



ARTICLE

# Joint Ventures in Construction: 'Where Did it All Go Wrong?'

The concept of joining forces with another party to take on a construction project is not a new one. Whether it be a means of entering a previously unexplored region, harnessing specialist engineering capabilities, or simply a means of diluting risk exposure, a joint venture (or “JV”) can be a very effective vehicle, if used correctly.

Working extensively in the disputes field, our construction professionals at FTI Consulting have observed numerous disputes arising among JV partners over recent years. While these disputes have their own unique characteristics and features, many of them share common underlying issues.

The various forms of JV agreements and their inherent features and legal intricacies are not considered in any great detail in this article. Instead, it looks to explore when, how and why common issues tend to arise in these relationships, and what might be done to address them.

## Common Issues

Embarking on a JV agreement for a construction project can and should be a very complex exercise in developing a contractual relationship. As if forming a multi-party JV isn't challenging enough from a legal and commercial standpoint, try throwing a construction project into the mix. A suitable analogy might be the difference between carrying a tray of full champagne flutes across a crowded room, and then trying to do the same but on roller-skates...

The long and complicated tender process for a major construction project takes a great deal of time and attention to navigate for any standalone contractor. It is essential for the tendering party to gain a full and detailed understanding of the technical aspects of the proposed project in order to coherently and accurately craft the commercial aspects of the tender submission (including risk allocation).

The origin of some of the issues commonly encountered in construction disputes involving JV partners is discussed below.

## Timing of JV Agreement

Consider this hypothetical scenario – a specialist cladding contractor based in Singapore sees Australia as a strategic growth market and therefore wants to gain entry to it. However, it wants to mitigate the inherent risks involved in entering an unfamiliar market and sees the formation of a JV as an effective means of achieving this.

Two options may present in this situation, and these are discussed further below.

**Option 1 – Search for contractors with complimentary skillsets/features that are already established in Australia and convince one of them to enter into a JV agreement with the idea of landing future projects together**

In theory, this option might appear favourable as it would allow the JV parties to strategize the tendering process jointly, with clearly defined risk, roles and responsibilities already agreed upon.

Without the imposition of the time pressures associated with a tendering process, the parties should have the opportunity to consider project level risks thoroughly and decide how to mitigate/allocate these. Then, when a suitable opportunity arises to tender for a project, the JV partners could focus fully on the tender process without the distraction of forming the JV agreement.

However, without a specific project in consideration, the time-consuming and expensive process of forming a JV agreement comes with no imminent cash inflow. Perhaps for this reason, Option 1 tends to be the exception rather than the norm in our experience.

**Option 2 – Approach contractors with complimentary skillsets/features that are on the tender list for a major project in Australia and use this potential project as the basis for the JV agreement**

This option would appear to have the disadvantage of an inherently uncoordinated tender process, due to the Singapore-based contractor's relatively late involvement.

Having the JV agreement in place prior to tender submission would generally be required by the Employer in the tender qualification process. This would mean that navigating both the negotiation of the JV agreement and the tender process would need to happen concurrently.

The tight timeframes, hard deadlines and high workloads typically involved in the tendering process could push the care and attention given to the terms and provisions of the JV agreement onto the backburner. After all, if the tender is unsuccessful, there may be precious little use for the JV agreement. It isn't hard, therefore, to see how priority would naturally be given to the tender process in this situation.

While the JV agreement produced in such a scenario can still be legally compliant and enforceable, will this document be suitably drafted to operate alongside a separate and potentially complex construction contract?

The evidence does not always appear to support this theory.

Notwithstanding these apparently inherent disadvantages, we tend to encounter Option 2 much more frequently in the context of construction disputes.

**Focus on Long-Term Collaboration**

Regardless of the timing of the JV agreement, parties often enter into such relationships with a 'bigger picture' strategy in mind (i.e. maintaining the relationship over more than one project). This approach promises a potentially greater reward than just a single project for all the initial cost and effort required to form a JV agreement.

As strategic decisions of this nature will tend to be made at a board level (as opposed to at project level), the negotiation and development of JV agreements tend to also take place at the same level. While it is clearly important for the strategy and purpose of the JV partners to be aligned, ignoring the project level considerations in the agreement is a common mistake, often with dire consequences.

As disputes tend to arise so frequently on construction projects, there can often exist a commercial tension amongst the parties when negotiating contractual terms. Most experienced contractors will have the battle scars of previous disputes in their consciousness, and this can produce a more adversarial atmosphere at the outset. This does not necessarily preclude the ultimate agreement of terms, as generally the parties know that they need each other to achieve their individual goals.

Conversely, negotiations at board level for long-term JV agreements might not contain such intense commercial tension. Each party will of course be looking for commercial advantage in negotiations, but with the undertone of collaboration usually looming large in the consciousness. Either party bringing an adversarial edge to negotiations might risk damaging this air of collaboration and derailing the JV strategy before it begins.

**Form of Contract**

The most popular standard forms of construction contracts (e.g. FIDIC, JCT, SIA, NEC, etc.) that we see today contain terms and provisions that are constantly being reviewed and refined for suitability. A large part of this refinement is based upon addressing past issues that have arisen on actual projects that resulted in a formal dispute. In common law jurisdictions, disputes heard in litigation

will form precedents that shape future amendments to these contracts.

Essentially, these standard form contracts are dynamic in that they are (in theory) constantly shifting to suit the surrounding legal framework in which they operate. This is not an exact science as construction projects are notoriously unique, and jurisdictions will have differing governing laws, but the intention is nonetheless to produce the most suitable and robust forms of contract for the purposes required.

In contrast, JV agreements prepared for construction projects do not generally exist in a standard form. Often the parties involved will have their own in-house legal teams involved in the drafting of any such JV agreements. Additionally, external law firms will often be engaged by the parties to assist with the drafting process. Combined with the input of board members and senior management of each party, the sum of all these contributions will generally result in a unique JV contract agreement, which is distinct from all others before it.

As such, the specific terms and provisions are likely to be untested in the courts, and therefore potentially vulnerable to attack in the event of a dispute. At FTI, we have seen instances of multi-billion dollar JV agreements being attacked on the basis of the basic legal concepts underpinning a certain provision. If a standard form contract had been available and in operation, there would very likely be precedent on the interpretation of that provision.

In summary, parties to a JV agreement may feel (or be advised) that there may be ways to escape from their obligations due to ambiguities and/or differing interpretations of the wording of the agreement itself. This potential uncertainty might be the driver for minor disputes under JV agreements to develop into much more formal ones which are referred to litigation or arbitration.

### Construction Contract vs JV Agreement

The outline features, issues and benefits of both construction contracts and JV agreements are discussed in the sections above. However, what is not directly addressed is how the two operate with one another in a 'live' project scenario.

For instance, assuming that a standard form construction contract is in operation, there will undoubtedly be contractual mechanisms to allow for a change in scope of work (e.g. an additional storey being added to a hotel). This contractual mechanism will usually prescribe how the change is to be instructed, measured and valued.

So, how would the same example be administered under the JV agreement? This may depend on how specifically the agreement references the terms and/or scope of work under the construction contract. Assuming each party's risk exposure in relation to the construction contract is pre-determined in the JV agreement, then the change required may be as simple as amending the construction contract sum stated.

However, difficulties inevitably arise when more complex events occur, such as a delay to the project caused in part by one of the JV partners. Such an event may change the outturn commercial position due to the imposition of liquidated (or general) damages by the Employer.

In such an event, the following key questions may instantly arise (among others):

- Does the JV agreement state how any such damages imposed should be apportioned?
- What if the JV partners were both responsible in some way for the delaying event?
- Is the demarcation between the lines of responsibility drawn clearly enough to ascertain which party is responsible for which part of the works?
- Does any overlap exist between these responsibilities?
- Alternatively, do any gaps exist?

In many cases, the JV agreement does not address the parties' respective responsibilities under the construction contract in sufficient detail to provide clear answers to these questions. It is in these circumstances that we see many disputes arising amongst JV partners, as they inevitably require the engagement of industry experts to provide independent opinion on these complex and technical matters.

### Other Issues

Apart from the issues discussed in the preceding sections, there are commonly 'softer' issues that arise in the formation of JV agreements for construction projects.

The list of such issues is extensive, but some examples of these are given below:

#### — Cultural issues

Given that many JV agreements involve international partners, the importance of cultural nuances are not to be underestimated. The concept of 'good faith', for instance, is much more prevalent in practice in some countries/regions than it is in others.

### — Multiple JV Partners

How many cooks is it that they say 'spoil the broth'? No further elaboration is required on this point.

### — Differing Risk Appetite

How aggressively each JV partner wishes to pursue a project with, say, poor design development, or a higher-than-average risk profile may vary greatly. These subtleties are unlikely to be captured within the JV agreement itself, and unequal voting rights may see a JV party being dragged into a project unwillingly.

## A Pre-emptive Approach

Construction projects tend to be complex in nature, and the construction contract itself tends to reflect this complexity. JV agreements, however, tend not to exist in the same level of detail, and this is an area from which we commonly see disputes arising.

As practitioners operating largely in the world of construction disputes, many of the cases we encounter involving JV partners involve a general lack cohesion between the JV agreement and the construction contract. While the allocation of risk and responsibilities can usually be effectively apportioned in the boardroom prior to project commencement, this allocation framework often unravels when unexpected events occur on the project itself, for example changes in scope, delaying events, force majeure events and the like.

Conventional wisdom (and experience) tells us that change in construction projects is inevitable, to a greater or lesser extent. It would therefore appear prudent for JV partners to prioritise how change will be managed from a technical perspective when forming the JV agreement. This would likely be most effective if experienced project level staff and/or consultants are engaged in the initial drafting phase in order to 'disaster test' the JV agreement against issues that commonly arise on construction projects.

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## The Greater Good

As long as disputes continue to occur on construction projects, they will naturally also exist to some extent in the JV agreements that parties enter into to carry them out. However, it is the instances where the dispute only arises between the JV partners where the most scope for progression appears evident.

While there is no 'one size fits all' approach to avoid the commonly encountered issues in JV agreements on construction projects, introducing some 'healthy' cynicism and construction experience to the process from all JV partners at an early stage should (in theory) help to flush out construction-related issues that may not have been considered in the boardroom.

Whether the long-term relationship of JV partners can withstand a dispute amongst them on a construction project will most likely depend on the conduct of the parties and the outcome of the dispute. Even if the dispute is independently and fairly determined, at least one party will inevitably feel hard done by. Can those feelings be swept aside for the greater goals of the JV?

Let us finish with a quote:

*"Whenever you're in conflict with someone, there is one factor that can make the difference between damaging your relationship and deepening it. That factor is attitude."*

– William James