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Making Your Partnership Work: Joint Ventures in Construction

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Rise of the Mega Projects

$1 billion tunnel project

$2 billion highway project

$2 billion light rail extension

$4 billion LNG liquefaction facility

Joint Ventures – What and Why?

- What is a joint venture? A partnership between one or more businesses to take on a commercial enterprise.
- Why?
  - Share risks/rewards
  - Share resources
  - Share knowledge and expertise
  - Increase market reach
  - Increase bonding capacity

Types of Joint Ventures

- Percentage Based
- Line-item joint venture
- “Silent” joint venture
- Small disadvantaged business joint ventures
- Design-Build joint venture
- Pre-Bid Joint Venture/Teaming Agreements
- Consortiums

Forms of Joint Ventures

- Partnership
  - Can be informal
  - Partners are jointly and severally liable
  - No employees for JV itself
  - Owners favor
- Separate entity – LLC or corporation
  - Limited liability for partners
  - Requires capitalization and separate operation
  - Owners disfavor

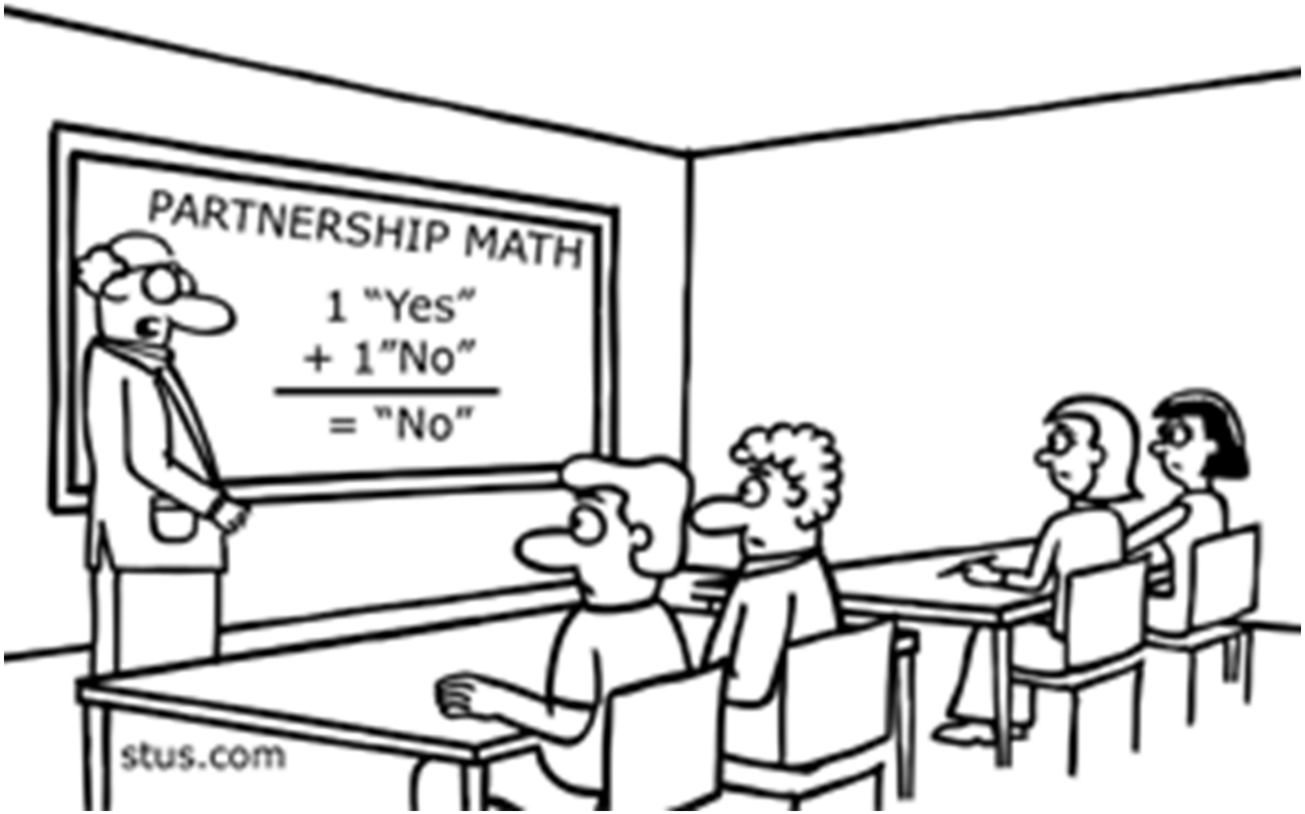
The Joint Venture Agreement

- Carefully drafted agreement is key to the success of JV
- Standard forms are good starting point
  - AIA C101-1993
  - ConsensusDocs Forms 297, 298, 299, 498 and 499
- Parties must consider the terms to ensure they reflect the parties' intent and account for unique circumstances

Standard Provisions

- Name
- Members
- Purpose
- Duration
- Bank Accounts
- Licensing and Permits
- Ownership Interests
- Insurance
- Professional Services

Management



Management

- Executive or Management Committee – JV's business affairs
  - Creation
  - Members
  - Responsibilities/Matters under control
  - Appointment/Removal of a chairperson
  - Meeting procedures
  - Voting requirements for different types of decisions
    - Majority v. Super-Majority
    - Tie breaker
- Managing Partner/Project Manager – day to day operations
  - Selection
  - Responsibilities/Matters under control
  - Appoint/Removal of Managing Partner/Project Manager
  - Liability of Managing Partner/Project Manager

Capitalization

- Bidding Costs
- Initial Capital Contributions
  - Type and value
- Additional Capital Contributions
  - Schedule
- Capital Calls
  - Who
  - Failure to Meet
  - Dispute resolution
- Third Party Financing

Profits, Costs and Distribution

- Definition of profit
- Definition of costs chargeable to JV
- Repayment of capital contributions
- Timing of distribution of profits

Liability of JV Partners

- Joint and several liability for actions of the JV and the JV partners
- Liability between the partners
  - Limits on Managing Partners liability (business judgment rule)
- Indemnification

Subcontracting and Rentals

- Subcontracting with a JV partner
  - Payment
  - Subcontract terms
  - Payroll
  - Insurance
- Rentals from JV partner
  - Rental terms including rates

Manpower and Equipment

- Who Provides Manpower and Equipment
  - Skilled labor
  - JV partner owned equipment
- Who Provides Supervision
  - Choice of project management and field supt.
- Accounting for Manpower, Supervision and Equipment
  - Agreed rates
  - Tracking of equipment usage

Confidentiality

- Need for open and candid communications including confidential and proprietary information
- Proper handling and use of such information

Reporting and Access to Information

- Types of books and records maintained
- Frequency of financial statements and other reporting requirements
- Access to information
- Who will conduct audit

Default

- What constitutes a default
- Common types
  - Failure to make capital call
  - Failure to perform work in accordance with industry standards
  - Breach of implied duty of good faith and fair dealing
  - Failure to disclose material information
- Notice and opportunity to cure
- Consequences and remedies for Default
  - Loss of rights in JV (voting, profits)

Withdrawal of a Partner

- Seldom happens because of joint liability
- Rights of the non-withdrawing partner – must provide consent
- Release of liability of withdrawing partner
- Liability to owner and JV's surety

Dispute Resolution

- Third party disputes regarding the JV
  - Usually common interest but not always
  - Different approaches to claims and disputes
  - Disputes decision process
  - Sharing of costs and proceeds
- Disputes between JV partners
  - Types of disputes
  - Dispute processes
    - Real time
    - Tie breaking
    - Mediation
    - Arbitration v. litigation
    - Jurisdiction, rules

Joint Ventures with Small Disadvantaged Businesses

- Federal Governments small business 8(a) program permits JV under certain circumstances
- Procurements set aside for business meeting the requirements of the 8(a) program
  - Types of businesses: small, disadvantaged, HUBZone, veteran-owned, service-disabled veteran-owned, women-owned
  - Size based on revenue or number of employees
- "Affiliates" considered in making a size determination
- Consider control, common ownership, common management, and subcontracting or other business relationships
- JV partners considered affiliates

Mentor Protégé Joint Ventures

- SBA regulations permit a small business (protégé) to enter a JV with a large business (mentor) and still qualify for the program
- The mentor and protégé must be in an SBA approved mentor-protégé relationship
  - Currently limited to 8(a) small businesses
  - Proposed regulations have been issued to expand the program to all types of small businesses

Mentor Protégé Joint Ventures

- If the joint venture is bidding on a contract that has been set-aside for 8(a) small businesses only, SBA must approve the joint venture agreement
- For other types of small business set-asides, SBA does not have to approve the joint venture agreement
  - Still have to comply with SBA's joint venture regulations (13 CFR § 124.513)

Mentor Protégé Joint Ventures

- SBA's regulations specify what must be in the joint venture agreement, including:
  - Assessment of the protégé's needs and the assistance the mentor will provide
  - 8(a) must be the managing partner of the JV
  - If the joint venture is a separate legal entity, the 8(a) must own at least 51% of the JV
  - 8(a) must receive profits from the JV that are commensurate with the work performed by 8(a)
  - Establishment of a joint banking account and maintenance of records
  - 8(a) must self-perform a specified percentage of the work and the work must be more than administrative or ministerial
  - Itemizing all major equipment, facilities, and other resources to be furnished by each party to the joint venture
  - Specifying the responsibilities of the parties with regard to the negotiation of the contract, source of labor, and contract performance
  - Obligating all parties to JV to complete the project despite withdrawal
  - Financial reporting requirements
- "3 in 2 rule"

Mentor Protégé Joint Ventures

- Failure to comply with the regulations will result in a finding that the JV does not qualify as a small business
- *Kisan-Pike, A Joint Venture*, SBA No. SIZ-5618 (11/24/14)
  - SBA found that the JV Agreement failed to itemize all major equipment, facilities, and other resources to be furnished by each of the joint venture partners
    - Merely stated that, "Upon award of the Contract, Kisan and Pike will provide equipment, facilities, and other resources to the Joint Venture required to execute the contract."
  - SBA found that the JV Agreement failed to specify the roles and responsibilities of the JV partners, including how the JV will comply with the requirement that the 8(a) protégé will perform at least 40% of the JV's work
    - JV Agreement made broad and generic representations that the 8(a) protégé will perform at least 40% of the work without any plan to support the claim

Mentor Protégé Joint Ventures

- Circumvention of the JV affiliation rule: FRAUD
  - Side deals
  - Ostensible subcontractor
- Examples
- Consequences
  - False Claims Act violation
  - Civil and criminal penalties
  - Debarment and suspension
  - Presumption of loss rule

Bonding

- Underwriting Considerations
  - Review of all partners to JV
  - Review of JV agreement
  - "Angel Deals"
  - Design-Build JVs
  - Federal 8(a) Program
    - Sever penalties
    - Payment and performance bond claims
    - Potential exposure for sureties and agents
      - *United States ex rel. McGough v. Covington Tech. Co.*, 967 F.2d 1391 (9th Cir. 1992)

Bonding

- Indemnity Requirements
  - Indemnity agreement
  - Joint and several liability
- Issuing Bonds to a JV
  - Get the Name Right
- Potential conflicts
  - Claims
  - Losses
  - Business disputes

What's wrong with this provision?

- Decisions of Management Committee – The Management Committee shall make all of the following decisions on behalf of the Joint Venture by unanimous agreement of the Managers:
  - Resolution of any dispute between the Joint Venture and any third party.
  - To borrow money in the name of the Joint Venture or create any loan, assignment, lease, pledge or encumbrance on the assets of the Joint Venture.
  - Capital expenditures of the Joint Venture in excess of $ 10,000.
  - Distribution of profits or other assets of the Joint Venture.
  - Initiate and/or resolve claims and/or legal proceedings by or against the Joint Venture
  - Selection of auditors to audit the books and records of the Joint Venture.

What's wrong with this provision?

- Additional Working Capital – The need for additional working capital shall be determined by a unanimous vote of the Management Committee. Within 24 hours of such determination, each partner shall pay to Joint Venture Account its percentage interest share of the amount determined by the Management Committee.

What's wrong with this provision?

- Payments by Joint Venture to Partners
  - The Joint Venture will pay all reasonable costs billed by partners for equipment, materials, supplies, labor, management, wages, salaries, benefits, taxes, temporary facilities, transportation, travel, hotels, legal costs, insurance, bonds and other expenses incurred in connection with performance of the Work of the Joint Venture.

What's wrong with this provision?

- Dispute Resolution -- All disputes arising out or relating to the Joint Venture agreement shall be submitted to arbitration before the American Arbitration Association using the Construction Industry Arbitration Rules.

Questions?

If you do not have the opportunity to have your question addressed during the seminar, you may contact the presenters directly:

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