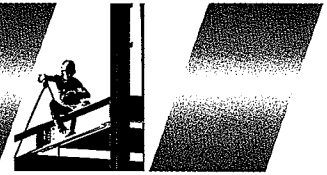


# CFMA

## Risk Management



# Protecting Joint Ventures against Third Party Liability

by Jeffrey L. Goodman

### Joint Ventures

Joint ventures (JVs) between small or medium-sized contractors and large regional, national, or international construction companies are becoming more commonplace as construction projects grow larger and more complex. Under such an arrangement, the smaller local contractor benefits from the specialized expertise, resources, and bonding capacity of the large construction company. The larger construction company benefits from its association with the local contractor because the local contractor enjoys a good reputation within the community and has typically forged ongoing working relationships with local labor unions, banks, subcontractors, suppliers, businesses, and equipment dealers.

In a nutshell, a JV is nothing more than an association of two or more individuals or entities who agree to carry out a single business enterprise for profit. In many ways, a JV resembles a partnership, except for the duration and limited scope of the business relationship between the members of the JV. A JV is typically a less-formalized relationship than a partnership because JVs are formed on an *ad hoc* basis.

While the courts have been reluctant to establish fixed criteria for determining the existence of a JV, there are certain factors that are common to most. These factors include the following:

- a) a common understanding and a joint proprietary interest in the subject matter,
- b) a mutual right of control, and
- c) a right to share in the profits and losses.

While a particular form or method of expression is not required to form a JV, most courts require some express or

implied understanding between the members of the JV, such as a written JV agreement. However, a JV relationship can also be inferred from the conduct of the parties. Overall, the courts have determined the existence of a JV on a case-by-case basis.

If you are considering forming a JV, it is recommended that a written agreement be drafted and signed by the involved parties. The agreement should address various matters, including, but not limited to:

- 1) the scope and nature of the work to be performed;
- 2) the expected duration of the work and the event(s) that will result in termination of the JV agreement;
- 3) the individuals who will manage and operate the JV;
- 4) the method by which profits and losses will be shared; and
- 5) the disposition of assets acquired by the members of the JV during the term of the JV.

Each of these factors will be discussed individually below.

### The Scope/Nature/Duration of the Work

Since a JV is an agreement between two or more parties or entities for a limited duration, it is important that the agreement prescribe what the parties agree to accomplish during the term of the JV, how long the members expect the JV to exist, and under what circumstances the JV agreement will terminate. Specific descriptions of the scope, nature, and duration of the JV is imperative because each member of the JV is typically engaged in other projects independent of the other members. Therefore, a clear delineation must be made between the work that is being

*continued on page 58*

done by each member independent of the JV and the work that is to be done pursuant to the JV agreement.

### Management of the Joint Venture

A management team should be selected consisting of representatives of each member of the JV. The management team should convene regular, periodic meetings to determine various matters of interest to the JV, such as the management policies that will apply during the JV. The management team should also supervise and direct the construction superintendent of the JV project.

### Apportioning Profits and Losses

In those instances where a small to medium-sized local contractor forms a JV with a large regional, national, or international construction company, the JV agreement may provide that profits and losses be shared on some basis other than 50/50. This is often the case where one of the members of the JV contributes more to the project in terms of employees, equipment, management, or other resources.

Since JVs are so closely akin to partnerships, most states apply partnership law to enforce and interpret JV agreements. To the extent that your state applies partnership law to JV agreements, each member of the JV is both the agent for and principal of the other member(s) of the JV. In this

regard, each member of the JV is jointly and severally liable for the acts and omissions of the other members. Therefore, the act of one joint venturer is typically the act of the other members of the JV.

In most states, the formation of a JV does not result in the creation of a third business entity separate and apart from the members of the JV. For example, if company "A" and company "B" execute a JV agreement to form a JV known as "A and B, a Joint Venture," the JV is not separate and distinct from the members of the JV. Therefore, company "A" and company "B" would each be jointly and severally liable for any losses or injuries caused by either member of the JV. In other words, each member of the JV could be sued individually or jointly, and each member of the JV would be fully and severally liable for the acts and omissions of the other member(s) of the JV to the extent that such acts or omissions were performed pursuant to the JV agreement.

In most cases, the JV agreement will provide that the losses and profits will be apportioned on a percentage basis (i.e., 50/50, 60/40, or 70/30). This percentage allocation between the members of the JV is only enforceable between the members of the JV. In other words, if "A and B, a Joint Venture" were sued by a third party (and assuming your state's partnership law applies to JVs), the individual members of the JV (i.e., company "A" and company "B") would each be independently liable for the losses suffered by the third party. However, if the JV agreement between company "A" and company "B" provided that losses would be apportioned between the joint venturers on a 60/40 basis, any award entered against the JV (or its individual members) would be subject to an apportionment between the members on the percentage basis provided for in the JV agreement. In other words, company "A" would be obligated to contribute a sum representing 60% of the losses and company "B" would be obligated to contribute 40% of the losses to the claimant.

In the event either member of the JV became bankrupt or insolvent, the claimant could seek satisfaction of its claim or judgment against the other member(s) of the JV. For this reason, the apportionment of profits and losses between the members of the JV is not binding on third parties and is only enforceable between the members of the JV.

The JV should also establish a JV bank account and accounting and auditing procedures separate from those used by the members of the JV.

### Disposition of Joint Venture Assets

During the life of the JV, certain supplies, equipment, and other assets will be acquired. The JV agreement should provide for the manner by which the JV assets will be liquidated. This can be done by selling the assets to a third party, dividing them equitably

*continued on page 60*



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CFMA 1/297



between the parties, or allowing one of the members of the JV to purchase the assets from the other.

### Third Party Liability

One of the issues that is gaining a great deal of attention in JV law is the liability of each member of the JV when a longstanding employee of one member is injured at the JV site and the injury is caused by an employee of the other member of the JV. Generally speaking, an employee who is injured within the scope of his employment would be entitled to receive workers' compensation benefits as the employee's exclusive remedy. However, more recently, claimants have been filing cases asserting that the claimant is an employee of only one member of the JV. In those instances where the injury was caused by an act or omission of an employee of the other member of the JV, the injured employee is entitled to recover workers' compensation benefits from his own employer and the claimant is also entitled to maintain a third-party action against the other member of the JV.

Case law on this subject varies from jurisdiction to jurisdiction and each dispute will be decided on a case-by-case basis. Some courts have concluded that by virtue of the formation of a JV, the parties to the JV have agreed to commit their resources (including equipment and employees) to the construction of the JV project. As such, many courts have held that the claimant is employed by the JV, thereby

enabling each member of the JV to assert the exclusive remedy provisions of the state workers' compensation act against the injured employee. In other states, courts have declined to extend the exclusive remedy provisions of the state workers' compensation act to both members of the JV absent an express understanding between the employee and both members of the JV that the employee has become an employee of the JV.

To avoid multiple claims, it is recommended that employees of either member of the JV be required to execute a document acknowledging that they will be serving as employees of the JV *before they begin to work for the JV*. The employees should also complete employment documents (i.e., W-2, INS-9, and other relevant employee forms) and be given employee handbooks from the JV. This may eliminate any doubt that the employee is employed by the JV.

Additionally, to further clarify that the work done at the JV site was performed on behalf of the JV, each JV employee should receive a paycheck on a check bearing the name of the JV. Any injuries sustained by employees while working for the JV should be covered by the state workers' compensation act. Finally, it is recommended that the JV purchase workers' compensation and general liability policies separate from the workers' compensation and general liability policies owned by each member of the JV.

These are a few suggested steps that should be taken to avoid multiple liability claims from employees who may suffer injuries or cause losses while working at a JV site. For additional recommendations that comply with your state's law, consult your legal counsel.

### Editor's Note:

The treatment of the employees of each member of the JV as employees of the JV can also give rise to some unique accounting issues. These issues will be discussed in the Accounting & Reporting Column of the March/April issue of this magazine. ■

### About the Author

Jeffrey L. Goodman is a shareholder in the West Des Moines, Iowa law firm of Shearer, Templer & Pingel, P.C., (515-225-3737) where he practices in a variety of areas including construction accident litigation.

Jeff received his J.D. from the Drake University Law School in 1985. Following graduation, he served as an Assistant County Attorney in Black Hawk County and later as an Assistant U.S. Attorney with the U.S. Department of Justice, Office of the United States Attorney for the Northern District of Iowa.

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