Construction Joint Venture Contracting

Veerask Likhitruangsilp, Ph.D.
Assistant Professor, Department of Civil Engineering, Chulalongkorn University, Bangkok, Thailand
Email address: fcevlk@eng.chula.ac.th

Apichart Prasitsom
Doctoral Student, Department of Civil Engineering, Chulalongkorn University, Bangkok, Thailand
Email address: popwani@hotmail.com

Abstract

Joint venture (JV) has become a common business form for construction contractors in large infrastructure projects worldwide. The success of construction JV management depends upon several factors, especially relevant law and contract, which are usually more complicated than those of typical construction projects. This paper presents primary considerations for preparing construction JV agreements. Key JV management issues were summarized by reviewing related literature and interviewing 14 JV executives of seven leading construction firms in Thailand. It was found that the life cycle of construction JV projects consists of four major phases: (1) the beginning phase, (2) the formation phase, (3) the operation phase, and (4) the termination phase. In each phase, all JV partners have to make several critical decisions, including objectives of participation, selection of partners, their contributions, and administrative forms of JV, all of which directly affect their construction JV agreements. Three types of construction JV agreements generally used in the industry are the memorandum of understanding (MOU), the pre-bid JV agreement, and the JV agreement. The MOU is made to informally establish a JV so that the contractors can obtain bidding documents from the owner whereas they are not strictly bound by such agreement. If the contractors are interested in bidding, the pre-bid JV agreement will be prepared to specify the scope of work and cost sharing for each JV partner while preparing their bid proposal. Finally, if the contract is awarded to the JV, the formal JV agreement will be executed to stipulate legal rights and liabilities in the project of every JV partner and will also be included as part of the construction contract between the JV and the owner. The paper summarizes main provisions in these agreements and identifies primary considerations while drafting them. The results can directly be used by all contractors for drafting and administrating JV agreements to maximize the efficacy of JV project management.
1. Introduction

Joint venture (JV) can be referred to a form of business undertaking by two or more persons engaged in a single defined project (Garner, 2004). In the construction industry, JV has become a common form of business, which is generally adopted by the contractors of large construction projects worldwide because it can enhance their competitiveness by pooling construction resources (e.g., capital, equipment, and expertise) from the partners (members) as well as allocating risk among the partners. Moreover, it is normally mandatory by public owners of large infrastructure projects for bidding contractors to be established in this business form [e.g., provisions in the project’s term of reference (TOR)].

JV project management is extremely challenging for all contractors due to several factors, especially relevant law and contract, which are usually more complicated than those of typical construction projects. For the countries where there is no specific law on JV (e.g., Thailand), the legal rights and liabilities among JV partners as well as between the JV and third persons are often ambiguous (Likhitruangsilp and Mekkriengkrai, 2007). Since construction joint ventures are usually established by an agreement between two or more contractors to jointly execute a certain construction project, they are formed as contractual (unincorporated) JVs, rather than corporate (incorporated) JVs. JV agreements must be prepared meticulously to maximize the interests of all JV partners and the JV itself as well as to minimize risk inherent in the project.

This paper presents primary considerations for preparing construction JV agreements. Key JV management issues were summarized by reviewing related literature and interviewing 14 JV executives of seven leading construction firms in Thailand. Major decisions by JV partners in each major phase of the construction JV project lifecycle were collected and related to the contents of construction JV agreements. The paper then explores three types of construction JV agreements generally used in the industry, namely, the memorandum of understanding (MOU), the pre-bid JV agreement, and the JV agreement by focusing on main provisions in these agreements and primary considerations while drafting them.

2. Life Cycle of Construction Joint Venture Projects

The entire lifecycle of construction JV projects consists of four major phases: (1) the beginning phase, (2) the formation phase, (3) the operation phase, and (4) the termination phase, as illustrated by Figure 1. In each phase, every partner has to make several critical decisions, which directly affect JV management and in turn JV agreement drafting. The details of these decisions are as follows.
2.1 **Beginning Phase**

The principal concept of a construction JV is the unification of two or more contractors that mutually agree to engage in a particular project. Thus, two main processes construction JVs must involve are investment decisions and selection of the partners.

Before joining other contractors to form a construction JV for a particular project, each contractor has to make several investment decisions, including establishing its objective of JV participation, performing research on the project, analyzing its current status (e.g., asset, financial, and amount of work on hand), as well as evaluating all available investment options and choosing the best one. Among these investment decisions, it is generally accepted that the objective of JV participation be one of the most significant decisions because it directly influences most aspects of JV management, including selection of the partners, administrative structure of the JV, and most importantly the JV’s success.
The objectives of JV participation collected from several past research works [e.g., Fong (1985) and Vaughan (2007)] were verified by 14 JV executives of seven leading construction firms in Thailand. It was found that the objectives of Thai contractors to participate in construction JVs are quite diverse, yet can be categorized into seven groups: (1) construction technology transfer, (2) track record improvement, (3) better competitive strategy, (4) financial issues, (5) increase in construction resources, (6) related laws and regulations, and (7) political issues. Detailed discussions of these objectives can be found in Prasitsom (2008).

2.2 Formation Phase

Once a group of contractors have decided to jointly undertake a construction project, a construction JV will then be formulated by a contract, which is generally called a JV agreement. The details of this construction contract will be discussed later.

One of the most important considerations while preparing a JV agreement is the administrative structure of JV, which primarily depends upon the participation shares (contributions) of the partners. The participation shares represent the percentage allocation of financial resources in terms of capital, profit, loss, and other responsibilities among the partners. In Thailand, all partners however must accept joint and several liability resulting from the project towards the owner and third persons (Likhitruangsilp and Mekkriengkrai, 2007).

Four common types of JV administrative structures in Thai construction industry are (1) the collaborative type, (2) the separated-work type, (3) the mixed type, and (4) the single-operator type. Figure 2 displays an example of the collaborative type of JV administrative structure. As can be seen, the S&K Joint Venture is constituted from Contractor S and Contractor K with the contributions of 51 percents and 49 percents, respectively. Human resources in the project are supplied from both JV partners and newly hired JV employees, all of which are allocated to three main works in the project. For example, the track and signaling works are the collaboration between the employees of Contractor K and of the JV.

2.3 Operation Phase

The operation phase of a JV project entails the administration of two parts: the construction project and the JV organization. The administration of JV projects is fairly similar to that of general construction projects, whereas the administration of JV organizations is unique. A construction JV is mainly administrated by executive bodies, which consist of the supervisory board, the sponsor (leading member), and the project (site) manager. Their main functions include JV asset and capital
management (i.e., procurement and allocation), human resources management, keeping of JV account, and warranty of the facility.

2.4 **Termination Phase**

After the dissolution of a JV, unless any other method of adjustment of property between the partners is agreed upon in the JV agreement, the liquidation will take place.

3. **Construction Joint Venture Agreements**

The JV agreement is a construction contract stipulating legal rights and liabilities among JV partners as well as between the JV and third persons. Before a formal JV agreement is made, the partners may mutually agree to enter two types of JV agreements: the memorandum of understanding (MOU) and the pre-bid JV agreement, respectively. The relations among these three agreements can be summarized as follows.

**Figure 2: Example of JV administrative structure—the collaborative type**
• The contents of the subsequent agreements must be in accordance with those of the preceding ones.
• The provisions in the subsequent agreements must be at least the same or have more details than those in preceding ones.
• Once a subsequent agreement is executed, the preceding agreements will be no longer effective.

Figure 3 shows the detailed steps of JV management during the beginning and formation phases. As can be seen, three types of contracts (i.e., the MOU, pre-bid JV agreement, and formal JV agreement) can be made at different points of time to formulate the JV. However, the specific objectives and contents of these contracts are somewhat different from one another.

4. Memorandum of Understanding (MOU)

The MOU (sometimes called “the starting of JV agreement”) is the first JV agreement where contractors can be used to informally constitute a construction JV. Typically, this agreement is made when the term of reference (TOR) provided by the owner stipulates that the contractors that want to obtain the bidding documents must be in this business form. Since the contractors may not have enough time to prepare a more formal JV agreement at this stage or may want to explore details of the bidding documents first, they may enter this type of agreement, rather than another more formal agreement. However, if the contractors have enough time to prepare a more formal JV agreement or are certain to submit their bid proposal, they may adopt a pre-bid JV agreement instead (i.e., step 4 in Figure 3).

The main provisions in the JV MOUs include:

• Name of JV
• Names of partners (sometimes called parties or members)
• JV objectives
• Responsibilities of the partners on expenses
• No competition with JV (e.g., prohibit every partner from obtaining the bidding document of this project and from joining other JVs that will compete in this project)
• Termination (validity or dissolution) of agreement

Once the JV obtains the bidding documents and intends to submit its bid proposal, the MOU will be replaced by the pre-bid JV agreement.
5. **Pre-Bid JV Agreement**

The pre-bid JV agreement (sometimes called “the bid-stage JV agreement”) is a contract made among JV partners to stipulate general information about the JV, especially the scope of work and responsibility of each partner during the bidding process. This type of agreement is usually required by the owner as part of the JV’s bid proposal to guarantee that the bidder is in the form of business the owner expects. As discussed previously, the pre-bid JV agreement can be signed before the JV
obtains the bidding documents from the owner in case that the JV is certain to bid the project. Otherwise, this agreement is made while preparing their bid proposal.

The contents of the pre-bid JV agreement are much more detailed than those of the MOU. Table 1 contains main provisions in the pre-bid JV agreement summarized from several agreements actually used in Thai construction industry.

In addition to the above provisions, some pre-bid JV agreements also stipulate that if the contract is awarded to the JV, its partners have to enter into a more detailed (formal) JV agreement, the contents of which must be acceptable to the owner, and register as a JV (for tax purposes).

**Table 1: Main provisions in the pre-bid JV agreement**

<table>
<thead>
<tr>
<th>Provisions</th>
<th>Details</th>
</tr>
</thead>
</table>
| General information      | • Name and address of JV  
                          | • Name and address of each partner  
                          | • Business objective           |
| Administrative structure | • Contribution (participation share or interest)  
                          | • JV leader (sponsor)  
                          | • Authorized representatives and authorities  
                          | • JV committee (chairman and members) |
| Operation                | • Submission of proposal  
                          | • Costs and expenses for the preparation and submission of bid proposal  
                          | • Scope of work and responsibilities  
                          | • Contractual rights and liabilities |
| Others                   | • Bond and security  
                          | • Assignment  
                          | • Exclusivity (no competition with JV)  
                          | • Confidentiality  
                          | • Termination (validity or dissolution)  
                          | • Applicable (governing) law  
                          | • Settlement of disputes  
                          | • Entire agreement |
6. Joint Venture Agreement

If the project has been awarded to the JV, a formal JV agreement will be developed to formally specify contractual rights and liabilities of each partner during construction. The JV agreement is normally included as part of the construction contract between the owner and the JV. In addition to the JV agreement, the partners often form other contracts such as articles of JV and shareholders’ agreement that will be used for the internal operation of the JV.

Similar to the previous two agreements, the provisions in JV agreements are quite diverse. The main provisions of JV agreements summarized from the actual JV agreements are presented in Table 2.

**Table 2: Main provisions in the JV agreement**

<table>
<thead>
<tr>
<th>Provisions</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>General information</td>
<td>• Name and address of JV&lt;br&gt;• Name and address of each partner&lt;br&gt;• Business objective&lt;br&gt;• Extent and duration of agreement</td>
</tr>
<tr>
<td>Administrative structure</td>
<td>• Contribution (participation share or interest)&lt;br&gt;• Authorized representatives and authorities&lt;br&gt;• Duties, authorities, and responsibilities of executive bodies (i.e., supervisory board, sponsor, and project manager)</td>
</tr>
<tr>
<td>Operation</td>
<td>• Scope of work and responsibilities&lt;br&gt;• Contractual rights and liabilities&lt;br&gt;• Working capital&lt;br&gt;• JV accounts</td>
</tr>
<tr>
<td>Others</td>
<td>• Auditing&lt;br&gt;• Assignment and subletting&lt;br&gt;• Exclusivity (no competition with JV)&lt;br&gt;• Confidentiality&lt;br&gt;• Insolvency or default of partners&lt;br&gt;• Termination (validity or dissolution)&lt;br&gt;• Applicable (governing) law&lt;br&gt;• Settlement of disputes&lt;br&gt;• Entire agreement</td>
</tr>
</tbody>
</table>
As can be seen, many provisions in the JV agreement are the same as those of the pre-bid JV agreement. However, some provisions are written in more detail, especially JV administrative structure. Another important provision in the JV agreement concerns the liability of the JV to the owner and third persons: “All the partners shall accept joint and several liability in connection with the works towards the owner and third parties.” The joint and several liability of all the partners is common for the JV projects in Thailand. Detailed discussion on this issue can be found in Likhitruangsilp and Mekkriengkrai (2007).

7. Conclusion

JV agreements play an important role in the success of JV project management. These contracts are necessary not only for forming the JV organization, but also for stipulating general conditions of JV operation. Three types of JV agreements are prepared at different stages of the project. The MOU may be signed by contractors at the early stage to informally establish a JV and obtain bidding documents from the owner. Nevertheless, if contractors are really interested in bidding, the pre-bid JV agreement can be made instead. As part of the bid proposal, a pre-bid JV agreement is drafted to stipulate the preliminary administrative structure of a JV as well as the partners’ scope of work and responsibility. Once the project has been awarded to the JV, the JV agreement will be signed by all partners to formally establish the JV. The agreements that are meticulously prepared can maximize the benefits of all parties involved as well as minimize potential risk in JV project management.

References


