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SPRING 2018 VOLUME 15/NUMBER 1 TODAYSGENERALCOUNSEL.COM



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ISSN: 2326-5000

View our digital edition: doi.org/10.1002/gc.12001



RISKS OF CONTRACTUAL JOINT VENTURES FOR GOVERNMENT CONTRACTS

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Parties pursuing government contracts or grants enter into joint ventures for many reasons, including to take advantage of expertise of the other parties, access proprietary technology, qualify for a contract for which a party would not otherwise be qualified, or pool financial resources. Nevertheless, there is no uniform understanding of what a joint venture is and what its legal implications are. In particular, joint venture participants often are unaware of the legal implications of operating as a contractual joint venture, as opposed to establishing a separate



legal entity. Unfortunately, many organizations end up regretting being part of a contractual joint venture.

A joint venture is an association of persons engaged in pursuing a business enterprise for profit. However, it does not necessarily indicate any particular legal form of association. Parties can associate by forming a legal entity such as a partnership, corporation or limited liability company; by entering into a written contract to create a joint venture; or by implying a contract with their actions. In any case, the legal implications of doing business as a joint

venture are determined by state law.

Parties often associate by entering into a joint venture agreement because they do not want to go to the trouble of forming and maintaining a separate legal entity. However, many parties do so without fully understanding the legal implications of doing business through a contractual affiliation. Unfortunately, participants often fail to consult legal counsel regarding the consequences of a contractual joint venture until after a problem has arisen. The problem triggering the consultation routinely relates to one joint venture participant's concern

about its liability for actions of the other participant, a desire to terminate (or withdraw from) the joint venture, or an opportunity that will be in competition with the joint venture or the other participant.

RISKS OF CONTRACTUAL JOINT VENTURES

In many states, a contractual joint venture is treated like a general partnership. Each partner is jointly and severally liable for the liabilities of the joint venture. Consequently, in the event



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that significant liabilities arise because of one party's faulty performance, the government customer may be able to recover damages from the joint venture and each joint venture participant. By contrast, a joint venture in the form of a limited liability entity provides a layer of protection for each party against the other party's liabilities. In that

case, a party's liability for damages caused by the other party typically would be limited to its investment in the joint venture entity and any profits from the joint venture.

General partners also typically owe each other fiduciary duties of care and loyalty. The duty of loyalty can prevent a joint venture participant from competing with the joint venture or terminating the joint venture before the purpose has been accomplished. The joint venture agreement may have specific provisions about the participants competing with or terminating the joint venture, but in states where fiduciary duties cannot be waived, a party desiring to do so would likely be faced with claims that the party's fiduciary duties cannot be contracted away. Some states, including Delaware, allow members of a limited liability company to waive certain fiduciary duties, but other states do not.

KEY POINTS TO ADDRESS

Despite the risks, sometimes organizations conclude that they prefer doing business as a contractual joint venture rather than forming a limited liability entity. In that case, they should take care to draft their joint venture agreement to minimize the pitfalls of a contractual

affiliation. Four of the most important contractual provisions to focus on are (1) choice of law, (2) waiver of fiduciary duties, (3) statement of purpose and (4) termination.

Legal counsel should be consulted to see if it is feasible to choose a state law to govern the joint venture agreement that would enforce a contractual disclaimer of being general partners with each other and of being jointly and severally liable for each other's liabilities. Legal counsel should also determine to what extent the parties may waive their fiduciary duties to each other. With a favorable choice of law and clear drafting, each party may be able to insulate itself from liabilities of the others. By waiving fiduciary duties, the parties can reduce the possibility that unexpected duties to the other joint venture party may interfere with the parties' respective businesses outside the joint venture.

The purpose clause should be narrow, such as "to submit a proposal in response to a designated solicitation, to perform the contract if it is awarded to the joint venture and to pursue other opportunities only to the extent the parties unanimously agree in writing."

venture partner in which it has lost faith. It is easier to expand the purpose by mutual agreement if the joint venture is going well than to try to narrow the scope unilaterally in a joint venture that is going poorly.

The termination clause should be clear. The term of the joint venture should expire upon the completion of performance and final closeout of all government contracts awarded to the joint venture. In addition, each party should have the right to withdraw from the joint venture upon a material, continuing event of default of the joint venture agreement by the other party. However, such a provision should be subject to a proviso that a party may not withdraw if it would result in a default by the joint venture on a contract or grant, or cause the joint venture to fail to meet its obligations under any proposal it has submitted. Such a right of withdrawal may give the non-defaulting party some leverage in dealing with the defaulting party.

Government contractors and grant recipients should seek to avoid entering into contractual joint ventures under the laws of states that deem the joint

PARTICIPANTS OFTEN FAIL TO CONSULT LEGAL COUNSEL REGARDING THE CONSEQUENCES OF A CONTRACTUAL JOINT VENTURE UNTIL AFTER A PROBLEM HAS ARISEN.

Parties sometimes want to lock in the other party, however, by providing as a purpose clause "to pursue any contract in a designated program and to perform any contracts awarded to the joint venture." But if the first contract does not go well and one party is not adequately performing its responsibilities, the other party may find itself with the limited options of not pursuing any more contracts in the designated program, or pursuing them with a joint

venture participants to be general partners with joint and several liability. If there are compelling reasons to do so, however, participants should consult with counsel to prepare their joint venture agreement so it will not create unintended liabilities. ■