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Contractual networks in the third millennium: Transnational principles

Prof. Fabrizio Cafaggi
Italian Council of State

The key questions

- Contractual networks as instruments to promote cooperation among SMEs
- Why should the focus be on multiparty contracts (MPKs) ? What are their functions?
- Do Contractual networks cover both domestic and international activities?
- What are the differences with the corporate entities? Contracts and company law: alternative or complements?
- Complementarity between contract and company law instruments to promote collaboration among SMEs
- 1) Which complementarity between contract and company law to promote stable and innovative cooperation?
- 2) Why are common general principles useful both at domestic and international level?
- Contractual networks in global value chains

When and why do contractual networks emerge?

- **When**
- **Contractual networks can be used to coordinate production.** Producers of inputs may coordinate in order to produce various components of an intermediary good like the turbine of an airplane or the drilling rig for a mine or for an oil platform. They can also coordinate agricultural production by integrating seeds producers, fertilizers producers and farmers into a single contract.
- **Contractual networks can be used to coordinate distribution. When a product has to be distributed in many countries.** Typical examples are franchise, distributorship, agency
- **Contractual networks can be used to integrate production and distribution.**
- Contractual networks develop differently in supply chains and markets. In the former they tend to be more stable and driven by the chain leader instructions to stabilize coordination among linkages along the chain. In the latter they emerge to find new competences and new skills. They are usually less stable and with a higher degree of entry and exit.
- **Why**
- **Access to global chains and to new markets.** Contractual networks may be used to meet larger requests that individual firms would not be able to satisfy. Contractual networks may promote access to new markets. These contracts are used when small producers aggregate to distribute complementary and at times even competing products in new markets. There are contractual networks concluded by wine producers to access the Russian or the Chinese markets.
- **Sharing innovation.** Contractual networks may promote platforms sharing IPRs to be used upon license by the suppliers of the same supply chain or by suppliers of different chains. These are frequent in agriculture, in telecom, in pharmaceutical industries.
- **Welfare for employees.** Contractual networks may integrate business and welfare supply. Employers may have agreements to joint supply welfare benefits

Business organizations. When and why do contractual networks emerge?

- Contractual networks are **one form of business organization** based on:
 - A) The complementarity of competences and expertise among the participants.
 - B) They focus on one or more projects to be jointly developed. They are usually relational and incomplete contracts. They define collaborative strategies to be specified by development plans subsequent to the agreement. **They go beyond pure exchange contracts.**
 - C) They feature different degree of asset sharing. They develop often when property rights, especially IPRs, are difficult to define ex ante in relation to the implementation of the project in the future. Several options are deployed:
 - C.1) Joint ownership and consensus based decision-making characterize many of the contractual networks when asset sharing is related to IPR.
 - C.2) An alternative to joint ownership by the contractual partners is represented by a contractual network combined with the creation of a newco with the ownership of IPRs

Contractual networks as multiparty contracts

- **Contractual networks are one type of multiparty contracts**
- Codified legal systems supply a few rules concerning the specificity of multiparty contracts.
- Some legal systems provide a legal framework for specific type of multiparty contracts. Others simply apply the rules for bilateral contracts.
- **Are multiparty contracts simply an extension of bilateral contracts?**
- **NO!** Often MPKs are not about simple exchanges but about complex projects that involve joint or at least coordinated activities of multiple actors. They are usually incomplete contracts that require collaboration to define implementation strategies difficult to be fully ex ante specified.
- How to protect the common asset from individual opportunism in MPKs? Opportunism and hold up in multiparty versus bilateral contracts. The toolkit against opportistic behavior in MPKs.
- Multiparty contracts call for specific rules concerning the entry in the contract, the implementation of the project, (fundamental) breach, remedies, rescission.
- They generally require a more complex governance structure than bilateral contracts. They create committees representing the parties controlling the implementation of the contractual program.

Contractual networks as multiparty contracts

- **Contractual networks represent a specific type of multiparty contracts.**
- They concern **temporary collaboration** between firms engaged into a common project or even in multiple simultaneous or sequential projects.
- They may be limited to information sharing or include some degree of asset sharing to implement the project.
- They usually include some degree of cooperative investments by each party.
- They may be limited to the parties engaged in the implementation or involve financing. In the latter case financial partners may be given special status and position in the governance of the contract.
- They may be executed by parties belonging to the same supply chains or by parties operating in different supply chains.

The boundaries between contractual networks and corporate entities

- Contractual networks and corporate entities can either be alternative or complementary.
- Firms engaging into a cooperative venture may choose a contract or a company depending on:
 - A) the degree of initial knowledge and trust among participants;
 - B) the number of projects parties want to realize;
 - C) the level of specific investments and its distribution among parties. The governance will be different if specific investments are asymmetric and if they are made at different points in time;
 - D) the degree of asset sharing instrumental to implement the project(s);
 - E) the governance structure and the level of asset partitioning.

The boundaries between contractual networks and corporate entities

- Cooperation among SMES both at national and transnational level can take different forms and can evolve over time.
- MPKs can be the initial step for a collaboration that can intensify over time with increasing sharing of material and immaterial assets. Hence parties may decide to start with contractual collaboration and transform into a corporate entity the collaboration after a period.
- Contracts and companies can also co-exist since the very beginning depending on the nature of the project. Parties may choose the contractual instrument for some project and the company instrument for other projects. Typically projects with higher level of uncertainty will be dealt with contracts. Projects with higher level of certainty will be dealt with companies.
- The Transnational principles should clearly define how the two or multiple instruments should be coordinated and integrated.

Contractual networks and network contracts: The Italian experience

- In the Italian legal framework a distinction is made between contractual networks and network contracts.
- Contractual networks is the genus. Network contracts is one example of the multiple options enterprises have to engage into cooperative endeavours.
- Network contracts represent a particular type of multiparty contracts between enterprises to exchange information, carry a common project, share assets.
- Network contracts have been introduced by legislation into a landscape that already featured collaborative contracts like consortia, multiparty joint ventures, GEIE, temporary enterprises group. **They do not replace any existing form.** They integrate the menu of available options and provide parties with a flexible and stable business organization.

Sectors

- Where do we find contractual networks?
- They can be found in many sectors
- Agriculture
- Construction
- Oil and gas
- bio tech
- telecom
- Automotive
- Distribution
- E-commerce

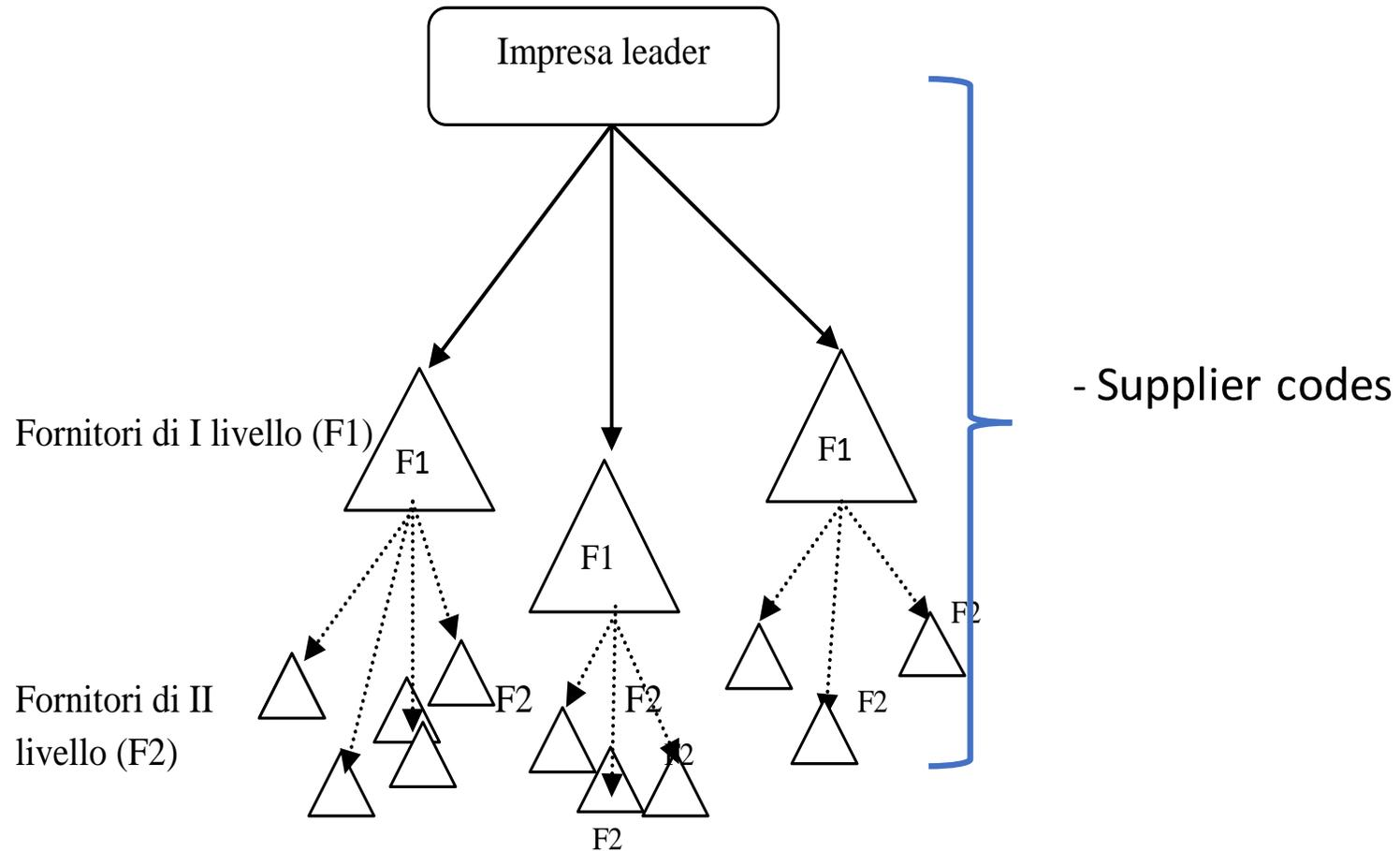
Multiparty contracts and some useful taxonomy

- Single versus multiproject networks
- Vertical versus horizontal networks
- Temporary versus stable cooperation
- Asset sharing versus non asset sharing

Vertical and horizontal contractual networks

- **Vertical Contractual networks** often emerge in global supply chains where production or distribution have to be coordinated among various enterprises often located in different jurisdictions.
- Vertical contractual networks can integrate different stages of a production process or production process and export. These contracts are embedded into global framework agreements or suppliers codes that regulate the relationships along the chain.
- **Implementing transnational standards.** Common quality and safety standards uniformly applicable along the same chain impose forms of coordination to a much stronger degree than in the past. The external coordination of the chain leader is a necessary yet insufficient condition to ensure effective coordination.
- **More effective monitoring.** The use of multiparty contracts in global supply chains can improve the quality of coordination, make performance monitoring more effective, trigger joint problem solving when unanticipated problems arise, decide sanctions for non performance when no cooperative strategies with non defaulting parties are available.
- **Joint problem solving.** Contractual networks are used to address common problems along transnational chains.
- The corporate model is not a viable alternative option to pursue these goals. Parties do not generally share assets, they have to implement common standards and contracts are proportionate instruments to ensure the necessary degree of asset sharing.

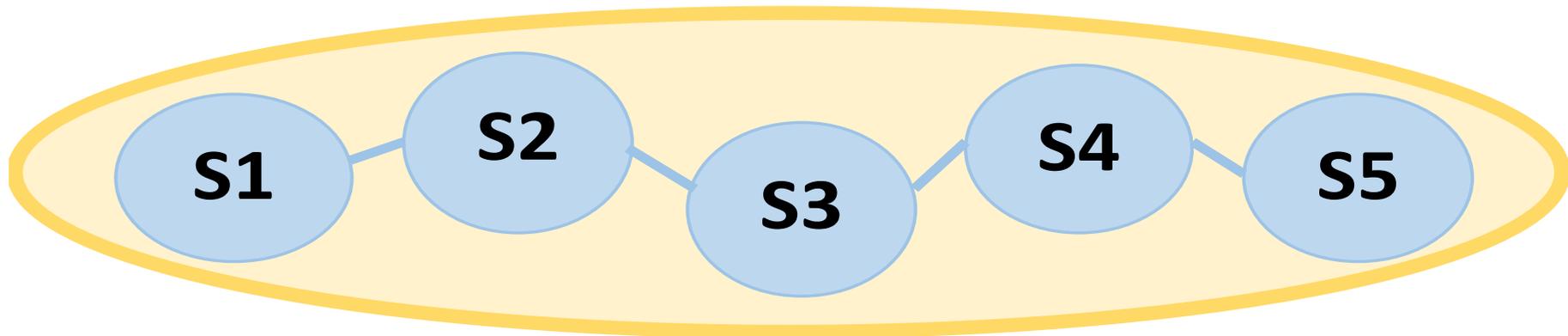
Vertical contracts within supply chains



The Automotive Supply Chain

CHAIN LEADER

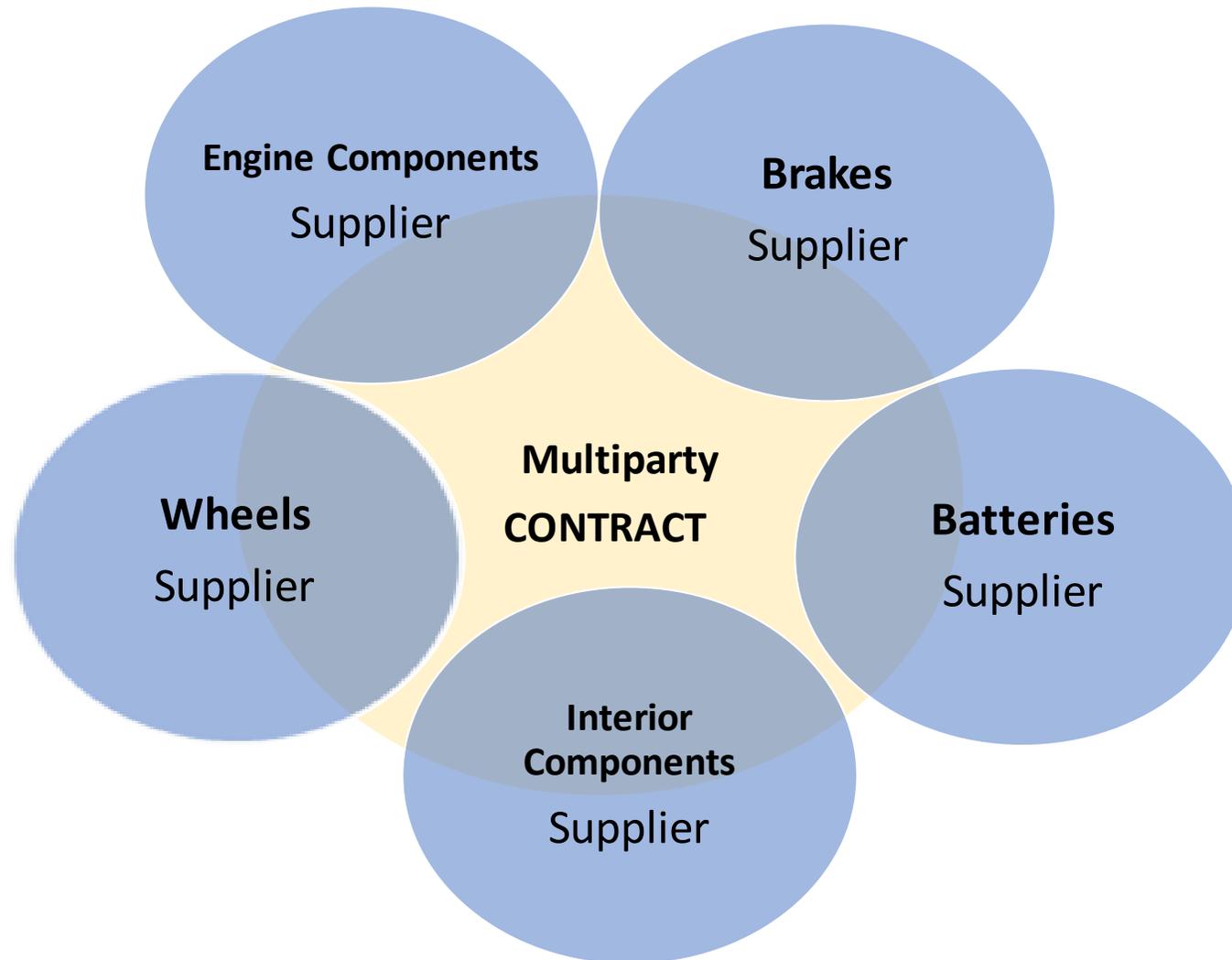
(BMW – FORD – TOYOTA etc.)



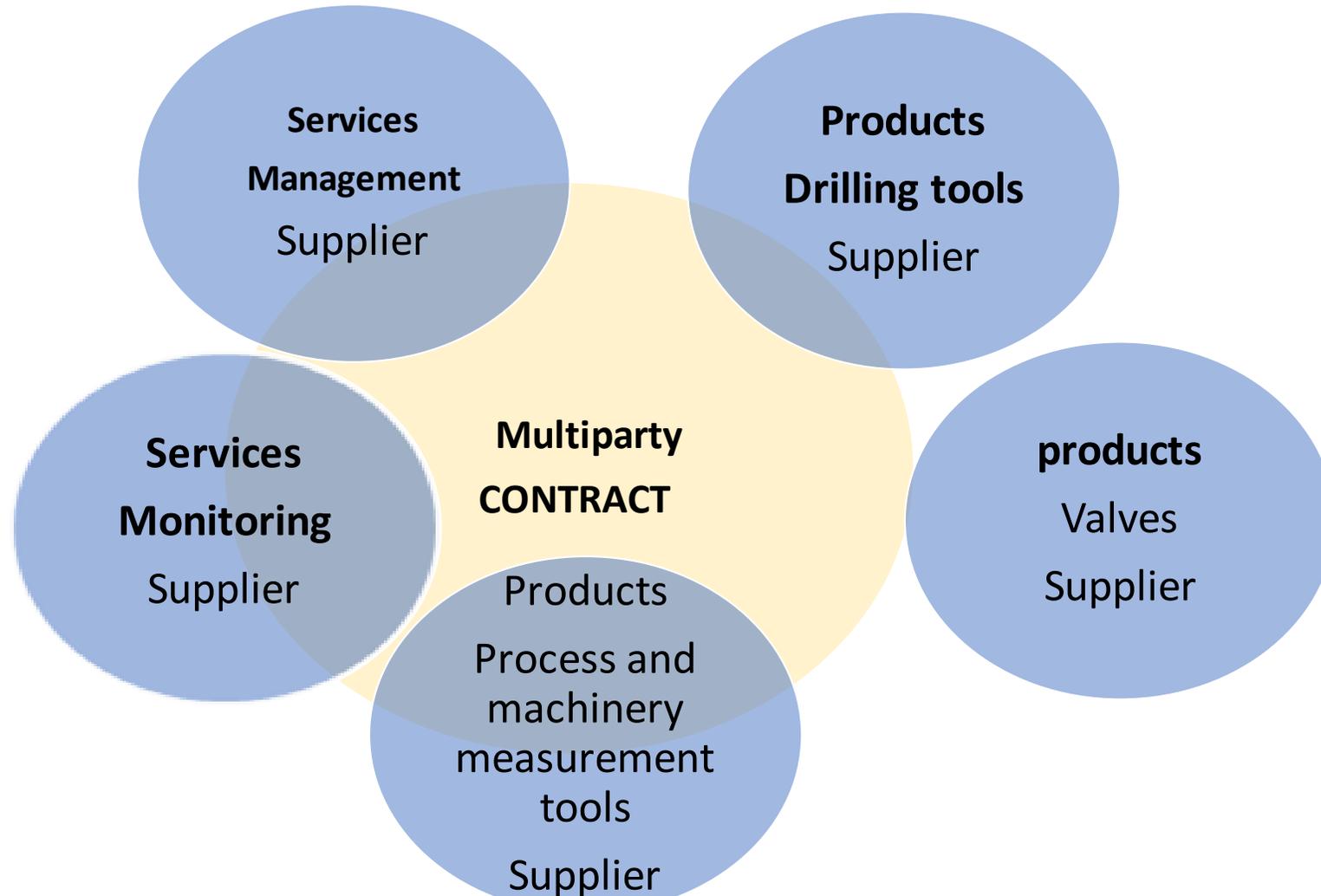
Vertical and horizontal contractual networks

- Horizontal contractual networks
- Platforms among SMES
- For innovation
- For logistics
- For export

Horizontal Network in the Automotive Industry



Horizontal contractual network in Oil and Gas



Temporary versus long-term cooperation

- Contractual networks are collaborative endeavors.
- Contractual collaboration can either be short or long term.
- Duration is usually associated with stability and complexity.
- Short term and single project collaboration tends to be implemented through simpler MPKs. They tend to have one network manager who represents the participants with third parties and is responsible for the implementation of the project towards participants and financiers. The corporate model is not a viable option for short term cooperation.
- Long term and multiproject collaboration may either be implemented through contracts or through companies or a combination. They usually have a more structured governance with a committee representing the partners and responsible for strategic implementation of the projects.

Investments specificity in multiparty contracts

- MPKs may require specific investments made by the parties. These investments may be made at different points in time depending on the project.
- When specific investments are asymmetric e.g. some parties make more than others and are made at different times risks of opportunistic behavior is high. Coordination and safeguards have to be imposed along the chain through clauses in MPKs.
- In order to address the risk and to avoid sunk costs cooperative incentives may be designed in MPKs to ensure that opportunism is mitigated and that cooperation is incentivized.

Common Transnational Principles for contractual networks: a modular architecture

- Many legal systems have one or multiple legal forms devoted to collaboration among enterprises.
- These forms range from consortia to joint ventures, from partnerships to strategic alliances.
- Barriers to transnational cooperation among SMEs. Huge differentiation both within and across countries exists, making international collaboration of SMEs often difficult and costly.
- **Common principles with a modular architecture** that allows multiplicity of forms but uniformity of principles can help economic growth, access to global chains and foster trade.

Common transnational principles for contractual networks

- The legislative instrument should provide SMEs with a large and diverse menu of options to engage into collaborative ventures both at domestic and transnational level.
- Common principles for contractual networks could have the following features:
- I) The nature of the principles. **Default rules** that allow self-sufficient application without making reference to legal regimes concerning bilateral contracts;
- II) **A modular architecture to include multiple forms of contractual networks.** General rules able to encompass different models from joint ventures, to consortia, from partnerships to GEIE, from network contracts to strategic alliances;
- **A modular architecture to accommodate sector specificity.** Common principles applicable to different sectors from agriculture to biotech, from automotive to telecom, from oil and gas to construction;
- III) **The focus should be on multiparty contracts** related to the implementation of common projects but some principles should also include financing;
- IV) **Complementarity between contracts and companies.** The complementary nature of contractual and company instruments require simultaneous and sequential coordination between the two instruments;
- V) **An evolutionary pattern.** The principles should envisage the possibility to transform the contractual network into a company but also the possibility to transform a company into a MPK depending on the goals of collaboration;
- VI) **Compliance with competition law.** The creation of contractual network both at domestic and transnational level should comply with competition law requirements.