Proving joint ventures: The importance of shared losses

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Without an agreement between parties to share losses, a joint venture, and therefore a fiduciary duty and the breach thereof, may not be found to exist. In this edition of their Commercial Division Update, Thomas J. Hall and Judith A. Archer discuss recent decisions that provide insight on the application of this requirement of the sharing of losses.

Justice Cardozo famously characterized one's fiduciary duty as imposing: "Not honesty alone, but the punctilio of an honor the most sensitive . . . ." *Meinhard v. Salmon*, 249 N.Y. 458, 464 (1928). In light of this heightened duty, it is not surprising that parties to disputes arising from commercial relationships often attempt to plead and prove that the parties had entered into a joint venture which, under New York law, imposes a fiduciary duty on the joint venturers. Not only does a joint venture expand the scope of duties owed beyond those that may be available for mere breach of contract, it may also open the door to tort damages, including punitive damages not available for breach of contract.

To establish the existence of a joint venture, a plaintiff will be called upon to plead and prove all of the required elements for such: a manifestation of intent of the parties to be associated as joint venturers; mutual contribution to the joint undertaking through a combination of property, financial resources, effort, skill or knowledge; a measure of joint proprietorship and control over the enterprise; and an agreement for the sharing of profits and losses. *Richbell Info. Servs. v. Jupiter Partners, L.P.*, 309 A.D.2d 288, 298 (1st Dept. 2003). Much litigation in this area has centered on the requirement that the parties had agreed to share losses because, without it, a joint venture, and therefore a fiduciary duty and the breach thereof, may not be found to exist. Recent Commercial Division decisions provide insight on the application of this requirement of the sharing of losses.

Loss sharing

In *Greene v. Manavalan*, 2014 N.Y. Misc. LEXIS 4652 (N.Y. Co. 2014), the plaintiff sued his co-owner of a wine bar. The parties had agreed, pursuant to an oral agreement, to share in its profits according to their respective ownership interests. While both parties submitted documents regarding ownership on the motion to dismiss, none of the documents addressed, or even alleged, whether or how the parties were to share losses. Justice Shirley Werner Kornreich of the New York County

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Commercial Division considered this missing factor fatal to the plaintiffs joint venture claim, notwithstanding Justice Kornreich's acknowledgement that the "complaint and documents submitted here demonstrate the intent of [the parties] to be associated in a joint venture to establish the wine bar, mutual contribution to that undertaking, and an allegation as to an agreement to share profits." Despite the considerable evidence supporting the intent to establish a joint venture, "nowhere is there any allegation of an agreement to share any losses" and, as such, the court held that no joint venture was created or fiduciary duty imposed.

As in *Greene*, the absence of a final loss sharing provision between the parties was fatal to plaintiffs fiduciary duty claim in *MacKay v. Paesano*, 2018 N.Y. Misc. Lexis 474 (Suffolk Co. 2018). In *MacKay*, the parties had orally entered into a referral arrangement where the plaintiff was rewarded for making investment referrals to the defendants. The plaintiff alleged that the parties would be responsible for their own overhead and expenses, and that they did not discuss what would occur in the event of a loss, but that he had incurred losses in this referral agreement including expenses for travel, entertainment, and a registered investment advisor examination. Justice Elizabeth Emerson of the Suffolk County Commercial Division rejected the plaintiffs argument that this constituted an agreement to share losses because while the parties may have risked losing their own individual expenses, the plaintiff did not allege that each party "intended to submit to the burden of making good the losses of the others." The court held that any agreement was merely that losses would be borne by whomever was responsible for a particular aspect of a transaction, which was not an agreement to share losses, and therefore held no joint venture was created.

Conversely, in *Blumenfeld Development Group v. Forest City Ratner Companies*, 50 Misc. 3d 1221(A) (Nassau Co. 2016), two parties worked together for years on a joint venture project, known as the "East River Plaza Project." For a new project on the Nassau County Veterans Memorial Coliseum they both orally agreed to form a new joint venture, and that it would have the same sharing of profits and losses as the joint venture agreement in the East River Plaza Project. Subsequently, the parties entered into a "proposed joint venture agreement" which memorialized their intent to execute a formal written joint venture agreement by a particular deadline or capital contributions to the venture would be refunded. The parties never fully executed the formal agreement, but continued to act according to the other terms of the joint agreement after the deadline had passed. Justice Vito DeStefano of the Nassau County Commercial Division nevertheless held that these allegations were sufficient to establish the losses requirement for purposes of surviving a motion to dismiss.

Implied agreements to share losses

While explicit proof of the existence of an agreement to share losses is the clearest evidence of a joint venture, an implied agreement may also satisfy the shared losses element. *Don v. Singer*, 92 A.D.3d 576, 577 (1st Dept. 2012). Not surprisingly, the Commercial Division closely scrutinizes arguments that an agreement to share losses was implied.

In *Lebedev v. Blavatnik*, 2019 N.Y. Misc. LEXIS 3760 (N.Y. Co. 2019), the plaintiff and defendants engaged in a series of business dealings surrounding ownership of oil and gas companies, with plaintiff and one defendant signing an investment agreement including a term to make income payments equal to 15% of the net income from the companies—such net income being calculated after losses. The plaintiff argued that, because his income was calculated only after factoring in the venture's losses, there was an implicit agreement to share losses, allowing him to sue for a breach of fiduciary duty. Justice Saliann Scarapulla of the New York County Commercial Division, however, rejected this argument, noting that income paid after expenses of the companies' are profits, and held that no joint venture was created because the agreement was only to share profits, not losses. Although the parties implicitly agreed to share losses where profits were earned, by deducting those losses in calculating the profits to be distributed, the court found that the parties had no agreement as to the sharing of losses in the event revenue was insufficient to cover those losses.

Likewise, in *Foster v. Kovner*, 2012 N.Y. Misc. LEXIS 203 (N.Y. Co. 2012), the plaintiff argued that, despite the lack of a loss sharing agreement between the parties, a joint venture was created because he risked the loss of the value of his services in exchange for a share of the profits, thereby impliedly agreeing to bear losses. Justice Barbara Kapnick of the New York County Commercial Division found this argument insufficient because, according to case law, "such an arrangement does not constitute sharing in the losses of a partnership or joint venture" (quoting *Artco v. Kidde*, 1993 U.S. Dist. LEXIS 21227 (S.D.N.Y. Dec. 28, 1993): "*Steinbeck v. Gerosa*, [4 N.Y.2d 302, 317 (1958)], stands squarely for the proposition that putting one's efforts and time at risk are not enough to show an agreement to bear losses."). Agreeing with the reasoning in *Artco*, Justice Kapnick further quoted: "This, of course, makes sense, because if [plaintiff] were correct that simply expending efforts to set up a venture were sufficient to satisfy the essential element of sharing of losses, the requirement could nearly always be satisfied."

Where no losses are contemplated

Interestingly, where it is demonstrated that losses are not reasonably anticipated by the parties, courts have found the requirement that the parties' agreed to share losses may not be a necessary to establish the existence of a joint venture. *See Don*, 92 A.D.3d at 577; *Cobblah v. Katende*, 275 A.D.2d 637, 639 (1st Dept. 2000). As with implied agreements to share losses, however, the Commercial Division closely scrutinizes such claims because "[i]f a party were permitted to dispense with proof of an agreement to share losses by simply claiming that the parties had no expectation of losses, the joint venture's loss-sharing requirement would be rendered meaningless." *Lebedev*, 2019 N.Y. Misc. LEXIS 3760 at *13.

This scrutiny can be seen in *Eisenberg v. Rem*, 67 Misc. 3d 1208(A) (N.Y. Co. 2020), where the parties agreed to purchase an apartment using funds advanced by plaintiff to resell the apartment quickly, and to split the profits, with defendant Rem agreeing to guarantee any losses suffered by the plaintiff. Justice Gerald Lebovits of the New York County Commercial Division held that, while the parties may have fully expected their transaction to be highly profitable, their agreement nevertheless plainly took into account the possibility of losses because of the defendant's guarantee. Therefore, the agreement did in fact anticipate the possibility of losses and, thus, could not fall under the exception requiring the parties had not reasonably anticipated losses. Since the defendant's guarantee that it would essentially bear *all* losses was not an agreement by two parties to "*each* bear a *share* of the contemplated losses," the court held that no joint venture had been created. *See also Lebedev*, 2019 N.Y. Misc. LEXIS 3760 at *13-15; *Foster*, 2012 N.Y. Misc. LEXIS 203 at *25.

Conclusion

The above cases suggest several best practices for practitioners attempting to assert claims for breach of fiduciary duty based on the existence of a joint venture. The strongest claims will include express statements that the parties will share losses. In the alternative, the element may be satisfied either by implicit agreement or simply because the parties did not reasonably anticipate losses. These latter doctrines, however, are analyzed very closely by the courts to assure this element is satisfied. Merely providing for compensation that takes losses into account or the fact that a party expends considerable time on a project that may result in losses is not enough to establish the parties intended to share losses, and courts will look to all available documents as context to interpret whether there was an implied agreement, or if losses were even reasonably anticipated.

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