Handcuffs or Rocket Booster?

Crafting Joint Venture Agreements that Launch Your Business Forward

By Jack Garson

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Businesses team up to pursue work all the time. These joint ventures take many forms and names, from teaming agreements, to partnership agreements, to more formal contracts such as limited liability company operating agreements. These agreements usually address — with varying degrees of success — the activities surrounding the attempt to win the work. But joint ventures all too often share common and critical flaws. Most notably, they often fail to effectively tackle how you will work together if you win the job.

Why the lack of advance planning for important functions? Why do otherwise bright businesspeople run before they can walk? Easy answer: they're in a hurry. They are so eager to win the prize, they're focused on the competition to win, not the problems and complexities of working together if they succeed and get the job.

The Fine Print

It may be a brilliant move to team up with another business. Or it could all be a disaster.

The risks are many. You could get cut out of the deal or receive far less work than you expected. In fact, one of the most common complaints of smaller businesses that team up with larger companies is that the little company only receives a few crumbs, while the big business takes the cake. Of course, the victims here jumped in without a fair and effective agreement with their teammates. Instead, they got fuzzy promises about the work they would receive — and little or nothing in writing. It takes a lot of foresight and discipline to nail down, in advance, exactly how you will divide the work, and price it, if and when you win the job. But that's not what often happens. Everyone is busy working 24/7 to prepare the proposal, and they don't have time to tackle or insist upon a formal joint venture agreement. So even if the "team" is victorious, that leaves many small businesses stuck with lower prices for their work or work that generates less profit, often on a take-it-or-leave-it basis.

If you do succeed in establishing a joint venture agreement that equitably allocates and prices each partner's share of the job, you still face the potential for considerable problems. For example, what happens when one partner does not perform and threatens to drag down the entire joint venture? This could not only cost you the contract, it could expose you to a lawsuit and paying out damages for another partner's misdeeds. All too often, partners fail to plan for the teammate that does not carry its weight. In one case, the two partners were being jeopardized by the poor performance of their third partner. But the group had cobbled together their own sketchy joint venture agreement and failed to reserve the right to expel a nonperforming partner. Even though the two partners proved, at an arbitration, that the third business was constantly understaffing the job and jeopardizing the contract, the arbitrator refused to expel this company because the partners had never agreed that any of them could be kicked out of the joint venture.

Control is also a big issue. The bigger the project, the more likely one of the partners will be a large company that has gone to the trouble of preparing its own agreement. Sometimes this agreement is a subcontract dressed up to look like a joint venture agreement. That is, the large company is really acting as a prime contractor, and your company will be its subcontractor. The prime contractor will have considerable, if not complete, control and your rights will be limited at best.

Where a group of companies with similar size and/or bargaining power are involved, there are often greater attempts at shared control. Yet these agreements can also present plenty of problems because it is complicated to share control. There are no simple answers. Sometimes it is appropriate to give each partner a degree of control over their areas of expertise, then require majority votes for other decision making. Other times, you need one strong boss or, alternatively, a board of directors to run the show. The solution to these and other problems depends on each situation.

Plan Ahead

Still, there is at least one plan that will solve a lot of these problems. If you are going to pursue joint ventures on a regular basis, create your own agreement so that you will have it ready when you're rushing to form a team and win the work. If you have an agreement that provides for the likely situations and problems you will face, then you are in a position to insist that the group adopt your agreement — of course, with their reasonable changes — rather than just proceed on a handshake and hope.

When you craft your joint venture agreement, you will need to address a variety of issues. Consider the following checklist:

- What type of entity will you pick for your joint venture?
- Who's in charge, how will you share control and who votes on what?
- Who gets what work, and how is it priced?
- How are profits distributed and when? What type of cash reserve will you maintain?
- Can you get rid of a partner? If so, when and how?
- How do you fund the joint venture, and can you require the partners to chip in more money later in a "cash call"?

- Does the joint venture restrict any of the partners from separately competing for other business?
- If you introduced the customer to the group, are your partners prohibited from doing other business with that customer? Likewise, are your partners prohibited from poaching your employees?
- If one of your partners breaks the law — for example, by bribing the customer — must they indemnify you, including paying your legal expenses?
- If you have a dispute, will you go to court or arbitration, and will the loser pay the winner's legal fees?

This is already a long list. But it's just a fraction of the issues you need to address in an effective joint venture agreement. Most folks don't bother. But businesses that have been burned by a bad agreement — or no agreement at all — understand the considerable risks of leaving these issues to chance. Yes, a joint venture can be a handcuff or a rocket-booster. But a good agreement is much more likely to launch your business.

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