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BARRISTERS *and* SOLICITORS

GETTING CLOSER AND BUILDING POSITIVE RELATIONS: WORKING TOGETHER IN COMMERCE AND TECHNOLOGY

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There is a lot of talk about "partnership" between vendors and purchasers and similar closer relationships. We get to the bottom of the issues, and suggest ideas that might achieve desirable outcomes (good relationships between vendors and purchasers) and ways which provide limited risk. We also deal with joint ventures, preferred supply arrangements and other scenarios.

Having closer relationships can be commercially very positive for both parties to a JV or the like. Careful drafting means the players can get the benefits yet reduce commercial and legal risk.

People should be aware of the extra risks, consider the position and then draft accordingly. Risks range across the spectrum.

Almost all implicit obligations can be overridden in the agreement. This is an area where careful legal advice is needed.

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Please note that since this paper was prepared, the Court of Appeal has produced a relevant decision on joint ventures, which deals with the circumstances in which courts will conclude there are fiduciary duties in a JV context: Chirnside v Day [2004] 3 NZLR 637.

1 Introduction

1.1 Generally, deals between suppliers and customers contain responsibilities to each other that are limited to what the contract says. But sometimes the participants – unwittingly or intentionally – extend

their duties to each other (for example, to create a strategic partnership or a preferred supplier relationship).

1.2 There can be other relationships too which might involve heightened responsibilities; for example a joint venture to develop software collaboratively.

1.3 There are many variations on the basic arms-length commercial contract. Examples include:

1.3.1 Partnerships and strategic partnerships;[1]
1.3.2 Joint ventures where participants share differing strengths in technology, people and asset resources, funding, publicity and marketing impact, creating links to new markets, etc;
1.3.3 Prime contractor selling to customer utilising subcontractors;
1.3.4 Preferred supplier arrangement;
1.3.5 Relationship between venture capitalist and technology developer; and
1.3.6 Collaboration to develop and commercialise legal and commercial technology.

1.4 Often such JVs and strategic partnerships tend to be longer term. They offer tremendous benefits. It's important for legal issues not to stand in the way so that commercial drivers aren't fulfilled. That can readily be done. Along with failed projects come many successes. And as Jack Welch, the former GEC CEO has said: "*If you think you can go it alone in today's global economy, you are highly mistaken*".

1.5 Along with the high benefits, these types of deals come with risks. In particular, these relationships are more likely to have high-level duties, such as to act in good faith and co-operatively with the other party.

1.6 Importantly, the parties can almost always choose to override any perceived risks by optimally drafting their agreement.

1.7 Otherwise, one or both parties could get stuck with unwanted risk. The important thing is to be aware of the risks and then draft and implement the deal accordingly. This often needs careful legal advice and careful legal drafting. If the parties know the risks of the particular deal, they can draft it to reduce the risk yet get the advantages.

1.8 This note overviews issues, risks and solutions. Some of the legal issues are contentious and difficult. We'll first look at what happens in "normal" arms-length commercial agreements (such as for use and installation of hardware and software). In that section we'll introduce the issues generally under review in this paper.

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[1] A helpful overview is set out in *Strategic Alliances in IT* at page 22 in the January 2003 *Computers & Law* Journal, published by the British Society for Computers and the Law.

1.9 Then we'll turn to the various legal and commercial categories where the parties could face greater duties and risks, such as JVs and strategic partnerships. And we'll address solutions.

1.10 There's a range of duties from low level at one end (eg: normal arms-length agreement) to high level (eg: partnerships). We'll cover the spectrum.

1.11 Finally, we'll deal with the preferred supplier relationships.

2 The Starting Point: What Obligations are there in a "Normal" Agreement?

2.1 Here, we're addressing a more straightforward commercial and arms-length agreement (such as the sale and installation of technology goods and services). Unlike, say, a legal partnership, the vendor and purchaser don't usually owe each other any particularly strong duties arising out of the agreement. They obviously have to do what the contract says they must do. *Implied terms* and *fiduciary duties* could elevate duties, though. Do they? If they do, how does this happen?

3 Arms-length deals: Implied Terms

3.1 Full written legal agreements are usually complete in themselves. But where the written contract fails to specify a term which is essential to give what is called business efficacy to the agreement, such a term can be implied into the agreement.[2] In other words, a term will be implied into an agreement where that's necessary to make it work. But, usually, other terms (ie: those not necessary to give business efficacy) will not be implied.

3.2 A relevant example: the written agreement might not be clear enough as to whether, and where, one party needs to co-operate to enable the other to fulfill its obligations. So there might be a term implied requiring such co-operation.[3] Sometimes the contract will specifically say the parties need to co-operate with each other.

3.3 Whether expressly stated or implied, this type of obligation is moving towards the sort of higher-level obligations present in deals such as JVs and strategic partnerships. But generally that obligation won't be high.

3.4 Generally also there won't be implied an obligation to act in *good faith* when dealing with the other party. Good faith duties are higher level duties akin to our approaching fiduciary duties (which we deal with below). What the terms are can differ in each contract. They can be

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2 *BP Refinery v. Shire of Hastings* (1977) 16 ALR 363 and *Dymocks v. Todd and Bilgola* [2002] UKPC 50.

3 Burrows, Finn & Todd, *Law of Contract in New Zealand* (2nd Edition) at para 2.2.6.

difficult to formulate (which is one reason they often will be found not to exist). This good faith area has been a controversial issue. It was only last year that our Court of Appeal confirmed (in three cases) that a duty to act in good faith will not usually be implied.[4]

3.5 However there are two important qualifications on this conclusion.

3.6 As the most recent of the three Court of Appeal decisions last year confirms, sometimes the circumstances and express terms will be such that there will be an enforceable obligation to act in good faith. Even a promise to negotiate in good faith or to use best endeavours to negotiate can be enforceable if there is enough detail. This could happen either (a) where the parties set out benchmarks and objective criteria to enable resolution of what is meant by good faith and what is required, or (b) in unexpected ways, as happened in a New Zealand case where the rental price ended up by being fixed under a lease because there was an arbitration clause (and the arbitrator was able to determine a price objectively).[5] One strategy for helping make these commitments enforceable is to appoint an arbitrator to decide unresolved issues, and/or set out a framework to resolve issues if the parties can't agree.

3.7 Limited doubt on these Court of Appeal decisions was cast by the Privy Council in the *Dymocks* franchise case.[6] Franchise deals are usually either JVs or treated in a similar way to JVs. In the interests of commercial certainty, our Court of Appeal in that case was reluctant to insert a duty to act in good faith in franchises (and therefore in many JV scenarios). The Privy Council didn't have to decide that point. It left it open for review in a later case (the implication being that the point might be decided differently).

3.8 The Privy Council decision is not directly concerned with arms-length agreements. But there is a sign that last year's Court of Appeal resolution of the long-standing good faith issue may not be the last word.

3.9 As there is residual uncertainty, that's even more reason to expressly deal with the position in the agreement, to override implied obligations.

4 Arms-Length Deals: Fiduciary Duties

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4 See our article http://www.wigleylaw.com/mainsite/TendersRFSCompetitivePurchasing.html *February 2003 Update* and also *Wellington City Council v. Body Corporate 51702* [2002] 3 NZLR 486, *Transit New Zealand v. Pratt Contractors* [2002] 2 NZLR 313 and *Fletcher Challenge v. Electricity Corporation* [2002] 2 NZLR 433. There are several reasons for this including: (a) often what is "good faith" is relatively subjective; in more complex situations it can be difficult to objectively determine; (b) agreeing to negotiate in good faith etc may just comprise an agreement to agree; (c) generally a term that the parties will act in good faith does not need to be implied for business efficacy reasons; (d) a good faith duty is difficult to reconcile with parties' self-interest.

5 *Attorney-General v. Barker Bros Ltd* [1976] 2 NZLR 495.

6 *Dymocks v. Todd and Bilgola* [2002] UKPC 50.

4.1 In addition to implied terms (such as duties to co-operate and act in good faith), there is the question of whether arms-length commercial contracts create *fiduciary* duties.

4.2 In addition to what parties expressly provide in the agreement, they can end up with high-level duties arising out of:

4.2.1 implied terms (dealt with above);

4.2.2 the Partnership Act (dealt with below) and/or;

4.2.3 fiduciary duties.

4.3 Fiduciary duties are added equitable duties to, for example, act in good faith, not to profit separately from the venture, not to compete with the other party, to act in the interests of all parties, to disclose all relevant information, etc. They derive from duties placed on people with higher-than-normal responsibility, such as trustees. The nature and level of such duties, where they apply, can vary from case to case.

4.4 Generally, however, the Court won't supplement (or patch up) a written arms-length commercial agreement with such high-level duties. As the Court of Appeal said in 1993:[7]

> "*Arms-length commercial transactions rarely gave rise to fiduciary obligations. They are matters of contract where the parties reasonably expected their contract to govern, rather than matters of conscience*".

4.5 The Court said that fiduciary obligations would not be imposed in these circumstances in order to overcome the shortcomings in the arrangement between the parties.

5 Arms-Length Deals: Summary

5.1 So in summary, generally parties don't have higher level duties in normal commercial arrangements, unless the agreement states this. Sometimes, however, additional duties can be implied and cause a problem for either party. To reduce the risk that they'll be inserted by a Court, each party should look at keeping such terms out of the agreement, and add an entire agreement clause – as commonly happens – to the effect that the written agreement is complete in itself.[8] If such obligations are to be included (there could be good commercial reasons to do this), do it in a considered way.

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7 *DHL v. Richmond* [1993] 3 NZLR 10.

8 Although that is not always assured of success (*Assn of Community Laboratories v. Ministry of Health* (CP287/01 (Wgtn Registry), 6/11/02, Master Gendall)).

6 The Other End of the Spectrum: Partnerships

6.1 Before looking at JVs etc it helps to look at agreements that inherently create some of the highest duties: partnerships. Then we can look t other points on the spectrum.

6.2 In our context, underlying the various relationships we are dealing with will be a contract. Superimposed could be an overlapping legal structure such as higher level duties (eg: fiduciary duties), and a *partnership,* which has clear-cut high-level duties.

6.3 Vendors often talk about setting up "*partnerships*" or "*strategic partnerships*" with their customers. Well executed, these are excellent for both vendor and purchaser. The parties however probably have in mind something that's quite different from what we'll call a *legal partnership*, namely a partnership which fits within the Partnership Act. An obvious example of the latter is a solicitors' partnership. But there can be a similar legal partnership as between companies. Many other relations are partnerships. They arise where the relationship "*subsists between parties carrying on a business in common with a view to profit*".

6.4 It's often difficult to figure out whether a joint venture is a legal partnership. The legal and factual issues can be established.

6.5 The sort of *partnership* that vendors and customers set up doesn't usually come within the Partnership Act. But a JV (for example, to develop and commercialise technology) could well be a partnership.

6.6 In the interests of both parties, ideally steps should be taken to make it clear that this is not what is intended (unless it is in fact what's wanted). The problem is that the partnership is likely to put high level duties on both parties akin to and including fiduciary duties.

6.7 There might even be tax implications (for example a need to file a partnership tax return). That highlights the point that, for each of the various structures we are talking about, those involved should be thinking about the tax implications generally.

6.8 While there's *legal* risk in using words like "partner" and "strategic partner", there are obvious commercial advantages. Suppliers want to be giving an added value service to their customers. They want to walk the talk of working together co-operatively to find solutions for their customers. Words and concepts like *partnership* and *strategic partnership* are good to use commercially. But use of those words raises the risk of inadvertently creating a legal partnership, and also increases the risk of the high level fiduciary and other obligations such as in joint ventures as noted below. This is an issue for both parties.

6.9 One possible solution is to say in the agreement that the parties intend the *partnership* or *strategic partnership* words and concepts to be used in a business not a legal sense. The agreement can go on and confirm – as many agreements do – that it has not created a partnership or joint venture in a legal sense.

6.10 One option is to have the underlying normal arms-length commercial agreement between the parties, with a superimposed non-binding partnership arrangement on top. The idea would be to operate as much as possible at the partnership level (which is not legally binding). The documents and processes could be practical, user-friendly and strengthen the relationship between the parties. They could focus on the all-important people aspects with the legal underlay dealing with the deliverables. The parties would fall back on the underlying legal commitments only when trouble brews.

6.11 3 points to watch for closely:

6.11.1 Sarah Gerdes has written a great book with plenty of helpful advice. Her 2002 book is called *Navigating the Partnership Maze – Creating Alliances that Work*. She notes at page 160 the problem of agreements defining partnerships rather than the other way around. She refers to an example of a technology company CEO who's highly experienced in partnership strategies. He rates this problem as the highest risk aspect of partnerships. So, having legal terms which don't follow the partnership arrangements can backfire. An option is to fully integrate the partnership strategy into the legal agreement. Carefully drafted, this can be done in a way which reduces legal risk yet achieves commercial needs. Alternatively the partnership layer is carefully integrated with the agreement layer, even though the style and method of implementation of both differs. Whichever way the parties go, walk the talk.

6.11.2 As we note in our article, *Tenders, RFPs and Competitive Purchasing: Traps for Unwary Buyers and Sellers: February 2003 Update*, vendors have got to be careful in how they describe what they're doing in their marketing material, proposals etc. The agreement when finally signed up might use all the right words about strategic partnership, limitation of liability, etc. But the vendor can be stuck with what it has said in the original proposal (in which it might not have been quite so clear about what the partnership (and its benefits and limitations).

6.11.3 If the parties go for a two tier partnership/legal agreement model, it's important to make sure that the non-binding or less binding strategic partnership agreement integrates closely with the underlying arms-length agreement. It's also important to

make sure that any concession made in a strategic partnership arrangement doesn't legally waive entitlements under the underlying agreement. There's a danger of setting up separate obligations, for example, one of which is covered by the limitation of liability clause and the other is not. Further, there is danger of waiving rights under the agreement (eg: by doing something over time that effectively waives reliance on a party's strict rights) unless careful words are used.[9] All this is soluble – in a fully commercial way – by careful drafting.

7 What's a Joint Venture and What Risks are there in a JV?

7.1 Unlike partnerships under the Partnership Act, joint ventures don't have any particular legal definition and encompass quite a few relationship variations.[10] For example, a legal partnership is really a clearly defined type of joint venture.

7.2 JVs can be unincorporated and incorporated. The former are two or more partners getting together to undertake a venture jointly. Their roles can be closely entwined (such as jointly developing software) or relatively removed (such as a joint venture between supplier and customer for outsourcing and so on of the customer's systems).

7.3 The incorporated joint venture on the other hand has the joint venture partners setting up a company to run the joint venture business. While they might have duties between each other, there is additional complexity because they are also shareholders in a company which is being operated as a separate legal entity.

7.4 JVs arise in a number of ways in the technology area, including:

- 7.4.1 Venture capitalist funding the operations of the business.
- 7.4.2 Companies getting together to develop and commercialise software, technology and so on.
- 7.4.3 Joint arrangements for marketing products.
- 7.4.4 Strategic partnership.

7.5 While something that's called a joint venture is more likely to have higher level duties than a standard arms-length commercial agreement, this doesn't automatically follow. These higher level duties are often called or are akin to fiduciary obligations and overlap with those as between partners in a legal partnership. We've outlined fiduciary duties earlier in this paper. These fiduciary duties (or comparable contractual obligations) won't necessarily be inserted into the arrangements between the parties.

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9 Burroughs, Finn & Todd, *Law of Contract in New Zealand* (2nd Edition) para 2.3.2.

10 See "*Joint Ventures*" by Justice B H McPherson, in *Equity and Commercial Relationships* (edited by Finn) at page 19.

7.6 However the effect of the *Dymocks* Privy Council decision is that JVs, given their long-term co-operative nature, are more likely to incorporate fiduciary and express or implied high-level duties.

7.7 By using words and styles akin to "joint venture", "partnership" and "strategic partnership", parties increase the risk that this will happen. The contract between the parties may expressly state those obligations, a deliberate choice to do so having been made. The commitments (ie: the extent and nature of the duties) can be expressly qualified. For example, the JV could say that the parties can compete with each other except in specified circumstances. This modifies any fiduciary duty that could be implied.

7.8 Because these duties tend to be relatively high level, parties should be particularly careful before deciding to allow such obligations to go forward in an agreement. They can create high levels of responsibility which go well beyond those in normal agreements. This can be problematic not only for vendors but also purchasers as well. Likewise in a technology development and commercialisation JV, where there can be issues for the lead partner as well as the other parties.

7.9 However, having worked through the issues, it's quite possible parties will decide to take the risks involved, so they get the benefits as well (commercial and legal). The point is to take a calculated approach in this area. Lawyers will almost always advise caution and generally standard form agreements will have clauses which tend to limit these types of obligations (and also the liabilities flowing from these types of obligations).

8 Sharing of Intellectual Property and Confidential Information

8.1 Ownership and licensing of copyright is of course a major issue throughout all technology contracts. Joint venture and similar relationships have similar and additional problems both as to intellectual property and confidential information. Parties to these sorts of deals should be particularly careful to address them up front in the agreement.[11] Issues to address include:

8.2 The position as it develops throughout the term of the JV (and before it starts).

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[11] For more detail see our *New Zealand Computer Society Law and the IT Seminar Paper* on intellectual property (http://www.wigleylaw.com/IntellectualPropertyInItContracts.html) and confidential information (http://www.wigleylaw.com/ConfidentialityAndRestraintOfTradePracticalIssues.html) (2002). See also the excellent New Zealand Law Society 2002 seminar paper on Confidential Information.

8.3 Is a mutually binding non-disclosure agreement needed to protect IP and confidential information, including at the early stages before contract?

8.4 Who gets pre-existing IP?

8.5 What happens to IP developed as part of the JV (generally co-ownership is awkward; other options will often be better, such as one party taking ownership, with the other (or the JV itself) taking a licence).

8.6 Various types of licence arrangements are possible, with additional issues in a commercialisation context.

8.7 How is the IP to be sold (if that's to happen)? Licences? How can that happen seamlessly (eg: avoiding any issues as between the parties)?

9 JVs: Issues to Consider

9.1 Here are some triggers. It cannot be a complete list as there are so many variables:

9.1.1 Where do the parties want and expect to be at each point until the agreement ends?

9.1.2 Pre-contract issues.

9.1.3 Issues that arise anyway in arms-length deals.

9.1.4 Exclude, include or modify higher level duties (eg: fiduciary duties or implied terms).

9.1.5 A lead participant?

9.1.6 IP issues (see above).

9.1.7 Other property.

9.1.8 How will products be commercialised?

9.1.9 Can participants compete with each other? Will certain markets be reserved for a participant?

9.1.10 Employees. Seconded? Non-poaching?

9.1.11 Decision-making and resolution (very important and can be difficult).

9.1.12 Milestones.

9.1.13 Payment. Into JV (including assets and IP). Out of JV (Royalties, fixed figures, licence fees).

9.1.14 Grounds for termination (and what happens when it's terminated).

9.1.15 Liability (and limitation of liability – (a) between participants and (b) between JV/participants).

9.1.16 Competition and Commerce Act issues?

9.1.17 Tax.

9.1.18 Regulatory issues?

9.1.19 International.

10 Preferred Supplier

10.1 *Preferred supplier* arrangements will increasingly be used by customers, including in the Government sector which has additional duties when going through the procurement process (for more detail see our article, *Tenders, RFPs and Competitive Purchasing: Traps for Unwary Buyers and Sellers: February 2003 Update).*

10.2 Vendors of course want long-term relationships with customers. But there is a risk: they could be locked into an unsatisfactory relationship and they could get caught out on pricing and products if the agreement is not carefully crafted.

10.3 Customers likewise may want long-term arrangements, despite their disadvantages. The advantages for them are potentially substantial:

10.4 Numerous and repeated procurement processes (such as RFPs etc) are proving to be particularly costly. A long term preferred supplier arrangement (perhaps incorporated with a variation on the strategic partnership model) reduces that very significant time and cost commitment.

10.5 The customer gets consistency of product and support (hopefully!), and develops a strong and mutually supportive relationship with a vendor.

10.6 This strategy fits well with a desire to use a common platform, common types of technology and so on.

10.7 The big worry the customer has is of being held to ransom by the vendor, and being locked into paying excessive prices or getting inadequate product over time. The latter is a particular problem for both parties given the rapid change of technology, pricing and so on.

10.8 At first blush, the simple solution for the customer is to set up a preferred supplier arrangement which can be terminated on short notice. The problem with that is that it is more difficult for the vendor to gear itself up for long-term supply arrangements with the commitment and discounts that go with that.

10.9 So the parties should try and work through a way which minimises the risk for both and yet achieves the advantages.

10.10 Generally these situations will be relatively unique and there won't be one cookie cutter solution available. Solutions include:

10.11 Benchmarking pricing and products against an objective standard. This might be a "*most favoured customer*" approach (ie: the customer gets the pricing and products that the most favoured customer gets). Pricing, products, etc could be benchmarked against some objective standard (and backed up by an arbitration clause so that an arbitrator can step in and determine the issue if ultimately it gets to that point). The agreement (or superimposed arrangements) can have a consultation process built on top (typically for a large project this might involve a committee made up of representatives from both vendor and customer), an escalation process and so on.

10.12 Although some care is needed, one or more of the high level sorts of duties noted above can be inserted such as an obligation for the vendor to act fairly in the interests of the customer and so on.

10.13 Some other form of objective measure a process such as a change control process and/or arbitration. A "quick and dirty" arbitration process is one option.

10.14 Service level agreements with rebates or the like where there's non-compliance.

10.15 A mechanism to go out to the market (a) for deals over a certain value or (b) when the pricing and product doesn't meet established criteria.

11 Conclusion

11.1 Having closer relationships can be commercially very positive for both parties to a JV or the like. Careful drafting means the players can get the benefits yet reduce commercial and legal risk.

11.2 People should be aware of the extra risks, consider the position and then draft accordingly. Risks range across the spectrum.

11.3 Almost all implicit obligations can be overridden in the agreement. This is an area where careful legal advice is needed.

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Wigley & Company is a specialist technology (including IT and telecommunications), procurement and marketing law firm founded 11 years ago. With broad experience in acting for both vendors and purchasers, Wigley & Company understands the issues on "both sides of the fence", and so assists its clients in achieving win-win outcomes.

While the firm acts extensively in the commercial sector, it also has a large public sector agency client base, and understands the unique needs of the public sector. While mostly we work for large organisations, we also act for SMEs.

With a strong combination of commercial, legal, technical and strategic smarts, Wigley & Company provides genuinely innovative and pragmatic solutions.

The firm is actively involved in professional organisations (for example, Michael is President of the Technology Law Society and Stuart van Rij its secretary).

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