

UNPOPULAR

**JOINT VENTURE/
LIMITED LIABILITY COMPANIES:**

**FORMATION AND
EXIT STRATEGIES**

BY BRUCE

COLLATERATED

THERE ARE SEVERAL THINGS THAT SHOULD BE CONSIDERED WHEN FORMING OR DISSOLVING A CONTRACTOR TEAM ARRANGEMENT.

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The federal government recognizes the practice of contractor team arrangements (CTAs), which, under the Federal Acquisition Regulation (FAR), means “an arrangement in which: (1) two or more companies form a partnership or joint venture to act as a potential prime contractor; or (2) a potential prime contractor agrees with one or more other companies to have them act as its subcontractors under a specified government contract or acquisition program.”¹ The government recognizes the integrity and validity of CTAs, provided the arrangements are identified and company relationships are fully disclosed in an offer or, for arrangements entered into after submission of an offer, before the arrangements become effective.²

The government and industry benefit from CTAs because they enable companies to complement each other’s unique capabilities to fulfill a broad government requirement. They can also offer the government the best combination (best value) of performance, cost, and delivery for the system or product being acquired.³

Other important benefits to the government from CTAs include:

- Consolidation of requirements with a single business entity,
- Reduced administrative burden,
- Single point of contact,
- Reduced program management,
- Support of small business contractor development,
- Increased competition and expanded opportunities for small business,
- Increased innovation, and
- Reduced schedule performance and financial risks.

Companies benefit from CTAs because they allow companies to pursue contracts they would not otherwise have the capability or capacity to perform. Competition is forcing companies to focus attention on maximizing returns on core strengths and fostering the outsourcing of any specialized support services or products. The combined capabilities of more than one company present the government with a stronger proposal (best value) and an increase in the likelihood of success.

Small businesses benefit from CTAs by allowing a small business to draw upon the capabilities and additional resources of a large business or other small businesses in order to maximize complementary skills, resources, and capabilities while minimizing risk, eliminating performance barriers, and distributing proposal development costs. Large businesses benefit from CTAs because they allow large businesses to propose on procurement actions set aside for small businesses.

However, CTAs also present challenges and risks to companies. A company may compromise its proprietary information through disclosure to a team member. Also, a company may experience reduced profits/fees from the sharing of revenues, expenses, and fee pooling.

BUSINESS STRUCTURE OF THE CONTRACTOR TEAM ARRANGEMENT

The prevailing federal government teaming business model is the traditional prime contractor/subcontractor relationship. Team members agree to serve as subcontractors to the prime contractor if the team is awarded a contract.

Team arrangements can also take on the form of partnerships or joint ventures. A partnership is a business enterprise consisting of two or more individuals or business concerns who come together to co-own a trade or business for profit. The teaming partners/members share ownership of a single business entity that is in privity of contract with the government. The partnership agreement defines the role and responsibilities of the teaming partners/members for their respective contribution(s) in one or more ways with money, property, labor, or schedule, as well as how to share in the revenues, expenses, profits, and risk of loss.

A *joint venture* (JV) is a special form of a partnership. A JV is an association of two or more individuals or concerns generally formed to undertake a single specific business venture for joint profit, rather than one intended to continue indefinitely as an ongoing business concern.⁴ The JV becomes the prime contractor upon award of a contract, not any of the partners/members. The JV can have subcontractors. The JV and its members are in privity of contract with the government, which is unlike the prime contractor-subcontractor relationship in which only the prime contractor stands in privity of contract with the government. However, one of the JV members should be designated as a “general partner” or “manager” to prevent fragmented contracts with the government. If any member of the JV fails to adhere to or breaches the terms and conditions of the contract with the government, the entire JV entity—and each of the members—can be held jointly and severably liable.

Partnerships/JVs can either be unincorporated organizations (which are not recommended) or formally incorporated as a *limited liability company* (LLC), which is a business structure allowed and recognized by state statute. LLCs are popular because, similar to

a corporation, owners have limited personal liability for the debts and actions of the LLC. Other features of the LLC are more like a partnership, providing management flexibility and the benefit of pass-through taxation. Owners of an LLC are called “members,” with one of the members being designated to manage the LLC. Since most states do not restrict ownership, members may include individuals, corporations, other LLCs, and foreign entities. There is no maximum number of members in an LLC.

Unpopulated Partnerships and Joint Ventures

A JV (partnership or LLC) can either be “populated” or “unpopulated.” A *populated* JV hires full-time personnel who are paid by the JV as W-2 employees and are responsible for running the day-to-day business operations of the JV, whereas an *unpopulated* JV does not have W-2 employees. The unpopulated JV relies on the partners/members to provide the personnel in accordance with the terms of the JV or partnership agreement, subcontract agreements, and/or other “nonmember” subcontractors.

Many are unfamiliar with the concept of an unpopulated JV. This is generally driven

by government project uncertainty and the required temporary nature of the JV for those JVs pursuing small business-type set-asides. As a result, there is unwillingness on the part of the JV partners to establish the necessary employee benefit plans that would reward resources to work for the JV as paid W-2 employees.

The concept of an unpopulated JV has several benefits, including relatively rapid mobilization of a workforce to commence work after contract execution while allowing employees to stay with their employer partner/member. However, an unpopulated JV also presents many challenges that must be addressed during the procurement life cycle, starting with the JV agreement.

CONSIDERATIONS WHEN FORMING A JOINT VENTURE

Prior to forming a populated or unpopulated JV, it is vital for the parties/members to evaluate certain strategic considerations when making the decision to enter into a team arrangement and choosing its business structure. Important considerations are outlined below.



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Solicitation/Contract Requirements

Each procurement solicitation or request for proposal generally will outline the requirements (or limitations) for any team arrangements for the desired scope of work, if acceptable to the government.

Small Business Administration (SBA) Requirements

SBA prescribes certain rules regarding affiliation between the parties/members and performance of work requirements and how they are applied to the applicable socioeconomic disadvantaged business set-aside prescribed for the procurement. SBA has recently issued new rules that have created new advantages for teaming or joint venturing that make them more attractive for certain procurements.

SBA limits a JV to carrying out no more than three specific or limited-purpose business ventures for joint profit over a two-year period. This means that a JV cannot submit more than three offers over a two-year period, starting from the date of the submission of the first offer.⁵ The JV partner/members must evaluate and decide which SBA rule best fits the procurement requirements and make certain that these requirements are fulfilled.

Rules of Engagement

The JV agreement should give particular attention to essential day-to-day operational issues, including, but not limited to, the management structure, distribution of work, sharing of costs and profits, protecting proprietary and business sensitive information, and transparency and reportability.

Management Structure

The JV agreement should commission an oversight board comprised of key executives from each partner/member. The JV oversight board provides executive leadership and strategic guidance to the JV to assure fulfillment of the requirements of the JV contract with the government and compliance with applicable rules and regulations such as those of SBA. The JV agreement

should clearly state the charter, goals and objectives, roles and responsibilities, authorities, and voting rights of the JV oversight board. The voting rights for the members of the oversight board must be clearly defined to comply with SBA requirements for the management of the JV, if applicable (e.g., at least 51 percent of the voting rights should align with the nature of the small business certification for the JV).

The JV oversight board should select a project manager from one of the JV partners. The project manager is responsible for day-to-day operations of the JV and the contract work. The selection of the project manager should comply with the SBA requirements for management of the JV, as applicable.

Distribution of Work Performance

The JV agreement must define the policy or rules regarding how work will be assigned to the member or members who will be responsible for carrying out and completing the work called for in the solicitation. Particular emphasis in the performance of work policy must be placed on compliance with any applicable SBA requirements. Under SBA normal work requirements, performance of work requirements are included in procurement actions that specify the percentage of contract work that must be performed by the designated SBA business classification (i.e., small business, 8(a), small disadvantaged business, service-disabled veteran-owned small business, or HUBZone).⁶ Under SBA relaxed work requirements, the performance of the work applies to the cooperative effort of the JV or team and not the individual members.⁷

A JV IS GENERALLY FORMED TO COMPLETE A SPECIFIC PROCUREMENT ACTION OR ACTIONS, AND FOR THAT VERY REASON HAVE A FINITE EXISTENCE.



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In an unpopulated JV, each member performs work for the JV independently as a subcontractor to the JV. Written subcontract agreements should be established between the JV and each party to the JV. The JV agreement should establish clear lines of responsibility and rules for negotiating and managing/administering these member subcontracts on behalf of the JV as well as any other contracts, subcontracts, and/or lease agreements for goods and services needed to complete the work. Any contracts, subcontracts, and/or lease agreements must be consistent with the terms of the JV agreement and the contract the JV has with the government.

Administrative and Accounting Responsibilities

The JV must carry out day-to-day business administration and accounting as a unique, standalone business unit that is separate and apart from the individual members. The JV agreement must define which member or members are responsible for setting up and managing day-to-day JV business administration and accounting. The JV will necessitate an exclusive accounting system (e.g., general ledger, invoicing, accounts receivable, accounts payable, job cost ledgers, payroll, etc.) as well as its own administrative books and records. The accounting system and administrative books and recordkeeping must comply with applicable statutory, FAR, Cost Accounting Standards, Generally Accepted Accounting Principles, SBA, contract, and JV agreement requirements.

The JV agreement must clearly spell out how and when profits and/or losses will be reported and distributed between the JV members. Any revenues and costs for the JV should be recorded in and reported from this accounting system established for the JV.

Responsibility for accounting and book and recordkeeping can be assigned to one of the JV members or can be outsourced to a third party to ensure independent emphasis and compliance. These administrative and accounting costs should be distributed between the members in accordance with the JV agreement.

A unique challenge for companies forming an unpopulated JV is finding a solution to protect their individual business-sensitive and proprietary information from each other during the procurement life cycle. After all, these “members” are most often competitors before forming the unpopulated JV. Each phase of the procurement life cycle (procurement action, contract performance, and contract closeout) has unique challenges with regard to business-sensitive and proprietary data protection.

As if protecting proprietary data from each other weren’t enough, members to an unpopulated JV must also satisfy the transparency, accountability, and reportability requirements of the contracting entity’s financial and contract performance data (i.e., earned value) in compliance with applicable statutory, contract, and JV agreement requirements. These requirements shall be flowed down to the members via subcontract agreements and managed.

Dissolution of the JV Agreement

A JV is generally formed to complete a specific procurement action or actions, and for that very reason have a finite existence. Each contract carried out by the JV has specific contract closure requirements that may extend well beyond the contract period of performance, as well as the JV’s existence for the purpose of performance (i.e., access to books and records for audit purposes). However, the JV must outlive any contracts to

address these latent contract requirements. Consequently, the formal dissolution of the JV needs to be specifically addressed by the members during its formation in order to sufficiently account for any applicable statutory and contract closure and records retention requirements. The members must assign responsibility for managing these latent contract requirements and establish a formal funding mechanism to cover these costs and potential liabilities. Therefore, the JV can only be dissolved after fulfillment of all of these latent contract closure requirements.

CONCLUSION

The decision to form a contractor teaming arrangement and type of business structure to pursue a government contract is not straightforward and should not be taken lightly. Careful strategic consideration should be given to the requirements set forth in the procurement action, applicable SBA regulations, management structure, distribution of work performance, administrative and accounting responsibilities, protecting proprietary information, maintaining transparency and reportability, and the dissolution of the JV. **CM**

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ENDNOTES

1. FAR 9.601.
2. FAR 9.603.
3. FAR 9.602(a).
4. FAR 19.101(7)(i).
5. 13 C.F.R. 121.103(h).
6. 13 C.F.R. 125.6.
7. 13 C.F.R. 125.6(h)(i).