BONDING JOINT VENTURES

BY WILLIAM CHEATHAM

Joint ventures have gained increased popularity among contractors in recent years as the preferred means of sharing and mitigating construction risks. Joint ventures are primarily associated with large, complex and long-term projects. Few published statistics (if any) can help shed light on the risks and rewards of using joint ventures.

However, there has been only one surety bond loss involving a project performed under a formal joint venture arrangement. In a surety industry that has paid out $6.5 billion in direct losses on bonded jobs over the past 10 years, this speaks volumes about the merits of employing joint ventures as a risk-mitigation technique.

Not all joint ventures are successful. Those that are, tend to work because the capabilities, expectations and responsibilities of each party are defined well in advance of the first certification being drawn. Every joint venture is essentially a formal partnership between two or more distinct parties, each with its own set of circumstances, needs and perceptions of risk and reward. The more the partners know and understand each other, the more likely they will be successful in working together and using each other's strengths to maximize their own objectives.

Most successful joint ventures share these two common characteristics:

- They are made up of two or more organizations that understand what they want and expect from each other. They are confident that the other parties can perform and honor their share of the obligations.
- They rely on a well-defined joint venture agreement that clearly specifies the venture's business objectives and spells out the essential obligations; i.e., sponsorship percentages, assignment of the joint venture parties' several responsibilities, insurance coverages, funding and equipment contributions, personnel, procedures, purchases, management authority/controls, dispute and default resolution, profit recognition and distributions, assignment of rights, pricing, bank relationships, records and accounting policies.

WHY ENTER INTO A JOINT VENTURE?

The reasons for formulating joint ventures are numerous. More often than not, joint ventures form because of a mutual interest by two contracting parties in sharing and spreading the risk associated with large, complex or long-term contracts, which could have dire consequences if all does not go as planned. Other reasons can be as simple or as varied as:

- to tap one another's unique skills and/or assets (equipment, personnel);
- to gain complimentary skills or pool resources;
- to take advantage of local geographic and/or sub-trade knowledge and expand market penetration;
- for political connections and/or owner relationships;
- to maximize surety capacity and/or influence surety underwriting;
- to meet set aside requirements;
- to obtain pricing security (i.e., second opinion);
- to strengthen financial structure and/or prequalification validation;
- to meet prequalification requirements—experience, capacity, licensing; or
- to comply with federal, state or local regulations/bidding requirements.

There is no standard joint venture—they can take several forms. While most are prime and limited in scope to a single job, a joint venture can be incorporated or even left open indefinitely, with the ability to take on new projects all the time. Some joint ventures are silent, with only one contractor appearing on the contract and/or bond, but this situation does not lessen the silent party's duty to perform or indemnify all of the contractual obligations. The form a joint venture takes is often determined by the nature of work, size, duration of the contract, skills and qualifications of each joint venture partner.

RISKS

Each contractor should consult its attorney, insurance agent/broker and accountant before entering into a joint venture agreement because of legal obligations, insurance issues and tax consequences.

Use care in selecting joint venture partners as each will be fully liable (jointly and severally) to the owner, subcontractors, suppliers, third-party claimants and sureties, irrespective of the defined obligations of the joint venture agreement.

It is not only proper, but also obligatory for each party in the joint venture to ask for and receive a full disclosure of the financial standing, work programs and other commitments of each prospective partner—and to provide the same when asked. It is common practice for the respective sureties to underwrite the finances and capabilities of the counterparts to a joint venture and prequalify the joint venture in its entirety.

Sureties do not look favorably on "angel deals" in which a contractor lends his balance sheet to another for surety capacity while having no real involvement in the management and execution of the bonded project. With the increased emphasis on surety prequalification of contractors, some construction firms attempt to leverage their lack of surety capacity by using another firm's surety credit.

Joint venturing can be a beneficial way to gain additional work and experience and expand a firm's market penetration. But it should only be approached with full appreciation of the risks involved, full knowledge of the prospective joint venture partners and after consultation with an attorney, tax accountant and surety all familiar with joint venture obligations.

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