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Construction Joint Ventures: Texas Style

By Karen Keniff

Joint ventures are a good way to grow a construction business, particularly when dealing with large and mega-projects.

With a growing economy and a new administration in Washington, D.C., stating its commitment to repairing America's infrastructure, the atmosphere within the construction industry could almost be described as jubilant. After a 5% increase in 2016, total U.S. construction put in place for 2017 is expected to increase 6% to $1.23 trillion according to FMI's latest Construction Outlook.[1] This means contractors around the country are gearing up for a busy year.

For some Texas contractors, this encouraging economic news comes as a great relief. The low oil prices of 2015 hit parts of Texas hard, with Houston seeing a 49% drop in construction starts that year.[2] The Dallas market, however, weathered the storm better. With a more diverse economy, the Dallas-Fort Worth-Arlington metro area had $17.8 billion in new project starts in 2015, 19% more (in dollar terms) than the year before and $1.2 billion more than Houston.[3] The positive trajectory continued in the Dallas market during the 2016 January-June period, with Dallas-Fort Worth reporting $2.8 billion, up 27% over the prior year.[4]

Like so many things in Texas, many new construction projects are expected to be large. Many of these projects will be put out to bid with specific requirements regarding specialized technological or heavy industrial expertise, staffing capacity and large project financing defined during the bid process. So what is a contractor to do when a large project is put out to bid with very specific requirements regarding expertise and staffing, but the interested contractor can't address all of those requirements in-house?

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[1] FMI's Construction Outlook First Quarter Report, 2017.

[2] Carlyle, Erin. "Building Boom Towns: The Metro Areas with the Most New Construction." Forbes. 10 February 2016.

[3] Ibid.

[4] "DFW Economic Indicators." Federal Reserve Bank of Dallas. 25 October 2016.

A Joint Venture May Be the Answer

Joint ventures have been effectively used in the Texas market and elsewhere to enable contractors to respond to large project bids. By utilizing a joint venture format, contractors may be able to easily expand within a specific market without having to borrow a significant amount of funds or look for outside investors. By joining together, construction firms can have the opportunity to maximize their areas of expertise and profits while remaining flexible.

Joint venture agreements can be established for a limited life span, or they can cover only part of a construction project. Longer agreements can have the added benefit of enabling contractors to strengthen relationships and leverage their expertise in an active construction market. Overall, joint ventures can help spread the risk and liability between partners, while sharing control and taxes associated with any large project.

Deciding to form a joint venture is not a simple decision. Not only should co-venturers help ensure that partners in the arrangement have shared business goals and sound relationships, but they also need to understand the best joint venture option for a particular project. The structure of joint ventures varies, depending on the type of project as well as the anticipated length of the relationship.[5]

To understand their legal rights and duties, contractors should seek legal and tax advice before entering into a joint venture agreement. Listed below are some of the typical joint ventures construction companies enter:

1. **Integrated joint ventures** involve nonlinear, complex projects split between two or more partners. These partners combine resources and employees, as well as share profits and losses according to their percentage of interest in the venture.
2. **Nonintegrated joint ventures** are restricted, non-partnerships. Every party is assigned a range of duties and is responsible for the profit, loss and resources related to that work.
3. **Combination joint ventures** involve elements of both integrated and nonintegrated joint ventures and are used for more complex projects. Parties to the agreement are responsible for assigned duties and their profits and losses.
4. **Equity joint ventures** involve two or more parties that create a separate legal company to carry out a project. The parties establish equity capital and agree on objectives such as staffing, profit sharing, the furnishing of bonds and other resources.
5. **Contractual joint ventures** involve two or more parties that form a partnership to achieve the business goals of a short-term construction project.[6]

Because partnering with another business can be complex, joint venture agreements should not be entered into without proper forethought and planning. There needs to be clarity regarding the relationship and clear communication of responsibilities of all parties. It is best that both parties have similar levels of expertise and investment

[5] Trent Cotney, P.A. "Types of Joint Ventures in the Construction Industry." Accessed 30 March 2017.

[6] Kale, V.V., et al. "Joint Venture in Construction Industry." IOSR Journal of Mechanical & Civil Engineering (IOSR-JMCE), ISSN: 2278-1684,PP: 60-65.

in the relationship, as well as an understanding of each partner's management style. Ultimately, success in a joint venture depends on a thorough understanding of aims and objectives that are clearly communicated to everyone involved in the new organization.

Steps to Consider When Creating a Joint Venture

Entering into a joint venture requires the contractor to be well-informed in order to build a successful business relationship. It is important to assess the success of a joint venture; here are some of the steps that should be considered:

- Make sure the venture's objectives are very clear and successfully communicated to all parties.
- Understand the level of expertise, investment or assets that each partner brings to the venture.
- Evaluate the different cultures and management styles to ensure successful integration and cooperation.
- Establish leadership and support structure in early stages of joint venture development.

Understanding Risk Exposures

When working with the parties involved in each venture and providing coverage for those ventures, insurance companies strive to understand the total exposures of the joint venture arrangement (rather than looking at the risk exposures of each party to the agreement separately). For a contractor that has a good relationship with its insurance carrier, for example, underwriters will analyze the business from the perspective of a new account and will not assume that the joint entity has similar risk exposures as its current business.

Whatever structure the joint venture takes, it is important to realize risks pertaining to this venture may be significantly different than the risk exposures for the individual corporate entities involved in the agreement. Contractors involved in these types of agreements should consider obtaining a separate coverage policy for each joint venture. In this instance, the joint entity will be the named insured on the policy.

In addition, companies entering into a joint venture should make sure they are well-versed regarding the insurance coverage ramifications of this shared risk. When a joint venture is approached as a separate legal entity, parties are encouraged to consult with their broker and insurance carrier to understand possible exposures. The insurance program should ensure the severability and removal of the ability of one carrier to subrogate against any member of the joint venture. This can be accomplished using proper coverage forms and endorsements.

Partners should also determine whether they should be added as additional insureds on the joint venture's general liability and umbrella liability policies. If the joint venture includes a design firm and a general contractor, for instance, all parties should consider professional liability exposure, which is not usually covered on a standard Commercial General Liability policy.

Policy Language Matters

Joint venture stakeholders should also pay special attention to the policy language pertaining to employees of the joint venture, as well as to the employees who are hired separately by one party of the joint venture.

- Direct employees of the joint venture can be insured on a separate workers' compensation policy in the name of the joint venture. An endorsement may need to be added to the policy to include the joint venture as an insured. By adding an endorsement, coverage is typically limited to employees of the joint venture and specifically excludes coverage for employees of the member companies.
- Employees hired separately by one party of the joint venture may not be fully covered by the joint arrangement. For this reason, all endorsements and indemnity statutes must be carefully evaluated.

Joint ventures usually take high-performing employees from each partner organization to the arrangement and move them into the joint venture. To successfully entice high-performing workers to join the new entity, those staff members must be convinced of the opportunities available to them through this newly formed organization. Many times, these employees may perceive risks associated with joining a new entity too great to ignore. For this reason, sign-on bonuses, bonus programs and retention awards are often used to attract the most talented employees to the joint organization.

Beyond the Joint Venture

When a joint venture concludes, there may be liability risks that exist beyond the life of the joint venture. Whether it is contract liability, tort liability or some other liability exposure, partners in a joint venture need to plan for risk exposures after the specific goals of the venture have been achieved.

The contractor should consider taking the following actions when assessing the coverage once the joint venture ceases:

- Arrange for copies of all liability policies to be kept into perpetuity.
- Identify whether extended reporting periods or "tails" will be purchased on claims-made policies and who will negotiate and pay for such coverage.
- Determine at the beginning of each joint venture who will be responsible for claims made after the conclusion of the joint venture relationship.

In Texas the statute of repose—which establishes the overall time limit for products liability actions—is 10 years. While the statute of repose specific to construction projects is designed to limit the period in which legal action can be brought after construction is completed, it still may run beyond the warranty period.

Understanding the risk exposures during every phase of a joint venture is critical to the success and profitability of the relationship for all co-ventures.

Achieving Success Through Collaboration

Joint ventures are a good way to grow a construction business, particularly when dealing with large and mega-projects. If both parties of the joint venture agree to do their homework before entering into the agreement—and understand the benefits and pitfalls of the relationship and work collaboratively to achieve common goals—then they will be successful.

Going forward, Texas' construction industry is expected to continue on an upswing. Companies that enter into successful joint ventures may improve their chances of landing large and lucrative construction bids in this upbeat construction market.

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