

Consortium: A Risky Business

Consortia are not right for every project. They are however a useful contractual arrangement for delivering risky engineering projects. But they bring their own unique risks and a considerable management challenge.

The execution of engineering projects is a risky business. The risks associated with their supply are normally defined in writing in the contracts that parties enter into. Contracts are in effect statements of risk; they contain obligations that need to be complied with and corresponding liabilities if compliance is not achieved. They are the written record of how the risks associated with the delivery of a given project are to be divided between the parties.

The form of the written contract can have a bearing on the respective risks of the parties. One particular type of contractual arrangement that has been specifically designed to achieve a more even spread of risk sharing is the consortium or joint venture approach.

A joint venture is a short or long term cooperation arrangement between two or more parties for the purposes of undertaking a common project or enterprise. There are two basic types of joint venture recognised by most legal systems. One is the Corporate Joint Venture the other the Contractual Joint Venture.

The Corporate Joint Venture as the name implies involves the creation of a corporation, an independent legal entity with shareholders and liable in law for all obligations of its interests which are separate and distinct from those of the shareholders. Such an approach is most common between large companies who pool their expertise in a particular field to develop markets or undertake large-scale development projects on a permanent or semi-permanent basis.

The Contractual Joint Venture by contrast has no permanent structure, is governed by a contract entered into by the parties and is formed mainly for the purpose of delivering short-term one-off projects. The most common use of such ventures in engineering is a consortium.

The Nature of a Consortium

The consortium approach to project delivery is chosen because of the desire to share as evenly as possible the risks inherent in that project. In this regard consortium agreements are sharply different in concept to subcontracts. Most legal systems view consortia as partnerships, simple partnerships (einfache Gesellschaft, société simple) subject to the laws of ordinary partnership current in the jurisdiction governing the

A Consortium is a partnership with shared goals and liabilities

contract. A consortium is like establishing a temporary business without the formal structure or tax liabilities, a business that is governed by the rules laid down in a contract or “consortium agreement”.

The key characteristic of an ordinary partnership (or consortium) is that all partners share responsibility for the performance of the common purpose of the partnership and the losses and profits incurred as a result (normally on an equal basis unless otherwise agreed). So for example a civil engineering contractor who joins a consortium that has as its purpose the turnkey supply of a car factory will be liable for the losses incurred in the equipment supply and erection up to its defined share (even though the civil contractor only supplies the foundations) unless its liability is limited in some way.

**Limiting liability
is not easy**

In the written consortium agreement parties are of course free to decide exactly what share of the liabilities they take, whether measured as a defined percentage (for example based on the relative values of their defined scopes of work) or limited in some other way. The best approach is to define with absolute clarity in the consortium agreement which elements of the project are “common elements”, for which losses or profits arising from performance are shared (and what the percentage shares are), and those elements that are solely the liability of an individual partner. However, in the latter case clear regulations are needed on what to do in case of non-performance and what sanctions can be applied to the non-performing partner. In the case of non-performance, the other partners will normally be bound to complete the defaulting party’s work or the common purpose of the consortium will not be fulfilled. Therefore it is very difficult for any consortium member to limit its liability simply to the risk attached to delivery of its defined scope of supply or the potential losses on predefined common elements.

In the case of our civil engineering contractor, if he were to limit his liability to matters arising directly from the supply of his scope of work only, there would be no point in him being a member of a consortium. In such a case it would be better to enter into a subcontract arrangement thereby giving the consortium better control over his performance. The corollary to this is that it is unrealistic to expect a supplier to join an engineering consortium as a member when the majority of the work involves the supply of elements so far removed from the normal business of the proposed member that he cannot judge the design and execution risks.

Advantages and Disadvantages of a Consortium

The advantages of forming a consortium are:

Ease of Formation

No formal procedure must be followed though most consortia are formed in writing by the execution of a consortium agreement. In addition no capital is required to create the consortium.

Flexibility

Members of the consortium can change their contractual agreement at anytime to suit changed circumstances.

Ease of Termination

Consortia can be set to expire on a given date or on the occurrence of certain events without the formal requirements needed in the case of the dissolution of a corporation.

Tax Transparency

The consortium is not directly subject to taxation the individual members are.

Confidentiality

Some of the members of a consortium may choose to be “undisclosed” parties in dealings with third parties.

Costs

The cost of running a contractual joint venture is generally lower than running a joint venture company.

There are however certain disadvantages:

Liability

It is difficult for a consortium member to restrict or limit its liability. Members may even become liable to third parties for the non-performance of other members of the consortium or the debts of such members incurred in undertaking the common project.

External Relationships and Funding

Third parties often find it difficult to enter into contract with a non-legal entity like a consortium. Because it is a non-legal entity funding is also normally only available to the individual members and not the consortium itself.

Lack of Permanent Structure

The lack of a permanent structure makes it difficult for a consortium to establish long-term business relationships with third parties. In addition, the lack of permanence means the consortium agreement is a crucial document and not easy to draft. It must be clear on the rights and obligations of the parties, which need to be focussed firmly on the purpose of the consortium.

Leadership

A Consortium Leader owes a high duty of care to other partners

It is quite common for one of the parties to a consortium agreement to be named as leader of the consortium and be given specific powers for example as technical manager or commercial leader. In such circumstances the consortium leader owes his other partners a high duty of care. This duty of care is higher than owed by a normal contractor to a sub supplier.

The leader will need to account for his actions and make available all necessary paperwork for inspection. This requires the leader to have considerable skills in project management and in particular be familiar with “open-book” procedures, something some organisations might find uncomfortable.

In Summary: Be Clear

A consortium is a contractual arrangement specifically designed for use when two or more parties wish to share the risk inherent in a common project. Therefore before entering into a consortium arrangement the parties need to be absolutely clear as to the common purpose of the venture and be completely aware of (and have clearly agreed on) what elements of the common purpose or project they have agreed to share liability for performance.

A written consortium agreement is crucial and requires to be drafted with the utmost clarity.