

A photograph of three business professionals in a meeting. A man in a dark suit and patterned tie is smiling and looking upwards. A woman in a white blazer is looking towards the camera. Another man in a dark suit is looking upwards. They are gathered around a table with documents.

Liability and Insurance Considerations of Joint Ventures

Energy companies are increasingly combining operations for specific functions to help minimize risk and costs. A common structure for these situations is a joint venture (JV). A JV is a strategic alliance where entities band together to achieve a common goal, separate from the parent companies.

JV's are confronted with the same liability exposures as every other company in the same line of business. The JV structure, however, can create a number of risk management and insurance wrinkles. A JV may be formed with one of its goals being to help minimize risk for the partners in the venture, but JV participants sometimes find they have assumed additional and unexpected risks as a result of entering into the enterprise. Companies participating in JVs must be aware of the unique exposures posed by JVs, and they need to be certain that adequate and appropriate insurance protection is in place.

Joint ventures in the energy sector

The costs and risks associated with many energy projects encourage companies to enter into JVs. Parties to a JV share the risk of the undertaking, resources, and profit (or loss). JVs are usually set up for a specific project or for a specific time period.

Most JVs are set up as partnerships, though they also can be incorporated. A partnership can be in the form of a limited partnership or a general partnership. The partnership form is attractive because a partnership can be more easily created, and can be dissolved with nearly equal ease once the JV has achieved its goal. However, significant liability issues are associated with partnerships: members of a partnership are jointly and severally liable, meaning that each partner is fully responsible for all the liabilities of the JV.

JVs are usually undertaken to play on the strengths all the parties bring to the venture. For example, one member may be responsible for means, while the other is responsible for the know-how. Each party is highly reliant on the performance of the other parties, and the obligations of each party must be clearly defined.

As with any business transaction, JV agreements should be committed to paper. The "constitution" of an energy JV is the "joint operating agreement" (JOA). The JOA should clearly address the purpose of the JV, each party's ownership stake, responsibilities and liabilities of each party, as well as the function of each party to the JV. Additionally, the JOA will detail whether one partner will be principally responsible for running the JV, whether the partners will jointly staff the enterprise or an operations management firm will be hired to oversee the operation.

Liability and Risk Management issues

All risks involving the JV are shared by the partners according to the terms established in the JOA. In addition to operational and financial risks, which typically are not insurable, JVs are exposed to a wide array of insurable property and liability risks specific to the business of the JV.

Allocation of liabilities among JV partners should be addressed in the JOA, but that agreement among the partners does not alter the fact that, by law, each partner is jointly and severally responsible for the liabilities of a JV set up as a partnership. That means that a partner with even a small minority ownership is legally responsible for 100 percent of the liabilities of the JV in the event the other partners are unable to fulfill, or otherwise are able to avoid, their obligations. JVs often are created to help reduce risk, but because of joint and several liability, a JV partner may discover that, far from sharing risk, it has inadvertently assumed the risk of the other partners.

Participating in a JV may create unanticipated exposures for partners outside the core operations of the JV. Shareholders may sue the directors and officers of partner companies if the JV fails or if something goes wrong that saddles the partner companies with extensive liabilities. Disagreements among JV partners may lead to expensive litigation. The Justice Department and the Federal Trade Commission routinely evaluate joint ventures for violations of Antitrust Law, and allegedly injured competitors and other private parties may bring antitrust suits.

Joint and several liability exposure can be largely eliminated in many cases by incorporating the JV entity. If a JV is incorporated, the resources available to pay for liabilities incurred by the JV are limited to the assets of the corporation. The assets of the shareholders, in most cases, are shielded. Incorporating the JV entity, however, can create other business, regulatory and corporate governance complications.

Liability and risk management issues should be addressed when structuring the JV and drafting the JOA. A thoroughly thought-out and well drafted JOA can help avoid issues that could impair success, cause friction among partners down the road, or raise anti-trust red flags. Allocation of liability among the partners should be clearly spelled out in the document. Additionally, the loss control and risk management activities of the JV entity should be considered early on and written into the JOA. If insurance is to be purchased for the JV entity, someone ultimately has to be responsible for deciding how much of what types of insurance to buy, how much risk to retain, and how to finance and manage retained losses. Options include assigning the responsibilities to the risk management department of one of the partners, forming a loss control committee representing each of the partners, hiring a risk manager specifically for the JV or contracting for risk management services.

Insuring the JV and its partners

In many cases, and especially if the JV entity has assets, the full spectrum of applicable insurance policies should be purchased by or for the JV entity with the partners identified in the policies as additional insureds. This typically is the most

efficient and effective way to help protect the interests of the partners, and to assure that the necessary coverages have been purchased. Even if the JV entity is insured, however, the partners should be certain their own policies will respond to claims that exceed the limits of the JV entity's policies or that are not covered under the JV entity's insurance program. Partners also should keep in mind that they can be held directly liable for their own acts or omissions with respect to their involvement with the JV, which most likely would require coverage in addition to the JV entity's policies.

Insuring the JV

Liability policies typically purchased by an energy JV are, for the most part, identical to the types of policies purchased by other types of companies in the same business. They include general liability, excess/umbrella liability, automobile liability, environmental liability and workers compensation. Because of rules promulgated by the National Council of Compensation Insurers, the JV entity in fact may be required to purchase workers compensation coverage rather than to insure the workers under the partners' policies. If the JV is incorporated, directors and officers' liability (D&O) insurance will likely be necessary. Depending on the specific nature of the JV, specialized coverages such as errors and omissions insurance may be required. If the JV is operating in more than one country, it may be necessary to purchase some policies separately in each country.

JV partners typically stop buying insurance protection for the JV entity once the alliance dissolves. This may leave the partners exposed to events that occur after the JV wraps up, but are still attributable to the prior activities of the JV. Discontinued completed operations coverages may be available to cover the past operations of the dissolved joint venture entity.

Endorsements

Many endorsements used today to add JVs as insureds under a liability policy specify that liability coverage provided is scaled to the insured's interest in the JV (i.e. if an insured has 25 percent ownership of the JV then their policy will only pay 25 percent of the JV's losses). This can result in inadequate coverage for the insured, if other JV partners are not properly insured and Joint & Several Liability comes into play, or if the insured is contractually obligated to provide insurance coverage for more than its percent ownership of the JV's operations and liability. Therefore, risk managers always need to evaluate whether the "scaled to interest" limitations of most standard JV endorsements leave their insured vulnerable to uninsured additional liability.

Insuring the Partners

Whether or not the JV entity itself is protected through its own insurance program, the partners need to be certain that their insurance policies provide coverage for losses arising from the JV. Even if the JV entity is separately insured, there are circumstances under which the JV's coverage may be inadequate or not apply at all.

Most insurance policies provide some protection for mergers, acquisitions or other consolidation. However, JVs are usually treated differently. For example, the “Who is an Insured” section of a commercial general liability (CGL) policy specifically excludes joint ventures.

Coverage for a partner’s individual interests in the JV usually can be accomplished through an endorsement to an existing insurance policy; otherwise, a separate policy will need to be purchased. Typically, coverage for JVs is on a “specified entity” basis, meaning each JV is added individually to a policy, but “omnibus” language that provides coverage automatically may be available for companies regularly involved with JVs.

Risk managers of the individual partners also need to assess what new types of exposures are created by participation in the JV. Each risk manager needs to be sure not only that their company’s existing insurance coverages will respond to losses from the JV, but also that the right amount of the right types of coverage are purchased for any new exposures arising from the JV. For example, in its normal course of business a company may not need pollution insurance, but it may have an environmental liability exposure arising from the activities of the JV.

Finally, risk managers need to be mindful of potential liability for their firms’ own acts or omissions with respect to their involvement with the JV, and be certain enough of the right types of insurance are in place. Losses from a JV, for example, could spark a shareholder suit or participation in a JV could result in an anti-trust lawsuit. Under another scenario, illegal activities by one JV partner could result in suits against other partners alleging they “knew or should have known” of these activities and did nothing to stop them.

Conclusion

JVs enable energy companies to take on larger, more complex and riskier projects than they would be willing or able to handle on their own. However, JVs can result in liability exposures that create risk management and insurance challenges. Successfully addressing these challenges begins at the very inception of the JV, with the drafting of the JOA. Assignment of responsibilities and allocation of liability among partners should be clearly laid out in the document.

In many cases, a separate insurance program should be purchased in the name of the JV entity. Nonetheless, JV partners need to keep in mind that a JV can result in exposures that are not covered by the entity’s own insurance program. Because of the complexity of the liability issues faced by JVs, energy companies need to be certain they are working with brokers and underwriters that thoroughly understand not only energy-related risks, but also the risk management and insurance issues posed by the JV structure.

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1400 American Lane, Schaumburg, Illinois 60196-1056
800 382 2150 www.zurichna.com

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