for example, an absolute guarantee for reaching a plant capacity of at least 95 per cent, whereas shortcomings between 95 per cent and 100 per cent may be covered by a guarantee liable to penalty.

The main reasons for creating the need for legal consequences are usually:

- Delays; the obligatory periods contained in the time schedule for the delivery of equipment, the construction of works, the commissioning or the performance test runs are not met;
- Defects which prevent the working of the technology in accordance with the contract or which otherwise affect the quality and durability of the components of the technology;
- Damage to property or injury to persons which are not the result of a faulty technology itself, but the result of additional negligence, violation of secondary obligations, etc. During the transfer of technology process, and especially during the construction period, the property of third persons may be damaged or persons injured. In addition, the products, even when produced in conformity with the technology, may have some defects or cause damage to other persons.

In the case of delays, contractual practice usually provides for fixed liquidated damages or penalties for each week or day of delay.

In the case of defects, the primary remedy is often some kind of rectification, where this is possible. If the supplier is unable or unwilling to rectify the defect contractual practice often provides for the right of the recipient to make good the defects himself at the expense of the supplier. However, this right is often subject to prior written notice and limited to expenses which are "reasonably and inevitably incurred".

In the case of damages, the loss caused by the supplier of the defective products will be dealt with in a similar way as with defects in the technology, but in these cases a certain degree of fault such as (gross) negligence is usually required. The liability may consist of the supplier's obligation to hold the recipient free from third party claims. Sometimes liability is limited to the amount paid by the supplier's insurance.

Practically all guarantees fix the maximum damage to a certain percentage of the entire contractual payment. In addition, certain types of damages such as consequential loss, consequential damage, and anticipated profits, etc. are excluded altogether.

Thus, the type and scope of the remedies in case of non-fulfilment must be formulated in such a

way that they serve as an incentive for the supplier to fulfil his obligation and that they compensate the recipient for the damages incurred. Their range varies considerably and may be distinguished as follows:

(a) Rectification. Since the recipient is interested in obtaining a well-functioning technology, rectification of defects is the primary and most important remedy. Payments, etc. are always a substitute for the main objective. Therefore proper rectification in a timely manner should be the remedy wherever applicable.

Often the suppliers insist on clauses relieving them of their obligation to rectify defects, if the rectification is too time-consuming or costly. The recipient should try at all costs to avoid clauses which give the supplier the right to pay off the primary obligation by a sum of money.

Even if the supplier fails to rectify the defect, the recipient should not accept damage payments, but should rather reserve the right to undertaken the rectifications himself or have them done by a third person, with the original supplier being obliged to cover all costs. This method may, however, not be feasible in the case of expert knowledge which cannot be obtained from a different source.

Rectification may take the form of repair, replacement or adjustment of the technology to meet the contractual requirements.

(b) Alteration of payments. The various forms of alteration of payments are: lower rates of royalties, return of payments, revision of the payment scheme, price reduction and suspension of payments. All these measures may alleviate the financial burden of a non-functioning technology, but they do not cure the defect itself. They should therefore only be accepted if rectification cannot be achieved or if the defects do not substantially affect the functioning of the technology close to the performance level expected. This type of remedy may also be acceptable for defects which can be repaired by the recipient himself or for which it is easy to find third persons who are able to undertake the repair. The alteration of payment should be equal to the diminution of the value of the technology.

Illustrative clause

"The purchaser who has taken over the works shall be entitled to a price reduction if the defects discovered during taking-over cannot be cured. The price reduction shall be equal to the difference between the value which the works without defects would have had, and the value of the defective works, at the time of the discovery of the defects."

(See UNCITRAL Draft Legal Guide on Drawing up International Contracts for Construction of Industrial Works, A/CN.9.WGV/WP.11/Add.3, p.20, fn.9.)

The value of the defective technology may also be determined for the time when the purchaser claims price reduction. The price reduction may also be fixed from the very beginning, i.e. by stipulating that the price reduction will amount to ... per cent of the total price for each per cent point below the agreed production capacity.

Often the supplier will try to insist on limiting the reduction of payments to a maximum amount or maximum percentage. This may be

acceptable in the case of reliable suppliers, and additional clauses covering damages and insurance. Otherwise, the limitation of the maximum reduction in payment may be an indication that the supplier himself does not trust the technology or is hesitant to believe in its proper functioning at the site of the recipient and under the conditions encountered there.

(c) Damages. A party who has failed to perform any obligation under the contract is liable to damages. Damage provisions should clearly specify the amounts to be covered under which conditions. Generally consequential damages, such as loss of anticipated profits, are excluded from damage provisions as the amounts of the loss cannot be foreseen. In the case of sophisticated technologies, e.g. chemical or pharmaceutical processes, the potential consequential damages may be far more important than direct damages. In such cases, consequential damages should be included in liability clauses. Otherwise the possibility of purchasing an insurance may be entirely or partially borne by the supplier.

Usually, the liability for injuries or damages is limited to a maximum amount which may equal the sum of an insurance purchased, a certain percentage of the payments, or an absolute amount. However the recipient should try to obtain absolute guarantees for at least some of the critical parameters, i.e. guarantees which are not limited to the amount to be spent by the supplier for damages incurred.

Since the estimating of damages is not easy, an average calculation and former experience may facilitate the estimating of damage payments. This may lead to the fixing of an agreed sum of money to be included in the contract which would be paid by the party who fails to perform its obligations (liquidated damages). Such a sum often serves as a means whereby the supplier may limit his liability. Damages should therefore only be agreed to if the potential damage can be clearly foreseen, if the agreed sum covers this foreseeable damage or if it is extremely difficult to calculate the damage at all.

(d) Penalties. Penalties should mainly be used as an incentive for the supplier to fulfil his guarantees. They are often used in the case of delays at the main works or delays in rectification.

(e) Termination. If the defects are grave or if the technology to be transferred has not been effectuated, then the recipient may reserve the right to terminate the contract.

Illustrative clause

"The recipient shall be entitled to cancel this contract in full or in part if despite repairs carried out by the supplier or after it has declined to eliminate the defects, the following conditions obtain:

- (a) The net power amounts to less than 95 per cent of the net nominal power;
- (b) The guaranteed value for specific heat consumption is exceeded by more than 10 per cent;
- (c) Within two years following reception of the nuclear power station, it was determined that the supplies and services provided by the supplier under this contract were defective in such a way as to hamper normal operation of the nuclear power plant;

(d) If for reasons ascribable to the supplier, reception of the power plant was delayed for more than one year."

The negotiation and enforcement of guarantee clauses: A case study on the construction of the first Argentine atomic plant.
Juan A. Valeiras, ICPE, 1981, p.13)

This, of course, is the admittance that the technology transfer has failed altogether. The loss of time and a great part of negotiating and implementation efforts are usually very difficult to recover. Termination of the contract should therefore always be an ultima ratio. In the case of turnkey projects and similar transactions, the right of stopping the plant erection may be important when certain defects appear and the continuation of work would increase the damages or make a rectification of defects more difficult and costly.

Illustrative clause

"The purchaser shall be entitled to check the production of any equipment and the construction of the works and to order stoppage of any production or construction which results or would result in defects in the works. The contractor shall discontinue such production or construction, and shall expeditiously replace or repair any defective supplies already effected, or any defective part of the plant."

(UNCITRAL, Draft Legal Guide for Drawing up International Contracts for Construction of Industrial Works, A/CN.9.WGV/WP.11/Add.3, p.16, fn.4)

(f) Financial securities. Some technology transactions, especially turnkey contracts, usually provide for some financial security to be provided by the supplier or a third party to the recipient. This financial security may be used by the recipient if certain contractual commitments are not fulfilled.

These may take the form of performance bonds, or stand-by letters of credit retention money.

In all these cases the recipient has access to a certain amount of money if the supplier fails to fulfil his obligations properly. Apart from the function to ensure coverage of certain damages or losses, these securities also work as an incentive for the supplier to perform his obligations properly in order to have the financial guarantee released or the last portion of the retention money paid. These securities are a comfortable cushion for the recipient, though usually they do not exceed 10 per cent of the total value of the technology transferred. The recipient must also be aware of the considerable costs of such securities for the supplier, which raises the price for the technology accordingly.

(g) Bonus system. A bonus system is a "positive" sanction. It may be combined with a penalty system, for example the granting of bonuses in case of early termination of work or the achievement of a better performance than guaranteed, and the imposing of penalties in case of delays or poor performance.

Illustrative clause

"If the supplier is not able, within a reasonable period, to fulfil the guarantees in respect of power and thermal consumption indicated in annex 9, it shall pay the following compensation to the recipient:

(a) For each full percentage point below the net nominal power, an amount of DM 3 million;

(b) For each full percentage point by which the specific heat consumption guaranteed is exceeded, an amount of DM 1 million;

For each full percentage point by which the guaranteed net power is exceeded, and also for each full percentage point below the guaranteed specific heat, the recipient shall extend to the supplier half the amounts provided for in the case of failure to achieve the guaranteed values. The maximum amount to be extended by the recipient as a bonus may not exceed the amount fixed as a penalty in paragraph 22.02."

(The negotiation and enforcement of guarantee clauses: A case study on the construction of the first Argentine atomic plant.
Juan A. Valeiras, ICPE, 1987, p.13)

6. Exemptions and force majeure

Impediments which were unforeseeable at the time of the conclusion of the contract may occur after the conclusion of the contract which prevent a party from performing his contractual obligations and thus release him from his liabilities. They can be of a physical nature (e.g. earthquakes) or they may be of a legal nature (e.g. amendment of laws which prevent the use of equipment specified in the contract). Exemptions and force majeure are enforced when it becomes impossible to implement the contract for reasons beyond the control of a party, whether temporarily or permanently, and which could not by reasonable efforts be overcome or avoided.

Grounds for exemptions and force majeure should be settled by the parties after taking into account the nature of the project, but considering the heavy losses which may be incurred by the failure of performance. It is generally desirable to limit the scope of exemptions and force majeure clauses. The wider the scope the greater is the uncertainty concerning the obligations in the contract as the parties are excused from performance in a wide range of circumstances.

It should also be noted that different terms such as "frustration" are currently being used to express exemptions and that the notion of e.g. force majeure may have a special meaning in some legal systems.

The drug industry and technology acquisition in Egypt

This paper was kindly supplied by Dr. A. M. Sallam, Chairman of the Arab Company for Drug Industries and Medical Appliances, Cairo, Egypt.

By 1952, the consumption of drugs in Egypt had reached the value of 5 million Egyptian pounds, 90 per cent of which was imported while only 10 per cent was locally produced. All pharmaceutical formulations were simple dosage forms. After the Egyptian Revolution in 1952, the Government took many steps to reorganize the drug sector. In 1957, the Supreme Organization for Drugs, a governmental institution, was created with

the main task of supervising the consumption and importation of drugs. By 1960, this Supreme Organization had completely taken over the import and distribution of drugs activities in Egypt, thereby putting paid to the wholesale dealers and private agents.

In 1961 a series of nationalizations and the creation of public-sector companies led the way to a total governmental supervision of the industry in Egypt including the pharmaceutical one. Consequently all privately-owned laboratories and nationalized small factories were submerged in the public sector. However, some joint-venture companies with a 60 per cent foreign capital and 40 per cent Egyptian share belonging to transnational corporations were retained.

In January 1962, the Egyptian General Organization for Pharmaceuticals, Chemicals and Medical Appliances (EGOPCA), a State-owned institution, was established in order to take in hand all activities concerning the drug industry such as planning, imports, production, control and distribution. As a result, new, modern State-owned pharmaceutical plants were set up while impetus was given to the already existing ones. None the less the Organization still had to face tremendous problems such as the lack of foreign currency due to the unsettled political situation in the Middle East, a sharp increase in drug consumption due to over-population, an increase in the purchasing power of the people after the introduction of social reform laws, the expansion of medical care and the establishment of many new hospitals. In spite of all these constraints, the local pharmaceutical industry was able to cover up to 80 per cent of the country's consumption of drugs during 1970. The remaining 20 per cent was imported. By 1975 the variety of proprietary drugs in Egypt was cut from 22,000 in 1952 to less than 2,500 of which 1,500 were locally produced and 1,000 imported.

By that time the structure of the pharmaceutical industry in Egypt was as follows:

The public sector

This sector consists of 11 State-owned companies which until the end of 1975 were affiliated to the Egyptian General Organization for Pharmaceuticals, Chemicals and Medical Appliances (EGOPCA).

These 11 companies were divided into:

(a) Seven companies manufacturing pharmaceutical formulations of all known dosage forms. Moreover some companies were specialized in medicinal herbs and had their own galenical extraction units to prepare liquid and soft extracts. Others were more involved in isolating the active principle of certain herbs such as the famous Ammoidin derived from *Ammi majus* which is used against leucoderma and is claimed, according to recent research work, to be an effective cure of psoriasis. Some companies have their own small chemical or synthesising units for some basic chemicals which are included in their own formulations, beginning from basic imported intermediates. These companies are:

1. Société Misr pour l'industrie pharmaceutique, founded in 1939.
2. Memphis Chemical Company, founded in 1940.
3. Chemical Industries Development Co. (CID), founded in 1947.

4. Kahira Company for Pharmaceuticals, founded in 1962.
5. Alexandria Company for Pharmaceuticals, founded in 1962.
6. Nile Company for Pharmaceuticals, founded in 1962.
7. Arab Company for Pharmaceuticals, founded in 1963.

(b) One company manufacturing basic pharmaceutical chemicals, "Nasr Company for Pharmaceutical Chemicals" founded in 1960.

(c) One company manufacturing packaging materials for pharmaceuticals e.g. plastics, glass and aluminium containers, tin and aluminium tubes for ointments, etc.

(d) Two trading companies: Gomhoria Co., to market pharmaceutical chemicals and medical appliances, founded in 1962; and the Egyptian Drug Trading Company, founded in 1965. The latter company owns a chain of drug stores all over Egypt and acts as wholesaler to the 7,000 private pharmacies in Egypt.

Private sector

This sector comprises three enterprises which are joint-ventures of transnational corporations. They were established in 1958 before nationalization and have remained private property ever since. The three enterprises are:

1. Pfizer Misr Co., of Pfizer International.
2. Hoechst Orient Co., of Hoechst, Federal Republic of Germany.
3. Swiss Pharma Co., of Ciba-Geigy-Sandoz Wander.

The capital shares of these companies are 60 per cent owned by foreign parent companies, and 40 per cent by Egyptian private shareholders. The percentage of the local production of these three companies in value to the total pharmaceutical production is about 30 per cent.

Period from 1975 to October 1983

The changed political situation after October 1973 laid the groundwork for a new "open door" policy as set out in President Sadat's October 1974 Working Paper. This policy reflects a great effort to accelerate economic development by modernization and through changing Egypt's largely publicly-owned and centrally controlled economy to a more market oriented one, with more scope for the private sector and a larger role for foreign investment. Through this new policy, EGOPCA was abolished on 1 January 1976, amongst other organizations, and the manufacturing companies were given a free hand and authority to run their businesses with a greater decentralization in decisions. Meanwhile a Supreme Council for the drug sector was founded, headed by H.E. the Minister of Health, and including all the presidents or chairmen of the pharmaceutical companies, as well as some experts as members.

The Council's main job is planning and co-ordination between the different aspects of the pharmaceutical industry and in effect it became the supreme authority related to drug policy in Egypt.

As a result of this new open-door economic policy adopted by the Government, coupled with external assistance by other Arab and developed

countries, new projects started up either in-land or in the newly established free zones:

1. Squibb Misr, a subsidiary of Squibb International, started production in 1979.
2. The Arab Company for Drug Industries and Medical Appliances (ACDIMA), a pan-Arab company which represents a holding company for various pharmaceutical industries. ACDIMA Egypt started many projects as joint-ventures with public sector Egyptian companies, some of which are:

- (a) Three new formulation projects;
- (b) A big project for production of pharmaceutical glass; bottles for syrups, vials for parenterals, vacuolizers for infusions, ampoules, jars, etc. The project covers all the needs of the pharmaceutical industry in Egypt and began production in 1984;
- (c) A big project for the production of hard gelatine capsules with an annual capacity of two billion capsules (with the assistance of Indian technology);
- (d) A project for medicinal plants;
- (e) A project for the manufacture of alufoils;
- (f) A project for basic synthetic chemicals, mainly semi-synthetic penicillins;
- (g) A project for the manufacture of medical and pharmaceutical appliances; and
- (h) A project to manufacture medical food products.

3. The Islamic Company for Pharmaceuticals (formulations).
4. The Developed Company for Pharmaceutical Industry (synthetic chemicals and formulations).
5. Otsoka Company, a Japanese subsidiary for manufacturing medical solutions (established in the free zone in 1980).

Up to now the total number of the above-mentioned projects is 11, but many others are expected to be established in the future.

Period starting from December 1983

The State has recently established the Public Sector Organization for industries, including the pharmaceutical industry. The Organization represents a holding system and is responsible for:

- Planning for companies within the general policy of the State and according to the State's socio-economic plan.
- Solving any problems that hinder productivity and promotion of the companies.
- Preparing the technical and economic studies necessary to develop practices in related companies.
- Organization and co-ordination between the companies to achieve maximum integration in production and finance.
- Periodical follow-up of the companies' activities in production productivity, marketing, export, investment, profitability, etc.

Factors affecting the pharmaceutical industry in Egypt

1. Economy

The Revolution's Government in 1952 aimed at developing the national economy and transferring it from a totally agrarian one to an industrial one through diversified industrialization programmes.

The pharmaceutical industry was one of the Government's targets. This industry attracted great attention, especially after it had been dominated by the public sector and the establishment of the Egyptian General Organization for Pharmaceuticals, Chemicals, and Medical Appliances (EGOPCA). Expansion and extension of the already existing factories took place and smaller production units were collectively gathered together into a single bigger one. Special attention was given to the renewal of machinery and equipment to increase production capacity.

Meanwhile, other new factories were established and began production, where special attention was given to research and development laboratories in order to promote development and create some sort of local technology.

To initiate and accelerate the transfer of technology the first transnational form of co-operation took place in the early 1960s through licence agreements with many transnational corporations.

The pharmaceutical industry steadily developed until 1967, when the burden of the Seven-Day War resulted in a chronic trade deficit and disequilibrium in the balance of payments. Many national infrastructures and much of the existing facilities and productive capacities inevitably deteriorated in almost all industrial sectors, including the pharmaceutical industry. This situation continued up to 1973. The changed political situation after October 1973 and the new "open door" policy reflected some progress in accelerating development by modernization through international assistance. The flow of foreign exchange earnings helped in the renewal and modernization of the deteriorating facilities.

This open-door policy approved the establishment of foreign subsidiaries with the aim of helping in the transfer of technology. As a result many foreign subsidiaries or joint-venture projects (foreign and local private equity) between well-reputed transnational corporations were founded and some started production.

2. Technology

Egypt possesses a comprehensive and self-reliant industry engaged in formulating and packaging pharmaceutical products.

Local production of pharmaceutical formulation products covers about 82 per cent of the total consumption of drugs, which amounted to 666 million Egyptian pounds in 1984. Such progress in the formulation industry was attained through the efforts of R & D laboratories and co-operation with transnational corporations through licence agreements.

Nevertheless the progress achieved in the formulations industry is not balanced with the required progress in other pharmaceutical industries which ought to be well developed viz. manufacture of basic bulk drugs either by synthesis or fermentation, production of drugs from plant or

animal origin, production of pharmaceutical requisites and packaging materials and the production of pharmaceutical machineries.

It is noteworthy at this point to review the methods of transfer of technology.

Lump sum payment

A specific industrial know-how is bought from a transnational corporation. This way proved unsuitable due to lack of skilled personnel, advance investments needed, negligence of training and the uneconomical production on old know-how. Egypt had experienced this means for transfer of technology when the El Nasr company for pharmaceutical chemicals was constructed through collaboration with the Soviet Union. Production when started proved to be expensive compared to international prices and great efforts were made to develop the methods of production. Such development represents overcosts.

Joint-venture companies

Egypt had a previous experiment of three companies which were established before 1961. They produce dosage forms competing with local companies. Joint-venture co-operation is recommended for production of bulk chemicals, packaging materials or machines needed for the pharmaceutical industry.

Foreign subsidiaries

This is recommended for the bulk drugs industry which requires huge investments for fermentation or complicated synthetic industry requiring highly advanced technology.

Licence agreements

In this way the product is manufactured through the know-how and under the trade name of the licensor against a maximum royalty of 5 per cent for five (5) years maximum. Such agreements guarantee the acquisition of know-how and training of personnel without interfering in management of the national enterprise or sharing in the profits, and subsequently the transfer of foreign currency over a long period. This formula proved to be the ideal means for transferring technology in the pharmaceutical sector in Egypt.

TECHNOLOGY ADVISORY SERVICES

In the "Dear Reader" editorial of our issue No. 30 of July 1985 we focussed on the Technological Advisory Services provided by UNIDO to assist governments and entrepreneurs of developing countries in their negotiations with foreign suppliers of technology.

Given the increasing interest of our readers in this field of UNIDO's activities, particularly in issues related to the negotiation of joint-venture agreements we prepared the following article with the aim of illustrating the kind of assistance currently provided.

The article is based on a real situation and partially reproduces an advisory report related to the request of a government of a developing country.

For the sake of confidentiality the names of the parties involved were omitted or disguised.

The case is as follows:

The government of a developing country under its programme of privatization and/or rehabilitation of enterprises is negotiating the format of an agreement with a foreign company to modernize SOVO (a local edible oil-producing company), according to which:

- The foreign company would become an additional partner in a new company to be called NOVO.
- The foreign company would be the supplier of such inputs as engineering and project management, would purchase the products and provide other forms of technical assistance.

The government requested that UNIDO study the draft agreement under negotiation with the foreign company and together with the text of the agreement, forwarded to UNIDO a number of documents and background information relevant to understanding the situation.

It was found that the government was facing an important negotiation, and that the structure and content of a number of the clauses of the draft agreement would have significant consequences.

Although the main purpose of the request was related to the terms and conditions of the agreement, a brief appraisal of the technical aspects of the project was also made.

As general remarks on the agreement, it was noted that:

- (a) The agreement broadly covers the obligations of the foreign company as the future manager of the oil mill, but it does not explicitly cover the equity participation of the foreign company although it has the right to take the majority equity shareholding in the new company (NOVO) which was to be registered initially with only a nominal capital. The agreement is therefore mainly a management one, since the foreign company's shareholding had not been defined. It would appear desirable therefore that equity participation of the foreign company be negotiated beforehand and specified in the agreement or in a separate joint-venture agreement to be signed at the same time as the management agreement.
- (b) The fact that the foreign company will assume management responsibilities and majority participation in NOVO's equity shareholding deserves special attention. In case this majority position is accepted contractual provisions should be designed to safeguard minority interests by conforming to a "qualified majority" on the most important decisions whereby the participation of local partners or government sanction should be assured. For example these may involve:
 - Production plans;
 - Budgets;
 - Financing and investment decisions beyond certain limits;
 - Plans for the acquisition of raw materials and the sale of products;
 - Contracting and dismissal of senior personnel;
 - Replacement of personnel.
- (c) Regarding NOVO, the foreign company had the responsibility for engineering, project

management, sub-contracting, purchase of equipment, etc. Although such an extensive role may be considered as normal under the circumstances, it is strongly recommended that local technicians be present at all stages of project design and implementation. Local personnel should be engaged in the preparation of enquiry documents, in the evaluation of bids, in the selection of suppliers and subcontractors and in the discussion of the actual guarantees to be provided by those suppliers and subcontractors, and by the foreign company itself. Local personnel should also be involved in other aspects of administrative and technical management such as the purchase of raw materials, the marketing of finished products, etc.

It is only in this way that local manpower can develop, that technology can be effectively transferred to another country and that the foreign company cannot abuse its powers of management and control.

- (d) NOVO's agreement did not specify when it entered into effect nor when it was to terminate. Although a durable relationship may be desirable and mutually beneficial, a certain period of say five or six years, with the possibility of renewal, should be established. In this regard we refer to the comments on articles 6.1 and 9.2 which appear further on in this paper.

The following sections represent a part of the comments on the specified articles of the agreement.

Article 2.6.1

Says in part that "The Government accords to NOVO the exclusive right to purchase the totality of cotton-seed produced in the country".

As the life of the Company, according to the Article of Association, is 99 years with possibilities for extension it may not be in the best interests of the country to grant such exclusiveness since conditions may change in the course of time, e.g. NOVO may not be successful in its operations, it may not be able to absorb all supplies or it may in future be desirable to set up a similar project, or maybe the production of cotton-seed could be expanded beyond the needs of NOVO. (A case which occurred in Kenya can be quoted here. The Del Monte Corporation of U.S.A. was given exclusive rights to process pineapples in Kenya in 1972 for 99 years. Later on the Government regretted this as Kenya was able to produce more pineapples than the company could process and there was a ready export market. This exclusiveness blocked the setting up of similar projects. After years of lengthy negotiations the Government of Kenya succeeded in lifting the exclusiveness in 1985, but it had to grant the company other concessions as trade-offs.)

It was therefore recommended that this clause be substituted in the sense that the government undertakes to supply to NOVO its cotton-seed requirements in accordance with production forecasts made from year to year by NOVO, subject to availability, and to give NOVO first option out of available supplies at current market prices.

Article 2.6.2

Says "... Le Gouvernement accorde à NOVO la latitude d'exporter la totalité de ses productions d'huiles à l'état brut, raffiné ou semi-raffiné ou, en cas contraire, de ne pas la contraindre à en céder une quelconque partie à un négociant local à un prix moindre que le prix de revient, au cours du

jour, de l'huile de même qualité. Sous la même présentation, rendue la capitale ou pays toutes taxes comprises, en provenance de ROTTERDAM".

This clause does not mention anything about export prices. Since the commodities have ruling international prices, it is recommended that a reference to the level of export prices be included (e.g. that export prices should be negotiated at "arm's length" and in any case should not be below 10 per cent of current prices on the Rotterdam market). This will obviate the possibility of transfer pricing especially if the foreign company carries out its sales transactions through affiliate or associate companies. NOVO should also reserve the right to sell to parties other than customers of the foreign company if better conditions can be obtained.

In this connection it should be noted that for eventual sale of the oil to local dealers NOVO proposes a price not lower than the price CIF from the country's capital, including all taxes, of an equivalent oil imported from Rotterdam.

Such a formula is hardly justifiable. It seems that the correct method for assessing a price for the local market is not to add the costs of transportation and taxes to the current Rotterdam price, but to subtract such cost components instead from the price of delivery in Rotterdam thereby making domestic consumers benefit from having a locally produced commodity.

Article 2.7.2

The fact that the price fixing conditions for oil cakes (tourteaux) is left for future negotiation could be a source for future problems. It would be desirable to establish a criteria for valuing the cakes in the agreement (or in an annex to it).

Article 4.1

In this article the foreign company undertook to "put at the disposal of NOVO" a Managing Director, a Technical Manager and a Maintenance Manager for a period of six years, with no mention of nationals, operating ostensibly under a Board of Directors. However, as day-to-day management does not come under the competence of the Board, and since it would be practically impossible for the Board to control day-to-day management even if it were its duty, it would appear that in practice management and control will be in the hands of the Managing Director. This may be feasible if and when the foreign company has a majority interest, although even then, from the point of view of manpower development, monitoring and safeguarding minority (and national) interests, it would be advisable to have a national Deputy Managing Director. Until such time as the foreign company does not have a majority equity shareholding, it may be advisable to have a national Deputy Director (Directeur Adjoint). The other two posts there should also have professional nationals attached to the offices of the expatriates. Expatriate technicians should also have national counterparts.

This section deserves the following additional comments:

- (a) Although it is stated that curriculum vitae for each expatriate will be supplied in advance to NOVO, it should also be made clear that NOVO should also approve the recruitment of each expatriate;
- (b) NOVO should have the right to replace any of the expatriates if it were found necessary for a proper performance of the respective functions;

- (c) Detailed planning and local staff training should be agreed upon in advance in order to allow the replacement of expatriates by local technicians in due course.

Article 4.2

The principle of calculating remuneration on the basis of real cost is a good one, but the way it was formulated in the NOVO agreement was vague and would be misleading. In order to avoid unpleasant surprises, the government should know how much is to be charged and compare these fees with the salaries of equivalent technicians in the foreign company's home country.

It is also suggested that the possibility for NOVO to have access to documents of the foreign company to ascertain such costs be included in this clause.

Article 4.3

Expatriates are granted two months' paid vacation per annum, which they can split in two parts if they so wish.

Expatriates should be granted as much annual leave as they would normally receive in their home country. Two months appears to be excessive. Also, expatriates do not normally travel on home leave more than once a year, many only do so every two years. This is of course subject to negotiation between the parties, but it does not appear right that NOVO should enter into the extra expense of providing two return passages a year for its expatriates and their dependants, bearing in mind that travel costs are very expensive.

Also, the concept of "family members" should be defined and, when selecting the technicians, NOVO should know the number of family members attached to each person recruited.

Article 6.1

(a) As already noted, the NOVO agreement is not clear concerning its duration. It stipulates that the expatriates will be made available for six years but this does not tally with the term of the agreement which is unspecified. As referred to in section 3.4, a certain duration (5 or 6 years) should be established. Of course, the possibility of renewal should not be excluded but, at the same time, the government will have the opportunity of renegotiating the agreement based on the past performance of the foreign company.

Article 8

The foreign company guarantees that its engagements conform to the current highest professional norms and that they will be executed with all necessary diligence, that it takes all action for production to reach forecast levels, and that it trains local personnel to satisfactorily run the oil mill.

The above wording guarantees that the foreign company will provide high standards of service, but the guarantee is not tied to performance. It would be desirable to add a clause to the article to the effect that the foreign company guarantees that with the services it renders in 8.1 through 8.3, all project forecasts will be reached, and that should this not be the case, the government would have the right to re-negotiate or terminate the agreement.

Article 9.2

If we understand the situation properly, in the light of the data available, the foreign company

intends to collect fees for management and technical assistance over 15 years at least (i.e. duration of reimbursement of long-term loans). We are of the view that a shorter period should be established (for example six years, as per clause 4.1) and then the conditions for eventual renewal (if found necessary) should be agreed upon, taking into account the actual needs of NOVO.

As to the level of remuneration for technical assistance of a general nature, we find the foreign company's demands rather heavy. We note that:

- (a) The foreign company will be a majority partner and will have the corresponding profit share;
- (b) The foreign company will be in charge of key management and technical direction positions (clause 4.1) and will have appropriate remuneration for that (clauses 4.2 and 4.3);
- (c) The other contributions of the foreign company concerning engineering, project management, procurement, etc. are remunerated as per article 9.1.

We are of the view that a compensation for continuous (general) managerial and technical assistance is not unreasonable; however, against the above background, it should reasonably reflect the actual cost of such assistance. From the figures available and the conditions stipulated in article 9.2 we see that the remuneration required by the foreign company is currently well above US\$100,000, while the technical assistance foreseen in section 6.1 (maximum 60 days and 5 trips) may be worth as much as US\$10,000. Of course there may be some assistance provided from the foreign company's headquarters but it is not expected that this would represent a significant amount of additional manpower.

In addition to a remuneration that would more appropriately reflect the actual value of the technical assistance, an incentive fee linked to the results of NOVO's activity (and not to the sales) could be considered.

As a matter of fact, fees should in principle, and as far as possible, be tied to performance, i.e. to profits - a percentage of the profits, or percentage on sales payable out of profits (no profit - no fees). The "raison d'être" of appointing a manager is to operate profitably. It is therefore recommended that the foreign company be asked to forego the fees related to sales, or at worst to accept only nominal fees on sales, say 0.5 to 1 per cent, and retain the fees related to profits.

Furthermore, the term "marge brute d'autofinancement" should be well defined as it may give rise to different interpretations. This term has been the subject of discussion with a number of UNIDO's expert staff and its definition has not been clarified. It probably refers to gross profit or operating profit, (i.e. before charging administrative costs, financial charges and depreciation). If this is the case, it is normal in management agreements to accept fees as a percentage of gross profit since the manager should control and contain administration costs and financial charges while depreciation is considered as a "cost" of production. By contrast, it is normal that the fees would relate to net profit before tax and sometimes before interest on long-term loans only. If the fees on sales are eliminated, fees on net profit between 5 and 10 per cent would appear to be fair if the manager is an outsider. Although the collection of management fees by partners in a joint venture of this kind is a widespread practice, a point of

principle can be made here. If the manager also holds the large majority of shares, he should look for remuneration out of distributed profits and not from fees. After all, and as noted above, the foreign company is going to be fully reimbursed for the cost of expatriates, and is also receiving remuneration as a percentage (5 per cent) of the investment cost.

The article also covers invoicing and payment procedure to the foreign company.

The article however does not refer to any taxes payable in the host country, e.g. withholding tax. The normal rule adopted by many countries obliges that payments of this kind be made after local tax deductions at source - such taxes to be the charge of the foreign supplier.

Workshop on Negotiation of Transfer of Technology Agreements

The workshop on negotiation of transfer of technology agreements jointly organized by the State Ministry of Industrial Development and Tourism - National Direction of Industry of Mali and the United Nations Industrial Development Organization (UNIDO) was held in Bamako, Republic of Mali, from 12-15 November 1985. It was designed, organized and conducted by UNIDO in co-operation with the National Direction of Industry and was tailored to meet the request and the needs defined by the Malian authorities.

The organization of such workshops represents one of the components of the Technology Programme of UNIDO aimed at strengthening the capabilities of developing countries in the process of transfer of technology and contract negotiation.

In this particular case the workshop was addressed to entrepreneurs (of both public and private enterprises) and to government officials with responsibilities in connection with technology acquisition and industrial development.

This note is intended to summarize, for future reference, the main aspects related to the organization and the conduct of the workshop as well as to present the workshop report which gives an account of the subjects of discussion and the respective conclusions.

It should be noted that the workshop was entirely conducted in French and that the documentation material was also prepared in French, thus enabling the Technology Programme to take advantage of the present experience to organize similar workshops in other French-speaking countries.

A complete set of the workshop documents is available from the Technology Advisory Unit.

Workshop programme

As a result of the discussions and exchange of views with the Malian authorities the subjects covered by the workshop were the following:

- (a) The role of transfer of technology in the development process;

- (b) Legal environment;
- (c) Forms and channels of transfer of technology;
- (d) Structure of the agreements;
- (e) Principles and strategies of negotiation;
- (f) Payments and guarantees;
- (g) Contracts for public works and industrial plants;
- (h) Contract implementation.

The programme also included the presentation of a case study which gave the participants the opportunity to discuss relevant issues and problems concerning contract negotiation.

Although the workshop had been planned for about 25 participants, the actual number was 37 participants representing private and public enterprises, and high level officials from government departments and development institutions.

Each of the presentations was followed by a debate and, in view of the interest and engagement of the participants it was decided to allocate longer time than originally foreseen to the discussions.

A detailed report gives an account of the questions raised by the participants who took the opportunity of seeking enlightenment on problems they are facing or anticipate in negotiations and projects under their responsibility.

The discussions on the model forms of agreement for the fertilizer industry served to clarify international practices in relation to several aspects of negotiation for the acquisition of industrial plants.

Workshop documents

Specific materials prepared by UNIDO staff and by the experts in connection with the subjects of their presentations:

- Importance et conséquence des transferts de technologie;
- Le cadre légal des transferts des techniques;
- La structure des contrats de transfert des techniques;
- Présentation de projet de négociation de contrats de transfert de technologie;
- Négociations, préparation, stratégie et principes;
- Priements relatifs aux transactions en matière de technologie;
- Les annexes techniques dans les contrats de transfert de technologie;
- L'implémentation du contrat de transfert de technologie.

Workshop report

On the basis of the presentations and subsequent discussions, a detailed workshop report was prepared in French. This report, together

with the documents mentioned earlier, can be obtained from the UNIDO Technology Programme.

Publications

ID/SEK.M/15 Industry and development No. 14
(85.II.B.7) (ISBN 92-1-106206-3) (ISSN 0250-7935)

Second Consultation on the Pharmaceutical Industry Budapest, Hungary, 21-25 November 1983

ID/WG.393/1/
Rev.2 Items which could be incorporated in contractual arrangements for the transfer of technology for the manufacture of those bulk drugs/intermediates included in UNIDO's illustrative list

ID/WG.393/4/
Rev.2 Items which could be included in contractual arrangements for the setting up of a plant for the production of bulk drugs (or intermediates) included in UNIDO's illustrative list

ID/WG.448/5 Approaches to contractual agreements aimed at access to technology and to its improvements in the petrochemical industry with illustrative examples

Round Table Discussion of an Advisory Group of INTIB Users Vienna, Austria, 23-27 September 1985

ID/WG.450/8 Perspectives on information delivery

ID/WG.450/9 Alternative means of information dissemination

ID/WG.450/10 Users of industrial information and their needs

ID/WG.450/11 Case study on the different categories of technological information users' needs and sectoral information needs. Emphasis on the experiences in the Republic of Korea

ID/WG.450/12 Analysis of different categories of industrial and technological information users' needs as well as sectoral information needs. Agriculture, food processing sectors

ID/WG.450/13 The role of the Industrial and Technological Information Bank (INTIB)

ID/WG.450/14 The Industrial and Technological Information Bank's (INTIB) future work. The need for an international industrial information programme

ID/WG.450/15 Report

Division of Policy Co-ordination Limited distribution:

UNIDO/PC.125 Third Consultation on the Petrochemical Industry, Vienna, Austria, 2-6 December 1985. Developing countries' technological capabilities in petrochemicals

UNIDO/PC.126 Third Consultation on the Petrochemical Industry, Vienna, Austria,

2-6 December 1985. Current world situation in petrochemicals

- UNIDO/PC.127 Ad-Hoc Expert Group Meeting on Strategies for More Integrated Development between the Iron and Steel and Capital Goods Sectors, Vienna, Austria, 16-18 October 1985. Report
- UNIDO/PC.128 Third Consultation on the Petrochemical Industry, Vienna, Austria, 2-6 December 1985, International trade and the marketing of petrochemicals

Division for Industrial Studies

- UNIDO/IS.568 Environmental study of the petrochemicals industry. Sectoral working paper series No. 36
- UNIDO/IS.573 Tariff and non-tariff measures in the world trade of petrochemical products (prepared by the UNCTAD Secretariat for UNIDO). Sectoral working paper series No. 37
- UNIDO/IS.574 Trends in commercialization of software in developing countries
- UNIDO/IS.578 Guidelines for the evaluation of contractual arrangements in the hotel industry in developing countries
- UNIDO/IS.580 Environmental considerations relating to the petrochemicals industry. Sectoral working paper series No. 40
- UNIDO/IS/R.18 Information paper. Computerized Registry Information System (CORIS)
- ID/316 Development and Transfer of Technology Series No. 20 Bauxite testing laboratories (ISSN 0250-801X)

Tenth Meeting of Heads of Technology Transfer Registries Cairo, Egypt, 8-13 December 1985

- ID/WG.454/2 TIES progress report
- ID/WG.454/3 CORIS development status report
- ID/WG.454/4 Trends in regional information exchange
- ID/WG.454/5 Trends in technology transfer flow. Preliminary version

Meetings

- 3-7 March - ICGEB - Workshop on Biotechnology and Industrial Commodities
- 10-14 March - Fourth meeting of the Ad Hoc Panel on Contractual Arrangements - Pharmaceutical Industry
- 17-27 March - UNCITRAL - Working Group on the New International Economic Order, eighth session (General Assembly resolution 33/92: (UN Meeting)
- 31 March - 4 April - Meeting of Consultative Group on Information Technology for Development (COGIT)
- 10-15 March - National Seminar on Technology Transfer
- 22-25 April - Solidarity Ministerial Meeting for the Co-operation in the Industrial Development of the Republic of Mali
- 5-16 May - First Workshop for Heads of INTIB focal points on utilization of personal computers for INTIB networking
- 9-13 June - Fourth Consultation on the Iron and Steel Industry
- 16 June - 11 July - United Nations Commission on International Trade Law, 19th session (UN Meeting)
- 28 July - 6 August - Eighth International Conference of Input-Output Techniques

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