

JOINT VENTURES

WHAT IS A JOINT VENTURE AND WHY IS IT BACK IN VOGUE?

Joint ventures provide a unique risk management approach for contractors who are pursuing larger, more complex projects or projects with a critical component not provided by their own expertise. In its simplest form, a joint venture is a “joint and several” partnership between two or more firms to jointly contract with an owner to fulfill a contract. While joint ventures are well established, recently we are seeing an increase in their use due to a variety of reasons.

WHY AN INCREASED INTEREST IN JOINT VENTURES?

- Project sizes have increased, testing the upper limits of surety capacity.
- Owners are looking to contract with a single responsible party that will manage a variety of construction activities, such as those required in complex civil work.
- Longer project durations increase risk, especially when material and labor costs need to be managed for projects lasting four or more years.
- Contractors’ local opportunities may not be as plentiful today as two years ago – many contractors are looking for partners to enter different geographic markets.
- Contractors may want to stretch for bigger jobs that are close to their home base, but they need a joint venture partner to address larger bonding requirements.
- There are also times when local knowledge, labor relations, political relationships, etc., make a smaller firm of great value to a large firm for unique project opportunities.



- One of the most significant benefits of a joint venture can be the independent bid “take-off” two firms undergo in reviewing a large project. This gives the combined JV team the opportunity to gain fresh knowledge and apply creative approaches to project execution and risk management.
- Contractors may view a joint venture for logistical or strategic reasons, as a prudent risk strategy for a given project.

WHEN DO YOU NEED A JOINT VENTURE?

- If the project size is significantly larger, different or in a new geographic area than something the contractor has done previously.
- Surety companies often encourage contractors to consider JVs on projects in excess of \$200 million.
- Sureties see JVs as desirable in managing the risk at the contractor level, as well as in spreading their own risk.



JOINT AND SEVERAL - WHAT DOES THIS MEAN?

It simply means that each partner, regardless of the percentage splits of profit or capital invested, is 100% responsible for the entire contract to the owner and the surety(ies).

Select your partners carefully – you are 100% responsible for your share of the work and the partner’s share as well! Formation of a JV should be the result of thorough, mutual evaluation of skills, financial resources, equipment, personnel and business philosophy.

HOW DO YOU MITIGATE JOINT AND SEVERAL RESPONSIBILITY?

The joint venture could be a limited liability company created from the operating subsidiaries of two construction companies. The joint and several responsibilities via the contract with the owner would then be to the joint venture entity and the operating companies, not necessarily the parent organization of the operating companies. This level of mitigation has to pass the test of the owner’s pre-qualification review process. Even if the owner agrees to this lower level “joint and several” commitment, the partners have to decide among themselves what level of guarantee they are giving to each other – just their operating companies, or parental guarantees, or something in between?

Another consideration is which type of JV model to use: a “line item JV” or a more traditional JV. In the line item JV each partner is responsible for specific work. For example, one does the roadway and approaches and the other bridge structures. Each would execute their share of the work, finance the related mobilization costs, provide the required equipment, labor and materials and incur the profit or loss on that specific work. In a more traditional JV arrangement, the partners agree to a split; for example, 60/40. They jointly agree on a work plan, and then capital contributions and profit/loss sharing will be according to the JV share, in this case 60/40. In both the line item JV and the traditional JV the partners remain joint and several for the entire project, regardless of the line item responsibility or the profit/loss split.

WHAT IS THE BENEFIT OF A JOINT VENTURE TO THE SURETY?

- They do not get involved until/unless all JV partners are unable to complete the work.

- They assume the surety risk jointly and severally as well with the other surety companies – not just for their client/contractor.

Let's say, Smith and Jones JV: Smith is bonded by surety A and Jones is bonded by co-sureties B and C. If Smith goes out of business, Jones has to finish the entire JV and the surety companies are not involved. Jones has no bond claim to Smith's surety A. If Smith and Jones both go out of business, surety companies A, B and C will share the JV bond claim according to the JV split. If surety company A is out of business, B and C have it all according to their co-surety split.

WHAT METHODS DO SURETY COMPANIES HAVE TO OBTAIN INDEMNITY FOR JOINT VENTURES?

Often their General Agreement of Indemnity includes JVs as well as "other surety" clauses that give the benefit of their indemnity agreement to a joint venture surety.

There are also three industry standard type JV indemnity agreements:

- Form 1 – All JV participants are parties to the contract and principals on the bond.
- Form 2 – The contract is signed by one or more JV participants, but there are also other "silent" JV participants. In this case the silent JV participant is not joint and several to the owner but is an additional indemnitor to the surety.
- Form 3 – The JV forms a separate entity to contract work; e.g., a limited liability company or a separate corporation.

WHAT SHOULD BE CONSIDERED IN A JOINT VENTURE AGREEMENT?

Common questions to address:

- How will the JV operate?
- Who will take the lead in contact with the owner or owner's representative?
- Who will provide the direct supervision?
- When will capital be required and distributed?
- Who will obtain the insurance?
- Who has the responsibility for safety?
- What are the events of default?
- What are the remedies?
- On what basis will disputes between the joint venture parties be resolved?

Clearly, all of these should be reviewed in detail and only agreed to in consultation with the contractors' legal representatives.



WHAT INSURANCE REQUIREMENTS SHOULD BE CONSIDERED?

- The contractor's own master policy needs to provide coverage for past joint ventures, because when past JV policies expire, they do not typically cover completed operations for unnamed JVs. The JV must be added as a named insured on the master policy in order to have this coverage. Some underwriters may agree to an omnibus type wording to be sure all past JVs are covered for the completed operations exposure.
- Recognize that a JV is a separate legal entity and, as such, needs to have an insurance program in place to cover its unique risk. It is possible to have coverage under each contractor's master policy but generally only for their interest in the JV – not their partner's interest.
- Some contractors prefer to segregate JV insurance risk into a separate policy so none of the losses from operations flow back to their master policy and in turn impact their own experience.
- The alternative is for the JV to have its own stand-alone coverage that gets priced into the bid and will be where all losses get reported and paid. This also ensures that the JV partners have the same coverage, carrier, limits, deductibles, etc., since they are jointly and severally liable for the entire project. This is especially important when deciding umbrella and excess limits, as a catastrophic loss on a major job where one partner does not have adequate coverage could lead to default and a shifting of the performance obligation to the other partner under the joint and several provision.
- The joint venture parties should be prepared to have their prospective sureties exchange underwriting information – including financial statements, WIP schedules, contract documents for the project, bond forms and a copy of the JV agreement. You are well advised to seek the guidance of both your CPA and surety broker in this process.
- Joint ventures, by definition, are risk management structures that are effective for the many parties involved in larger, more complex jobs. We expect their popularity to continue to grow as the economy changes. Sureties seek to protect their contractors and themselves as larger big packages are developed. Willis can assist you in making sure the surety, insurance and other risk considerations are well understood, structured and managed in your joint venture.



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