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A/E Joint Ventures: A Liability Challenge

Collaboration seems to be a key concept in today's design and construction environment. Integrated project delivery, design-build, and other alternative project delivery methods emphasize nontraditional arrangements and partnerships among designers and between designers and contractors leading, to a blurring of roles and responsibilities.

One collaborative method with a long history in the design and construction field, particularly in the public sector, is the joint venture. With this technique, two or more design firms, or a design firm and contractor or developer, team up in a strategic alliance to take the lead on a project.

According to a study by *ENR* magazine, the majority of joint ventures are collaborations between two design firms, typically an architect and an engineer. Therefore, we will address the A/E joint venture for the balance of this article.

Typically, the two A/E parties may establish the joint venture as a separate legal entity. This new entity may take one of various forms, such as a partnership, a limited partnership or a limited liability corporation. The joint venture can be "integrated," and include assets of both of the founding firms, or it can be set up as a "shell" corporation that holds the contract but subcontracts all of the work to the partners. Individual states have their own rules and regulations regarding the formation of joint ventures, so it is vital to receive expert legal advice as to what type of entity can operate in your locale or locales and which would be most beneficial for your particular situation.

Regardless of form, a joint venture is typically established for a particular purpose, such as an architect and engineering firm joining together to specialize in the design of medical labs. What's more, the joint venture may be established for a single project and then dissolved; or it may be a long-term arrangement that ultimately completes several projects.

Why should a design firm consider entering into a joint venture? What are the major keys to success and warning signs of failure? Let's look at some of the key factors to consider.

Selecting a Joint Venture Partner

Most successful joint ventures are based on a suitable match of skills, expertise and trust. An architect and engineer may specialize in a certain industry. A design firm and developer might have had one highly successful project and want to fuse a continuing working relationship. A designer and a

contractor may combine resources to land a major new project. Like a good marriage, a successful joint venture depends on the careful selection of a compatible partner.

While a good match of skills and expertise is an excellent starting point to forge a successful joint venture, there are other equally important factors to consider. Culture is a vital consideration. A company focused on maximizing immediate revenue generation will likely not make a great partner for a firm with a strong risk-management philosophy that regularly turns down what it perceives as risky projects. Likewise, a company with an autocratic, top-down management style is likely a poor match for a firm with a bottom-up, more democratic approach. Even two seemingly similar companies can make poor partners if their leaderships are misaligned operationally because of different visions for the future.

While there have been successful joint ventures between large and small design firms, size differentials can present problems. A large firm with more resources at play may not see the joint venture as the 50-50 marriage that the smaller firm anticipates. As we'll cover later, size differences can have important liability and insurance ramifications as well.

Based on these and other factors, design firms should think long and hard about entering into a joint venture. Don't hesitate to ask probing questions of a potential partner regarding management philosophy, financials, claims history, technical proficiency, staffing levels and the like. What's more, be willing to reciprocate and share information equally. If you request a company's five-year financials, be ready to open up your books to your potential partner as well.

The Joint Venture Agreement

Assuming that after a lengthy courtship you conclude that a joint venture with your chosen firm can result in a strong strategic alliance, it's time to draft a carefully worded joint venture agreement. This is a matter best left to expert legal counsel thoroughly knowledgeable of the prevailing laws in the locale or locales in which the joint venture will operate.

The joint venture agreement should carefully allocate the roles and responsibilities of each party. The importance of clear and comprehensive scopes of services can't be overstated. The agreement should also clearly address issues such as decision-making and signing authority, income and expense allocation, compensation, task management, liability allocation, resource management, confidentiality, communication protocol and dispute resolution (between the parties and with third parties). How responsibilities are allocated can result in one firm becoming the majority stakeholder in the joint venture.

The agreement should also make it clear whether this is a one-project fling to be dissolved upon completion of construction or something much more permanent.

In some cases, one of the parties is assigned the role of managing member; in others, responsibilities are allocated more evenly. Regardless, every important decision reached by the parties to a joint venture should be put in writing as part of a signed joint venture agreement.

The AIA, EJCDC, AGC and SBA all have sample agreements which are good starting points.

Professional Liability Issues

A key concern for any party to an A/E joint venture is the allocation of liabilities. As a rule, each party to the joint venture assumes "joint and several" liability for the actions of the entity, regardless of which party made the error or omission. Under joint and several liability, a claimant may pursue an action against any one party as if it were fully liable for the damages. It would then be up to that defendant to pursue the other party or parties to the joint venture to try to collect their share of the liability.

These liability issues should be addressed in the joint venture agreement. The parties may agree that each will be responsible for their own actions, with liabilities allocated accordingly. Or, the agreement may stipulate that liability is split 50-50 regardless of

cause. It is important to realize, however, that only the parties to the joint venture are governed by this agreement. While a claimant client, contractor or other third party may be willing to abide by the terms of the joint venture agreement as long as they are made whole by the ultimate settlement, they are not legally bound to do so. If fault is assigned to one party to the joint venture, but that party is uninsured or does not have adequate insurance limits or other resources to make the claimant whole, you can bet that the claimant will go after the other party to the joint venture agreement in order to mitigate the damages.

When it comes to insuring a joint venture for its professional liabilities, begin by looking to the individual practice policies of the design firms involved. Some practice policies automatically include coverage for a design firm's legal liability arising out of a joint venture. Other policies may specifically exclude joint ventures, but the issuing insurer might agree to provide a special joint-venture endorsement. Be aware, however, that an endorsement adding the joint venture to the policy could erode limits and trigger a deductible to be paid under the policy.

Realize also that having the joint venture listed as a named insured on your policy does not provide coverage for the other parties to the joint venture. It is a good idea, therefore, to obtain a certificate of insurance (or other form of evidence) from all parties to the joint venture showing that professional liability insurance is in place. This same practice should be employed for the project subconsultants whether a party to the joint venture or not.

PL Coverage Gaps

Even when each party to the entity has joint venture coverage on their PL practice policies there are still opportunities for gaps in coverage and potential liability for the actions of others. This is especially true if each party has its insurance with a different carrier. Coverages may be denied if an insurer feels the claim against its insured partially or entirely belongs with one of the other parties to the joint venture.

As mentioned earlier, big differences in the size of parties to a joint venture (and corresponding differences in the size of the insurance limits they carry) can create significant liability issues. A claimant may seek damages from both parties, aggregating the limits, even though the larger design firm wasn't primarily at fault for the error or omission. And in such an instance, the insurer issuing the policy with the bigger limits could theoretically deny coverage for the full claim because it is not a legal liability.

Here is an example: Say the smaller party to a joint venture has \$2 million in coverage, while the larger party has \$10 million in limits with a different insurance carrier. A client files a claim against the joint venture for \$10 million. Under joint and severable liability, the larger party could have a judgment against it for \$8 million of the \$10 million claim, while the smaller party has a \$2 million judgment against it, exhausting its limits. However, the insurer of the larger firm could hold that it is only covering 50% of the claim, or \$5 million, since its insured is only a 50% equity partner in the joint venture. That would potentially leave \$3 million of the \$10 million claim uncovered by insurance.

Other insurance gaps can result when the project is completed and the two parties go their separate ways. If both parties don't secure completed operations or "tail" coverage, one or both firms could be left holding the bag. Also, there is no defense coverage for the entity itself.

Insurance Solutions

Ideally, the parties to a joint venture would all have professional liability insurance from the same carrier with the joint venture listed as a named insured and all policies would have equal and adequate insurance limits. But in most cases, that simply isn't possible. Fortunately, there are several insurance options to avoid these gaps in joint venture coverage. Among them:

A separate joint venture practice policy. It is possible for the joint venture, as a separate legal entity, to purchase its own PL practice policy. The parties to the JV could stipulate how the policy would be maintained and how the cost of the premiums would be

divided. This would be an added cost to the joint venture, but solves the gap problem of having two practice policies with inadequate or unequal coverage.

Specific job excess. With specific-job excess coverage, each party could maintain its current limits on their practice policy while purchasing an endorsement that provides a higher limit to cover a specific joint venture project. For example, you can maintain a \$2 million practice policy and purchase a \$5 million limit on one joint venture project for substantially less than raising your entire practice policy limit to \$5 million or purchasing a \$5 million joint venture practice policy.

Project policy. If the joint venture has been formed to execute a single project, you might consider a project policy. This is a PL policy whose limits are dedicated to a single project and covers all design firms working on the project. In many instances, the project owner is willing to pay all or part of the premium since the policy limits are dedicated solely to the project and limits cannot be depleted by other claims against the designers. Project policies can be expensive and are not always available, but they are definitely worth looking into for single-project joint ventures. Note: some insurers will agree to have the designers' practice policies serve as excess coverage in the event the limits of the project policy are depleted.

Finally, be aware that joint ventures create insurance challenges for commercial lines as well. For instance, most commercial general liability policies specifically exclude joint ventures in the "Who is an Insured" clause. How your workers' compensation insurance responds to a joint venture will depend on whether those who perform work for the JV are considered employees or "borrowed servants" from the individual practices. Your jurisdiction's rules will apply. Commercial umbrella policies will also likely exclude joint ventures. For these reasons, a separate joint venture insurance program for all required coverages should be considered. Coverage options might include alternative employers endorsements, completed operations coverage for general liability, waivers of subrogation and additional insurance status. We can help you explore your options.

For Better or For Worse

Unfortunately, some design firms fall victim to love at first sight and enter into a quasi joint venture where a separate legal entity is not established and roles and responsibilities are not clearly spelled out. Such collaborations often result in confusion, conflicts, claims and catastrophe.

Entering into an A/E joint venture is a serious business not to be taken lightly. Legal, financial and insurance advice is needed so that the venture is properly structured to obtain the desired objectives and the parties to the new entity can minimize risks while maximizing rewards.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN).

We're here to help.

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