



Risk Tip 15 – Risk Considerations When Forming a Joint Venture

Provided as a courtesy by the ACEC/MA Risk Management Forum

November 2016

There are many valid reasons why design firms form joint ventures for construction projects. Often the formation of a joint venture is driven by the project owner seeking to enhance competition or to increase Small Business Enterprise or Disadvantaged Business Enterprise participation on a project. Design firms may enter into joint ventures with contractors to bid on design build work. Some firms may enter into joint ventures in order to gain additional expertise or enhance capacity. Though joint ventures can be useful tools for project performance, they are not without additional risk.

The liability to members within a joint venture is not limited to the member's percentage ownership in the joint venture. Our legal system imposes "joint and several" liability upon each member within a joint venture. Joint and several liability means that a third party pursuing a claim against a joint venture can pursue the claim individually against any member of the joint venture. Each member is liable for the full amount of the obligation regardless of their ownership within the joint venture. If another joint venture member is unable or unwilling to contribute their share toward satisfying an obligation, the other members will have to make up for the shortfall. Thus a 40% owner in a joint venture could be responsible for 100% of the liability incurred by the joint venture in the event that the other owner(s) are not able to pay their share.

Before entering into a joint venture, it is important to know the reputation and financial condition of the other partners within the joint venture. Do they have the ability to perform their obligations as set out in the joint venture agreement? Are they financially able to bear their share of the risk?

A design firm considering a joint venture with a contractor to serve as prime on a design build project needs to carefully assess the additional risk associated with the performance of the construction. Even though the agreement may have the designer bear responsibility for the design and the contractor bear responsibility for the construction, the joint and several liability of the designer puts the firm at risk in the event that the contractor does not perform. The designer is jointly responsible for any payment obligations to subcontractors as well as warranties on the construction. If bonds are required on the project, the surety will seek a cross indemnity from the design firm making it equally responsible in the event of a default. There is no insurance that the design firm can secure against these financial risks. The designer's only protection is the extent to which the contractor is willing to perform its obligations and has the financial capacity to do so.

Often firms entering into joint venture agreements will establish the JV as an LLC with little capitalization. The JV LLC then enters into separate contracts with each member firm to perform their portion of the work. Each firm then indemnifies the JV against liability arising out of the services the firm performs under contract to the JV. A qualified attorney needs to be consulted in order to determine whether or not this strategy would provide any protection to a firm against the joint and several liability risk incurred as a member of the joint venture. Even if this strategy affords some protection, a firm still risks damage to its reputation if another member within the joint venture fails to live up to its obligations.

A detailed written joint venture agreement is critical to managing risk. The agreement should be in place before bidding or proposing on the project so that responsibilities and expectations are clear. The scope of the agreement should clearly address what the joint venture will and will not do. There also needs to be a clearly defined time as to when the joint venture begins and ends. The contract should specify whether or not the members are free to perform on other projects for the same client or if all work can only be done through the joint venture. Depending upon the degree to which the JV will be capitalized and the type of work the JV will contract to perform, other key clauses include ownership of assets/liabilities; responsibilities of the members; accounting and tax matters; distributions of assets to the members; disputes resolution; default/termination and insurance. AIA has a standard form of Joint Venture agreement for use by designers. Consensus Docs can be consulted as a starting point for a design/build joint venture. *Regardless of how firms develop the joint venture agreement, it is essential to seek competent legal as well as accounting advice when forming a joint venture and in drafting the joint venture agreement.* It is also important to check on registration regulations and tax ID requirements in the state where the joint venture is to be formed.

In the written agreement, each member should indemnify the other members for any amount above each member's proportionate share of the joint venture. Also each member needs to indemnify and hold harmless the other members for liability that is caused by the individual member's own actions.

Finally the contract needs to address how decisions will be made within the joint venture. Will decisions be based upon a simple majority or will they require unanimous consent? In the event of a claim made against the joint venture, how will litigation be handled? Who will choose counsel? Who can decide on settlement?

Though there may be benefits to forming joint ventures to perform projects, be aware of the risks inherent in such a partnership and have a solid plan to manage those risks.

This ACEC/MA Risk Tip is intended to provide current and accurate information to assist the reader in becoming more familiar with the subject matter. It is informational only and not intended to substitute for technical, legal, or risk management professional advice. The reader is encouraged to consult with an attorney or appropriate professional consultant to explore this information further.

For more information on the ACEC/MA Risk Management Forum or on other ACEC/MA activities, call 617-227-5551 or go to: www.acecma.org.