Questions and Answers Regarding Industrial Cooperation Contracts

QUESTION: You mentioned in discussing know-how agreements how you could not expect to have more than one know-how agreement on the same technology for the same country, which I understand. My question is whether you are aware of any evidence of leakage, let's say, of know-how passing between two Eastern countries.

MR. HERTZFELD: To my knowledge, there has not been. From the record, Eastern contract performance and their respect of confidentiality appear to be very good. It should be remembered that, in a foreign trade monopoly system, a clear breach of contract will reflect not only upon the particular foreign trade corporation but on the business reputation of the country as a whole. The consequences for the bureaucrats involved in a wilful breach would be far reaching, including administrative and even criminal sanctions. This creates a strong incentive to act conservatively and to observe the black letter of the contract.

QUESTION: I would like to ask each of the panelists whether they could mention one unforeseen contract drafting problem which later caused trouble, or one which was foreseen but could not be dealt with.

MR. HERTZFELD: One such case arose recently where a Western seller undertook to supply a scale model of a product as part of his delivery obligations, but the parties had failed to define the degree of required detail in the model. The result was a costly delay in payment until the problem was ironed out. The description of what is to be delivered needs to be defined as precisely as possible in the contract. It should not be assumed that the Eastern party will apply the same interpretation as a Western party might with respect to ambiguous delivery obligations.

MR. POPE: We had an experience about seven years ago in connection with the transfer of technology for construction of a plant. Our agreement specified how many engineers and how many man-months we owed the other party to help them in starting up the plant. At startup the plant did not perform as expected, so we fulfilled the terms of the contract by sending a number of engineers for the specified number of man-months; but it still didn't work. We were thus faced with the problems of sending additional manpower at our expense or at their expense. The area of disagreement was not only whether we

had given enough manpower, but whether we had fulfilled our obligation to make that plant work. We ended up sending people there at the other party's cost until the plant did work.

MR. GUFFEY: One item I would like to mention is fixed price. At the beginning of the negotiations, the Russians had no feel for escalation. Now, think of the time I am speaking of, the last part of '73 and early '74, when we had the biggest escalation the United States has experienced in my lifetime. In the United States you couldn't go to any engineering company and get a fixed price, lump-sum contract, but this was something the Russians had to have. They don't have escalation, to speak of, in the Soviet Union. We couldn't get fixed prices from our equipment suppliers, yet the Russians wanted us to give a lump-sum fixed-price contract. Without a provision for escalation, all we could have done was to keep adding contingency on contingency. In the end we did agree to a maximum of 10 percent escalation on the base contract price.

One other problem area involved our cash flow. The Russians have a standard form of repayment in the engineering contract field. As we looked at it, for a two- or three-year period for technical documentation, design, supply, construction, and so forth, under their original proposal we would have a positive cash flow for about five months, and the rest of the time we would have to borrow money to put in the project. By showing them that all we could do would be add to the price for the interest on borrowed money, in the end we got them to agree to a 10 percent down payment and then some progress payments. This kept our cash flow positive for about a year, although we then went into a negative position and came back into a positive position at the end of the project. We made a little headway in our negotiations on this point, but we didn't get the whole thing.

QUESTION: Did I detect a difference of opinion on the panel as to whether you should go to the Eastern bloc countries with your own draft in the first place and try to use your form?

MR. POPE: I didn't say you don't go with your own text. I said, don't use your *standard* form. In other words, try to draft something that you expect to be at least possibly acceptable to them, but don't use your standard form. For example, don't take your standard *force majeure* clause and plug it there. Try to simplify it so it is compatible with their circumstances. For example, there is no such thing as a "strike" over there, so eliminate that provision and make the clause simple.

MR. HERTZFELD: Basically, I agree with Mr. Pope. You should not submit your standard form contract and expect it to be a basis for the negotiations. You are more likely to achieve your objectives if you design a contract which will be familiar to the Eastern side in structure while acceptable to you in content.

As to *force majeure* clauses, it is no longer possible to generalize about Eastern practice. Strikes are sometimes included as *force majeure* circum-

stances in contracts with Eastern European countries. The Soviet Union, as a matter of customary policy, has rejected strikes as *force majeure*, but still I have seen three contracts signed by Soviet organizations in which strikes were nonetheless explicitly listed as a case of *force majeure.*

As I have pointed out earlier, almost everything is negotiable and the limits are being stretched daily, so you should take an imaginative approach in developing a draft and a negotiating strategy.

QUESTION: Mr. Pope, would you kindly give some additional explanation of your last sentence to the effect that a position of force may be more effective than any arbitration clause?

MR. POPE: I don't think I was trying to convey the concept of force written into an agreement. I was trying to see to what extent, in case of default, you can force your partner to perform, thereby avoiding this arbitration thing, which is unrealistic anyhow in some instances.

I was talking in terms of, let's say, an automatic penalty of one sort or another. Perhaps I exaggerated the point by saying that if you don't supply us that material, we will not supply our share of the other material you need; or, as you have in construction agreements, written penalties for delays or non-preformance. In other words, there is no use in discussing at length whether *force majeure* includes strikes. You know that it is not a worthwhile proposition to discuss, so forget about it. In Eastern Europe I found that continually trying to insert clauses for non-performance, such as referring to arbitration, is a little bit unrealistic.

QUESTION: Could someone bring us up to date with respect to governing law clauses?

MR. HERTZFELD: Here, again, you have to distinguish between Eastern European countries and the Soviet Union. In Soviet contracts, the choice-of-law provision usually follows the choice of arbitral forum. Since most contracts with Western firms generally call for arbitration of disputes in Stockholm, the typical approach calls for Swedish choice-of-law rules to apply. Under Swedish principles, this will in most cases refer the arbitrators back to Soviet substantive law, as the law of the place where the contract was signed, where most of the performance takes place, where the payments are made, and so forth. In some cases, the Russians will accept the application of Swedish substantive law, excluding Swedish choice-of-law rules, which at least assures the Western party of a neutral body of law equally accessible to both parties.

Of course, to the extent that you define rights and obligations clearly in the contract, the need to refer to any provisions of national law will be reduced.

The governing law alternatives are more varied in contracts with the different Eastern European countries, although the most frequent preference seems to be the Swiss Federal Code of Obligations.