MCAA Management Methods Manual

Bulletin

Bulletin No. JV 1 Revised
(Replaces 2011 version)
File: Joint Ventures

Joint Ventures

WHAT IS A JOINT VENTURE?

A joint venture (or co-venture or joint Adventure, as it is sometimes labeled) has been defined in many ways. One such definition is:

> "A joint venture exists when two or more persons (corporations) contribute cash, labor or property to a common fund with the intention of entering into a transaction for the purpose of making a profit to be shared in proportion to the respective contributions."

A more detailed definition would be:

> "An association of persons with an intent to engage in and carry out a single business venture for joint profit, in which they combine their efforts, property, money, skill and knowledge, without creating a partnership or corporation, by agreement that there shall be a community of interest among them as to the purpose of the undertaking, and that each joint venture shall stand in the relation of principal as well as agent to each of the other co-venturers with an equal right of the control of the employees necessary to carry out the common purpose of the venture."

A joint venture should have all or most of the following characteristics: joint control and management, sharing in profits and losses, a common undertaking, and a single venture.

It has sometimes been referred to as a "one shot partnership," but it is not a traditional partnership. Nonetheless, most of the state laws that govern partnerships apply to joint ventures and the rights of members of the venture.
It is now possible in most states for corporations to enter into partnerships and, of course, joint ventures.

A joint venture generally is not an association considered taxable as a corporation, but the danger exists that if it does not satisfy certain requirements, it could be so treated for tax purposes. These requirements relate to the free transferability of interests, centralization of management, continuity of life of the venture and limitations on liability.

A joint venture is not a separate corporation. However, for specific long-term ventures, such as operation of a particular plant, a "joint venture corporation," that is a corporation formed by two or more corporations as the sole shareholders, may be created.

WHO MAY CREATE A JOINT VENTURE?

Under the definition, any two or more persons, partnerships or corporations may form a joint venture.

In the construction industry, a joint venture would ordinarily be between two or more corporations or firms in the industry on a “horizontal” or a “vertical” basis.

“Horizontal” means two or more corporations in the same field, such as two mechanical contractors, whose skills, know-how, equipment and other resources complement and extend each other. If the “marriage” is between two or more companies, neither of which would, on its own, have the capacity to bid or perform the job and the result is to increase competition by creation of a new bidder, little or no danger under the antitrust law exists. However, if the joint venture is comprised of two or more companies and each of which has the capacity to bid and perform the job independently, and its result is the reduction or elimination of competition, the formation of the joint venture may be a violation of the antitrust laws.

In a “vertical” venture, two or more companies complementing but not duplicating each other would become the joint venturers. This could be limited to two venturers such as a mechanical contractor and an electrical contractor. A better example, however, would be an architect, engineer, general contractor, mechanical contractor and electrical contractor coming together in a joint venture to furnish the owner with a “turnkey” project.

Since a joint venture has all the elements of a partnership, but none of the safeguards as to limited liability enjoyed by a corporation, the most important question that a prospective joint venturer has to ask is, “Who is my co-venturer going to be?” The profitability of the venture will depend in large measure on the ability of the venturers to work together and, critically, on the financial strength of the coventurer.

All of the potential benefits, as well as the advantages of sharing risk, can be lost by the insolvency or bankruptcy of a single member of the venture.

WHY IS A JOINT VENTURE DESIRABLE?

The reasons for a contractor to enter into a joint venture are numerous and sometimes unique. As a general rule, the following are usually present:

- To guard against mistakes in bids by crosschecking and dual estimating;
- To increase working capital;
- To increase bonding capacity or provide bonding capability and to decrease bonding cost;
- To add managerial strength and knowhow;
- To secure specialized and complementary skills;
- To increase labor supply;
- To pool equipment;
- To reduce overhead expenses;
- To spread the risk of loss;
- To involve a local contractor;
- To expand into new geographical areas;
- To be more competitive on projects with diverse components; and

• To enhance Small Business Enterprise/Disadvantaged Business, Enterprise/Minority Business, Enterprise/Women Business and Enterprise participation.

The reasons for the inclusion of a local contractor are numerous. They include:

• Knowledge of local conditions;

• Access to a local labor supply and union relationship;

• Familiarity with local license and permit Requirements;

• Knowledge of local suppliers;

• Personal relationship with or knowledge of owner; and

• Political connections.

All of the above reasons can be reduced To one—the ability to bid and perform larger and more complicated or specialized jobs and return a larger profit to the co-venturers. Of course, the corollary is that the joint venture gives the owner an additional bidder and a stronger contractor at a lower cost.

There is one further reason for forming a joint venture which may involve either a local or national co-venturer. Under Executive Orders prescribing Equal Employment Opportunity (No.11246 as amended) and the Office of Minority Enterprise (No. 11458), the Labor Department has adopted rules and regulations requiring provisions for equal employment opportunities in all government contracts. Federal departments and agencies, particularly the "8 (a)" program of the Office of Business Development of the Small Business Administration, have established preferences and incentives for minority contractors. In the case of a partnership or its alter ego, a joint venture, this would require 50 percent ownership by members of a minority group: African-Americans, Native Americans, Asians and Spanish-surnamed Americans. In the case of a joint venture between corporations, the minority company must have at least 51 percent of its voting shares owned or controlled by minority persons. Including a minority contractor not only complies with Labor Department regulations, but such a joint venture may gain preference or set-asides when the companies bid on federal contracts. They may also be eligible for direct procurement not subject to competitive bidding.

When Should the Joint Venture Be Created?

1. **Before a potential job or contract is open for bid**. The advantages are derived by the opportunity of having two or more organizations doing preliminary "spade" work with time to work out cooperative arrangements on management and financing. The disadvantages are that since each job is unique, many of the details of the joint venture agreement must be left until the contract details are known.

2. **When bids are solicited**. By forming a joint venture before bidding so that the bid can be submitted in the name of the joint venture, the co-venturers can reduce or spread their costs of bid preparation. In addition, by cross-checking or preparing separate estimates, the co-venturers can materially reduce the chance of bid omissions or mistakes.

3. **After receipt of an award by one co-venturer**. By waiting until an award is made, the contractor has the advantage of knowing the exact extent and details of the contract and can select his co-venturer or venturers with knowledge of what additional capital,

labor, equipment and knowhow are necessary to complete the contract. He does not know, however, if a potential co-venturer is willing to enter into a joint venture with him. Care must also be taken to assure that the contract permits assignment to a joint venture.

4. **Before each separate venture**. Often co-venturers, after completing a successful joint venture, will wish to continue the venture to bid on or perform additional contracts.
It is best that a new joint venture agreement be executed for each such venture, not only for the different conditions present in each job but to prevent treatment of the venture as an association considered taxable as a corporation and to limit trust fund liability created by statutes such as Article 3-A of the New York Lien Law.

5. **Use of a letter of intent to create a joint venture**. If the parties considering a joint venture elect to put a joint bid together but wait until the award to formally establish the joint venture, it is advisable to prepare a letter of intent, signed by both parties, to enter into a joint venture if the joint bid is accepted by the customer. Many times, the owner or general contractor will want to see the letter of intent as evidence that the bid is reliable.

HOW TO CREATE A JOINT VENTURE

A joint venture can be created without any written agreement and merely by actions of the parties and the application of law. To do so, however, puts the parties in the position of having created liabilities and duties that have not been precisely delineated.

1. **Who should prepare the joint venture agreement?**

The joint venture agreement is a contract governed by law. Usually the law governing the contract will be that of the situs of the work, which may not be the home—and familiar—state of one or more of the co-venturers. In New York, for example, a little known ruling of the Attorney General states that since corporations have the power to enter into joint ventures under the New York Business Corporation Law, a corresponding obligation exists to file a certificate of assumed name under the General Business Law. It is vital, therefore, that your lawyer—and the lawyer for the other venturers—prepare and review the agreement, not only to assure that it complies with the governing law but that it accurately sets forth the intentions of the parties and adequately protects your interests with respect to potential liability to the bonding company, owner and subs.

2. **What should the joint venture agreement include?**

First, the agreement should set forth the name by which the joint venture will be known and the contract or job which the venture is to bid and/or perform.

The most important provision concerns management. Is management to be shared equally? (This is often a basis for disagreement, particularly if the parties have not worked together before.) Is one venturer to have the general management of the job? Is each of the venturers to have management responsibility for a particular segment of the job? (This is often necessary in a vertical joint venture between contractors in different fields.)

The second most important provision Is financing, not only how, when and in what proportions the capital is to be supplied but how the profits—or losses—are to be shared. Usually, the co-venturers will share profit and losses in the ratio in which they contribute capital. The agreement should also establish how the parties will provide additional capital for the joint venture if needed.

The joint venture agreement should state how machinery and equipment and expendable equipment and working tools are to be acquired for the job. Often machinery and equipment are rented from the parties, while expendable tools are purchased by the joint venture, from the co-venturers, at an agreed price or from outside sources. And, it should be determined what fee, if any, the managing party should receive.

It should also be determined whether overhead items (such as executive, administrative and supervisory services) are to be furnished without cost by the parties, and in what proportion, or charged to the joint venture, and at what rate.

Separate books of account and a special bank account must be set up in the name of the joint venture. Typically, one of the joint venture partners is assigned the responsibility for keeping the accounting books, including accounts payable, accounts receivable, billing functions, job cost, etc. These books should be open to each co-venturer and a statement furnished each month. An accounting firm, not necessarily representing either co-venturer, should be selected in the agreement to audit or review the books of the joint venture, as necessary.

Contracting authority should be clearly stated, such as who may bind the joint venture without joint consent and any dollar limitations on such authority.

A method of settling disputes between or among venturers, usually by arbitration under the rules of the American Arbitration Association, should be included. If one co-venturer should fail to carry out its part of the joint venture by failing to contribute funds, equipment or manpower or by reason of insolvency or bankruptcy, the remaining co-venturer or venturers must have the right to take over the uncompleted contract and to control such capital, equipment, tools and labor as were previously engaged in the venture. In such a case, the share of profits of the defaulting co-venturer will be reduced to its proportion of the total contributions, but the defaulting party would remain liable for its full share of any losses incurred by the joint venture. It is important in this connection that the liability of any of the parties under indemnity agreements with sureties be limited to that percentage of the total liability assumed by such party in the joint venture. This provision, however, should apply only to those losses directly connected with or arising from the performance of the contract and not incidental, indirect or consequential losses that may be sustained by one of the parties. A cross indemnification agreement indemnifying the parties against losses in excess of the proportionate share of each is also worthwhile.

The joint venture agreement, in addition to prescribing when and how capital and profits—or losses—are to be distributed after completion of the job, should specify how equipment, tools and other assets purchased by or contributed to the joint venture are to be liquidated. Often the parties will be given the right to purchase or repurchase at book value before sale to outsiders. Provision should be made for obligations which continue beyond the completion of the project, such as job insurance, warranty work and other costs.

Finally, the joint venture agreement should state that it should not be construed as a continuing partnership or association but as a joint venture and no one of the co-venturers may assign its interests therein without the prior written consent of all.

3. Other considerations*:*

Insurance – Be sure to consult the insurance agents for all joint venture partners. All insurance contracts need to be reviewed for appropriate insurance limits established, not only by the customer but also by the parties, based on the risk associated with the particular job. Also be certain that each party's insurance policies allow and cover the party for joint venture work.

Bonding – Will both joint venture partners' surety companies agree to bond the project? Typically, one of the sureties will issue the bond with a cross indemnification agreement from the other. However, each surety may look at joint venture projects differently. Discussion with the bonding agents early in the process is critical.

Staffing – Be sure to have a clear idea of each party's staffing commitments. Who will provide the project manager, the superintendent, accounting support, scheduling, etc. A project organization chart detailing who does what will minimize confusion later

POSTSCRIPT

The growing trend in the construction industry of joint ventures involving mechanical contractors has prompted this bulletin as a means to furnish MCAA members with information and guidance on the subject. It should be understood that before a joint venture is undertaken, other methods for accomplishing the project should be studied to assure that the best procedure is used.

For example, there are other forms of combined efforts performed under agreements with other contractors other than the type of legal joint ventures covered, and such approaches should be considered and carefully evaluated during the early planning stages. These include:

1. **A joint bid***.* In this case, one party may install all plumbing while another handles all heating, ventilating and air conditioning (or various other combinations) for a project. This type can be one bid from a liability standpoint to an owner, but does not create the same cross-liability in depth as a joint venture.

2. **Variations of a joint bid***.* Each party takes specific lump sum parts of the total project and then all share responsibilities on other parts, such as major equipment and subcontracts.

3. **Subcontracting***.* In this instance, one party subcontracts a part of a job to another party, as opposed to a straight joint venture.

In addition, the motivation for initiating a joint venture should be studied realistically to assure that the reasoning behind the undertaking is sound. There are examples of poor or weak reasons for attempting a joint venture, as well as reasons for not attempting a joint agreement at all. These categories may include:

1. **Establishing a joint venture for financial assistance only**.

2. **Serious tax disadvantages that exist for legal joint ventures in some states.**

3. **Initiating a joint venture with an attitude and reasoning that mitigate against a competitive effort.** For instance, this can occur when each party to the venture is stretching because of the size of a project and bases their bids on the high risk involved if they get the job. Such bidding likely will not be sufficiently competitive to make the joint effort worthwhile.

4. **A possible alternative to a joint venture could be a Limited Liability Company (LLC)**. An LLC is established pursuant to specific state laws, so be sure to consult legal counsel. In some states an LLC can provide an additional layer of protection to the LLC partners, but there can also be complications including insurance, tax, bonding, etc.