Australian Journal of Public Administration
Vol. 53 No. 1, March 1994

LEGAL IMPLICATIONS OF PARTNERING

ALAN ROSE*

The merits of close working relationships between commercial parties have provided the focus of this symposium. Such a consideration needs to take into account the structure of the arrangement between the parties and the general obligations which the law imposes on the parties in their dealings with each other.

This paper will look first at some of the structures a close working relationship may take and the ramifications that structure may have in terms of risk allocation and the ownership of assets developed by the commercial parties. Secondly, this paper will consider some of the areas of the law which are concerned with the standards of conduct which are expected of some commercial parties in their mutual dealings.

Structuring the relationship

The concept of "partnering" has been used in this symposium to cover a broad range of relationships. Essentially it has been used to refer to any relationship where the parties become partners in the legal sense or become joint venturers or to describe a situation where parties to a contract simply agree to work more closely together to their mutual advantage.

These different structures have different ramifications in terms of risk allocation and in terms of the ownership of assets developed by the commercial parties. In an advanced industrial economy, the main type of asset that is likely to be of concern to the parties is intellectual property and valuable commercial ideas. Intellectual property is potentially a very valuable asset because of the monopoly rights to commercial exploitation of the asset which are conferred upon the owner. For this reason, it is critical that the parties properly deal with the issue of ownership of intellectual property at the beginning of their relationship.

Partnerships

Partners in a legal sense are persons (whether natural persons or companies) who carry on business in common with a view to making a profit. Partners generally have capacity to bind each other in their commercial dealings with third parties and are jointly and severally liable for each other's debts or wrongful acts or omissions. It is a feature of partnerships that, as well as sharing profits, partners also share losses — although it is possible for the partners, between themselves, to come to some other arrangement as to the allocation of loss. Any intellectual property developed by the partnership or one or other of the partners in relation to the partnership will be owned by the partnership rather than by any individual partner.

Partners also owe certain duties to each other which are known as "fiduciary duties". These duties are discussed in more detail later in this paper but essentially they amount to duties of loyalty. For example, if a partner uses confidential information or a trade secret of the partnership to his or her own advantage rather than for the benefit of the partnership, this would amount to a breach of fiduciary duty. Use of confidential information or trade secrets belonging to the partnership may also breach provisions of the partnership acts in the various states and territories.[1]

In determining whether or not a partnership exists, regard is to be had to certain rules which are set out in these partnership acts. The main

*Secretary, Attorney-General's Department, Canberra.

rule to be observed in determining whether a partnership exists is that regard must be had to the intention of the parties from all of the facts in the particular case. The fact that property is jointly owned by the parties does not, of itself, create a partnership. This is so whether or not they share profits arising from it. The sharing of gross returns from property jointly owned also does not, of itself, create a partnership. However, receipt of a share of the profits of a business is evidence, though not conclusive evidence, that the person receiving those profits is a partner.

Joint ventures

The basic features of a partnership, such as joint and several liability and the capacity of the partners to bind each other in contract, make it a structure that is only sometimes desirable to commercial parties. Commercial parties may become joint venturers by agreeing to work cooperatively on a project to a common end.

In this case, the parties should be careful to ensure that their agreement is structured so that they do not, in fact, become partners responsible for each other's debts and wrongful acts or omissions. In this regard, it should be noted that if the real effect of the arrangement between the parties is to create a partnership, a statement in their agreement to the effect that they do not intend to create that relationship will be of no effect and the parties will not be permitted to escape the consequences of partnership.

It is quite difficult to structure a joint venture relationship which does not amount to a partnership. It has been argued that a "one-off" undertaking is a joint venture and not a partnership because it is said that the requirement of the partnership acts that partners have to be "carrying on business" has an element of continuity about it.[2] Another argument is that, if the parties do not share profit, but rather only share product, the relationship will not be characterised as a partnership. Alternatively, the carrying on of separate businesses with only some aspects in common may provide a means of avoiding the consequences of partnership. It is by no means clear that any of these methods of structuring the arrangement will necessarily be successful.

Where the joint venture is successfully structured so that it is a non-partnership joint venture, the terms of the contract between the parties will often describe the use that can be made of any confidential information or intellectual property generated by the joint venture. It will then be a matter of the interpretation of the contract to decide what uses are or are not authorised. In the absence of any written agreement on such matters, it has been suggested that use of confidential information and trade secrets owned by the joint venture could be restrained (McComas *et al*, 1981, p.80). Support for this view is found in one of the landmark cases in the law of confidentiality.[3]

Strategic alliances

Another business arrangement may be one where A contracts with B for the provision of particular goods or services to B. Here the parties are not "partners" in a legal sense, nor are they joint venturers: they are separate parties, carrying on their own businesses. There has been a recent growth in the number of these arrangements which commit the parties to a long-term contractual relationship. This is the kind of relationship which most of the earlier papers in this symposium have been discussing.

Strategic alliances may offend certain laws relating to anti-competitive conduct. For example, the Trade Practices Act 1974 (Commonwealth) proscribes the practice of "exclusive dealing".

This practice includes situations where a supplier of goods or services indicates that he/she will only supply those goods or services to the purchaser on the condition that the purchaser will not acquire particular goods or services from a competitor of that supplier and where this would have the effect of substantially lessening competition. The law in this area is quite complex and parties should seek legal advice to ensure that their arrangements are legally valid in this regard.

Often strategic alliances establish a panel of representatives made up of an equal number of representatives from each of the parties as a mechanism for fostering more consensual relationships. Each of the parties commonly undertakes, through the panel, to exchange information which may be of relevance to the other party and which may lead to cost savings

and improved service. From a legal perspective, it is vital that the legal responsibilities of the parties be properly documented in their contract and that each party adequately manages its side of the relationship. It is generally in these two areas that most legal and commercial mistakes are made.

Management panels provide valuable opportunities for the parties to communicate with each other on a regular basis and can have positive implications in terms of the working relationship. However, they also create opportunities for the legal relationship between the parties to be affected. Legal rights may be affected because of a representation which may be made by one or other of the parties. For example, one party may represent to the other that in some particular respect it does not intend to insist on strict compliance with the contract. Although the contract may not be formally varied to reflect this representation, the party making the representation may, nevertheless, be restrained if it then attempts to assert its strict legal rights. Moreover, in relation to variations to the contract, even the presence of a clause in a contract to the effect that the contract can only be varied in a particular manner, for example by means of a formal contract amendment, may not prevent the parties from varying the contract by some other method (Corbin 1952, pp.1065-6; Guest 1984, pp.432-3).

Clearly, these potential problems could also arise in situations where the parties do not have any formal management panel structure built in to their agreement; however, it would seem that the opportunities for representations to be made which may affect the rights of the parties under the written contract are far greater where this structure exists. I would suggest that the spirit of cooperation which permeates the concept of the management panel may even encourage representations which the parties may not have made had their consideration of the issues been more mature.

The parties should, therefore, take care that they do not make representations or induce the other party to adopt an assumption which they may not wish to be bound by at a later point in time. As a practical matter, careful notes of the matters discussed and agreed upon at the meetings of the management panel should be kept by the parties. If a representation is made at a meeting of the management panel which the parties wish to adopt, it should be documented by means of a variation to the contract.

Often strategic alliance agreements also contain provisions in relation to the resolution of disputes by negotiation. Frequently the parties agree upon a structure where disputes will be referred in the first instance to a low level of management in their respective organisations. If the dispute cannot be resolved within a stated short time-frame, the dispute will then be escalated to a higher level of management for resolution within a slightly longer time-frame and so on until the dispute is resolved. These escalated dispute resolution provisions have much to recommend them. They can achieve quick results. They are private and inexpensive and do much to preserve the commercial relationship between the parties. Any resolution reached should be documented as the agreed resolution of the parties so that it becomes a binding agreement in itself. It is desirable to ensure, however, that a formal and definitive alternative resolution process can be quickly triggered once the negotiation procedure set out in the contract is exhausted either without the parties reaching agreement or where one of the parties is demonstrating a lack of goodwill in the resolution process.

Where a legal relationship fails to satisfy the expectations of those parties, losses may be incurred and it is necessary to determine where the losses will fall. In the case of a strategic alliance where there may be several links in a supply chain, risk allocation will be of particular relevance because, if one link in the supply chain fails, the entire venture may collapse. Usually the parties allocate risk by way of their contract. It is always best for the party who controls the risk to assume the responsibility for it. Several devices are available to allocate risk, the chief of these being indemnities exclusion clauses and guarantees.

Perhaps the most common form of contracting-out of risk is by obtaining insurance. Frequently, it is a condition of the contract that one or other of the parties will take out insurance to cover liabilities which may be incurred to the other party. Often there is also a requirement that the party obtaining the insurance procures insurance in its own name and in the name of the other party. There is recent High Court authority

which allows a named insured to recover under a policy of insurance in certain circumstances even though it was not a party to the policy.[4] An indemnity shifts not the risk as such but the economic consequences of the risk from one party to another. The party giving the indemnity undertakes to pay the party to whom the indemnity is given for any damages, costs or losses which may be suffered by the party indemnified. A performance guarantee is often a useful mechanism where the greatest risk is that the party who is contracted to perform a particular service is unable to complete it.

Where intellectual property is developed by a contractor in the course of performing a contract, the contractor will usually become the owner of this intellectual property in the absence of any agreement to the contrary. If this is not the result intended, then the contract should provide for an assignment of the intellectual property rights to the other party.

Contractual reform: dealings between the parties

There have been some significant recent developments in the law which have led to a more exacting standard of probity being demanded of contractual parties in their relations with each other.

Until recent decades, the law did not require contractual parties to have much consideration for one another beyond fulfilling their contractual obligations. Its doctrines operated in such a way that only minimum standards of probity and fairness were required. As an English court said in a late nineteenth century case:

> any right given by contract may be exercised against the giver by the person to whom it is granted, no matter how wicked, cruel or mean the motive may be which determines the enforcement of the right.[5]

More recently, however, there has been a growing concern in the law with the standards of conduct required of persons in their contractual dealings. In the context of today's discussions, these developments in the law are extremely important. I want to look at a few of the more important of these developments.

The fiduciary principle

The imposition of fiduciary obligations in certain situations is a clear example of the law imposing a duty of loyalty upon parties to a relationship.

As mentioned earlier, partners owe fiduciary obligations to each other and joint venturers may owe such duties to their co-venturers. Whether or not fiduciary obligations are owed in non-partnership joint venture relationships or in other cooperative contractual enterprises raises difficult questions of law. It seems that whether or not the relationship between joint venturers can be said to give rise to fiduciary obligations will depend upon the form which the particular joint venture takes and upon the content of the obligations undertaken by the parties to it.[6]

It seems, however, that, in situations where strategic alliances are formed, the particular management structure adopted in these cases makes it more likely that the parties may owe each other fiduciary obligations than in the traditional arm's length contractual scenario. In addition, the relationships which may be created in respect to property and/or to confidential information make it likely that the parties will owe fiduciary obligations to each other for other reasons (Finn 1989, p.91).

The main fiduciary obligations prohibit a fiduciary:

- from using his or her position, knowledge or an opportunity obtained in or by reason of that position to his or her own, or to a third person's, actual or potential advantage or to the disadvantage of the person to whom he or she owes a fiduciary obligation, and
- from having a personal interest or an inconsistent engagement with a third party,

unless the person to whom the fiduciary obligation is owed gives free and informed consent or unless the fiduciary's action is authorised by law.

Once it can be established that fiduciary obligations are owed, the precise scope of those obligations and the remedies available for a breach of those obligations are further questions which need to be resolved in individual cases.

Promissory estoppel

Another situation where the law has been increasingly involved in modifying the behaviour of contracting parties or parties who are negotiating with a view to entering into a

contractual relationship is the law of promissory estoppel. Promissory estoppel is concerned with the prevention of unconscionable conduct and operates upon representations or promises as to future conduct, including promises about legal relations.

Promissory estoppel arises in a situation where there is a representation or promise by one person to another which reasonably induces in the other an assumption that a contract will come into existence or a promise will be performed, and reliance upon that representation in circumstances where allowing the person making the representation to resile from it would be unconscionable. In these circumstances the person making the representation will be precluded from resiling from the representation unless adequate notice or compensation is given. The estoppel is binding as soon as the person to whom the representation or promise was made has acted upon it.

The remedy available to persons who have relied upon a representation made to their detriment is not necessarily that the representation will be made good. Rather, they will be granted whatever relief is necessary to prevent the unconscionable conduct of the party seeking to resile from the representation and to do justice between the parties.

It is important to stress that promissory estoppel can now operate in situations where parties are negotiating with a view to entering into a contractual arrangement. Representations or assurances that a contract will be entered into when a party may privately wish to consider its options may encourage the party with whom they are dealing to expend money, time and effort in preparing for the undertaking it expects to be entering into with the other party.

If the party making the representation then decides not to enter into the contract or to enter into a contract with another party and the necessary ingredients of promissory estoppel are made out, the absence of any formal agreement between the party making the representation and the party to whom it was made will not preclude the party who relied on the representation from being entitled to legal relief.

This was essentially what happened in the case of *Waltons Stores (Interstate) Ltd* v. *Maher (1988) 164 CLR 387.* In this case, Waltons Stores had been negotiating with the Mahers for a lease of land owned by the Mahers in Nowra for the purpose of opening a new department store there. Before a formal lease had been entered into, Waltons had made it clear that the Mahers should begin demolishing the existing building on the site and should commence construction of a new building to Walton's specifications as a matter of priority. When the terms of the agreement had been settled between the solicitors for the parties, the solicitor for Waltons indicated that his client had notified him orally that the amendments to the lease proposed by the Mahers were acceptable but undertook to obtain formal instructions from his client by the next day and to let the solicitor for the Mahers know if any of the proposed amendments to the lease were not agreed to by his client. The solicitor for the Mahers heard nothing from the solicitor for Waltons and the Mahers proceeded to demolish the existing building on the site and construct the new building in the belief that there would soon be a binding contract between them. In fact, Waltons had changed its mind. It decided not to go ahead with the lease from the Mahers but did not inform the Mahers of this even though officers of Waltons were aware of the demolition work and building work being carried out by the Mahers. In these circumstances, the High Court considered that it would be unconscionable for Waltons to be allowed to resile from the assumption which its conduct had induced. The majority of the High Court found for the Mahers on the basis of the doctrine of promissory estoppel. The remedy was not that the lease be executed by Waltons but that Waltons should pay damages for the expenditure incurred by the Mahers in reliance on the assumption that Waltons had created.

This situation can be distinguished from the situation where both of the parties to the intended arrangement are clearly reserving their options and deliberately refrain from becoming legally bound precisely for that reason.[7] In such a situation an estoppel will not be found.

Section 51AA of the Trade Practices Act

Another area of the law which is concerned with unfair behaviour in contracts is the doctrine of unconscionability. This doctrine applies where the bargaining power of parties to a contract is unequal and the dominant party has

taken advantage of the other party's weaker position. The doctrine has a rather limited operation in commercial transactions where commercial parties are considered to be experienced in business dealings. It is important to note in this regard, however, that s.51AA of the Trade Practices Act 1974 (Commonwealth: "the act") gives statutory force to the doctrine in the case of unconscionable conduct by corporations. By virtue of s.2A, the act applies to the Commonwealth and Commonwealth authorities, in so far as they carry on business, as if they were corporations. Section 51AB (formerly s.52A) prevented unconscionable conduct by corporations in respect of transactions involving consumers within the meaning of the act but s.51AA is not limited to such transactions. While s.51AA is not intended to change the substance of existing law, it would seem likely that the existence of the section will lead to greater reliance on the doctrine of unconscionability in commercial situations. A breach of s.51AA gives rise to a variety of remedies such as having the contract declared void, having the terms of the contract waived, an entitlement to damages or a refund of money or property.

Section 52 of the Trade Practices Act

Section 52 of the act is another example of the law intervening to monitor the conduct of parties in a commercial relationship. Subsection (1) of s.52 provides that a corporation is not, in trade or commerce, to engage in conduct that is misleading or deceptive or that is likely to mislead or deceive. This provision is a comprehensive provision which has far-reaching implications.

In very brief terms, whether conduct is "misleading or deceptive" is a question of fact to be determined on a case-by-case basis in the light of the surrounding circumstances. Conduct cannot be categorised as misleading or deceptive unless it amounts to a misrepresentation. The words "likely to mislead or deceive" are thought to add little to the meaning apart from making it clear that it is unnecessary to show that the conduct was actually misleading or deceptive.

Initially, there was some reluctance on the part of the courts to find that s.52 had been breached in a situation involving parties to a private contract. It was thought that the section had application only if some statement had been made by a corporation to members of the public; however, there have now been a significant number of cases in which courts have been prepared to find a breach of s.52 in a situation involving parties to a private contract.

Although Australian law has not progressed to the same stage as American law in respect of the duty of disclosure in business transactions,[8] it has been said that s.52 promises to be the "central force in the expansion of duties 'to speak' in business dealings" (Finn 1989-90, p.93). In some cases, silence has been held to be a breach of s.52 in circumstances where there is an obligation to disclose relevant facts.[9] This does not mean, however, that in commercial matters a full disclosure is necessary in order to avoid a breach of s.52.[10]

Good faith in contracts

Another doctrine which is concerned with the appropriate standard of conduct to be expected of contractual parties is the doctrine of "good faith" in the performance of contracts.

The doctrine of good faith is one which is regarded in many of the civil law systems in Europe and in all states in the United States as an implied element in many kinds of contracts. Australian courts have not been as ready to imply such a term apart from in the insurance context, where the duty of good faith is of primary importance. Nevertheless, it appears from judicial and academic comment that this concept may begin to play a greater role in Australian law. It is important for us to bear this possibility in mind, as contractual parties who consider the law to be static do so at their peril.[11]

Interestingly, the doctrine was originally part of English law in the late eighteenth century,[12] but there was a strong reaction against the concept of good faith in the nineteenth and early twentieth centuries in the quest for legal certainty. This reaction was not as strong in the United States where a sprinkling of cases kept the doctrine alive.

There is a remarkable lack of unanimity about what the concept of good faith in the performance of a contract means. It seems possible that the concept will remain closely associated with notions such as fairness, honesty and reasonableness. For linguistic as well as historical and jurisprudential reasons it is argued that the doctrine of good faith requires fidelity to

the bargain and "a real commitment to the laws which govern contracts, to the contract itself, and most importantly to the other party's aims and objectives provided these are or should be known and understood" (Lücke 1987, p.164).

It is said that good faith looks to the spirit and intent of transactions rather than at the literal meaning of the contract. According to this view, one party to a contract may have obligations to achieve the spirit of the contract even if it cannot be carried out according to its letter. The literal approach calls for mechanical obedience to the written words of the contract, whereas the good faith approach calls for flexibility in helping to fulfil the purpose behind the contract even if it cannot be done precisely in the way that it is documented.

Although Australian courts have not been willing to imply a term of good faith in contracts, there are indications that the concept may gain explicit recognition by Australian courts.[13]

Conclusion

From this brief overview of some of the pertinent developments in the law, it can be seen that there is an evolution occurring in our legal system. The emergence of principles ameliorating against certain sharp commercial practice appears to be a continuing theme. Commercial parties cannot afford to be unaware of these principles and their ramifications for their commercial dealings.

Documenting the relationship and structuring it correctly are also matters which are integral to the success of any commercial relationship. A skilfully structured arrangement will ensure that the appropriate vehicle is used for the particular enterprise and that unintended relationships are avoided. A carefully drawn contract will precisely document the agreement reached between the parties and will assist them to a proper understanding of their legal rights and obligations.

NOTES:

1. See, for example, s.28, and ss.29(1) of the Partnership Act 1892 (New South Wales).
2. Brett LJ in *Smith v. Anderson* (1880) 15 Ch. D.247 at 277-278 but contrast *United Dominions Corp. Ltd* v. *Brian Pty Ltd* (1985) 59ALJR 676 at 681.
3. *Coco* v. *A.N. Clark (Engineers) Ltd* [1969] RPC41.
4. *Trident General Insurance Co. Ltd* v. *McNiece Bros. Pty Ltd* (1988) 80 ALR 574.
5. Wills J in *Allen* v. *Flood* [1988] AC 1 at 46.
6. See the High Court's decision in *United Dominions Corp Ltd* v. *Brian Pty Ltd* (note 2 above), rejecting the views of Cardozo CJ in *Meinhard* v. *Salmon* (1928) 164 NE 545.
7. *Austotel Ltd* v. *Franklins Ltd* (1989) 16 NSWLR 582.
8. Restatement (Second) of Torts 1977 s.551(2)(e).
9. *Henjo Investments Pty Ltd* v. *Collins Marrickville Pty Ltd* (1988) 79 ALR 83; *Warner* v. *Elders Rural Finance Ltd* (1993) 113 ALR 517.
10. *Poseidon Ltd* v. *Adelaide Petroleum NL* (1992) ATPR 41-164.
11. *Waltons Stores (Interstate) Ltd* v. *Maher* (1988) 164 CLR 387.
12. Lord Mansfield in *Carter* v. *Boehm* (1766) 97 ER 1162.
13. See the comments of Priestly JA in *Renard Constructions Pty Ltd* v. *Minister for Public Works* ACLR 11(3), 127 at 147 on *The Commonwealth* v. *Amann Aviation Pty Ltd*, in which both the full Federal Court (1990) 22 FCR 527 and the High Court (1991) 66 ALJR 123 seemed to have given some approval to the basic idea of the good faith obligation: Davies J at 22 FCR 532; Sheppard J at 22 FCR 542 and the joint judgment of Mason CJ and Dawson J at 66 ALJR 135 refer.

REFERENCES:

Corbin, A.C. 1952. *Corbin on Contracts*, West Publishing Co., St Paul, Minnesota.
Finn, P.D. 1989. "Contract and the Fiduciary Principle", *University of New South Wales Law Journal*, 12(1).
— 1989-90. "Commerce, the Common Law and Morality", *Melbourne University Law Review*, 17(1).
Guest, A.G. 1984. *Anson's Law of Contract* (26th ed.), Clarendon Press, Oxford.
Lücke 1987. "Good Faith and Contractual Performance", in P.D. Finn (ed.), *Essays on Contract*, Law Book Co., Sydney.
McComas, W.R., Davidson, M. & Gonski, D. 1981. *The Protection of Trade Secrets*, Butterworths, Sydney.