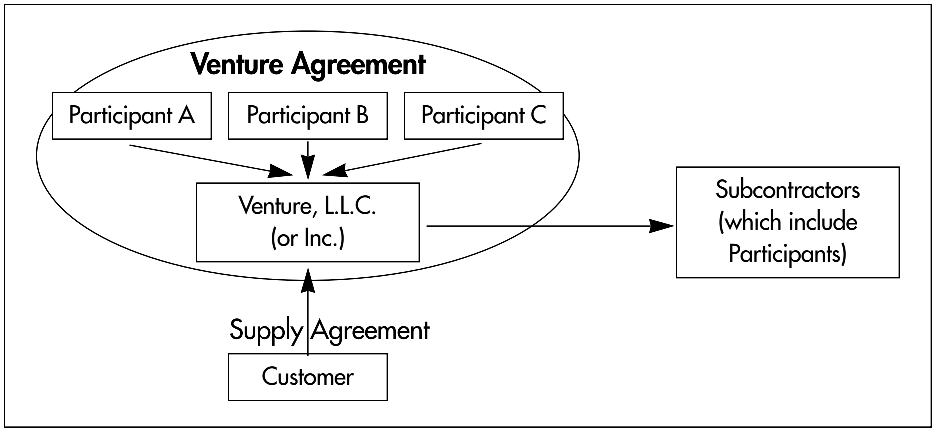
By J. C. Bruno and Justin Peruski

Construction and Supplier Joint Ventures

Rethinking Transactional Structure under the Uniform Partnership Act after Byker v Mannes

Construction companies or suppliers of goods often unite to bid on and/or perform a construction contract or supply agreement. As a result, construction or supplier group members (participants) form a joint venture (venture).[1] A venture can be structured as an entity (corporation, limited liability company, limited partnership, or partnership) or a non-entity (consortium or a master subcontract relationship). Whether it is an entity or a non-entity, there should be an agreement (venture agreement) that delineates the rights and obligations of the participants.



Ventures are complex because of the number of parties involved and the variety of substantive provisions generally required in both the venture agreement and in the contract (supply agreement) between the venture and the customer. Consequently, venture agreements should be carefully developed to govern and accommodate two sets of relationships: (1) the "outside" relationship between the venture and the customer; and (2) the "inside" relationships among the participants. These two relationships raise interconnected issues such as the responsibility for liabilities, taxes, financing, insurance, performance, payment, and control.

Each entity or non-entity structure has its own advantages and disadvantages. One of the significant risks facing a non-entity venture is that the inside relationship and outside relationship, when taken together, may be deemed to have formed a partnership. When a venture is a non-entity, it is similar to a single purpose partnership, and it is this similarity that can raise an inference of "partnership" and the resulting joint and several liability of the participants.

The Michigan Uniform Partnership Act Section 6, defines a partnership as "an association of 2 or more persons . . . to carry on as co-owners, a business for profit."[2] Recently, the Michigan Supreme Court strictly interpreted this definition. The court held that MCL 449.6 does not require subjective intent to form a partnership, but merely an intent to carry on, as co-owners, a business for profit.[3] This article discusses the various venture agreement structures and explains that a great amount of care is required when using the consortium or master subcontract, non-entity formats after the holding in *Byker v Mannes.*[4]

Common Venture Formats

The three most common formats of ventures—separate entity, consortium, and master subcontract are outlined below.

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The editor invites lawyers and judges to submit articles to be considered for publication. Articles should focus on planning opportunities and on practical solutions to common problems encountered in representing businesses. They should be short, practical, and under 1,250 words.

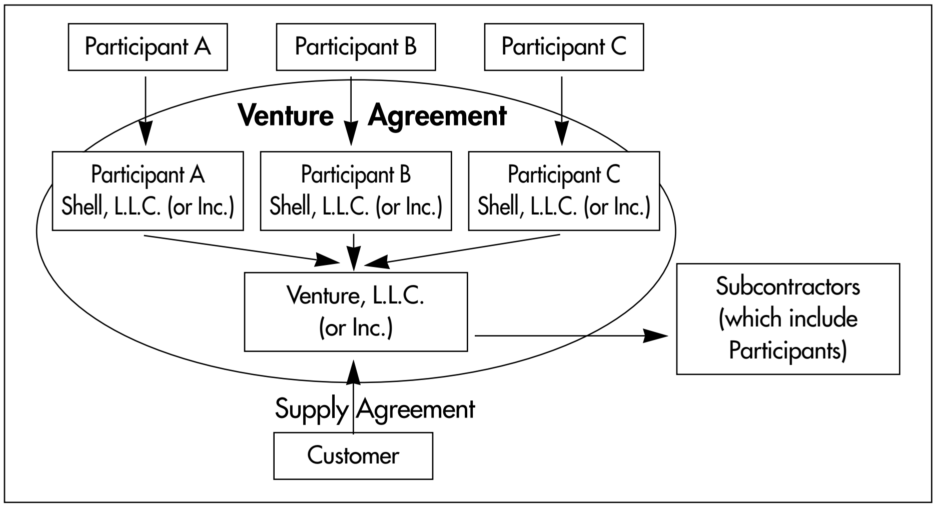
Separate Entity

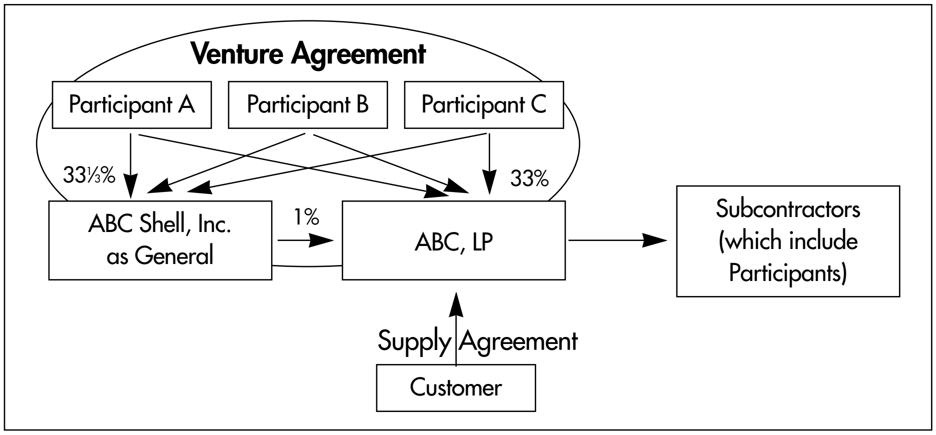
Creation of a separate entity venture in the form of a corporation, a limited liability company, or a limited partnership is accomplished by a filing with the state. A separate entity venture using the partnership format may be formed by contract or implied by law, and may also be registered with the county under the Uniform Partnership Act (UPA). The most useful formats for a separate entity venture include:

a) A limited liability company or corporation owned by the participants. (See diagram above.)

b) A partnership formed by shell corporate or limited liability company subsidiaries of the participants. A partnership composed of the participants directly is not advisable because partners are exposed to joint and several liability. (See diagram on the following page.)

c) A limited partnership formed by the participants and a shell corporation owned by the participants, where the participants' jointly owned shell corporation serves as the general partner with a one percent interest in the limited partnership. (See diagram on the following page.)





The use of a limited liability company to act as the venture entity is generally recommended because of its tax flexibility and limited liability. However, many participants will continue to opt for a non-entity venture. They are willing to accept, or are unaware of, the dangers of a possible classification as a partnership. They are attracted to the flame of perceived advantages such as not having to file an entity tax return (which may not be correct if the venture is deemed to be a partnership),[5] to file articles of incorporation or other entity formation documents with the state, and to adjust insurance coverages to include the new entity.

Consortium Agreement

A consortium is a non-entity venture that is formed by contractual agreement. The supply agreement may be issued in one or more of the participants' names.[6] Michigan law recognizes a consortium relationship without identifying it as such. Michigan law treats a consortium relationship as a contractual affiliation that does not rise to the level of a partnership joint venture. Michigan has a long line of cases permitting contractual relations permitting joint action for material benefit without creating a partnership or the legally defined "joint venture."[7] It has, however, become more difficult to establish a consortium without it being deemed a partnership after *Byker v Mannes.* Nevertheless, there is still an opportunity under Michigan law to create and use a non-entity venture without incurring joint and several liability for contract obligations[8] and tort liability.[9]

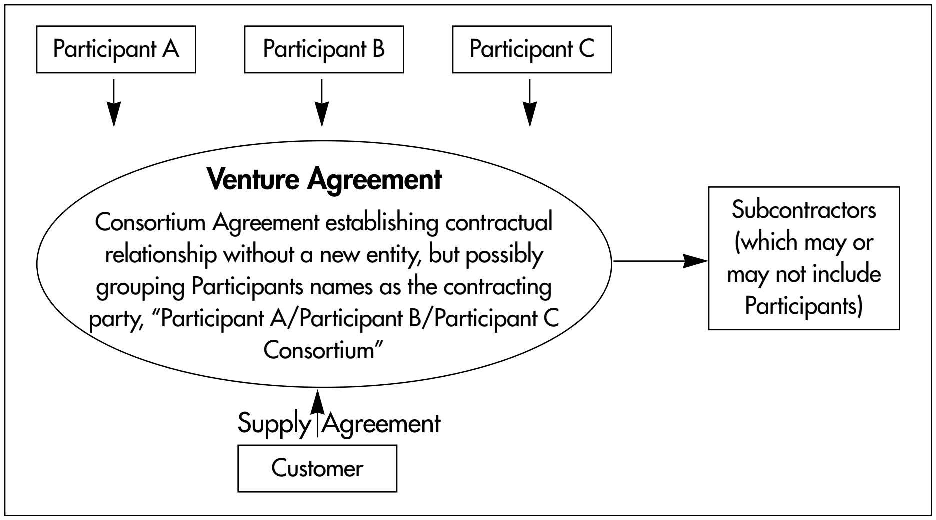
A consortium model is diagramed on the following page.

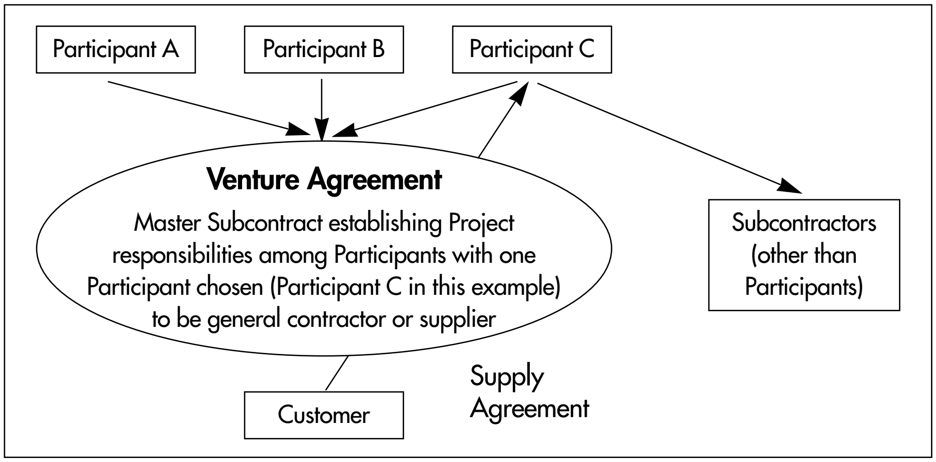
To increase the odds that the consortium will not be deemed a partnership under *Byker,* consortium participants should not have jointly owned property; a common firm name; firm funds; firm accounts; a firm letterhead; any commingling of funds or property; a filed certificate of partnership; an agreement as to sharing losses; or a perpetual agreement.[10] These acts are all indicia of a partnership. Avoiding all of the above would be impractical if not impossible. The lesson to be learned is that consortium participants should do as much as possible to keep assets, accounts, properties, and names separate and distinct.

Michigan precedent denotes circumstances under which a non-entity venture is least likely to be determined to be a partnership by operation of law:[11]

a) The participants should not agree to share losses. Thus, any joint and several liability owed to a customer should be covered by an indemnity agreement in the venture agreement. The indemnity agreement should place the ultimate loss on the participant that causes the loss. Moreover, losses are not limited to monetary losses. The loss of a participant's time and effort may be deemed to be a sharing of losses. Therefore, the participant performing the administrative work should receive compensation.
b) The participants should profit only from their own work or supply.
c) Each participant should control its own portion of the work or supply.
d) A partnership will not necessarily be found even if a single contract is issued to "Participant A/Participant B/Participant C Consortium." Additionally receiving a single check for all work done does not require a partnership finding. This holds true even if the participants were equally liable to the customer to perform all of the work.
e) Never reference participants as "partners." Do not use the term "partnership" to describe any inside or outside relationship and include a disclaimer of partnership in the venture agreement and supply agreement.

Thus, it is possible under Michigan law to create and use a non-entity venture and at the same time avoid a potential partnership finding. However, the venture agreement and supply agreement must be drafted and followed meticulously to avoid such a finding.[12] Additionally it may be difficult to convince a customer to sign a supply agreement with a loosely formed non-entity. Lastly, not every state may recognize a consortium as a non-partnership arrangement and, consequently,





may impose partnership liability for accidents and contracts occurring in those jurisdictions. Because of these uncertainties in the consortium model a separate entity venture will almost always be the preferred venture format from a legal perspective.

Master Subcontract

A master subcontract is also a non-entity venture that is formed by contractual agreement. The supply agreement is granted to only one of the participants, but all participants agree in advance in the venture agreement as to work distribution and to the allocation of risks normally assumed by a general contractor alone. Similar to the consortium model, the relationship in a master subcontract assumes each participant is independent and no partnership is formed.

The master subcontract model is diagramed at right.

The master subcontract is a variation of the standard general contractor-subcontractor relationship used in construction agreements. The venture agreement designates one of the participants to be the general contractor. Additionally, each participant promises exclusive participation, indemnity, and other forms of cooperation. It is always possible that, despite the disclaimer language of the venture agreement, a court could hold that the master subcontract relationship is a partnership by operation of law. This would be particularly likely if most or all of the partnership indicia discussed above are present.

Conclusion

The Michigan Supreme Court held in *Byker v Mannes* that a partnership requires only an intent to carry on, as co-owners, a business for profit and not an intent to form a partnership; thus, participants choosing the non-entity format will always face the risk of a court finding joint and several liability. After *Byker,* it is clear the subjective intent of the parties is not an essential element under Michigan law in determining the existence of a partnership. It is, however, now unclear how far the courts may reach to find a partnership and to impose joint and several liability even if that is directly contrary to the intent of the participants. Therefore, participants are recommended to use a separate entity venture. Generally, a limited liability company should be used to obtain maximum certainty as to the legal exposure. If a separate entity is not feasible in a particular situation, great care should be used in drafting the venture agreement to avoid joint and several liability under *Byker.* ✦

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FOOTNOTES

1. This article uses the term "joint venture" broadly and not to denote a single-purpose partnership.
2. MCL 449.6.
3. *Byker v Mannes,* 465 Mich 637 (2002).
4. A discussion of terms to be covered in venture agreements establishing all three formats is included in the longer version of this article on the *Michigan Bar Journal* website.
5. A partnership must file a partnership information return. IRC 701, 6031.
6. A consortium name could consist of the separate and distinct names of the participants, for example "Participant A/Participant B/Participant C Consortium" or "Participant A/Participant B/Participant C Venture."
7. *Barnes v Barnes,* 355 Mich 458 (1959); *Miller v City Bank and Trust Co,* 82 Mich App 120 (1978); *Reed & Noyce, Inc v Municipal Contractors, Inc,* 106 Mich App 113 (1981); *Williams v Brown,* 2000 Mich App Lexis 2405 (2000); *Byker v Mannes,* 2003 Mich App Lexis 500 (2003).
8. *American Mut Liability Ins Co v Hanna Zabriskie & Daron,* 297 Mich 599 (1941) (holding that an undisclosed joint venturer is not liable to a third person when the parties to the joint venture have made an agreement which restricts the authority and liability of the undisclosed joint venturer).
9. *Denny v Garavaglia,* 333 Mich 317 (1952) (holding that joint payment to a joint venture for separate work done is not determinative of joint venture partnership).
10. *Morrison v Meister,* 212 Mich 516 (1920).
11. See n 9; *Summers v Hoffman,* 341 Mich 686 (1955); *Reed & Noyce, Inc v Municipal Contractors, Inc,* 106 Mich App 113 (1981).
12. George Dent, *Lawyers & Trust in Business Alliances,* 58 Bus Law 45 (2002).