

A joint venture – is there any risk?

How to set up a joint venture, without exposing yourself to unnecessary liability.

The demand letter made Jane's heart sink. A \$15,000 debt of which she knew nothing about, yet her name was going to appear as the Defendant in court proceedings. When she rang up John, it transpired that the debt was for advertising spend she knew nothing about and would never have approved. Yet her neck was now on the line.

How Jane ended up with a \$15,000 liability

Jane a successful lawyer met John at a business networking function. John was a real estate agent and after a wine or two they both discovered they shared a goal of creating an online magazine on property investment. That evening and several business meetings later, they had decided to join forces, build their website and had agreed on a business name. They both intended to carry on with their own businesses and this was just a part time joint venture.

What is a joint venture or JV?

The term joint venture can mean different things to different people. To non lawyers it simply describes when two people or businesses join forces to pursue a common business aim. Legally however JVs come in many different forms:

1. The contractual joint venture.
2. The joint venture partnership.
3. The joint venture company.

The structure you choose to operate your JV is crucial and needs careful thought. Jane and John gave no thought to their joint venture relationship. They simply set up their website, gave their business a name and then went full steam ahead. Without Jane's knowledge, John committed the business to \$15,000 of advertising spend. When it came time to pay, John's business couldn't come up with the cash. So the advertisers looked at the website and saw that the business was really a joint venture of two other businesses. Jane's legal practice was doing very well, so they decided to sue her for the debt.

Why Jane ended up with the liability

There was no documented agreement between Jane and John. The business which they had set up was simply Jane and John's company working in tandem. To the rest of the world, including their advertisers, this looked like a partnership and so their relationship was governed by partnership law. Under partnership law, all parties are liable for partnership debts regardless of whether they have given approval to incur those debts. That meant that Jane was liable.

A further problem is that under partnership law there is no limited liability protection. That meant that Jane was liable for the whole debt irrespective of how much money was in the business or her contribution to the business. It need not have been like this had Jane set up the JV properly.

Contractual JV vs. Partnership JV

One option available to Jane and John would have been to set up a contractual JV. A contractual JV is essentially a JV governed by a written agreement which sets out what the parties contribute to the JV and what they get from it. Under a contractual JV, the JV partners contract with the outside world in their own name, not under the name given to the JV. So in other words, John's agreement with the advertisers would have been an agreement with his company and the advertisers; Jane would not have been liable.

JV agreements of this nature are complicated documents and suffer the disadvantage that the JV business has no separate legal identity. That means, if the business becomes successful difficulties will arise trying to sell it. Furthermore, the JV agreement doesn't confer limited liability protection. So for Jane, since she is a sole trader, any debts incurred by her would be her liability irrespective of what she had invested into the business.

Contractual JV's will only be suitable for a limited number of circumstances. Generally, the JV will be short term and may simply involve a one off piece of research or development. However, if the

purpose of the JV is to create a viable business in its own right, then a contractual JV would not be appropriate.

Enter the JV Company

It is in these circumstances that a JV company would be most suitable. In this scenario, the JV partners form a separate limited liability company and then take shares in the company. The JV is now a legal entity so any contracts entered into by the JV Company will be with it, not with the JV partner. That means that the JV partners have the benefit of limited liability protection.

More than that, if the business becomes successful they have an asset which they can sell, or alternatively they can sell their individual shares in the company in order to provide an exit strategy.

Of course, this doesn't get around the problem of one JV partner acting without authority. However, safeguards can be put in place with a well drafted shareholders' agreement which regulates the operation of the company. Though not ideal, even if you don't have a shareholders agreement, at least you have the company constitution and company law to fall back on, both of which are likely to be more user friendly than the law of partnership.

Jane and John became partners, but didn't realise it

By not thinking things through and rushing straight into business together, Jane and John unwittingly became partners in the strict legal sense of the word. That meant Jane was responsible for John and vice versa. Jane became liable for John's debts and because she was a sole trader, also became personally liable. Had they set up a joint venture company with a shareholder's agreement, it is likely John would have got Jane's approval before incurring that debt. Even if he hadn't at least Jane would have been protected from personal liability by the JV Company.

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