by *Michael A. Rossi*

Joint venture and partnership horror stories... and how to prevent them

In today's fast-paced, global marketplace, one of the trends of business organisation appears to be some form of joint venture or partnership - typically two entities joining forces for the benefit of both. However, with the frenetic pace of the globalizing marketplace, one must ask whether entities that are getting involved with joint ventures and partnerships are looking at the risks faced by such a business organisation. The questions to ask are:

* What are the liability risks?
* What are the first-party property and time element risks?
* Which co-venturer or partner is responsible for such risks?
* What, if any, risk management techniques and insurance should be in place to deal with such risks?
* Who is responsible for addressing such risk management and insurance issues?

Often, such issues are not addressed, or are addressed only partially. Such omissions can prove problematic, if not life-threatening, for any joint venture or partnership, and can also cause problems for each co-venturer or partner. But such omissions typically are not the fault of the risk manager; rather, such omissions typically are the fault of management who advise their risk managers, if at all, only after a deal is done.

This article will discuss some of the issues that risk managers of US companies have considered when addressing joint venture and partnership issues for their companies. It should be noted that there are a host of structural and operational risk management issues that should be considered but are beyond the scope of this article. Such issues address the details of how the joint venture or partnership is actually set up and run, including:

(a) how will the entity be financed, and by whom?;
(b) who has the authority to make decisions?;
(c) who runs the day to day operations?;
(d) how will proprietary information be shared?;
(e) whose employees will be used?; and
(f) what, if any, system of checks and balances are in place for the foregoing?

Each of these issues, if not properly addressed, can expose a company to loss. In any event, it is hoped that the issues that are addressed in this article prove useful to risk managers of Australian companies.

Defining joint ventures and partnerships

The phrase 'joint venture' and the word 'partnership' can be used for many different types of business organisations. Rather than get caught up in the detail of all of the various types of business organisations that can fall under the rubric of either 'joint venture' or 'partnership,' it is important for risk managers to understand at least the following concepts.

First, a business organisation can be classified as a Joint venture' or 'partnership' by operation of law, in addition to and apart from by way of express, written agreement. Courts will look at the conduct of the parties at issue to determine whether, as a matter of law, the parties were involved in a joint venture or partnership.

Thus, merely because there is no written agreement between the risk manager's company and another company, that does not mean that the risk manager's company is not exposed to joint venture and partnership risks, not only from a legal liability standpoint but also from a first-party property and time element standpoint.

Second, a joint venture can be organised as a corporation, but it does not have be organised as such. In contrast, a partnership cannot be organised as a corporation. However, there are various forms of partnerships, including the 'limited partnership' (or 'LP') and the 'limited liability partnership' (or 'LLP'). By organising a joint venture as a corporation, or a partnership as a limited partnership or limited liability partnership, the co-venturers or partners, whichever the case may be, typically are trying to limit their liability for the acts of the others involved in the enterprise.

Third, unlike a partnership, a joint venture typically does not entail a continuing relationship among the parties who have joined together for the common enterprise. Rather, a joint venture typically entails a joint undertaking of a relatively short duration.

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> The principle of 'severability' or 'separation of insureds' should exist in all insurance policies.

The agreement - don't leave home without it

The written joint venture or partnership agreement is an extremely important document that no company should do without. Risk managers should keep the following thoughts in mind when explaining to their companies why such agreements are essential and what issues, at a minimum, should be addressed by such agreements.

First, the agreement can serve to address most of the risk issues that are presented by joint ventures and partnerships, including which party is responsible for which risks, which party is responsible for insurance purchasing and maintenance, etc. The agreement should explain which party will defend and indemnify the other and under what circumstances such defence and indemnity will be provided. The agreement also should explain which party is responsible for purchasing and maintaining insurance, what insurance should be procured, and how long such insurance should be maintained after the joint venture or partnership ceases to exist.

Second, the agreement can serve to put the risk manager on notice that the company is entering into a joint venture or partnership. As noted above, a joint venture or partnership, with all concomitant liability risks, can be formed by operation of law in addition to and apart from by way of express, written agreement. It is hard enough for a risk manager to keep track of all joint ventures and partnerships into which the risk manager's company gets involved by way of express written agreement. It is not possible to keep track of all joint ventures and partnerships that are imposed by operation of law. This fact can prove very problematic for risk managers.

For example, virtually all Commercial General Liability ('CGL') policies sold in the US provide that the liability of a Named Insured arising out of the activities of a joint venture or partnership that has not been expressly added by name to the policy as a Named Insured will not be covered. There have been instances in the US where such a provision proved problematic for companies whose employees have conducted themselves on behalf of a joint venture or partnership which had not yet been formalised in a written agreement. When a liability claim is made against one of the companies in connection with such activities, some CGL carriers have denied coverage.

This 'formative' joint venture or partnership risk can be addressed in CGL policies in at least two different ways. On the one hand, the risk manager should discuss the issue with its CGL carrier during policy placement or renewal. Either a letter of intent, or better yet, an 'endorsement, should be obtained providing that the clause prohibiting coverage for joint ventures and partnerships that are not added by name to the policy will not be applied to bar coverage for the company's liability that:

(a) arises from a joint venture or partnership that was in the process of being formalised by a written agreement; or
(b) is imposed because a court deemed the company's conduct to create a joint venture or partnership by operation of law.

In either instance, it is not reasonable for an insurer to believe that a risk manager can keep track of such joint ventures and partnerships and report same to the carrier to add such entities to a list of Named Insureds. On the other hand, the risk manager might try negotiating different joint venture and partnership insurance language in its CGL policies.

Many other types of liability policies, including D&O, EPLI and Multimedia Liability policies, contain express language addressing the issue of insuring a Named Insured's liability arising out of a joint venture or partnership. Such language often says that the Named Insured is covered only for its own liability, unless providing insurance for the joint venture or partnership is the Named Insured's responsibility, in which event the joint venture or partnership is treated as a Named Insured for coverage purposes, so that all parties to the joint venture or partnership are covered.

Addressing senior management exposures

Another important issue to address for any joint venture or partnership is the exposure faced by the senior management of the business organisation. That exposure will depend upon what form the joint venture or partnership takes. Is the joint venture incorporated or not? Is the partnership a general partnership, limited partnership or limited liability partnership?

One of the 'tools' used by US risk managers to address this issue is to 'map out' the senior management exposure and analyse the map to make sure that all of the possible senior management exposure is insured somewhere in the company's insurance portfolio, otherwise separate insurance should be procured. 'Mapping out' is as simple as it sounds. Place on a piece of paper the joint venture or partnership. Draw lines to every coventurer or partner, whichever the case may be. Write underneath each business organisation so identified the type of organisation it is, whether it be a corporation, limited partnership, etc. Based on the map, are all of the exposures faced by the senior management of the joint venture or partnership at issue covered by one of the existing insurance programmes? If not, insurance should be put in place to cover the gap(s).

A word of caution is warranted for buying separate insurance for senior management exposure. Insuring the senior management exposure for limited partnerships can be very tricky in the US. In most cases, the senior management of a limited partnership are designated as general partners. Such general partners can be sued by the limited partners of a limited partnership. Such a lawsuit is analogous to a lawsuit where the shareholders of a corporation sue the directors and officers of the corporation. Because of such similarities, the senior management exposures of general partners typically are insured under a General Partners' Liability and Limited Partnership Reimbursement ('GPL') policy (a policy that looks just like a D&O policy).

If the personal liability of general partners of a limited partnership worked the same way as the personal liability of directors and officers of a corporation, using a GPL policy that looks just like a D&O policy would not be a problem. However, that is not the case.

In some states in the US, the general partners are functionally sued in a lawsuit where the limited partnership is named as the only defendant. The directors and officers of a corporation, in contrast, must be added to the lawsuit by name in order to face personal liability. Because GPL insurance is based on a D&O policy format, the policy only responds if one or more general partners is sued by name.

In other words, the policy does not respond if only the limited partnership is sued Gust like a D&O policy does not respond if only the corporation is sued - except in the case of newer forms of D&O policies offering 'entity' coverage for certain claims). Accordingly, this issue should be addressed in any placement of a GPL policy. The policy should expressly recognise coverage when the claim is brought in a jurisdiction that allows a plaintiff to functionally sue all general partners by merely suing the limited partnership. This issue should also be kept in mind at claims time; depending upon which state's law applies, a GPL insurer's declination of coverage may be in error.

This word of caution regarding GPL insurance illustrates the unique issues presented by insuring senior management exposures of joint ventures and partnerships. The importance of mapping out senior management exposure, identifying the different risks faced by such senior management and structuring the appropriate risk management and insurance treatment cannot be overstated.

Such risks are personal liability exposures of the men and women who assume management responsibility for a company's well being and financial success, and the personal assets of such men and women must be protected. This truth, perhaps more than any other, should be reason enough for management to involve risk managers throughout the creation and implementation of a joint venture or partnership - to ensure that their own personal liability is properly protected.

Insuring certain property and liability risks

There are at least three different ways to insure joint venture and partnership risks:

(l) each party insures its own risks under its existing insurance programme;

(2) one party insures the joint venture or partnership in total, including all parties' risks with respect to the joint venture or partnership; and

(3) the joint venture or partnership procures its own insurance.

Of these three alternatives, there does not appear to be one 'best' way to insure joint venture and partnership risks. There are, however, several issues that should be addressed regardless of which of these three alternatives is used.

Insurance policies have express joint venture and partnership provisions

One of the first principles to keep in mind when addressing insurance issues for any joint venture or partnership is that insurance policies from one line of insurance to another often contain dramatically different provisions regarding joint ventures and partnerships. So, one must, (a) analyse the particular language in each insurance policy that is supposed to respond to property or liability risks faced by the joint venture or partnership, and (b) add the joint venture or partnership risk intended to be insured to the policy based on the particular language at issue.

Is all of the risk intended to be insured, or just the risk of one of the parties? Unless the particular language of the policy at issue is followed, one could very easily insure something other than what was intended to be insured. Let's take, for example, the language of CGL policies as discussed above. Assume that your company enters into a joint venture agreement whereby each party agrees to insure its own liability risks with respect to the activities of the joint venture. Assume further that the joint venture is added by name to your company's CGL policy. Would that be correct?

The answer typically is no. The standard CGL language makes not only the joint venture a Named Insured, but also all co-venturers insureds under the policy. This is problematic in two ways. On the one hand, your company's co-venturer can make a claim against your CGL policy. On the other hand, the insurer of your company's co-venturer can make a claim against your CGL policy for contribution and/or reimbursement. Either way, your CGL policy is being tapped and exhausted for claims that are not supposed to be your company's obligation to insure.

Analyse the particular language in each insurance policy that is supposed to respond to property or liability risks faced by the joint venture or partnership.

Severability or 'separatlon of insureds' on insurance programme

Another important point to keep in mind when insuring both property and liability risks faced by joint ventures and partnerships is ensuring that severability between the parties exists. This is especially important if one party is assuming the obligation to insure the entire joint venture or partnership under its existing insurance programme. The principle of'severability' or 'separation of insureds' should exist in all insurance policies. However, often there must be express provisions in a policy of insurance for such severability to be recognised.

The lack of a 'separation of insureds' provision or its equivalent in an insurance programme can prove problematic when insuring joint ventures and partnerships. One example of such a problem actually was played out in a US court in the 1980s. In this case, the joint venture was a corporation that was owned in equal shares by a large steel producer and a large coal mining company. The coal mining company undertook to insure the joint venture, and added it to its policies. The joint venture owned and operated a single coal mine. The joint venture sold a large percentage of the coal to the steel producer.

As a result of a fire and explosion in the mine, the mine was out of production for several months. The coal mining company was able to sell coal to the steel producer from other mines owned and operated by the coal mining company (which operations were also insured under the coal mining company's policies).

The joint venture presented a business interruption claim to the property insurer. The insurer acknowledged coverage for the joint venture, but sought an offset of the loss by looking to the revenues generated by the coal mining company and its other operations when selling coal to the steel producer. The insurer argued that to recognise coverage for the loss caused by the fire and explosion, without taking into account the gain caused by the same fire and explosion, would give the insured coal mining company a windfall. Litigation was instituted.

The court agreed with the joint venture, reasoning that the joint venture was a separate insured under the policy, separate and apart from the coal mining company and its other insured operations. Having a 'separation of insureds' clause or 'severability' clause might have avoided this dispute in the first place, and should protect against aberrant courts from agreeing with this type of an argument.

Contribution actions against your Insurance programme

As noted above, one of the problems associated with insuring property and liability risks of joint ventures and partnerships is contribution and/or reimbursement actions brought against your insurance programme by an insurer who was supposed to be the primary source of coverage for the joint venture or partnership. This happens, for example, when the joint venture or partnership procures its own, stand-alone insurance but each co-venturer or partner adds the joint venture or partnership to its own programme.

Often, this is done to provide protection in excess of the limits of the stand-alone programme. The problem associated with this scenario is that, unless 'priority' language is used in one or more of the programmes, the insurers who issued the stand-alone insurance programme to the joint venture or partnership may be able to seek contribution and/or reimbursement from the insurers of each of the parties to the joint venture or partnership. Such a contribution and/or reimbursement action would, in part, defeat the purpose of requiring the joint venture or partnership to procure and maintain its own insurance.

Such priority issues should be addressed expressly in the policies procured and maintained by the joint venture or partnership, with an endorsement that expressly recognises that all insurance policies maintained by the parties to the joint venture or partnership are excess to the policies procured and maintained by the joint venture or partnership itself.

Such priority issues also should be addressed in each coventurer's or partner's own insurance programme, with language that provides that any coverage afforded for the liability of a Named Insured for the activities of a joint venture or partnership is excess of any insurance procured by the joint venture or partnership itself. By addressing priority issues in all sets of policies, unwanted contribution and/or reimbursement actions should be minimised if not avoided altogether.

Liability risk exists beyond the life of the venture

Another important point to keep in mind for insuring the liability risk presented by joint ventures and partnerships is that such risk will continue to exist long after the joint venture or partnership ceases to exist. Whether one is talking about contract liability, tort liability or some other liability, the fact remains that you can be sued tomorrow for your activity today. This fact often is not taken into account when addressing the issue of insuring liability risk presented by joint ventures and partnerships.

If, for example, the joint venture or partnership is obligated to procure its own insurance, it should be discussed and agreed upon in advance what obligations shall be in place to address claims made after the venture ceases to exist. Such issues include:

(a) whether Extended Reporting Periods or 'tails' will be purchased on claims-made policies and, if so, who will negotiate and pay for such coverage;

(b) who will maintain copies of all liability policies into perpetuity; and

(c) who will adjust insurance claims.

Concluding remarks

Risk managers can and should play an important role in the joint venture and partnership activities of their companies. Risk managers not only can help ensure the prosperity, let alone survival, of the joint venture and partnership but also can help ensure that any property or liability risks faced by the joint venture or partnership have minimal if any adverse impact on their companies. However, as in many business activities, those who are making the decisions on when, how and under what circumstances a company will get involved with a particular joint venture or partnership often include the company's risk manager in the discussions only after the deal is done, if at all.

Hopefully, this article proves useful to risk managers whose companies are involved with joint ventures and partnerships, if not to help them spot and address issues then hopefully at least to help them persuade management to get them involved in the front end of such deals rather than after the deal is done. It is only in this way that the benefits offered by a good risk manager can be realised. ■

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