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## International Consortia: Definition, Purpose and The Consortium Agreement

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## **Abstract**

This article explores what an international consortium is, offering a definition which establishes the consortium agreement and the essence of consortium, explains the reasons for using a consortium in large projects and offers some practical advice in the formation of a consortium agreement.

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## INTERNATIONAL CONSORTIA: DEFINITION, PURPOSE AND THE CONSORTIUM AGREEMENT

*Joseph Russell Milton\**

### INTRODUCTION

The world press for many years, has made references to contracts being awarded to international consortia, particularly for large infrastructure projects in lesser developed countries.<sup>1</sup> This Article will explore in Part I what an international consortium is, offering a definition which establishes the consortium agreement as the essence of the consortium. Part II explains the reasons for using a consortium in large projects, and Part III offers some practical advice in the formation of a consortium agreement.

### I. WHAT IS AN INTERNATIONAL CONSORTIUM?

#### A. A New Definition

A consortium has been defined as "an association of two or more business entities of different nationalities temporarily joined together for the performance of a limited task . . . ,"<sup>2</sup> and as "an ad hoc or ongoing, informal or formal, sometimes 'shell', associa-

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1. See, e.g., Wall St. J., Oct. 20, 1978, at 10, col. 3 (hydroelectric complex in Paraguay); *id.* Feb. 16, 1977, at 4, col. 1 (petro-chemical complex in Saudi Arabia).

2. Hannon, *Use of an International Consortium in a Major International Project*, in 1970 PRIVATE INVESTORS ABROAD 103, 105.

tion of two or more business/governmental/financial entities to profitably pursue, generally on a competitive basis, one or more common commercial activities . . . .”<sup>3</sup> These definitions suffer from not making clear how the word “association” is being used. As there are different forms a consortium may take,<sup>4</sup> an “association” could be mistaken for any of them.

It should be clear that the consortium itself is not an entity, but a contractual relationship between the consortium members. This relationship is separate and distinct from the form the consortium may adopt. To avoid any definitional confusion between the contractual relationship of the consortium members and the form of the consortium the word “form” should not be included in the definition of a consortium, as in “a form of cooperation between two or more parties for the purpose of meeting a customer’s requirements for a specific project.”<sup>5</sup>

Another problem with all the aforementioned definitions is their general character, such that they are applicable to more than just consortia. A proper definition of consortium should include the central concern of contracts entered into between the companies forming a modern consortium; namely, “obtaining and executing, jointly and severally, a contract for the supply of goods and services.”<sup>6</sup> Taking this fact, and bearing in mind that the relationship between the consortium members is contractual, the following new and comprehensive definition of a modern international consortium emerges: a temporary contractual relationship of two or more business entities of different nationalities, formed for the purpose of executing, jointly and severally, a specific contract, usually involving complex civil engineering,<sup>7</sup> for the supply of goods and/or services.

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3. C. DHAWAN & L. KRYZANOWSKI, EXPORT CONSORTIA: A CANADIAN STUDY 9-10 (1978).

4. Consortia have typically taken one of four forms: common approach, common agency, partnership and corporation. A. BOULTON, BUSINESS CONSORTIA 41 (1961). A recent consortium form, endowed with its own legal characteristics, and particularly suited for transnational cooperation, is the French Groupement d’Intérêt Economique. See Bott & Rosener, *The Groupement d’Intérêt Economique*, 1970 J. Bus. L. 313.

5. Guide for Drawing Up an International Consortium Agreement 5 (1976) (a study of the working group “Legal Affairs” of ORGALIME) [hereinafter cited as Guide].

6. M. MERCADAL & M. JANIN, LES CONTRATS DE COOPÉRATION INTER-ENTREPRISES ¶ 941 (1974) [unofficial translation].

7. *Id.* Typically, a consortium will be involved in large infrastructure projects, e.g., a power generating plant.

All the members of the consortium are jointly and severally liable for the performance of a contract entered into by the consortium.<sup>8</sup> There is, however, no fiduciary relationship between the members. Without a specific clause in the consortium agreement creating a fiduciary relationship, none exists.

### B. *What a Consortium is not*

In the following discussion, consortia will be distinguished from unincorporated associations, partnerships and joint ventures. It should not be presumed that a consortium is any one of these entities, as the relationship between the consortium members is a contractual one embodied in the consortium agreement. In the absence of any agreement as to form, the duties and liabilities of the consortium members are to be determined by looking at the consortium agreement.

Under the concept of an unincorporated association, if an "association is formed for conducting business for the purpose of profit, it is a partnership and the liability of the individual members incurred or contracts made on behalf of the association by officers or individual members is governed by the law of partnership."<sup>9</sup> As the relationship between the members of the consortium is purely contractual, there is no *a priori* intention to adopt the fiduciary impositions of partnership.

It is necessary to recall some of the distinguishing features of joint ventures as opposed to partnerships. In turn, it can be seen how consortia differ from both partnerships and joint ventures.

Usually, the parties to a joint venture form a corporate entity whereby all the relations between the parties are embodied in the charter, by-laws and related documents. However, this entity is

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8. An attempt to limit liability by the formation of a consortium corporation usually will be resisted by the customer, for the obvious reason that the customer wants to have all the assets of the member companies subject to judgment in the event of a breach of contract. Further, two or more companies from different nations generally find it difficult to create a corporation for the sole purpose of completing an industrial project. This is because their native corporation laws usually will differ, and each will be reluctant to accept the corporate laws of another country. Also, management of each company will have to face the problem of whether ownership of an interest in a consortium corporation will create any undue tax liability which will cause an increase in the contingency pricing to the customer.

9. 2 WILLISTON ON CONTRACTS § 307, at 435-37 (3d ed. 1959).

not required in order that there be a joint venture. What is required is a group of companies, individuals, or both, with all the following characteristics:

- (1) Contribution by the different parties of money, property, effort, knowledge, skill or some other asset to a common undertaking;
- (2) Joint property interest in the subject matter of the venture;
- (3) Right of mutual control or management of the enterprise;
- (4) An expectation of profit;
- (5) A right to participate in the profits;
- (6) A limitation of the objective to a single understanding.<sup>10</sup>

The courts, in many cases, have seized upon the single undertaking characteristic of the joint venture to distinguish it from a partnership.<sup>11</sup> If a profit-making association is to continue for a series of commercial or professional transactions, the partnership relation is deemed to be intended.<sup>12</sup> International consortia, like joint ventures, exist for a single undertaking, thereby being distinguished from partnerships. Further, the members of a consortium do not undertake any fiduciary duty toward each other, which is a characteristic of partnership,<sup>13</sup> unless contracted into the consortium agreement.

A consortium also is distinguished from a joint venture in that the consortium lacks two very important characteristics of the joint venture: (1) a joint property interest in the subject matter of the venture, and (2) a right to participate or share in the profits.

In the usual project consortium each party contributes and retains ownership of those elements of property required for the particular project, other than the equipment to be supplied to the cus-

10. *Id.* § 318A, at 563-65.

11. See *Matanuska Valley Bank v. Arnold*, 223 F.2d 778, 780 (9th Cir. 1955) ("[P]artnership agreement . . . for a single purpose establishes the association of the parties as a joint venture."); cf. *Clark v. Sidway*, 142 U.S. 682 (1891) (joint purchase of land does not constitute a partnership when the purchase was a single, special adventure). See generally 2 WILLISTON ON CONTRACTS § 318B, at 593-95. Other characteristics which distinguish joint ventures from partnerships are: (1) the eligibility of corporations for membership, (2) the absence or extreme limitation of the agency relationship, (3) the sharing of losses as not being essential, (4) the ability of venturers to bring an action at law on the agreement as opposed to the restriction of partners to suits in equity, (5) that a partnership is an entity while a joint venture may or may not be an entity. *Id.* at 592.

12. See 2 WILLISTON ON CONTRACTS § 318A, at 563-65.

13. See generally 1 BOWLEY ON PARTNERSHIP ch. 21 (2d ed. 1960).

tomers. In the vast majority of cases this property consists of construction aids which are, and continue to be, the property of the general contractor.

A far more important distinction between a consortium and a joint venture is that *in a consortium there is no right to share in profits*. Each party's profit results from its participation in the consortium. Profit calculations are made without reference to the calculations of other members. The only concern is that other members may take, or fail to take, actions which could endanger expected profits.<sup>14</sup>

## II. WHY A CONSORTIUM?

A number of reasons have been advanced for the formation of consortia. Often cited is a desire on the part of the consortium members to share the risks of a particular project.<sup>15</sup> Assume three companies, A, B and C, all of equal technical and financial strength, contemplate a project in which each will supply one-third of the required goods or services. Further assume that company A can take on the job as a prime contractor, be a member of a consortium, or be a subcontractor to either or both of the other two companies. If company A is a prime contractor, it will be legally responsible for the total risk of the entire project. By properly drawn subcontracts, however, it may "lay-off" two-thirds of that risk except for those contingencies caused by inevitable gaps in scope of the subcontracts, *i.e.*, the prime contractor will have to supply those items of material or services which are not specifically delineated in the subcontracts.

If company A becomes a member of a consortium for the same project, joint and several liability for the entire project will be attributed to it, as well as its fellow members. A properly drawn consortium agreement, however, would call for a proportionate sharing of the costs of any items not anticipated when each of the companies delineated its scope of supply.

If company A becomes a subcontractor, it has legal risk only for its own scope of supply, which is delineated in its subcontract.

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14. This does not mean that a consortium member has the freedom to act in all situations without regard to the interests of the other members. *See* Judgement of Oct. 30, 1969, Cour de Cassation, Cass. civ. 3e, Fr., [1969] Bull. Civ. III 530 (where the French court did not allow the leader of a consortium to keep for itself the proceeds of a successful renegotiation with a customer).

15. A. BOULTON, *supra* note 4, at 16.

From the point of view of risk sharing, this is the best situation for company A.

Thus far, the only advantage to company A in forming a consortium is the sharing of the risk of unanticipated gaps in the scope of supply. That benefit may be outweighed by a consideration of the tremendous effort required to negotiate, consummate and implement a consortium agreement. In other words, company A may find it more beneficial to add a contingency amount to its price and treat the other companies as subcontractors.

Notice what happens if the facts of the hypothetical are varied. Assume that company C is not as strong, financially or technically, as the other companies. If company A is prime, it has an additional risk of having to cover the obligations of company C if that company defaults in any manner. If, however, company A can form a consortium with company B, then it can truly be said that it has shared the risk of company C's possible failure of performance.

Strangely enough, if company C were weak, company A's position as a subcontractor may be worse than if company C were strong. Most prime contractors try to negotiate some form of *pari passu* payment arrangement with their major subcontractors. Default by company C might cause the customer to slow down or cease making payments to company B, the prime contractor, which, under a *pari passu* arrangement, means that company A would suffer.

Thus, it is clear that consortia have value as a risk-sharing device only if one of the members is financially or technically weak. In that case, the other members are arranging in advance for proportional contribution to the cost of making good a potential default.

Another reason for the formation of consortia is the need to combine the technical expertise of several concerns in order to realize a large, complex project.<sup>16</sup> An atomic power plant or a complex petro-chemical facility may be beyond the technical capability of any one company. In such a situation, an association of companies, each known for its expertise in different areas of a project, can give the particular group a definite competitive advantage in any evaluation by the customer.<sup>17</sup>

Additionally, consortia are formed due to the sheer size of the project from a financial point of view.<sup>18</sup> Some companies lack the

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16. *Id.* at 20; M. MERCADAL & M. JANIN, *supra* note 6 at ¶ 943.

17. A. BOULTON, *supra* note 4, at 106.

18. M. MERCADAL & M. JANIN, *supra* note 6, at ¶ 943.



resources to provide the working capital required for a multi-million, or even billion, dollar project. Examples of such projects are the large power generation and desalinization projects in Saudi Arabia, which require enormous capital commitments.

There are also political reasons. In certain countries local contractors and suppliers are clearly favored as a matter of government policy.<sup>19</sup> Associating with such entities in a consortium gives the foreign members a competitive advantage in any evaluation.

Finally, in some countries, particularly those with a value-added or "turnover" tax system,<sup>20</sup> there may be a tax or fiscal advantage to the formation of a consortium. To the extent that the proposal must include all such taxes, *i.e.*, that they are for the account of the contractor and not reimburseable, such additional costs can be reduced or eliminated by placing all major suppliers on the same tier by means of a consortium.

### III. THE CONSORTIUM AGREEMENT

It should be clear at the outset that there is no universal model or standard form of consortium agreement. Indeed, the one well developed monograph on the subject<sup>21</sup> disregarded this approach in favor of the creation of a check list of issues for settlement between prospective members, followed by the presentation of a Specimen Agreement as an example of a "work-out" of some of the items discussed under the check list.<sup>22</sup> In the spirit of that ap-

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19. *Id.*

20. In a "turnover" tax jurisdiction it is extremely important for a consortium to avoid an entity form, as normally only one level of exoneration from turnover taxes is available. Further, the companies forming the consortium would then be treated as subcontractors to it.

21. Guide, *supra* note 5.

22. *Id.* at 6-7. The check list covers the following areas:

- (1) Parties, Object, Form and Duration;
- (2) Law of the Contract and Settlement of Disputes;
- (3) Internal Organization;
- (4) Management of the Project;
- (5) Tendering;
- (6) Division of Work among Members;
- (7) Members Obligation to each other;
- (8) Financial Considerations;
- (9) Liabilities;
- (10) Retirement from the Consortium Agreement.

The author has reservations about the check list approach. A number of years of practice in the field have convinced him that the difficulties among members of consortia are all too often caused by a failure to consider a well-drafted pro-

proach, this section of the Article will deal only with some of the more important areas which should be covered in a consortium agreement.

#### A. *Parties to the Consortium*

Care should be taken to provide in the consortium agreement for the possible admission or withdrawal of consortium members before, as well as after, the execution of the contract with the customer. In the event of an admission of a new member to the consortium, unanimity should be required as the original members usually will be jointly and severally liable for the performance of the new member.<sup>23</sup>

The take-over of one of the members by another company outside the original group is a possibility which has led to the following recommendation:

The agreement should . . . provide that in the event of a constituent coming under the control of any other corporation it should, if called upon so to do by any other constituent, withdraw from the consortium and transfer its share to any person or company nominated by the other constituents. The reason for this is that co-operation in a consortium involves the sharing of a

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posed form of consortium agreement which has been prepared and presented well in advance of the negotiation of the contract between the consortium and the potential customer. This merely encourages delay in consideration of vital issues. On the other hand, presentation of a model agreement (if a specific consortium agreement cannot be drafted for the particular project) has the exact opposite tendency—it forces other members to consider the aforementioned vital issues in fear that the creator of the original draft may be trying to take advantage of those potential members who have been focusing all their attention on obtaining the ultimate contract with the customer.

One can simplify the legal relationship to some degree and put the other members on appropriate notice by adopting a technique which has been used rather successfully in a limited number of cases. This is to draft a short letter of intent to form a consortium, usually called a "Memorandum of Association," and attach to it a proposed form of consortium agreement. Such documents are normally two or three pages long and do little more than indicate the project, the intent of the parties to engage in a consortium to seek a contract for the realization of the project, and their respective scopes of work and an intention to negotiate their relations generally along the lines set forth in the proposed draft. Besides crystallizing attention of the provisions of the draft form of consortium agreement, such a memorandum indicates at least a moral commitment to work together. However, it is common for European companies to attempt to convert the moral commitment into a legal covenant by inserting a provision that the parties will not attempt in any other fashion, or with any other partners, to achieve a contract for the project.

23. See note 8 *supra* and accompanying text.

great deal of confidential information, not only in the matter of technical data, prices and the like, but also in the more subtle insight into mental attitudes and methods of doing business that comes from working together. The possibility of take-over bids must be kept in mind. Take-over can make the once-independent company into the puppet of a competitor, can overnight change a friend and collaborator into an object of distrust.<sup>24</sup>

In the event the prospective members of the consortium desire to operate as a consortium corporation, restrictions should be placed on the possibility of a voluntary transfer of shares as "a consortium is an organization whose success generally requires that members have a high degree of confidence in one another. . . ." <sup>25</sup> If, however, a voluntary transfer of interests is agreed upon, the consortium agreement should then:

either freely permit a transfer of an interest resulting from a merger, a consolidation, or a sale of substantially all the assets of a consortium member, or it should permit the resignation of the member from the consortium in such event. With today's business climate here and abroad characterized by frequent corporate reorganizations, few consortium members can afford to put themselves in a position in which a major corporate reorganization could constitute a transfer of an interest in the consortium, giving the other consortium members (who are sometimes a member's business competitors) a right to withhold consent to such reorganization.<sup>26</sup>

It is suggested that no clause be inserted in the consortium agreement prohibiting separate tenders by consortium members. The reason for this is that the:

formation of a consortium is never the only way and sometimes not even the best way to handle a complex project, and many companies would feel more attracted to supplying their contribution to such a project as specialist sub-contractors than as members of a consortium in which they will have the responsibility of sharing in administrative control and in answering for the completeness, the overall adequacy and technical functioning of the complete installation.<sup>27</sup>

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24. A. BOULTON, *supra* note 4, at 72.

25. Hannon, *supra* note 2, at 124.

26. *Id.* at 124-25.

27. *Id.* at 54-55.

If the company concerned is a specialist manufacturer producing prod-

These business reasons against the insertion of an anti-tender clause are supported by antitrust considerations, which argue against anything but a qualified restriction on the freedom of the members to bid in competition with the proposal.<sup>28</sup>

### B. *The Consortium Leader*

A consortium is commonly led, as well as represented in negotiations with the customer, by a Consortium Leader or *Chef de File*. This position calls for careful definition in the consortium agreement.

The primary function of the Consortium Leader is to coordinate the work between the consortium members, while also serving as an intermediary between the customer and the members. Coordinating the work of members prior to signature of the contracts means reviewing each member's part of the proposal to insure that it is complete, and then reducing all members' parts to a unified, internally logical and consistent whole.

This question of division of work causes more problems in modern consortia, particularly those involving members from different countries, than any other. This is due to an inadequate definition of where one member's scope ends and another's begins. Vague phrases such as "supply all construction materials," or "provide all equipment needed for," should be avoided in any consortium agreement. Good practice indicates that annexes listing the exact scope of each member, in the maximum degree detail possible, be prepared prior to the conclusion of either the consortium agreement or the final contract with the customer. At this stage,

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ucts which either by reason of patent protection or specialised technical qualities cannot be matched by other manufacturers, an attitude of exclusiveness, by which it refuses to tender to a competing organisation, will obviously give great strength to the consortium. It may however earn severe criticism, since such a manufacturer, as a matter of prestige, usually attempts to present the appearance of scrupulously fair dealing with all.

*Id.*

28. International consortia are subject to antitrust laws. U.S. DEP'T OF JUSTICE, ANTITRUST GUIDE FOR INTERNATIONAL OPERATIONS (1977) (Case C). See B. HAWK, UNITED STATES, COMMON MARKET AND INTERNATIONAL ANTITRUST: A COMPARATIVE GUIDE 296-99 (1979). For this reason the author has resisted calls by members for exclusivity. Instead he has recommended: (1) requiring disclosure to all consortium members by the member who will bid in another fashion, (2) a commitment that no member will offer more favorable prices, conditions or delivery terms to outsiders than it offers to the consortium, and (3) a prohibition against disclosure of all intra-consortium information to outsiders.

differences in opinion as to proper scope can be adjusted rather easily, pricing can be modified in accordance with the resulting allocation, and unwarranted, possibly duplicative, contingencies can be eliminated, to the commercial enhancement of the project. Conversely, such preparation also will reveal omissions in coverage which can require either an upward adjustment of the total price or, if that is no longer possible, a review by the members of their collective desire to continue with the project.

If the Consortium Leader will be negotiating on behalf of his fellows,<sup>29</sup> the consortium agreement must come to grips with what limits should be put on the Leader and how they should be defined. This problem can be divided into price and other terms of the principal contract. As to the former, there should be a clear understanding that there can be no reduction or increase in price without the prior consent of all consortium members. As to the latter, there is a significant practical distinction between businessmen from common law countries and businessmen from codified civil law countries.

Civil law countries tend to have less complex contracts, as the principles of the Code set outside limits to contracting powers, and establish a frame against which all contracting must take place. This, in turn, creates an attitude on the part of such businessmen with respect to delegation of negotiating authority to the Consortium Leader. They are much more apt to grant broad powers to the Consortium Leader than representatives of companies from common law countries, who do not have any codes to protect them in negotiating construction contracts. Only with respect to "financial" questions, such as price, terms of payment and the rate and amount of liquidated damages, are civil law-oriented businessmen likely to insist on a right of review. This facilitates drafting the clause setting the limits of the power of the Consortium Leader.

When businessmen and their lawyers from common law countries contemplate broad delegations of power to negotiate everything but "financial" terms, they tend to react with unease, if not horror, as they are accustomed to more detailed contracts and tend to feel that they must carefully consider the potential impact of every clause of a contract.

The solution is to make a common law representative the

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29. In some countries it is not uncommon for the consortium members to be told that a customer will only negotiate with the Consortium Leader.

Leader in all contract negotiations, and impose the "financial" limitations upon it. If that is not possible, and a representative of a civil law country becomes Leader, then the representatives from the common law countries should carefully consider a limited list<sup>30</sup> of clauses, other than "financial" ones, as to which they insist on a right of review and *this list should be embodied in the memorandum of association or the consortium agreement.*

### C. Management of the Project

The problem of how to manage the project, after the consortium has signed the principal contract, breaks down into two separate questions: (1) how is the project to be managed from the point of view of overall policy? and (2) how is the day-to-day work in the field to be directed? There have been two traditional solutions to the problem. One is management by committee;<sup>31</sup> the other is

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30. The list must be limited as it would be impractical for each member to review all the terms of the principal contract.

31. Members' meetings [*i.e.*, meetings of the Management] committee should be regarded as the Executive or Plenary meeting of the Consortium, at which all Members should be present before the meeting is valid (*i.e.* the quorum is 100%). Full attendance is suggested as a *sine qua non* because the Members' meeting is the only evidence of the collective personality of the Consortium and is the only body with plenary powers capable of making executive decisions. It is obvious that the absence of any member of the Consortium from such a meeting might prove fatal to any decision taken. On the other hand the establishment of the quorum at less than 100% might be the means of preventing the blocking of decisions by a self-interested minority. It might be advisable to provide that if a quorum is not present at the time and place notified for a Members' meeting, the meeting shall stand adjourned for a specific period and at the postponed meeting the business shall be transacted whatever the number of Members present. It will be necessary to include in the agreement proper regulations to cover the procedure at meetings, voting and the competence of the meetings, and a time limit for approval of the minutes of Members' meetings. A particular point to be borne in mind would be the definition of the Project Manager's [*i.e.*, Consortium Leader's] rights (if any) at a Members' meeting. Arrangements for the convening of Members' meetings should be settled, *e.g.* periods of notice, frequency of meetings, notice by post, telex, etc. together with who has authority to convene such meetings and for the taking and approval of minutes.

As regards competence, *it would be convenient to reserve all questions of policy to the Members' meeting* and to take care to lay down what part the Project Manager may take in Members' meetings. If technical or commercial committees are required their responsibilities and powers should be carefully defined.

It would be necessary to lay down whether or not all decisions of the Members or committees require a unanimous vote and if not, what is the

delegating all questions of policy and management, except those specifically reserved in the consortium agreement, to one company.<sup>32</sup>

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majority required to authorise a decision.

The number of votes as between Members should be laid down.

Guide, *supra* note 5, at 9 (emphasis added).

This statement is quoted at length, first because the author disagrees with this technique for the reason that the very attempt to build an agreement on all the points mentioned will often cause the legal edifice to come crashing down and, second, because he does not think this truly reflects the actual practice of consortia which are managed by a committee. In practice, if the consortium is operating successfully, all of the formalities described tend to be ignored; if it is unsuccessful (and generally this means that one but not all of the companies is not successful—usually the construction company), then these formalities become a means for one or more companies to obtain relief from the other members.

Another problem with the description of management by committee is the definition of the word “policy.” Obviously, not all companies think the same questions are matters of policy. What is not so obvious, but just as valid, is that what is a matter of policy for one consortium grouping may not always be a matter of policy for another. The difficulties in defining policy are illustrated by the following example. Suppose one member is asked by the customer to perform some highly profitable extra work, and that performance of such work will delay acceptance of the project and the consequent release of the moneys due upon provisional acceptance, for a period of several months. As all members would share in these moneys, the remaining members may complain bitterly about the delay in receipt of their share. Yet the author doubts that any consortium agreement has ever defined the acceptance of extra work orders as a matter of policy to be decided by a management committee.

32. An alternative to management by committee is the practice found, particularly in less complex projects, of delegating all managerial powers to one company, or even to one individual. There are different ways of resolving the question of choice of manager:

First, one of the Members of the Consortium can be appointed Project Manager to deal with the Customer and all aspects of the project. In this case management may be performed by one or more of that Members’ employees.

Secondly, the Members may wish to appoint an independent person, e.g. a Consulting Engineer, who would be appointed under a separate agreement with the Consortium. That agreement will need to provide that in matters of policy he is subject to the direction of the Members’ meetings.

Thirdly, the Project Manager could be an employee of the Consortium itself with all the employment problems that that entails.

The fourth possibility is that an employee of one of the Members be appointed Project Manager, in which case it is likely that his role will be primarily an executive one subordinated to the Members’ meeting. This solution is similar to the third but should avoid the problem of the Consortium being the employer. It has the disadvantage of the possibility of divided loyalties.

Guide, *supra* note 5 at 9.

The first of the four choices described really involved the choice of a company as

Another technique of project management that has proven quite useful in recent years has been that of distinguishing between overall project management and management in the field. This offers greater efficiency and flexibility in many areas, and is generally most effective in construction projects in lesser developed countries. Under this concept, one company, usually the major equipment manufacturer, is designated Consortium Leader with total responsibility for overall management, including scheduling of equipment deliveries and procurement of any additional services that might be required outside of the country in which the project is to be constructed. Inside the country, another member of the consortium (or an independent company), known as the Field Project Manager,<sup>33</sup> is responsible for management at the site, as well as procurement of all local material and services.

Liaison with the customer can be handled at the executive level by the Consortium Leader, and at the site by the Field Project Manager. When, as occasionally happens, a customer insists on dealing only with representatives of the Consortium Leader, the difficulty is met by attaching to the staff of the Field Project Manager an individual as consortium representative with the customer.

Whatever method of management is used, it should be obvious that the powers of those responsible must be clearly defined in the consortium agreement.

#### D. *Liabilities*

The basic liabilities facing a project-oriented consortium are of two types: (1) those for defects in the performance or quality of the

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Consortium Leader and presents the same problems with respect to loyalty that the fourth method poses. This question of divided loyalty is further complicated by the practice, which is not at all uncommon in consortia with European members, of the payment of a fee to the Consortium Leader for its services. It is suggested that the imposition of such a fee might, under American law, raise a question as to whether the Consortium Leader has become an agent for hire by the other members and, thus, a fiduciary in its relations to them under the normal principles of Agency law. For this reason, the author has always recommended against this practice. Absent such a fee, it seems that the Consortium Leader owes no special duty beyond that of ordinary commercial good faith to his fellow members.

33. With respect to the Field Project Manager, there is the possible problem that progress in the field is being achieved by methods which, if discovered, could bring opprobrium to the entire group, thus endangering the future market potential in the host country. The publicity resulting from identification with a briber of officials in the host country is something most American companies would prefer to avoid. There are, in addition to publicity, possible sanctions under the provisions of the Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78dd(1)-(2) (Supp. I 1977).



project, and (2) those for delay in completion of the project.<sup>34</sup> The first type of liability is a consequence of "poor performance," *i.e.*, performance which does not meet the contractual guarantees of the equipment supplied. The second type originates in the failure of one or more of the consortium members to meet the commitments of the original schedule.

It would seem natural for the consortium agreement to contain a clause to the effect that the party responsible for the imposition of any liquidated damages is liable for their payment. This, however, ignores two important facts. First, the potential exposure to the consortium may be much greater than any one company normally calculates as its own share of a reasonable contingency for defect or delay in performance. Second, it is often times impossible to assign fault to any single individual member. Therefore, consortium members will seek a formula to determine how liability for fault will be assessed.

Initially, it may seem appropriate to calculate the percentage of liability based on the relative amounts of profit that each of the consortium members anticipates from the job. Experience dictates, however, that many companies are extremely reluctant to disclose profit margins. Also, differences in calculating profits from company to company and from country to country, as well as the desire of each company to insure that such information remains "in house" and not subject to disclosure to competitors, makes the usage of formulas based on profit margins very difficult.

The best solution seems to be the so-called "rough justice" approach.<sup>35</sup> To begin any calculation of interests, exposure to liabilities and the like, the expected gross receipts of each consortium member is used as the basis.<sup>36</sup>

In the unusual situation of a defaulting member who is clearly at fault, but cannot bear the imposition of the entire amount of liquidated damages, then:

provide in the consortium agreement that the guilty member will bear the first slice of liquidated damages, but that damages in excess of a stated amount or stated percentage of the value of his supplies or of the total contract value will be shared pro rata among the other members.<sup>37</sup>

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34. Clarke, *Contingent Liability in Consortium Arrangements*, 120 *SOLICITORS' J.* 240 (1976).

35. Hannon, *supra* note 2, at 122.

36. *Id.*

37. *Id.* at 242.

This may seem unfair to the other members, but such an approach significantly reduces the risk that the defaulting member will find the threatened penalty so great that it will opt, or be forced, to declare bankruptcy which will then throw the initial burden of the payment of the entire amount of the liquidated damages owed to the buyer of the project back on the remaining members of the consortium. Of course, all the members could seek mutual protection at the time of creation of the initial consortium by demanding guarantees of parent companies, or requiring insurance company bonds, or bank guarantees from each member,<sup>38</sup> but a degree of prudence in estimating the sum required must be exercised, as the cost of such financial guarantees will have to be included in the price to the customer.

### E. *Financing*

Most large infrastructure projects in the world today require that the companies bidding on such project arrange for some type of long term financing of the project. As long as the bidders are all from one country, this is a relatively simple problem. The problem becomes serious when a consortium of companies from two or more countries seeks to arrange such financing. The various banks involved have significant differences as to terms, interest rates, grace periods and formalities.<sup>39</sup> This makes the preparation of the financing package extremely complicated, and may penalize the more complex international consortia if they must prove the competitiveness of their proposal, with its several varieties of repayment terms, against the single offer from companies coming from one country with one financial package. It is contended that this is a major reason why many large projects in recent years have been bid by "national" consortia, *i.e.*, those coming from one country, rather than "international" consortia. The latter combination may be able to put together a package of currencies which is cheaper to the ultimate customer when measured against an absolute standard of any one currency, but many customers prefer not to make such evaluations, feeling that the paperwork complexities and difficulties in making currency evaluations for budgetary purposes are so great that they outweigh any apparent financial loss.

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38. This discussion assumes that no single source project financing by an agency such as the International Bank for Reconstruction and Development (the World Bank) is available to the host nation for the project.

39. *Id.* For a general discussion of multi-source international project financing, see 1975 FORDHAM CORPORATE LAW INSTITUTE, INTERNATIONAL PROJECT FINANCE (J. Sweeney ed. 1976).

### F. *Payment*

Even if the parties to the consortium agreement are able to acquire financing, they are then confronted with the problem of reconciling the terms of payment offered by the bank(s) with that of the potential customer in the project contract. Here the interests of the usually asset-rich equipment manufacturer and those of the usually thinly capitalized construction company may diverge rather sharply. The manufacturer, while he would like to recover all his costs in advance, usually is more willing to waive the benefits of such a demand than a construction company which must conserve its working capital at all times.

The problem is made more difficult if a specialist type of contractor is involved in the project, and is not prepared to wait for payment until the consortium is paid. If this entity provides services that are unique and thus is able to insist on its own terms, its demands can be met by either of the following two alternatives:

[F]irst . . . to arrange for one of the constituents to take responsibility by accepting the non-member as a sub-contractor, and to be remunerated for bearing the responsibility of furnishing the temporary capital required by being permitted to take a marginal profit on the transaction.

[S]econd . . . for the consortium to draw upon the constituents by way of loan to bridge the gap in time between the payment to the non-member supplier and the receipt of funds from the customer.<sup>40</sup>

Another problem arises from the refusal of companies to accept the payment terms or procedures of the customer without the other members' assurance that they will be indemnified in some manner if the customer fails to insure payment within a stipulated period of time. A clause in the consortium agreement giving a member either the right to suspend work or the right to receive advances from the other members of the group, if invoices are not approved and paid within a stipulated period of time, is vital to any company weak in working capital. Of course, all the members should seek either a right of suspension or the right to charge interest on delayed payment if the same period of time passes and the customer has not acted so as to insure payment within that pe-

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40. Boulton, *Finance in the "Single Project" Consortium*, 1961 J. BUS. L. 368, 371-72.

riod. Still, interest to a thinly capitalized company is only marginally helpful; it is better for such a company to forego the interest in favor of reimbursement from the other members. The "remuneration" to the other members making the advances is the share of interest on the delayed payment which would have gone to the member which insisted on indemnification.

### G. *Procedure for Invoicing and Payment*

A related element of a properly drawn consortium agreement, which is sometimes overlooked or treated somewhat superficially, is the procedure for invoicing and payment.

The method of invoicing and payment will almost certainly be laid down in the main contract. Within the Consortium it is normal for each Member to send invoices to the Project Manager who will collate them and, after adding an appropriate part of his fee and the common expenses, provide a separate invoice to the Customer in the name of the Consortium or in his own name.

The method of invoicing chosen may be affected by the fiscal laws in the Members' or Customer's countries, or by the respective laws of the Consortium agreement or main contract.<sup>41</sup>

Additionally, there are the following considerations. First, billing in the name of the consortium should be avoided in any jurisdiction where, for tax reasons, it is desirable to avoid giving the appearance that an entity has been created.<sup>42</sup> For this reason, the separate invoices should be merely collated and transmitted in such a jurisdiction. Of course, besides separate billing, each member should keep a separate set of books.

Second, the parties may find it more convenient to divide the invoicing procedure in two, and have one locus for the preparation of invoices for that portion of a project to be paid in foreign exchange, and another for the portion of the price which is payable in the local currency. Normally, the formalities for the approval and payment of invoices denominated in a foreign currency are much more complex than those calling for payment in the local currency; the former often requiring the approval, or review, of a separate central bank or ministry of finance.

It is also often convenient to have the office of the Field Pro-

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41. Guide, *supra* note 5, at 13.

42. See note 20 *supra*.

ject Manager, rather than the staff of the Consortium Leader, prepare and present the invoices in the local currency. Where billing is on a "percentage of progress completed" basis, arguments over the amount of work done can usually be settled or compromised by the Field Project Manager and his counterpart on the staff of the customer. Also, payment of invoices may be pursued more effectively by the staff of the Field Project Manager on the scene which, hopefully, will be able to establish a good rapport with the financial staff of the customer.

Third, care should be taken to insure that setting out a separate charge for the services of the Consortium Leader is acceptable to the customer, as in some countries such a fee would have to be "buried" in a breakdown of the prices for equipment and services.

#### H. *Expenses of Consortium Members*

While it is understood that each consortium member supplies its own working capital and pays its own expenses once the contract for the project has been obtained, the memorandum of association and consortium agreement should pay particular attention to the following questions. (1) How are the costs of preparing and negotiating the proposal to be allocated, particularly in the event the consortium is unsuccessful in its quest for the main contract? Some companies, particularly those that specialize in engineering, will want some guarantee of reimbursement for all or part of their expense regardless of the success of the group. However, all proposal and precontract expenses are usually for the separate account of each member. (2) If one of the members of the group decides to drop out because it cannot accept the price or terms of the main contract, will it have any obligation to reimburse any of the other members for the expenses they incurred in pursuing the project? Presumably, any member who wishes to drop out of the group should be free to do so without penalty of any kind. Forcing it to pay part of the precontract expenses of the other members is a coercive device which leads to decisions to accept contracts that it would otherwise not enter. A provision might be drafted obliging a withdrawing member to pay expenses of the other members up to an agreed upon amount, with the knowledge that such a limited liability provision might find a greater degree of acceptance. Good commercial relations demand that such a provision be discussed at the very beginning of the consortium's relations, rather than raised after negotiations with the customer have commenced. Absent such

a provision, each cash member should be free to make its own "bid-no bid" decision without penalty. (3) In the event of delays caused by the fault of one or more of the members, will those members reimburse the other members for the extra costs incurred by them as a result of the delay? Many companies that willingly accept all or a portion of the liability of the customer, feel that the added costs of the other members are in the nature of consequential damages which are either unacceptable or acceptable within certain narrowly defined limits.

While there is a good argument that a delaying member should be responsible to his fellows for their added expenses, the proper solution calls for a limit to be placed on this exposure. Each member can add to its contingency pricing a reasonable amount to cover possible delays by other members. To make another totally liable in an attempt to protect against this contingency is to ask for endless argument and, ultimately, some form of litigation. (4) Who is to bear the costs incurred after completion of the project? Unanticipated delays in obtaining provisional acceptance of the project may cause additional costs to the construction company furnishing the facilities for the technical advisors. While in theory such costs should be for the account of the customer, in practice it is almost impossible to obtain reimbursement for such expenses.

It seems that the costs incurred after completion should be borne by all the members, not just those directly obligated to absorb them, in proportion to their respective percentages of the entire project, on the theory that all should suffer for delay or default of the buyer.

### CONCLUSION

A consortium is a contractual association between business entities which does not presume any fiduciary relationship. The heart of the contractual association is the consortium agreement. This document embodies the relationship between the consortium members, and therefore should be drafted carefully. Clarity and specificity in the consortium agreement hopefully will prevent the imposition of duties and liabilities on the consortium members that were never intended or anticipated.