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ESTABLISHING A NEW LEGAL MODEL FOR THE GOVERNANCE OF CONTRACTUAL JOINT VENTURES THROUGH THE APPLICATION OF RATIONAL CHOICE THEORY

BY

ZOE GOUNARI

The purpose of this thesis is to rationalise the law on contractual joint ventures, in the sense of rendering it consistent with its own fundamental tenets and declared objectives. The declared objective of contract law is to give effect to the intentions of reasonable persons, whom the law presumes to be self-interested by default. To this end, this thesis argues for a new legal model to govern the contractual (project-specific) joint venture, which centres on the joint venture contract but is fundamentally augmented through the application of default, mutually binding, fiduciary duties. By applying David Gauthier's take on rational choice theory in the context of cooperation, the thesis demonstrates that submitting to default duties of this type is the long-term utility maximising strategy for self-interested commercial parties who have chosen to cooperate. For this reason, it argues that English law should imply fiduciary duties into the joint venture contract by default on the basis that this is what the co-venturers would have intended had they properly reflected on what their long-term self-interest requires.

ESTABLISHING A NEW LEGAL MODEL FOR THE GOVERNANCE OF CONTRACTUAL JOINT VENTURES THROUGH THE APPLICATION OF RATIONAL CHOICE THEORY

Zoe Gounari

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Doctor of Philosophy

Durham Law School

Durham University

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1 INTRODUCTION AND METHODOLOGY

1.1 Joint ventures and the law

Let us imagine a common commercial scenario. Two companies of equal bargaining power and means decide to pool resources to jointly exploit a capital-intensive opportunity. For the purposes of our example, the nature of the opportunity is immaterial. It could be a project to research, develop and market a new technology, the exploration for and development of an oil field offshore Brazil, or the development of a screenplay into a movie for worldwide release. The key feature is that the opportunity at issue is capital-intensive, and therefore risky, and for this reason our companies have decided to cooperate. In doing so they have dedicated time and finance to determine the details of their relationship, in both legal and financial terms. Thus, they form a 'joint venture'.

In the eyes of the law, a joint venture is a curious beast. The relationship between the parties is founded on the exchange of promises and therefore, in law, invariably involves a contract. Whether express or implied, this contract sets out the parameters of the relationship in terms of legally enforceable rights and duties. But the legal framework applicable to the relationship can be much wider than what the contract suggests and, in some cases, antagonistic to the parties' intentions. What then is the appropriate legal response to our companies when, in the course of their joint venture, they each come across opportunities for profit at the expense of the other? The joint venture does not have a distinct status in law, so the applicable legal framework will be determined by the form attributed to the relationship by the parties themselves. Where that form is expressly recognised in law (such as a corporation or a partnership), the attached framework allows the parties to predict the consequences of their decisions in the context of the joint venture. But vagueness abounds where the parties simply rely on the contract between them to encapsulate their relationship, which they are wont to do (see 2.5.2). In this case, the co-venturers are faced with three possibilities: (a) they are deemed to be in an 'arm's length relationship' with any dispute addressed with sole reference to their contract; (b) they are deemed to be, in fact, partners in law; or (c) they are not partners but are deemed to be in a relationship closer than what 'the arm's length' characterisation entails.

The consequences in each case vary and their impact can be legally and financially devastating for the co-venturers, both collectively and individually. For instance, should they be identified as partners, partnership law will apply by default, the contract itself coming second to the overall partnership regime. In and of itself, this eventuality should not be as devastating an issue for the co-venturers, who may well take measures to mitigate the consequences of partnership law from the outset, e.g. by laying out a detailed dispute resolution mechanism in the contract, avoiding court involvement. The trouble here is with the operation of the partnership regime itself. As I argue in chapter 3, with the meteoric rise of the joint venture model, the law has not caught up with the needs of the parties to the venture, which is evident from the regime's reliance on the ancient tenets of partnership law to tackle any disputes between co-venturers. Consequently, the current law is geared towards parties whose relationship has broken down, rather than those who simply wish to resolve a dispute and move on with their collaboration. This makes partnership law an inappropriate regime to apply to joint ventures

Having said that, even if their relationship does not satisfy the broad criteria for a partnership, co-venturers may still face outside interference on the basis that their relationship is not in fact an arm's length one, i.e. one where the only connection between the parties is the contract pertaining to the joint venture. In this case, the problem lies not in the concept of the law's interfering in the contractual relationship of private parties, but rather in the manner in which this jurisdiction is implemented. As chapter 4 demonstrates, the court has interfered on several occasions with commercial relationships that have been classically defined as arm's length (either because they involve a one-off exchange or even no bargain at all), on the ground that such interference was warranted in the interests of equity and justice. The court did this by implying equitable duties into the relationship, inferring breach of those duties from the facts and, consequently, awarding significant equitable remedies. Naturally, there is no set definition of what is just and equitable so as not to unnecessarily restrict the equitable jurisdiction.[1] The same holds for the courts' interference with on-going collaborative relationships, where the parties have expressly dismissed attributes of their respective roles that would suggest the basis of a fiduciary relationship. Even in

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[1] This is not say that there are no delimiting parameters applying to the equitable jurisdiction itself, for there are strict rules as to *when* the equitable jurisdiction of the court can arise.

those cases, the court may well find that the joint venture relationship gives rise to equitable duties, known as fiduciary duties, discussed in chapter 6. The obvious downside of this is that in both cases the implication of additional duties into an existing contractual relationship is not determined according to a set formula. In turn, this renders the judicial treatment of contractual joint ventures unpredictable and undermines their usefulness as a viable business vehicle.

For these reasons, I argue that English law must re-evaluate its approach to joint ventures, taking into account the realities that make the contractual joint venture such an attractive business vehicle. I argue that the foundation of this new approach must be the joint venture contract, which, express or implied, is both the legal expression and operational nexus of the collaborative relationship. It is also the outsider's primer to the co-venturers' intentions. The interpretation and implementation of these intentions is the cornerstone of contract law and must also be the focus of a new contract-based legal model applicable to joint ventures. The challenge here is determining those intentions with replicability and, therefore, with predictability.

1.2 Economic theory and moral theory: relevance and application

Therein lies my central thesis: if the law purports to construe contracts so as to give effect to the intentions of the parties, then the rules of construction themselves must respect the purpose of all commercial contracts, which is the pursuit of financial gain. However, in order to ascertain the intentions of commercial parties with any hope of reflecting reality we must rely on principles from outside of the law of contract, whose purpose is merely the enforcement of promises as understood by the parties at the time of the agreement. We must examine the economic basis of those promises so as to gain an understanding of the driving forces behind the contract itself. The study of the mainspring and mechanics of economic activity is the remit of economics. Therefore, I propose that an economic theoretical methodology is essential in ascertaining the intentions of parties to a commercial contract.

However, I do not propose to undertake an economic analysis of the law. That is, I do not propose that the legal rules of contract construction must be implemented so as to achieve the most efficient economic outcome ('efficiency' itself being defined as the net benefit, financial and social, gained from an exchange). My thesis is that a new legal model addressing joint ventures must determine the intentions of the parties by taking

into consideration the economic basis of the contract itself. To be sure, 'economic basis' does not refer to the specific accounting benefits accruing to each party due to their bargain. These are neither replicable nor transferable. Rather, my focus will be the economic rationale, which the parties must have implemented or, if acting prudently, would implement in order to establish and sustain a successful collaborative relationship.

1.2.1 Economic theory and rational behaviour

1.2.1.1 Rationality and self-interest

My contention is that by employing an economic theoretical approach to the examination of the co-venturers' relationship, I will be able to establish an objective standard for ascertaining their intentions for the purposes of contractual monitoring and enforcement. An objective standard of conduct is one that can be uniformly applied to commercial collaborative relationships and therefore it squarely serves the interests of legal certainty, by allowing for reproducibility of results and predictability. Economic theory itself purports to observe and explain economic behaviour, namely behaviour pertaining to the distribution of resources deemed desirable or necessary for human welfare. On this basis, its aim is 'to provide a system of generalizations that can be used to make correct predictions about the consequences of any change in circumstances'[2] that befalls the economic agent(s) under observation. Therefore, an economic theoretical methodology involves the examination of the actions of an economic agent – which is what entities involved in commercial collaborative relationships invariably are – acting *rationally*.

The concept of rationality is much debated in economic literature, because of its key role in the development and application of economic theory. This is because 'rationality' is the criterion the economist attributes *a priori* to the agent(s) under consideration, and is what allows the economist to make generalised projections. Thus, rational conduct in economic theory is understood in its instrumental sense, that is, a course of action taken in pursuit of achieving a given goal following careful

[2] M. Friedman 'The Methodology of Positive Economics', in M. Friedman, *Essays in Positive Economics* (University of Chicago Press, 1953), 4.

consideration of surrounding circumstances and past experience.[3] In the case of an economic agent, this all-important goal is the *maximisation* of a desired resource – itself variously described by the language of 'welfare', 'utility' or 'ophelimity'. In other words:

> 'Maximization provides the moving force of economics. It asserts that any unit of the system will move toward an equilibrium position as a consequence of universal efforts to maximize utility or returns.'[4]

Maximisation, therefore, lies at the heart of rational behaviour as understood by economists. This is because, in its study of resource distribution, economic theory presumes that several of the resources necessary for human welfare are scarce by nature.[5] Being aware of this empirical fact, when humans interact for the purpose of distributing such resources amongst themselves, they each first and foremost seek to secure their respective self-interest. They do this by ensuring that they obtain the maximum possible units of the resource under consideration. The language of self-interest is neatly summarised in the following excerpt from Adam Smith:

> 'It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.' [6]

In other words, according to dominant economic theory, rational behaviour is synonymous with pursuing one's own interest by maximising the resources regarded as necessary for one's own welfare.

[3] The ability to learn from past experience through trial and error is the key characteristic of a rational economic agent, according to Pareto, who was the first to identify the possibility that the same economic agent is capable of both rational (i.e. logical) and irrational (i.e. illogical) economic conduct; V. Pareto 'Manual of Political Economy' ch.III.3; and see V. Pareto, 'The New Theories of Economics' (1897) 5(4) *J. Political Econ.* 485, 496, on the necessity of putting economic theory deductions through the test of practical experience to ensure their validity.

[4] S.R. Krupp, 'Equilibrium Theory in Economics and in Functional Analysis as Types of Explanation' in D. Martindale, *Functionalism in the Social Sciences* (American Academy of Political and Social Science, 1965), 69.

[5] For a critique of some key presumptions of the economic method, see R.L. Heilbroner, 'Is Economic Theory Possible?' (1966) 33(2) *Social Research* 272.

[6] A. Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (MetaLibri Digital, 2007), 16.

1.2.1.2 Collaborative relationships and the pursuit of self-interest

Against this background, how do we go from one-off economic exchanges between self-interested maximisers to the collaborative commercial relationship envisaged in this thesis? The answer lies somewhere in the study of rational behaviour in the event that one's own interest becomes intertwined with the interests of others. This is the remit of game or rational choice theory. In very general terms, game theory examines the rational response in situations where an agent's range of preferred outcomes depends on the decisions of other agents, who are themselves rational and seek to achieve their own preferred outcomes. Assuming absolute rationality, game theory seeks to predict the choices that the agents under consideration would make when given a range of possible outcomes. It does this by assigning a numerical value – called a 'utility function' – to the preferences of each agent, on the presumption that (a) the agent accepts the possibility that the alternative outcomes they are presented with may depend on chance alone (and are therefore described as 'lotteries') and (b) that their preferences are consistent.[7] Given that the agents under consideration are assumed to be unfailingly rational, the all-important utility function itself is determined on the basis that an agent will choose one lottery over another, only if its utility function is higher than the utility function of the other. Therefore, predicting the choice of a rational agent, when faced with a range of outcomes dependent on the choices of other rational agents, is a matter of establishing the outcome with highest expected utility.[8]

The mechanics, as well as the limitations, of game theory are illustrated by the famous Prisoner's Dilemma paradox. The classic version of the paradox[9] involves two individuals arrested by the police on suspicion of a serious crime. They are interrogated in separate rooms so that each cannot know what the other is saying. At the beginning of the interrogation, the prosecutor tells each suspect that the first one to confess will serve a nominal prison term of three months for turning Queen's evidence, while the other, at the prosecutor's recommendation, will serve the maximum term of 10 years. If both confess, then the prosecutor will recommend a more lenient sentence of 8 years for both. If neither confesses, the suspects are told that they will be prosecuted on a

[7] See R.D. Luce and H. Raiffa, *Games and Decisions: Introduction and Critical Survey* (Wiley, 1957), 4.

[8] *Ibid*.

[9] *Ibid*, 94.

lesser charge, for which the prosecutor is confident they can secure a conviction. The sentence in this case will be one year's imprisonment. As the game is presented to them, each suspect has now two strategies: confess (thus implicating both themselves and the other) or stay silent. The following matrix illustrates the suspects' strategies with their associated payoffs (the first numerical entry refers to Suspect 2's payoff and the second to Suspect 1's):

Suspect 1:

Suspect 2:

	Confess	Stay silent
Confess	8 yrs, 8 yrs	3 mths, 10 yrs
Stay silent	10 yrs, 3 mths	1 yrs, 1 yrs

For each suspect, the outcomes of the 'confess' strategy dominate those of 'stay silent' – for one, bearing the highest payoff of just 3 months in prison – and is therefore said to be in 'equilibrium'. Specifically, a strategy is in equilibrium if it is the best strategy that either player can choose in the circumstances knowing the strategies available to the other. Here, this means that even if one suspect knew that the other was going to confess, neither could do better by choosing another strategy, i.e. 'stay silent'. Therefore, confessing is the 'dominant' strategy in this game.[10] Notably, the effect of the dominant or equilibrium strategy for each player is to achieve the highest 'security level' and is therefore naturally risk averse.[11] Therein lies the *paradox*: if acting rationally, both suspects must choose the dominant strategy and confess, so as to receive the minimum sentence and, in any event, avoid the maximum sentence. Yet, if they both act 'irrationally' by staying silent, their payoff is much better than that of *both* following the dominant strategy. In other words, the *collective* interest of the suspects lies in their both defecting from the dominant, risk-averse strategy, and, therefore, it

[10] For a more detailed explanation of the mechanics of a non-cooperative, no zero-sum game (i.e. a game where if one player gains something the other must correspondingly lose), see *ibid,* 60-63.

[11] See the analysis *ibid*, 67.

conflicts with their *individual* self-interest, which is determined by the dominant strategy.[12]

How does the prisoner's dilemma reflect the mechanics of joint ventures? The suspects in the prisoner's dilemma are self-interested individuals, much like the rational economic agents who stereotypically take part in joint ventures. They do not necessarily compete but, when they interact, they are theoretically expected to pursue their self-interest and be indifferent to the interests of others. However, unlike the two suspects in the prisoner's dilemma, prospective co-venturers have extensive communication before they agree to the joint undertaking. Given their nature as self-interested agents, that decision is based on the initial acceptance that at least for the time being their individual self-interest[13] lies in cooperating rather than competing with the other. *Pre-play communication*, therefore, is key to a possible cooperative outcome.

Let us consider then, how the dominant strategy in the prisoner's dilemma game would be affected if the suspects had the opportunity to communicate before their interrogation. In this case, it is plain that they would agree to both stay silent. The outcome of this agreement is cooperation on the one hand, but, on the other, it is a conscious forfeiture of the best strategy in the game, which is to choose 'confess' *if* the other chooses 'stay silent'. In other words, the 'stay silent' strategy pair is not in equilibrium, which means that each suspect has a strong incentive to defect from the agreement so as to obtain the highest possible payoff (a mere three months in prison) as opposed to the second highest (one year), as per the payoff matrix above. In the joint venture context, this translates to one of the parties defecting from the agreement with the other, in pursuit of the highest payoff once the opportunity arises. For the purposes of joint ventures, the prisoner's dilemma illustrates that sustained cooperation between self-interested agents (post pre-play communication) is always a *second-best* option. This is because collaboration requires a minimum sacrifice from each participant, which in joint ventures means sharing the outputs of the joint undertaking, rather than keeping its fruits entirely for oneself.

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[12] The Prisoner's Dilemma has been described as a 'martyrdom game', because adherence to the dominant strategy ultimately involves sacrificing one's self-interest for the other's benefit; see A. Kelly, *Decision Making using Game Theory* (CUP, 2003), 99.

[13] This does not necessarily translate into the maximum possible gain out of the situation – e.g. in joint ventures, the advantage lies mostly in risk mitigation: see 2.3.

In light of the fact that, theoretically, sustained cooperation is a second-best option in the context of economic activity, the question arises: why would a rational (i.e. self-interest maximising) economic agent choose to sustain a cooperative relationship with another equally rational agent? Game theory does not have, nor does it purport to provide, an answer to this conundrum.[14] If anything, its purpose is to examine and formalise the options available to the classically defined rational agents under consideration given specified strategies reached according to given data. Therefore, to address this question, I will turn to the work of David Gauthier. In his book *Morals by Agreement*, Gauthier responds to the practical rationality problem in the prisoner's dilemma by developing a theory of morals, which holds that, in certain circumstances, a rational agent reasoning from non-moral premises must behave morally, i.e. submit to an impartial (namely, other-regarding) constraint on his pursuit of self-interest, in order to behave rationally.[15]

1.3 Morals by Agreement

Gauthier's starting premise is that of a maximising conception of rationality;[16] he assumes, like Hobbes before him, that the driving force behind human behaviour is the need to maximise the satisfaction of one's desires. This 'straightforward (utility) maximiser' [17] initially has no concept of morality, i.e. is not burdened by the consideration of what he may or may not do in the interests of others, simply what he can do in order to maximise his utility or self-interest. If such an individual were operating in a world resembling a perfectly competitive market, there would be no need for a concept of morality to constrain his behaviour. This is because in a perfectly competitive market, the supply of resources necessary for the human welfare matches demand for them perfectly,[18] no external factors can affect this process, or vice versa, and therefore there is no need for individuals to compete for resources. The perfect market is, in other words, a state of 'moral anarchy, a human society that neither has

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[14] See Luce and Raiffa, n.7, ch.1.

[15] D. Gauthier, *Morals by Agreement* (OUP, 1986).

[16] *Ibid*, 34.

[17] *Ibid*, 167.

[18] This is possible in a perfect market because it 'presupposes private ownership of all products and factors of production' so that each person is endowed *from the start* with all the means necessary to pursue their welfare: *ibid*, 86.

nor needs internal constraints – a society of peaceable, productive and companionable persons who nevertheless are without conscience'.[19]

The world does not reflect a perfectly competitive market. Market interaction is always affected by externalities, rendering resources scarce.[20] Consequently, as individuals we are driven to compete for them while striving to maximise the satisfaction of our desires. Without suitable adjustment of human behaviour, such adversity would lead to a frightening reality where no society would be possible. Humans would be at constant war with each other, living in 'continual fear and danger of violent death'[21] and ultimately leading a life 'solitary, poor, nasty, brutish, and short'.[22] In light of such prospect, each person, inclined by nature to safeguard their interest before pursuing the satisfaction of their desires, must agree to give up some of their liberty to do so, provided others agree to do so as well.[23] The forfeited portion of one's liberty refers to their liberty to prevent others from pursuing the satisfaction of their own desires. This all-round agreement to constrain one's pursuit of their self-interest, so as not to interfere with each other's ability to pursue their respective well-being, can also be described as an implied contract among social actors. Accordingly, human society is a 'cooperative venture for mutual advantage' among persons 'conceived as not taking an interest in one another's interests'.[24]

Adopting this contractarian view of society, Gauthier holds that market failure, i.e. the absence of perfect competition due to the existence of externalities, necessitates a new mode of interaction between agents. If, when interacting with others, economic agents only consider the costs and benefits of their independent choices and ignore the operation of externalities, the outcome of their independent choices in many situations will be sub-optimal.[25] Thus,

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[19] *Ibid*, 84.

[20] *Ibid*, 87.

[21] T. Hobbes, *Leviathan* (Andrew Crooke, 1651), 78.

[22] *Ibid*.

[23] *Ibid*, 80.

[24] Gauthier, n.15, 10.

[25] *Ibid*, 116-117.

> 'In order to take effective account of externalities, each person must choose her strategy to bring about a particular outcome determined by prior agreement among those interacting. This agreement, if rational, will ensure optimality'.[26]

He identifies this new mode of interaction as cooperation.[27] In the context of cooperation, Gauthier explains, the content of 'rationality' is different from that in the context of an agent acting independently of others, i.e. in the context of natural or market interaction. In the latter case, rational economic behaviour is determined by the equilibrium (i.e. utility-maximising) strategy, namely the best strategy in the circumstances when considered in light of the strategies available to others. By contrast, in the context of cooperation, the basis for action is a prior agreement among the interacting agents, culminating in a joint strategy and, ultimately, a joint payoff. The individual payoffs for each interacting agent are naturally determined by the agreement between them.

Therein lies the difference between pursuing one's self-interest in a cooperative context rather than independently: interacting agents must voluntarily constrain their naturally utility-maximising behaviour by adhering to the terms of a prior agreement. Complying with the agreement entails that the interacting agents must share the joint payoff, thus, by definition, eschewing the prospect of payoff/utility maximisation (i.e. keeping the entire output of the collaboration for oneself). This contradicts the traditional understanding of rational economic behaviour. Gauthier's response to this is that such compromise is perfectly compliant with the classic conception of rationality, if we accept that, in cases where the risk of externalities prevails, cooperation, rather than individual action, will yield a higher payoff for each interacting agent. This is what Gauthier refers to as the 'co-operative surplus', namely the collective gain arising from co-operation between interacting agents, which is above the utility they would obtain in their 'initial bargaining position'. The latter term refers to the base point from which the bargaining proceeds. It is, in essence, each agent's factor endowment (i.e. 'what [each] brings to the bargaining table')[28] and the utility it affords is what the agent would achieve outside the bargain.[29] This understanding lies at the heart of the agreement to cooperate and the ensuing constraint on the parties' economic behaviour. Accordingly,

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[26] *Ibid*, 117.

[27] *Ibid*.

[28] *Ibid*, 130

[29] *Ibid*.

assuming everyone involved complies with the pre-agreed terms, individual payoff maximisation within the cooperative framework is not possible. Therefore, rather than pursuing equilibrium, the interacting agents must be concerned with achieving the second-best option in the circumstances: optimality. Ultimately, in cooperation, obtaining the *optimal* benefit out of the circumstances must be the focus of rational economic behaviour.

Crucially, for the bargaining agents to be able to optimise their utility, the mechanics of the bargain itself must be rational, in the sense that the bargain is founded on the pursuit of optimality rather than maximisation. The foundational premise of a rational agreement is that each agent bargains from a position, which complies with the 'Lockean Proviso'. In his *Two Treatises for Government*, John Locke stated that it is legitimate for humans to appropriate, for their own use, goods, which they find in a state of nature, if they mix their labour in with them. However, this concession is subject to the proviso that 'there is enough, and as good left in common for others'. [30] Gauthier's interpretation of Locke's proviso is that it 'prohibits bettering one's situation through interaction that worsens the situation of another'.[31] He continues:

> 'The proviso is intended to apply to interaction under the assumptions of individual utility maximizing rationality and mutual unconcern. Each person is supposed to choose a strategy that maximizes his expected utility, unless specifically forbidden by the proviso to do so. Each then is free to better his own situation as he chooses, provided that he does not thereby worsen the situation of another'.[32]

When applied to self-interest maximising agents who must reach an accord so as to efficiently deal with externalities, the Lockean proviso ensures that, *ceteris paribus*, no party to the agreement becomes worse off as a result of the agreement than they would have been had there been no agreement at all.[33] In other words, choosing to cooperate with other self-interested utility maximisers is only ever rational where every prospective collaborator has agreed to constrain their behaviour at least to the extent required by the Lockean Proviso.

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[30] J. Locke, *Two Treatises of Government* (1690), second treatise, Ch.V, [27]-[33].

[31] Gauthier, n.15, 205. Note that the proviso is to be taken to apply to the manner in which the parties have each obtained their initial factor endowments.

[32] *Ibid*, 205-206.

[33] See the discussion, *ibid*, 204-205.

On this foundation Gauthier builds his vision of a rational bargaining process. The process begins with the interacting agents making their respective claims. Gauthier defines a claim as 'a demand by a prospective co-operator for a particular co-operative surplus'.[34] The ensuing bargaining process will be rational, if the following four factors are met:

> (a) the parties make rational claims off the co-operative surplus, i.e. those that afford them maximum utility, subject to the Lockean Proviso;
>
> (b) the parties presume the existence of at least one 'feasible concession point' for each rational agent involved in the bargaining process;
>
> (c) each party is in fact willing to concede in relation to one such concession point; and
>
> (d) all concession is limited to the extent that it is required by conditions (b) and (c).[35]

Provided these conditions are satisfied, the interacting agents will have succeeded in constraining their behaviour only to the extent required to obtain an optimal outcome out of the bargain and no further. Gauthier refers to this optimal level of constraint as the 'minimax relative concession'.[36] The minimax relative concession refers to the maximum extent to which an agent would be required to constrain the pursuit of their self-interest that would afford them the least deviation from their claim on the cooperative surplus.[37] Gauthier refers to that deviation as the 'relative magnitude' of an agent's concession and he calculates it as the proportion that the absolute magnitude of that concession[38] bears to the difference between the utility afforded by the claim and the utility of that agent's initial bargaining position:[39]

$$\text{A concession's } \textit{relative magnitude}\text{:} = \frac{\text{Utility of claim - utility of concession}}{\text{Utility of claim - utility at initial bargaining position}}$$

[34] *Ibid*, 142.

[35] *Ibid*, 143.

[36] For a formal proof see, *ibid*, 141ff.

[37] *Ibid*, 142.

[38] That is, the utility afforded by that agent's claim minus the utility of the concession; *ibid*.

[39] *Ibid*.

In sum, according to Gauthier, rational economic behaviour in cooperation is the pursuit of utility optimisation rather than utility maximisation. Such optimality is achieved when the interacting agents agree beforehand to constrain their otherwise maximising behaviour, thus becoming 'constrained maximisers'. Only through such agreement is the prospect of cooperation between straightforward maximisers rational. This constraint is other-regarding and requires that all parties in the agreement pursue their self-interest only to the extent that they do not end up making the other participants in the bargain worse off than they would have been, had there been no bargain at all. The optimal level of constraint, which bargaining agents must undertake, is determined by calculating their respective minimax relative concessions. Ultimately, constrained maximisation emulates a system of morality, to which rational agents must submit in order to successfully secure their own interest.

1.3.1 Gauthier's prudential view of rational choice: Long-term welfare and the freeloader problem

A crucial tenet of Gauthier's theory of rational choice in interaction is that:

> 'rational choice must be directed to the maximal fulfilment of our present considered preferences, *where consideration extends to all future effects* in so far as we may now foresee them'.[40]

In other words, rational choice must be informed by an agent's desire to secure their long-term interest. To understand why this emphasis is necessary we need to go back to the classic definition of rationality as utility maximisation, the pursuit of which is the *raison d'etre* of the archetypal economic agent featured in the majority of economic models. In fact, so peculiar to economics is this singularly clear-headed being, (considered briefly in 1.2.1.1) that it has also been described as 'homo economicus'.[41] As the quintessential rational agent, homo economicus always looks for the best possible bargain and is presumed to have the necessary information to achieve this. They do not get bored, tired, distracted or forgetful in their constant pursuit to maximise their utility out of any given situation. They pursue their self-interest first and foremost

[40] *Ibid*, 37 (my emphasis).

[41] See J. Persky, 'The Ethology of Homo Economicus' (1995) 9(2) *J. Econ. Perspect.* 221.

and they expect every other agent they interact with to do the same.[42] This basis for conscious action is in game theory known as the ‘common knowledge of rationality’ and informs the economist’s efforts to predict the actions of rational agents given specific data.

Let us then consider how a rational agent (Gauthier’s straightforward maximiser) would approach the prospect of cooperation with others when acting on the common knowledge of rationality. The short answer is that the common knowledge of rationality renders the very concept of cooperation between economic agents nonsensical. The issue is amply illustrated in the ‘centipede game’, a repeated version of a no zero-sum, non-cooperative game.[43] The centipede problem involves two players, A and B, and 100 gold coins.[44] The players are told that they can take turns taking and keeping coins from the pile, a maximum of two every time. The game stops the moment one coin is left in the pile. A and B are also told that they may take three coins rather than two, but the moment one of them does so the game stops and the rest of the coins in the pile disappear. In that case, the players are left with however many coins they have each managed to acquire up to that point. Both A and B are straightforward maximisers and operate under a common knowledge of rationality, meaning that they each know the other to be a straightforward maximiser as well. The ensuing game takes its name from the linear diagram below[45] depicting the players’ moves pursuant to each of the two strategies in the game, i.e. Continue or Stop. Thus, ‘C’ indicates the moves that continue the game (i.e. taking 2 coins from the pile) and ‘S’ indicates the moves that stop the game (i.e. taking 3 coins from the pile). The first numerical value in each pair reflects A’s payoff and the second value reflects B’s.

A: C1 (2,0)   B: C2 (2,2)   A: C3 (4,2)   B: C4 (4,4)   A: C5 (6,4)   B: C6 (6,6)

[42] *Cf*. M. Hollis and E. Nell, *Rational Economic Man* (CUP, 1975); A.K. Sen, ‘A Critique of the Behavioral Foundations of Economic Theory (1977) 6(4) *Philos. Public Aff.* 317 (discussing *inter alia* the realism and consequences of the widespread assumption that rational action must be self-interested); H. Gintis, ‘Beyond Homo Economicus: evidence from Experimental Economics’ (2000) 35 *Ecol. Econ.* 311, 313ff (demonstrating that in experiments involving decisions with long-term pay-offs, agents’ actual behaviour contradicts the expectations of classical economics); H. Simon, ‘Theories of Decision-Making and Behavioral Science’ (1959) 49(3) *AER* 253, 260-261 (on utility theory and maximisation contradicted in experiments with agents).

[43] See R.W. Rosenthal ‘Games of Perfect Information, Predatory Pricing and the Chain-store Paradox’ (1981) 25 *J. Econ. Theory* 92.

[44] Example from M. Hollis and R. Sugden, ‘Rationality in Action’ (1993) 102 *Mind* 1, 21.

[45] *Ibid*.

S1	S2	S3	S4	S5	S6
(3,0)	(2,3)	(5,2)	(4,5)	(7,4)	(6, 7)

From the diagram it is evident that A is always in the lead in terms of number of coins acquired from the pile because A started the game. B is aware of this, as well as of the fact that her very participation in the game is always dependent on A's decision to continue or stop the game. Consequently, the moment that A decides to continue the game by choosing C1, B being rational will likely seek to maximise her payoff by taking three coins as soon as she is able to, thus stopping the game before A gets the chance to stop it herself. On the diagram, this reasoning manifests in B's picking S2 rather than C2. For her part, A apprehends all this from the very beginning because A is aware that B is rational. Therefore, in order to avoid losing out to B's maximising choices by picking C1, A will more likely pick S1 thus ensuring that she will obtain the maximum number of coins on any one move. The result is that the game will end after the first move, despite the plain fact that, if the game were to continue, both players would be significantly better off.

The centipede paradox demonstrates two important flaws with regard to the classic conception of rational conduct. First, when theoretically applied to its own terms, the immediate effect of the common knowledge of rationality is to stall collaboration between economic agents, however guaranteed the payoff for all involved. More importantly, the maximising conception of rational conduct operates so as to preclude the pursuit of one's long-term interest (in this case continuing the game until the pile of coins is depleted) in favour of short-term gain (here, the maximum number of coins obtainable on any one move). This conclusion is simply incongruous with the very reality of joint ventures, whose whole premise is the joint pursuit of necessarily long-term payoffs. Indeed, even if we accept for the sake of argument that homo economicus is capable of forming a joint venture, they will be unable to sustain it. This is because the dominant strategy, even in a scenario that involves cooperation pursuant to a pre-play agreement (i.e. a classic joint venture), will be one of defection from the agreement so as to favour maximum short-term gain on any given move.

Thus, given common knowledge of rationality, Gauthier acknowledges that every collaboration between straightforward maximisers has the potential to devolve into a prisoner's dilemma, despite any pre-agreed set of terms that should, in principle, guarantee optimal payoffs for all interacting agents.[46] This is because, a straightforward maximiser concerned only with the satisfaction of their preferences in the short-term (e.g. Player A in the centipede game) would renege on the agreement whenever the opportunity arose to maximise their benefit in the present. In the prisoner's dilemma this would amount to one suspect choosing 'confess' aiming for the minimum possible sentence, having first secured the other suspect's agreement to choose 'stay silent'. This type of opportunistic behaviour, Gauthier refers to as 'parasitic', where it directly causes the other party in the interaction to become worse off, or 'free-riding', where the opportunist obtains a benefit without paying all or part of its cost (but without displacing that cost directly onto the other parties in the interaction).[47] With regard to free-riding, Gauthier uses the example of a number of ship-owners who pool together to build a lighthouse so as to improve the navigation of their vessels. A free-rider will be a ship-owner who receives the navigational benefit of the lighthouse without contributing to the cost of its building or maintenance. From here on, I will refer to *both* types of opportunistic agents as 'freeloaders'.

Consider the following scenario. The Council of a popular seaside resort town opens up a large beachfront area to residential and commercial development. Accordingly, it divides the area into ten plots and invites land developers to tender their bids. Ten developer companies of varying sizes and resources come forward. However, due to the popular location of the area on offer, the developers predict that an all-out bidding war over the plots would drive their prices too high for a decent profit to be made out of their development. Thus, they agree amongst themselves that every developer will bid for only one plot each, offering no more than the minimum bid set by the Council in every case. As with the Prisoner's Dilemma, the best payoff for each developer clearly lies in defecting from the agreement when every other developer keeps to it. The defector would thereby bid for multiple plots and acquire them by offering only a

[46] Gauthier himself uses the arms race as an example of a mutually suboptimal outcome for rational agents acting on the common knowledge of rationality.

[47] Gauthier, n.15, 96.

fraction over the minimum-set bid, having secured the others' agreement not to drive the prices up by over-bidding themselves.

Gauthier responds to the problem of defection or freeloading by adopting a prudential approach to rationality, to the effect that the freeloader's reneging on the agreement to cooperate is both counterproductive and counter intuitive in the long run. It will be remembered that Gauthier relies on the (purportedly) empirically established premise that the driving force behind all human action is the pursuit of one's self-interest and this is naturally underpinned, he claims, by a disposition to ensure one's own survival first and foremost. According to Gauthier, it follows that all efforts toward survival and maximisation of one's considered preferences would be meaningless, were they not aimed at securing one's long-term – as opposed to their immediate – wellbeing. Therefore, in my land developer example, a developer who acts as a straightforward maximiser and reneges on the agreement will eventually become known as a freeloader, be shunned by others in the future and thus become unable to reap the benefits of cooperation again. Therefore, while constrained maximisation does not guarantee the highest payoff from cooperation in every case, it is an agent's best strategy *overall*, for it ensures that agent's continued participation in fruitful collaborations with others. In other words, it is in one's best interest *in the long run*, to constrain their pursuit of their short-term interest when others have agreed to do the same. Ultimately, Gauthier argues, by habitually adopting the minimax relative concession (and the corresponding principle of maximin relative benefit) [48] in constraining their conduct during cooperation, agents will become conditioned into moral beings, whose natural disposition is to keep to their agreements.

1.3.2 Limitations of Gauthier's contractarian morality

Gauthier's contractarian project flows from his presumption that constraining human conduct is legitimate only in two cases. First, if the rational (utility-maximising) agents under consideration have expressly consented to the proposed constraint. Secondly, if the rational agents under consideration are required by their self-interest to consent to the constraint, in which case Gauthier implies that, had the agents under consideration reflected on the prospect of constraint rationally, they would have consented to it

[48] This becomes relevant in the calculation of one's share of the cooperative surplus, where the latter does not consist of a single, transferable good. Essentially, in cooperation one *maximises* their relative benefit by *minimising* their relative concession; Gauthier, n.15, 154-155.

anyway. Thus, by utilising a hypothetical contract between interacting agents, Gauthier assumes that the agents under consideration will only consent to a mutual constraint on their conduct if it is to their mutual benefit. What follows is that agents will only consent to their conduct being constrained if there is a benefit to be derived from it. Consequently, those who cannot consent or have little or nothing to offer in a bargain, such as 'animals, the unborn, the congenitally handicapped and defective'[49] – in Gauthier's words – 'fall beyond the pale of a morality tied to mutuality. The disposition to comply with moral constraints, … may be rationally defended only within the scope of expected benefit'.[50] Clearly, a rational defence in this case is one that perceives the primary driver of human action as the pursuit of self-interest.

It will be remembered that according to Gauthier, moral constraint is required merely as a response to market failure and the presence of externalities, for – in a perfect market – agents are in a state of mutual unconcern,[51] reasoning only from self-centred imperatives. Accordingly, Gauthier avoids using the language of categorical imperatives and adopts that of *rationality as self-interest* hoping to establish a rational, non-moral justification for moral constraint on human conduct, where 'moral' is understood to refer to 'other-directed concerns'.[52] However, I submit that his strategy cannot reach a universal justification for moral constraint. Certainly, in the narrow context of two or more straightforward maximisers contemplating a bargain and calculating their respective payoffs in light of their considered preferences, constrained maximisation may well be the best strategy for these agents *overall.* But, as Moore observed, it is one thing to calculate one's benefit from a prospective collaboration and, as a constrained maximiser, to honour the resulting agreement, but quite another to *become disposed* to keeping one's agreements.[53]

What this comes down to is that if the primary criterion of rational conduct is the pursuit of self-interest, why is it rational to *become disposed* to keeping one's agreements, when the payoff from breaking just one may be so large as to make it worthwhile for the freeloader to accept being shunned by others with respect to future collaborations?

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[49] *Ibid*, 268.

[50] *Ibid*.

[51] *Ibid*.

[52] *Ibid*, 103-104.

[53] M. Moore 'Gauthier's Contractarian Morality' in D. Boucher and P. Kelly (eds), *The Social Contract from Hobbes to Rawls* (Routledge, 1994), 212, 215-216.

Gauthier's response is that, by virtue of the social contract (through which humans escape the dystopia of their existence in a state of nature), more agents are naturally disposed to being constrained maximisers than not. Therefore, while adopting morals by agreement will not work in everyone's favour always, it will work most of the time. Thus, adopting such as a disposition is in the interest of rational agents in the long run.

This claim, of course, presupposes that constrained maximisers are able to identify and avoid freeloaders most of the time or that constrained maximisers operate within a system where freeloaders face a significant risk of being caught out. It also presupposes that freeloaders are not able to deceive the constrained maximisers or are likely to be caught if they do deceive. In Moore's words:

> 'In Gauthier's world, it seems, there are no good poker players; there are no people who find it rational to cultivate their considerable powers of deception rather than simply accept Gauthier's argument that the threat of being recognized will result in fewer opportunities for beneficial cooperation'.[54]

Indeed, Gauthier accepts that parasitic behaviour will ultimately be inevitable in some contexts and that clever freeloaders could gain more than constrained maximisers. But given the future consequences of being caught out as a freeloader, it is easier and less risky, and therefore far more efficient overall, to be a constrained maximiser.

But, does Gauthier have a response to a freeloader whose initial factor endowment and resulting bargaining power are so large that they can afford to *openly* renege on their agreements apparently fearing no consequences? Gauthier insists that adopting the lens of the free market in understanding and guiding human actions provides the impartiality necessary to achieve an objective foundation for morality. He claims that it is not the fault of the market (as a concept) that the distribution of public goods is inefficient and unfair, but that of externalities. Rather remarkably, Gauthier expressly does not take the inequalities in the factor endowments owned by interacting agents into account.[55] In fact, he assumes that all interacting agents are of equal rationality, the market itself acting as an equalising force ensuring that all interactions amongst agents are governed by the Lockean proviso.[56] In this context any inequalities in their respective factor endowments will be immaterial, for the market, imperfect though it is, will ensure that

[54] *Ibid*, 216.

[55] Gauthier, n.15, 270.

[56] *Ibid*.

the agent with the larger endowment has access to more goods (as their endowment will allow) without this being at the expense of less-endowed parties. The Lockean proviso (and the twin principles of minimax relative concession and maximin relative benefit) will ensure that cooperation between straightforward-turned-constrained maximisers makes up for the failures of the market.

The Lockean proviso may be effective in mediating the bargain between agents of more or less equal endowments, but how effective is it as a *voluntary constraint* when the disparity is large? Therein lies the flaw in Gauthier's core reasoning; his strategy requires agents to accept that *overall* it is easier and less risky, and thus more efficient, to become generally disposed towards constrained rather than straightforward maximisation. But this is incongruous with his core premise that rational agents must always reason from self-centred imperatives. According to this premise, if the agent were faced with the prospect of a payoff so large that it could render the consequences of reneging on an agreement irrelevant, it would be irrational for them *not* to renege on their promise. At worst, Gauthier's choosing to ignore the often-immense inequalities in the bargaining power of interacting agents renders his view of the market, even with the acknowledged externalities, nothing more than an irrelevant utopia and naturally falls prey to the criticisms that many classical economic theories and their underlying assumptions tend to face. At best, this fundamental contradiction means that Gauthier's strategy cannot provide a universally applicable rational justification for moral constraint, but it does provide a well-reasoned methodology by which to calculate *when* a straightforward maximiser would be better off submitting to moral constraints on a case-by-case basis.

1.3.3 The role of 'Morals by Agreement' in this thesis: instrumental but not justificatory

Given its limitations, can Gauthier's strategy for rationally justifiable moral constraint form the basis for a new joint venture model? My contention is that it can, so long as it is understood that its role will be instrumental (and explanatory) rather than justificatory. Indeed, if 'morals by agreement' were to be used on a justificatory basis then the implementation of the new model would be challenged by the freeloader problem near-constantly. This is because the proposed model's primary purpose is to

provide an objective methodology for ascertaining the default intentions of parties to contractual joint ventures and implement rules which will give effect to those intentions on a predictable and replicable basis. My proposed methodology is based on Gauthier's conception of rationality, *in the context of cooperation,* as self-interest through utility-optimisation rather than utility-maximisation. In practice, utility optimisation translates into constrained maximisation of one's self-interest in the collaborative venture, the extent of constraint being determined by the Lockean proviso and the minimax relative concession. My contention is that, in terms of a new joint venture model, Gauthier's constrained maximisation translates into default legal rules implied into the contract between the commercial parties under consideration, whether that contract is express or implied (e.g. from past dealings). Following Gauthier's line of reasoning, the conceptual basis for these default rules is as follows: the commercial parties under consideration are rational (i.e. self-interested) agents, who, having chosen to cooperate, are required by their self-interest *overall* to constrain maximisation of their considered preferences in the short-term by submitting to the constraints represented by the implied default rules. On a means-end application of Gauthier's strategy, the content and extent of the default rules will be itself determined by the Lockean proviso, so the rules cannot cause a party to become worse off *overall* than they would have been had they defected from the joint venture agreement.

Let us now consider the case, where Gauthier's strategy is used to justify the imposition of default rules on rational contractual parties, where rationality is conceived as 'self-interest'. The default rules to be implied into the parties' agreement, as per the proposed model, would have to be justified on Gauthier's own starting premise of rationality as self-interest. Therefore, the justificatory claim would be that the default rules must be implied into the agreement, because the parties are required by their self-interest to submit to the default rules. At first blush, and given Gauthier's own view of the world as populated mostly by constrained maximisers, justifying default rules on what the contractual parties would want, if they behaved rationally, is not necessarily a problem. This is illustrated in my earlier example of the prospective resort developers and their agreement. If all the land developers were of more or less equal resources and bargaining power it would, on Gauthier's reasoning, certainly be in their self-interest *overall* to keep to the agreement, even though on a utility maximising basis the best strategy would be to defect so as to acquire multiple plots at once (but only if all the others kept their end of the bargain). Legally, this translates into a framework, which

attributes Gauthier's line of reasoning to the contractual parties *by default* and, accordingly, subjects them to implied rules preventing defection, because this is what the parties would have intended, if they had reflected on what their self-interest requires. This line of justification does not hold up, however, when the legal framework is faced with the conundrum of the powerful freeloader.

For the sake of simplicity, say that one of the land developers in the agreement, whom I will name Colossus, is a significantly larger concern than all the rest and in fact has the financing and resources in place to bid for most of the plots on offer, at several times the minimum bid for each. The only benefit Colossus would get from an agreement with the others is to ensure that the rest refrain from bidding over the minimum, so as not to drive the prices of the plots further up. Therefore, upon defection, Colossus would be able to acquire as many plots as its resources allowed at a significantly lower price. In this case, a default rule implied into the agreement between Colossus and the rest, simply cannot be justified on the basis that all the parties would submit to it because their respective self-interest requires it. Rationality as self-interest would make it irrational for Colossus to submit to any conduct-constraining rule; given its resources Colossus could well absorb the risk of being shunned from future agreements with other land developers and still prosper. Therefore, a justification for a conduct-constraining rule based on what Colossus would have intended, if it had reflected on what its self-interest requires, cannot hold up. Consequently, rationality as self-interest cannot be the justificatory basis for a universally applied default rule that requires rational commercial parties to become constrained maximisers.

1.3.4 A justificatory basis for the long-term conception of self-interest

The previous section established that a legal model, which purports to give effect to the (attributed) intentions of rational commercial agents, cannot rely on the concept of rationality as self-interest so as to justify conduct-constraining rules,[57] without eventually being stymied by the freeloader problem. This section argues that the justificatory basis of conduct-constraining defaults is to be found instead in the operation of English law itself. In particular, I will demonstrate that many of the legal

[57] The justification being that the parties would voluntarily submit to the conduct-constraining rules, if they had reflected on what their self-interest requires.

rules pertaining to commercial parties already map onto Gauthier's prudential conception of self-interest as *long-term* wellbeing. It will be remembered that a major limitation of Gauthier's moral theory is that Gauthier takes for granted that prospective collaborators are driven by the need to secure their long-term interest, which in turn dictates that they become constrained maximisers so as to ensure that they can reap the benefits of cooperation in the future by cultivating their reputation as trustworthy collaborators. This contrasts sharply with straightforward maximisers and freeloaders, who are by definition motivated by the pursuit of their short-term interest and therefore the prospect of future collaborations is irrelevant to their reasoning and strategic choices. My contention here is that if English law *already* adopts a definition of rational action as the pursuit of one's long-term self-interest, then the powerful or cunning freeloader conundrum is no longer an obstacle to my proposed legal framework, which imposes default rules effecting constrained maximisation among collaborators based on what they would have intended if reasoning rationally. In other words, mapping onto existing presumptions of English commercial law, my proposed model amounts to an objective standard of conduct.[58] This standard of conduct assumes that a reasonable person would adopt Gauthier's utility optimisation strategy as the best strategy for maximising their considered preferences *overall*.

Having said that, what evidence is there that English law does in fact presume rationality to mean the pursuit of long-term welfare? And even if it does, would English law intervene into a commercial relationship by imposing default rules onto co-venturers in the first place? Consider this in light of the fact that English law is generally perceived as fundamentally respectful of commercial agreements and sceptical of legal intervention into commercial matters. The soundness of this point will be discussed in chapter 3. For the purposes of this section and demonstrating the long-termism advocated by English law, I contend that English commercial law is peppered with principles founded on other-regarding imperatives,[59] whose purpose can only be to establish and preserve social harmony in the long-term. This is not to say that economic agents are in any way required to forego pursuing their self-interest or that they must

[58] i.e. the standard of how a reasonable person having all the relevant background knowledge would reason, along the lines of the Supreme Court's decisions and reasoning in *Arnold v. Britton* [2015] UKSC 36 and *Rainy Sky SA v. Kookmin Bank* [2011] UKSC 50, in the context of interpreting contractual language, where the Court held that evidence of the parties subjective intentions with respect to the use of certain language had to be disregarded.

[59] E.g. the concept of a fiduciary duty, see Ch.6.

do so subject to a positive duty of safeguarding the interests of others. Rather, I contend that English commercial law takes a view similar to that of Gauthier's core methodology, i.e. that one's self-interest is best served in a system, which supports and protects reliable market exchange, competition and constructive collaboration.[60]

A case in point is the UK's relatively recent reform of the law regulating corporations, which culminated in the much-debated Companies Act 2006 (hereafter 'CA(2006)'). This legal development is pertinent to my argument for two reasons. First, because it is representative of English law's wider approach to commercial parties. The corporation is undeniably the archetypal vehicle for commercial activity. Therefore, the regulatory approach that English law takes with regard to the corporation will inevitably inform its approach to commercial parties in general. Secondly, the UK company law reform is pertinent here because it explicitly addressed the conflict between short-termism and long-termism with regard to pursuing one's commercial interests. By way of background, the reform involved detailed consultations with the professions and industry as to where the priorities of the new legal framework ought to lie, essentially looking for the answer to the short-term versus long-term conundrum. This manifested *inter alia* in the question of who is the proper beneficiary of the duties of company directors, which rather conveniently also represents one of the most debated issues in company theory. The possible beneficiaries are the company, its shareholders and, rather controversially, third parties with whom the company interacts on a regular basis, generally identified as 'stakeholders'. The arguments for and against the inclusion of one constituent over others in the pool of beneficiaries unfold in two major schools of thought: the shareholder value model and the stakeholder value model. I regard the first as representative of short-termism and the latter of long-termism.

Briefly, the shareholder value or shareholder primacy model requires companies to be managed with the sole purpose of maximising the wealth of the company's shareholders.[61] Accordingly, this model measures the success of the company by how much value it creates for its shareholders. In general, this value is reflected in the amount of profits available to be distributed as dividends, and if a public-listed company, either in the price of the company's shares, or the ratio of the value of the

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[60] E.g. see the aims of the UK's company law reform in DTI, *Modern Company Law for a Competitive Economy: The Strategic Framework* (HMSO, 1999), [2.4]-[2.9].

[61] A.A. Berle, 'Corporate Powers as Powers in Trust' (1931) 44 *Harv.L.Rev.*1049.

company's assets to its stock market value (known as the 'Tobin's Q' ratio).[62] The company director under the shareholder primacy model is nothing more than an agent for the shareholders,[63] with the company being the shareholder's private property.[64] Therefore, when the director exercises their discretion in conducting the company's business, they must do so with the best interests of the shareholders in mind.[65] At the other end of the spectrum lies the stakeholder value model,[66] which acknowledges that throughout its lifetime a company must interact with other constituencies, such as customers, employees and creditors, putting the company in a unique position – it is not a natural person with the ability to reflect, make decisions and act accordingly, yet it can impact the wider economy and society. On this interpretation it is a matter of public interest[67] to ensure that the management of a company is conscious of the company's 'social responsibility'[68] and the interests of the constituents it affects and is affected by.[69]

For the sake of simplicity, I have reduced this most crucial theoretical debate to its bare bones. Its relevance to my argument, here, lies in my interpretation of it as,

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[62] See generally J.E. Fisch, 'Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy' (2006) 31 *J. Corp. Law* 637, arguing that it is not the function of corporation law to be 'efficient', which is an ill-defined concept to begin with.

[63] *Cf.* S.M. Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2003) 97(2) *Nw.U.L.Rev.* 547, arguing for managerialism (i.e. the idea that corporations are governed entirely by their managers, who alone choose the interests they will serve, the existence of shareholders being immaterial) with respect to the *means* of corporate governance, combined with shareholder primacy, with respect to the *ends* of corporate governance. Thus, the company is to be ultimately managed for the sole benefit of the shareholders, the rationale being that directors should not be exposed to more liability than necessary by expanding the class of beneficiaries to other stakeholders (as most stakeholder models propose).

[64] *Cf.* J. Heath, 'The Uses and Abuses of Agency Theory' (2009) 19(4) *Bus. Ethics Q.* 497, arguing that the application of agency theory here merely denotes how vulnerable the shareholders are with respect to the company's management and therefore an agent-principal relationship becomes necessary for the protection of the shareholders' interests. Agency theory, however, does not *by itself* justify the denial of a company's moral duties toward other constituencies.

[65] But see D.G. Smith, 'The Shareholder Primacy Norm' (1998) 23 *J. Corp. Law* 277, demonstrating that, in practice, shareholder primacy is more relevant to closely held, private companies rather than to public trading corporations, where the norm appears to be the maximisation of corporate rather than shareholder wealth.

[66] M. Dodd. 'For Whom Are Corporate Managers Trustees?' (1932) 45 *Harv.L.Rev.* 1145.

[67] *Ibid*, 1148-1149, referencing W.H. Hamilton, 'Affectation with Public Interest' (1930) 39 *Yale L.J.* 1089 who discusses the test of 'public interest' in the context of the US legislatures' constitutional power to fix prices with regard to certain products/services.

[68] Dodd, *ibid*, 1161.

[69] Which is not to say that identifying which of these and other constituents can legitimately be identified as stakeholders for the purposes of the stakeholder value model is a simple matter; see R.E. Freeman, 'The Politics of Stakeholder Theory: Some Future Directions' (1994) 4(4) *Bus. Ethics Q.* 409.

fundamentally, a conflict between the short-term and the long-term pursuit of self-interest. Specifically, a company model focused solely on the maximisation of shareholder wealth as per the shareholder primacy model has a short-term outlook. In other words, the company's directors will, theoretically, be concerned only with strategies that boost the company's share price or its profits, so as to secure a return on the shareholders' investment as soon as possible. On the other hand, a model that requires a company to conduct its business in the manner of a 'good citizen'[70] has a long-term strategy, for it builds on its relationships with the various constituents with whom it interacts. In Gauthier's parlance, the former approach is adopted by straightforward maximisers and provides ample opportunity for freeloading because of its short-termist outlook. The latter approach is one adopted by constrained maximisers, for they must apply other-regarding considerations and thus optimise their utility in the short-term, so as to ensure its maximisation overall.

In its reform of UK company law, Parliament addressed this conflict by expressly embracing the long-term conception of a company's interest. It did so by reformulating the duties of company directors. The most unambiguous example of Parliament's response to the short-term versus long-term conundrum is s.172 of CA(2006). S.172 is the second of seven provisions in CA(2006) that collectively codify the duties of company directors,[71] which had previously been set out only in common law. Imposing on company directors a general duty to promote the success of the company, s.172 is special, because it introduces – for the first time in statute – a non-exhaustive list of considerations that directors must have regard to in the exercise of this duty. Before this, company directors were perceived as being responsible for serving the interests of the company (and those of its shareholders) exclusively.[72] Consequently, the duties of

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[70] Dodd, n.66, 1154.

[71] Set out in CA(2006), ss.171-177.

[72] E.g. gratuitous payments by the company are invalid, if not made with the intention to benefit the company or its members (see esp. *Parke*, below): *Hutton v. West Cork Railway Company* [1883] 23 ChD 654 (payment to theretofore unpaid company directors for past services, following the company's winding up *and* discharge of all liabilities), *In re Lee, Behrens and Co Ltd.* [1932] 2 Ch 46 (payments made to a former managing director's widow), *Parke v. Daily News Ltd.* [1962] Ch 927 (payment of balance of purchase price, having discharged all other liabilities, to former employees who were dismissed following the sale and closure of a newspaper); *Cf. MSL Group Holdings Ltd. v. Clearwell International Ltd.* [2012] EWHC 3707 (payment made to minority shareholder director following an oral agreement pertaining to the distribution of a licence fee on technology patented by the company was valid as it was 'for the benefit of and to promote the prosperity of the company because it provided for the remuneration of its directors', per Sir Raymond Jack, [41]-[42]); But note: on insolvency, payments by the company must benefit the creditors first: *MacPherson v. European Strategic Bureau Ltd.* [2002] BCC 39.

company directors were generally interpreted with 'an undue focus on the short-term and the narrow interest of members at the expense of what is in a broader and a longer term sense the best interest of the enterprise'.[73] Thus, the fundamental purpose of s.172 (along with s.171, which pertains to the proper exercise of the directors' powers) was to *re-state* the directors' duty of loyalty[74] to the company, which defines the scope of the directors' duties on the whole, so as to ensure the inclusion of broader interests into the conduct of the company's business,[75] on the express condition that this is in the best interests of the company overall.

First among the considerations listed in s.172 are the likely consequences for the company *in the long-term* of any decision the director makes (s.172(a)). At the outset, this demonstrates that Parliament's conception of a rational commercial actor is akin to that of Gauthier in that decisions are understood as made in the service of one's long-term interest.[76] But even more importantly, the rest of the considerations listed in s.172 reveal a marked shift in the law's expectations of companies, and, arguably, of commercial parties in general: the instrumental adoption of other-regarding imperatives. Thus, the provision goes on to require that directors also have regard to: 'the interests of the company's employees' (s.127(b)), 'the need to foster the company's business relationships with suppliers, customers and others' (s.172(c)); 'the desirability of the company maintaining a reputation for high standards of business conduct' (s.172(e)); 'the impact of the company's operations on the community and the environment' (s.172(d); and 'the need to act fairly as between members of the company' (s.172(f)).

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[73] DTI, n.60, [5.1.17].

[74] The duty of loyalty was itself regarded as a collective expression of the directors' individual duties to: (a) act within the company's constitution; (b) exercise their directors' powers for their proper purpose and (c) act in good faith for the benefit of the company as a whole; DTI, *Modern Company Law for a Competitive Economy: Developing the Framework* (HMSO, 2000), 32.

[75] *Cf.* L.S. Sealy 'Directors' "Wider" Responsibilities – Problems Conceptual, Practical and Procedural' (1987) 13 *Monash Univ. Law Rev.* 164, arguing that directors' duties jurisprudence is not an appropriate vehicle through which to protect the interests of wider constituents, with the exception of the interests of creditors in the event of expected insolvency; See also A. Alcock 'An Accidental Change to Directors' Duties?' (2009) *Co. Law.* 362.

[76] This long-term minded outlook is also endorsed by the UK's Financial Reporting Council, an independent body responsible for promoting standards of corporate governance and reporting, and it is heavily reflected in its 'The UK Corporate Governance Code', September 2014 (https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf, accessed 14.8.18).

What is the place of these third-party interests in the director's pursuit of the company's own interests? Is the director required to pursue the company's interests *subject to* the interests of these constituents? It would appear not; the director is expected to promote the success of the company 'for the benefit of its members as a whole' (s.172), but this duty along with all others in ss.171-177 of CA(2006) is expressly owed to the company alone (s.170). Indeed, it is trite law that, if and until it is wound up, the company is its own legal person,[77] who acts through its directors (and, sometimes, its members passing resolutions in general meeting). For their part, should a (solvent) company be wound up, its members are entitled to the residual value in its assets. It is in this light that the statute's reference to 'the benefit of the members as a whole' should be read. Accordingly, I submit that the correct interpretation of s.172 is that the interests of the company – rather than those of the shareholders/members – are to be the director's foremost consideration. This is supported by the fact that s.170 makes the director liable as an agent to the company alone, which in turn makes the company the director's sole principal. Therefore, the interests of the members must be understood as springing from – rather than being identified with – the interests of the company. In other words, if the company benefits from its directors' management then its members should expect to benefit as well, e.g. in the form of receiving dividends distributed on the recommendation of the directors from the company's profits.[78] This is in line with the fact that despite their rights as residual owners of the company's assets, shareholders are not automatically entitled to dividends. Whether dividends are declared from the company's distributable profits rests entirely on the discretion and business judgment of its directors.[79]

Considering the directors' priorities in this light, it follows that the stakeholder interests listed in s.172 should be interpreted as guidance on the factors that can contribute to the *company's* success and, ultimately, its preservation. Admittedly, by making the director legally accountable to the company alone[80] but, essentially, equating the

[77] *Salomon v. A. Salomon & Co Ltd.* [1897] AC 22.

[78] S.829 CA(2006) provides that dividends may only be distributed from profits (rather than e.g. capital: see *In re Exchange Banking Company, Flitcroft's Case* [1882] ChD 519, which established that directors are personally liable for unlawfully paid dividends in the same vein as trustees being liable for restoring a trust-fund which they have unlawfully – i.e. dishonestly– reduced).

[79] *Burland v. Earle* [1902] AC 83; see also Worthington's assessment of the shareholders' entitlement in 'Reforming Directors' Duties' (2001) 64 *MLR* 439, 447.

[80] See, e.g., s.170; furthermore, s.260(3) –which gives shareholders the power to bring an action in the name of the company for the company's benefit (assuming that a majority of the shareholders has not in

company's interests with those of the 'members as a whole', s.172 clouds perhaps the most debated issue in company theory: whose interests ought the directors pursue, given that the interests of the shareholders are not necessarily those of the company, which is a separate entity altogether. This raises two questions. First, does my interpretation of the considerations in s.172 conflict with the provision's stated purpose to be the statutory expression of the principle of 'enlightened shareholder value',[81] which, however 'enlightened', by definition appears to shift focus onto the interests of the shareholders? Secondly, does the specific reference to 'the benefit of [the Company's] members as a whole' ultimately undermine the long-termism advocated in CA(2006)? This question should be considered in light of the fact that shareholders can be members of a company (especially in the case of a public company) for a very short time and therefore their primary concern will be the price of the company stock rather than how sustainable the company is in the future.

On the first question, I submit that, if s.172 is read in light of Gauthier's own conception of rational self-interest, there is no conflict between a list of factors that can be conducive to the success of the company (i.e. an entity entirely separate from its members) and a principle that seeks to ultimately increase shareholder value. After all, 'Enlightened Shareholder Value' is a principle which 'recognises that directors will be more likely to achieve long-term sustainable success for the benefit of their shareholders, if their companies pay attention to a wider range of matters'[82] than merely the maximisation of the company's profits in the short-term (thus boosting the share price for public companies and/or making the declaration of dividends that much more

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fact ratified the alleged wrong) – clearly indicates that only the company is the proper claimant in an action against a director.

[81] CA(2006), Explanatory Note, [7.325]-[7.327]; It is also a product of a global shift in corporate law toward the protection of the *long-term* interests of shareholders, including those of minorities, which are ultimately identified with those of the company: see H. Hansmann & R. Kraakman 'The End of History for Corporate Law' (2001) 89 *Geo.L.J.* 439. *Cf.* P. Ireland 'Company Law and the Myth of Corporate Ownership' (1999) 62 *MLR* 32 - who points out that the shareholder-centric view of the role and function of directors and of corporate law disregards the essence of the company, as a separate legal personality. See also P. Ireland 'Property and Contract in Contemporary Corporate Theory' (2003) 23 *LS* 453, specifically doubting the view of the company as a nexus of contracts and emphasising its separate legal personality as the proper foundation of all discourse regarding its management. *Cf.* C. Riley 'Understanding and Regulating the Corporation' (1995) 58 *MLR* 595 – essentially defending the contractarian view, but alluding to the same concerns as to whether a company can be 'owned', 609.

[82] A. Darling, Secretary of State for Trade and Industry, Hansard, 6 June 2006, n 125.

likely).[83] Notably, by formulating the issue in light of Gauthier's approach to rational self-interest and its pursuit, I do not equate the interests of the shareholders to those of the company, but regard the former as stemming from the latter. Furthermore, for Gauthier's theory to work, a hypothetical contract must be capable of being implied. However, the structure of the company provides an answer in this regard: the company is created as a result of a (hypothetical) contract between its shareholders and the State, which allows for the creation of a separate legal entity, with or without limited liability, in the first place. Once formed, the new entity is then manifest in a contract between it and the shareholders, as well as a contract between the shareholders *inter se* (s.33 CA(2006)). It is also manifest in contracts between it and its directors, employees, suppliers, customers, etc., as well as in implied contracts with the wider community in which it operates.[84] Accordingly, Gauthier would hold that the company, acting through its directors must constrain the maximisation of its utility/preferences in the short-term by conceding the interests of relevant stakeholders, as *partly* indicated in s.172, on the understanding that this will ensure the maximisation of the company's self-interest overall. At the same time, the shareholders' interests are inextricably linked to those of the company and therefore as the director secures the company's maximum utility *overall*, so the shareholders' own utility is secured.

On the second question, I submit that given the statute's insistence on the company's long-term sustainability, irrespective of the enlightened shareholder value principle, it is highly unlikely that a court would ever expect a director to prefer the shareholders' interests over those of the company.[85] But would it be possible for a shareholder to sue (either for unfairly prejudicial conduct, under s.994 CA(2006), or through derivative action, under s.260 CA(2006)) on the ground that a director has failed to take into account the factors listed in s.172? On the one hand, it is not for Parliament or the courts to substitute their judgment for the business judgment of company directors,[86] so long

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[83] See a more detailed discussion on the merits of short-term versus long-term pursuit of shareholders' interests in A. Keay 'Getting to Grips with the Shareholder Value Theory in Corporate Law' (2010) 39 *CLWR* 358.

[84] The 'nexus of contracts' theory of the company: see F.H. Easterbrook & D.R. Fischel 'The Corporate Contract' (1989) 89 *Colum.L.Rev.* 1416.

[85] Unless the circumstances were exceptional, e.g. where the company was essentially a partnership, whereupon, as with a partnership, it could be wound up on the 'just and equitable' ground: *Ebrahimi v. Westbourne Galleries Ltd.* [1973] AC 360. *Cf. O'Neill v. Phillips* [1999] 1 WLR 1092.

[86] *Carlen v. Drury* (1812) 35 ER 61 (bad, rather than negligent or improper, management was not a valid ground for a claim, especially where the plaintiffs could have sought and gotten redress offered under the partnership's constitution).

as there is evidence that the latter have acted in good faith in pursuit of the benefit of the company[87] and that they exercised their powers for their proper purpose.[88] Moreover, as Lowry observes,[89] s.172 does not give *locus standi* to the stakeholders mentioned in its list of relevant considerations against a director who fails to take into account their particular interests. After all, s.170 of CA(2006) makes abundantly clear that the only constituent the director owes a duty to is the company and therefore only the company may sue the director for breach of any of the duties set out in CA(2006).[90] Nevertheless, Lowry suggests that the effect of a director's failure to properly consider the factors listed in s.172 is to point to 'action [taken] otherwise than in good faith'.[91] This, he argues, would expose the director to liability beyond that for mere incompetence (e.g. for breaching their duty of care skill, now enshrined in s.174), thereby extending to liability for breach of trust with all the equitable remedies that this implies.[92] Equally, if the director can show that they have effectively taken into account the interests listed in s.172, their conduct will be virtually unassailable in light of *any* of the relevant sections in CA(2006), so long as they can establish that their primary purpose was to secure the interests of the company.[93]

I submit that Lowry's conclusion can be invoked as a response to those critics of the long-termist approach to company management (whether or not as part and parcel of the 'enlightened shareholder value' principle), who contend that subjecting the company director to considerations other than those dictated by the free market

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[87] *Re Smith & Fawcett* [1942] ChD 304, 306, per Lord Greene MR.

[88] This duty is now enshrined in s.172, CA(2006). The company's constitution determines the purpose *and* scope of the directors' powers: *Eclairs Group Ltd v. JKX Oil & Gas Plc* [2015] UKSC 71: Exercising a power so as to restrict the voting rights of minority shareholders on suspicion that they were 'corporate raiders' was deemed to be improper, given that the purpose, for which the power was originally conferred, was merely to incentivise shareholders to disclose information on the beneficial interests behind their shareholdings, which the appellants had done.)

[89] J. Lowry, 'The Duty of Loyalty of Company Directors: Bridging the Accountability Gap through Efficient Disclosure' (2009) *CLJ* 607, 618.

[90] E.g. through a derivative action brought by a shareholder in the name of the company under s.260.

[91] Lowry, n.89, 622.

[92] *Ibid*.

[93] This is in line with the 'primary purpose' test in *Howard Smith Ltd v. Ampol Petroleum Ltd.* [1974] AC 821, 832B-C, per Lord Wilberforce (considering the issue of additional shares whose 'primary purpose' was found to be the dilution of the shareholdings of those members who opposed a takeover bid, rather than promote the interests of the company, and was therefore deemed to be an improper exercise of directors' powers.) In *Eclairs Group*, n.88, [55], Lord Sumption suggested that determining the 'primary purpose' of a director's exercise of their powers should rely on an enquiry of whether the director would have reached the same decision even if they had not had the illegitimate purpose in mind.

(consequently exposing the company to substantial opportunity costs) ultimately undermines the company's interests.[94] At worst, the principle of enlightened shareholder value, as expressed in the stakeholder interests listed in s.172, provides the company with an additional route to legal redress, which goes well beyond that afforded by directors' duties prior to codification, for it offers a clear indication as to what constitutes good faith considerations in the performance of directors' duties. At best, s.172 forces directors to conceptualise the company as a member of a wider ecosystem and as such imprints upon them the necessity of a positive reputation. This, in turn, leads to business strategies whose purpose is to secure a sustainable future for the company, rather than the maximisation of its profit in the short-term while facing an uncertain future. Understood in this sense, the principle of enlightened shareholder value is *prima facie* consistent with Gauthier's own conception of moral conduct in an imperfect market, as being a rational (i.e. self-interest maximising) response to externalities. The company acting through its agents (i.e. its directors and shareholders in general meeting) is required by its self-interest to take into account the interests of constituents it interacts with, so as to secure its own sustainability in the long-term.

In summary, a major problem with regard to applying Gauthier's contractarianism to the interpretation of contractual agreements between commercial parties has been justifying the presumption that one's self-interest necessarily implies their long-term as opposed to short-term welfare. Indeed, Gauthier does not justify this presumption, which appears to be entirely intuitive. Regardless, Gauthier's contractarian methodology has much in common with the manner in which current English law perceives rational economic behaviour, i.e. that a self-interested pursuit of one's preferences must take into account the interests of others with whom they directly or indirectly interact, so as to secure one's long-term (economic) interest. This tendency in English law is showcased clearly in its regulation of companies and, more specifically, in the evolution of directors' duties, which now expressly adopt a long-term outlook taking into account the wider community of which companies are members. Based on this example, I have sought to *justify* my presumption that an

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[94] E.g. M.E. Van Der Weide, 'Against Fiduciary Duties to Corporate Stakeholders' (1996) 21 *Del.J.Corp.L.* 27; M. Friedman, 'The Social Responsibility of Business is to increase its Profits' *New York Times Magazine*, September 13, 1970; *Cf.* Upon review of the legislative impact of s.172 on businesses, directors have demonstrated 'high awareness [of the s.172 duty] but minimal changes in behaviour'; Department of Business, Innovation and Skills, 'Post-legislative Assessment of the Companies Act 2006 – Memorandum to the Business, Innovation and Skills Select Committee', 12 January 2012, 11.

economic agent pursues, or is presumed by law to pursue, their self-interest in the *long-term*. Therefore, I contend that the problem of the cunning or powerful freeloader will not be a logical barrier to ascertaining the intentions of a rational party to a commercial contract, according to Gauthier's methodology for rational bargaining.

1.4 Thesis Breakdown

The aim of this chapter was to present the main argument of this thesis and lay down its method. Thus, I will make the case for a new legal framework to govern contractual joint ventures as a separate legal category. I will argue that the central purpose of this new framework must be to give effect to the contractual parties' original intentions and to preserve the original spirit of the contractual relationship. To address this most central issue, i.e. ascertaining the parties' original intentions, I will be utilising Gauthier's method of utility maximisation in the context of cooperation. Thus, in this chapter I have sought to demonstrate that Gauthier's unique approach to rational bargaining is an effective solution to the limitations of rational choice theory, when it is employed to ascertain the intentions and strategies of economic agents in the context of cooperation. I have also sought to address the inevitable roadblock to judicial application of my argument created by the limitations of Gauthier's own methodology, i.e. his *a priori* assumption that self-interest denotes an agent's long-term, as opposed to short-term, welfare. I have done this by establishing that English law already endorses the conception of self-interest as long-term welfare, which is amply demonstrated in its approach to the regulation of companies and their management, and argued that this fundamental presumption operates to dispel the limitations of Gauthier's methodology in practice.

The rest of this thesis unfolds in five chapters. Chapter 2 examines the concept of contractual joint ventures from an economic perspective so as to establish the motives behind their creation. These motives will, in turn, inform any efforts on the part of the law to ascertain the intentions of the commercial parties at the core of the venture. Chapter 3 goes on to examine the legal rules, which currently govern the contractual joint venture. Its purpose is to demonstrate that the current law does not adequately reflect the rationale behind contractual joint ventures and as such it is not an appropriate means by which to regulate the joint venture relationship or arbitrate co-venturers' disputes. The chapter ultimately argues that contractual joint ventures should be addressed as a separate legal category of their own through a new legal framework. The

essence of my proposed framework is the implication of default rules into the contractual joint venture relationship, while allowing for the joint venture agreement to be otherwise fully enforceable as between co-venturers without first having to dismantle the joint venture relationship.

The purpose of Chapter 4 is then to discuss the mechanics of English contract law with respect to the implication of such default rules and to answer the question of whether the implication of default rules into the joint venture is even desirable, let alone possible. To this end, the chapter will address what I regard as the three main objections to the imposition of extra-contractual rules on contractual parties, specifically in the context of commercial agreements between 'sophisticated parties' dealing at arm's length. These objections are: (a) English law should not intervene into contractual relationships between commercial parties, where there is no actionable defect in the bargaining process (such as mistake, undue influence, misrepresentation, or fraud); (b) English law already provides for a mechanism through which the parties can substantially change their contractual obligations post-contractually; (c) the joint venture is by definition a relational contract and over-regulating through extra-contractual default rules would be counter-productive – the parties may address any friction that arises in their relationship organically and privately. Ultimately, in this chapter I conclude that implying default rules into a commercial relationship of the type I examine in this thesis is not only possible, but also desirable for the sake of legal certainty and commercial predictability.

The purpose of Chapter 5 is to determine the content of the default rules to be implied into the joint venture relationship, by reference to what a constrained utility maximiser would intend had they properly reflected on what their self-interest requires. Thus, the chapter first identifies a generic ideal of good faith as best reflecting the other-regarding values required of constrained maximisation. Secondly, it examines the jurisprudential and procedural avenues available to the court for the implementation of the good faith ideal in the joint venture relationship, in light of the parties' presumed goal of (*overall*) utility maximisation. Thirdly, it concludes that implementing the good faith ideal through the contract mechanism affords the least utility to co-venturers understood as constrained maximisers.

In response to this, Chapter 6 examines default rules implementing the good faith ideal into the joint venture relationship through the mechanism of fiduciary law. The chapter

concludes that a good faith standard of conduct mandated through the fiduciary mechanism represents the highest utility option for the co-venturers, as, in theory, it effectively addresses the freeloader problem. Finally, Chapter 7 frames the central argument of this thesis in terms of the hypothetical imperative. It argues that if English commercial law purports to be consistent with its own tenets (of giving effect to the objectives of commercial parties) then it must imply other-regarding conduct constraints into collaborative commercial relationships by default (on the basis that this is what the parties would have intended, had they reflected on what their long-term interest requires); or abandon the goal of being consistent with its own tenets.

2 JOINT VENTURES: THEORY AND PRACTICE

2.1 Introduction

Cooperative strategies have long featured in commercial activity. The facilitating effects of cooperation are evident from the long history of organisations, such as merchant guilds, cooperatives and trade associations, as well as from routine arrangements between commonplace economic actors, such as banks, entrepreneurs, raw materials producers, manufacturers and distributors. Over the past four decades, however, cooperative strategies have been on the rise between economic actors who had hitherto been fierce competitors; a trend that directly contradicts the traditional paradigms of business growth. This unprecedented but increasingly widespread phenomenon now affects all fields of commercial and economic activity.[1] The purpose of this chapter is to examine the incentives driving these arrangements and the forms which they frequently take, in order to understand the place of the contractual joint venture in the worldwide commercial (and legal) ecosystem.

2.2 The Firm, the modern Enterprise and Models of Growth

2.2.1 The Evolution of the Firm

An exchange economy manifests in the continuous production and direction of resources by and amongst various economic agents. In this system, the price of those resources is the mechanism governing the organisation of production and the subsequent direction of its outputs. Thus, the economic system 'work[s] itself'[2] with 'supply [being] adjusted to demand, and production to consumption, by a process that is automatic, elastic and responsive'.[3] However, the price mechanism is not without flaws. Discerning the price for the exchange to take place can be a costly exercise in

[1] E.g., several law firms have taken the synergy route: see G. Johnson et al., *Exploring Corporate Strategy* (Pearson, 2008), 361. See also P. Lorange and J. Roos, *Strategic Alliances: Formation, Implementation and Evolution* (Blackwell, 1992), 13-14 for examples from the IT, biotechnology, air transport and pharmaceuticals sectors.

[2] A. Salter, *Allied Shipping Control: An Experiment in International Administration* (Clarendon Press, 1921), 15.

[3] *Ibid*.

itself.[4] Furthermore, completing exchanges on the strength of price alone leads to only short-term market relationships because prices tend to fluctuate between vendors. This can be very problematic when long-term relationships are desirable, either to avoid repeating price negotiations and the associated transaction costs, or to mitigate the risk of losing supply of a commodity.[5] Thus, Coase observed that the need to supersede the price mechanism and overcome its inefficiencies in a specialised exchange economy gave rise to the firm, an organisation headed by an authority ('the entrepreneur'), which organises the distribution of resources. He defined the firm as 'the system of relationships which comes into existence when [in a specialised exchange economy] the direction of resources is dependent on an entrepreneur' and not on their price.[6]

The effect on the firm itself of this transaction-centric view of the economic system is that the size of the firm will grow the more transactions the entrepreneur chooses to organise. These transactions concern none other than the mundane day-to-day business of the firm, i.e. payments for labour, production equipment, raw materials, distribution of outputs and so forth. The size of the firm will ultimately be determined by a number of factors. These may include the cost of organising additional transactions within the firm, such as the cost of recruiting specialised labour, the entrepreneur's efficiency in allocating production resources and the price of the factors of production.[7] According to this view, the firm will inevitably experience growth and this will be proportionate to the number of transactions the firm becomes the catalyst in. In fact, Coase concludes, firms will continue to expand so long as the costs of organising an extra transaction within the firm are smaller than the costs of carrying out the same transaction in the open market or in another firm.[8]

Coase's theory materialised with the onset of the industrial revolution of the late 19th century. Before that time, firms were restricted in terms of geography, size and outputs.[9] However, with the development of the new transportation and communication networks (the railroad, steam engine and telegraph), raw materials were more easily delivered to

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[4] R.H. Coase, 'The Nature of the Firm' (1937) 4(16) *Economica* 386, 390.

[5] *Ibid*, 391.

[6] *Ibid*, 393.

[7] *Ibid*, 394-395.

[8] *Ibid*, 395.

[9] A.D. Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism* (Belknap Press, 1990), 26.

production sites, while outputs could be more widely distributed. This led to the development of more efficient production technologies, accommodating the larger outputs at a lower price per unit. Construction of larger plant, then, became necessary, so that the new technology could be exploited to its fullest potential. The unprecedented volume of production had to be matched with a corresponding volume of sales, meaning that firms now had to invest in marketing and distribution networks of analogous reach. These new functions had to be managed and coordinated seamlessly in order to produce the cost advantages they were set up to secure leading to the creation of a new organisational model for the firm, the managerial hierarchy.[10] This model involved the establishment of several separate departments administering each function of the firm, such as purchasing (of raw materials, equipment, etc.), production, sales and distribution. This gave rise to what Chandler called 'the modern enterprise'.

2.2.2 Traditional Models of Growth: Market Exchanges vs. Integration

The modern enterprise embodies Coase's vision of the firm in that it evolved by initiating increasingly more transactions, adding more units to accommodate them and ultimately responding to the market's demands. Its growth was motivated by the advantages inherent in the firm's internalising certain processes rather than seeking to source them through exchanges in the open market. Williamson classified these advantages into three categories: incentives, controls and structural advantages.[11] From an incentive perspective, when processes are organised internally interests are aligned and, even if not perfectly harmonised, they are free of the opportunistic, self-promoting aspects of arm's length bargaining, which is characteristic of market exchanges. Internalisation is therefore preferable to the market where an exchange is likely to require repeated and protracted bargaining. From a control perspective, internalisation means that the entrepreneur has access to all the data necessary to monitor the progress of the internalised processes and to enforce policies or resolve conflicts by fiat alone. Finally, from a structural perspective, internal organisation allows for 'economies of information exchange',[12] namely systems which not only codify information for the sake of efficiency, but also clearly identify which communications are authoritative.

[10] *Ibid*, 31.

[11] O.E. Williamson, 'The Vertical Integration of Production: Market Failure Considerations' (1971) 61 *AER* 112, 113 [hereafter, Williamson(1971)].

[12] *Ibid*, 113-114.

When these exchanges take place internally, repeated communications become even more economical and effective. Conversely, such economies are difficult to achieve through market exchange where the relationships resulting from spot contracts lack the requisite familiarity.[13]

Growth can take several forms, with the firm adding more units by building new plant, taking on more staff or buying up more storage space or distribution outlets. This can be done in as many different ways – through (short- or long-term) contracts or integrating the new units to its existing outfit. According to transaction costs economics, the optimal mode of growth for the firm will depend on three factors: asset specificity, uncertainty and transaction frequency. Asset specificity refers to the degree to which an asset supporting a trade operation is tied to the operation at issue or whether it can be moved and used in different operations. The asset can be anything from plant and equipment, to production processes and administrative procedures, to human and knowledge capital. Therefore, where specificity is high, rather than short-term transactions, which are more akin to market exchanges, integration may be the optimal mode of growth, so as to allow the firm to whose operation the asset is specific (and therefore essential) to be in full control of the asset.[14]

Uncertainty, on the other hand, refers, to the parties' inability to predict certain aspects of the transaction, namely the environment in which the transaction takes place or the ultimate behaviour of the parties in it. Environmental uncertainty is common in volatile industries, such as information technology, where product life is short and knowledge can quickly become dated, which makes its value as a transaction-specific asset fluctuate dramatically. Behavioural uncertainty refers to the possibility that a party in the transaction will act opportunistically by reneging on the contract in pursuance of its own self-interest. The transaction costs resulting from seeking to enforce the original agreement through external arbiters, e.g. the courts, will be considerable. Therefore, where asset specificity is high and there is a considerable chance of opportunism, it

[13] *Ibid*, 114. See also the discussion on the importance of accurate information exchange in O.E. Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* (The Free Press, 1975), 31-37 [hereafter, Williamson(1975)].

[14] So holds a version of transaction cost economics, which views the firm as a collection of assets rather than the sum of relationships arising from repeated transactions, placing greater importance on control of these assets (and where that control lies) rather than on the transaction costs inherent in securing them: see S.J. Crossman and O.D. Hart 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration' (1986) 94(4) *J. Political Econ.* 691.

may be optimal to internalise vertically related assets rather than securing their use through contract [15] Finally, transaction frequency relates to the frequency of transactions over a specific issue. The degree of such frequency determines whether it would be optimal to invest in internal governance structures that accommodate the transaction in question, e.g. setting up a human resource department, rather than having an external agency handle recruitment, payroll, etc.

When integration is deemed optimal, at the outset, the firm will necessarily grow thus potentially producing economies of scale. These economies are achieved when the increase in the *size* of the production or distribution operation results in the decrease in the cost of producing or distributing a single unit.[16] Integration itself can take place through horizontal or vertical internalisation of assets. Horizontal integration involves expansion by combination with firms operating at the same level of the production process and in the same or similar line of business. These firms may have been competitors, but their combination may be what ensures their survival where a larger competitor enters the field. Horizontal integration has been shown to be the most efficient mode of expansion, where the firms in question seek to diversify their product or operations portfolio and thus achieve economies of scope.[17] Economies of scope are those achieved when the cost for *joint production* of all outputs is less than the cost of producing each output separately.[18] Chandler identifies further benefits in horizontal integration, such as achieving the size necessary to control prices, market entry and industry standards and to even achieve first-mover advantages (especially in the

[15] See B. Klein, et al., 'Vertical Integration, Appropriable Rents, and the Competitive Contracting Process' (1978) 21(2) *J. Law Econ.* 297. The chance of opportunism increases where the asset is specialised and there are appropriable quasi rents, i.e. the rent that arises from the asset being 'so expensive to remove [once installed] or so specialised to a particular user that if the price paid to [the asset's] owner [for its use] were somehow reduced, the asset's *services* to that user would not be reduced' (my emphasis); *ibid*, 299. In other words, the rent arises from the high cost of making a highly specialised asset available to other users. Therefore, the user to whom the asset is specialised cannot source it elsewhere, while the asset's owner (even though unable to easily transplant it) will have considerable margin to act opportunistically by withholding its use despite any previous agreement. In this case integrating the asset into the specialised user's outfit may be the optimal way to deal with post-contractual opportunism.

[16] Chandler, n.9, 17.

[17] See generally D.J. Teece, 'Economies of Scope and the Scope of the Enterprise' (1980) 1 *J. Econ. Behav. Organ.* 223

[18] *Ibid*, 224.

research and development department) if the integration comes early enough in the process.[19]

On the other hand, vertical integration involves internalising vertically related assets, i.e. assets which are used at different stages of the production chain. For example, for a copper wire manufacturer, vertically related assets would be a copper mining operation, a copper processing plant, a wire manufacturing facility and a storage and distribution network. From the outset, and based on the discussion on growth determinants above, vertical integration has a number of advantages. These include security of supply of raw materials (while potentially controlling availability of supply to competitors), as well as lower transaction costs, which would normally be associated with extensive pre-contractual bargaining, as well as post-contractual monitoring and enforcement. Furthermore, vertical integration is considered an optimal growth model where there is technological interdependence. Waterson offers an example of such interdependence from the newspaper industry, where typesetting, printing and publishing were traditionally carried out on the same premises so as to avoid time delays, given that reporting speed in the news industry is crucial.[20] Joskow offers another potent example from coal powered electricity generation, where the power plant must be designed according to the type of coal available, which determines the type of generation technology to be deployed. When the plant is optimised to the characteristics of the coal available (e.g. chemical composition, sulphur content, ash content, grindability etc.) it becomes more efficient thermally, thus minimising maintenance costs and the risk of power outages.[21] In this case, it may well be advisable to not only acquire the coal mine providing the fuel but also to build the plant in its vicinity so as to ensure uninterrupted fuel supply. According to Williamson, vertical integration is indicated where there is technological interdependence, because of the 'flow economies' observed in these examples. Such economies may also be present in a non-integrated firm operating on long-term contract with the owners of the vertically linked assets, but because of pervasive behavioural and environmental uncertainty no contract could be complete in the sense that it addresses every eventuality. As a result, in addition to flow economies, the vertically integrated firm benefits from the general

[19] Chandler, n.9, 37.

[20] M. Waterson, 'Vertical Integration and Vertical Restraints' (1993) 9(2) *Oxf.Rev.Econ. Policy* 41, 45.

[21] P.L. Joskow 'Vertical Integration and Long-Term Contracts: the Case of Coal-burning Electricity Generating Plants' (1985) 1(1) *J.L.Econ.& Org.* 33, 44.

advantages of internalisation; namely the harmonisation of interests defeating opportunism, as well as the more efficient decision making aided by direct access to information pertaining to the vertically linked but separable processes and the summary control mechanisms available to internal organisation.[22]

2.2.3 The middle road

The previous section considered two extremes: growth through market exchanges and growth through integration. At the one end of the spectrum, the firm grows by initiating more transactions in the open market, each exchange determined primarily by the price mechanism. At the other end, the firm grows by internalising assets, placed either horizontally or vertically in the production chain. Neither model requires on-going coordination or cooperation with other firms as agents of production, beyond what is expected under a spot or short-term contract in the market exchange scenario. Between these two extremes comes another type of growth structure which combines the transactional independence afforded in firms operating under the market exchange model with several of the advantages of the integrated model, whether horizontal or vertical. These relationships Williamson first named 'hybrids'.[23] Hybrid models of growth depend on profound collaboration and coordination between otherwise independent and often competing firms, i.e. the type of cooperation which corporate strategies worldwide have been increasingly pursuing since the 1980s.[24]

The hybrid route is indicated where the parties' objective requires a more enduring arrangement than those featured in market exchanges and short-term contracts but where vertical integration is equally unsuitable, for instance where the objective of the arrangement is the flexibility necessary to adapt to rapid change. Thus, integration is particularly counter-indicated where product cycles are short, technological change is rapid, innovation is key and markets are specialised. This is because large scale integrated firms tend to adopt an invariably bureaucratic structure, featuring strict adherence to written rules and procedures and a highly decentralised decision making

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[22] See Williamson(1971), n.11, 116-117.

[23] See generally Williamson(1975), n.13.

[24] On the growth of hybrids see indicatively E.A. Murray and J.F. Mahon, 'Strategic Alliances: Gateway to the New Europe?' (1993) 26(4) *LRP* 102, J.M. Podolny and K.L. Page, 'Network Forms of Organisation' (1998) 24 *Annu.Rev.Sociol.* 57 and, in more detail, W.W. Powell, 'Neither Market nor Hierarchy: Network Forms of Organisation' (1990) 12 *Res.Organ.Behav.* 295.

process, in the sense that day-to-day decision making is delegated to several stages down the vertical chain of command and does not necessarily come from those high up in the hierarchy.[25] The ensuing structure is unavoidably cumbersome, unable to respond to changes in international markets and systematically resistant both to process innovation, which affects the structure of the production chain, and to the introduction of new products. These were the conclusions of Mariotti and Cainarca's research in the textile clothing industry, an intensely turbulent market characterised by non-standardised production processes, a long production to distribution line (creating various intermediate products), as well as rapid technological changes stemming from the development of new fibres and associated textile production processes.[26] In this type of industry, where speed of response to change is crucial, the traditional integrated model is not indicated. Powell offers an example from the US auto industry, characterised by tight vertical integration until the mid-1970s, when the US firms started facing international competition.[27] The emergence of new competition exposed the US system's inflexibility and its inability to innovate due to its cost-minimising mentality. Because of the auto-manufacturers' tight grip on their parts suppliers, the latter were prevented from developing expertise, which in turn lowered the skill standard of their workforce. The suppliers had neither the incentive nor the ability to update equipment or suggest technological changes. In response to the ensuing drop in their market share, US auto-manufacturers started to disaggregate their production chain and to enter into complex cooperative arrangements with their Japanese counterparts, seeking to revitalise their production processes, as well as retrain labour and establish new relationships with auto parts suppliers.[28]

The hybrid route is also indicated where the firm seeks to achieve benefits of growth, such as economies of scale and scope, but without increasing its size as such. Merging with or acquiring another concern in the spirit of horizontal or vertical integration may lead to the firm acquiring assets for which it has no use. More importantly, increasing the size of the firm beyond what is optimal may lead to what Williamson named 'the

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[25] See J. Child, 'Organisation Structure and Strategies of Control: A Replication of the Aston Study' (1972) 17(2) *Adm.Sci.Q.* 163, esp. 169-170.

[26] S. Mariotti and G. Cainarca, 'The Evolution of Transaction Governance in the Textile-Clothing Industry' (1986) 7 *J.Econ.Behav.Organ.* 351.

[27] See Powell, n.24, 320.

[28] *Ibid.*

control loss' phenomenon.[29] Control loss refers to the decision maker's inability to make correct decisions about the firm due to erroneous or incomplete information. This issue arises from transmission of information over serially linked individuals in an organisation which changes radically the content of the material transmitted. In the context of growth through integration, Williamson explains that the firm's top manager 'cannot have all the information he had before the expansion plus the information generated by the new parts… he has more resources under his control, but the quality (serial reproduction loss) and the quantity (bounded capacity constraint) of his information are both less with respect to the deployment of each resource unit.'[30] In other words, over-expansion may cause the firm's management to lose a substantial degree of control over the firm's assets and production stages. This may also create significant transaction costs where the management attempts to counter this phenomenon by implementing safeguards, such as information coding or a reduction of the management chain.[31]

2.3 Drivers of Cooperation

2.3.1 Sharing Risk

The previous section established some of the advantages of the hybrid option over the more traditional models of growth. The purpose of this section is to explain the factors that make cooperative strategies so prevalent among established and start-up firms worldwide. The first of these factors is rather straightforward: cooperation provides a platform for risk sharing. Risk is the potential for the firm to lose value[32] and can arise due to factors internal or external to the firm. This rather broad definition entails that risk can take numerous forms and therefore its magnitude may depend on anything from the size of the firm's own investment, to the stability of the regulatory system, the political regime, even the weather. Therefore, for a firm seeking to not only maximise its revenue but to ensure its continued existence and growth, minimising risk in every foreseeable form is a major priority. This is particularly the case in resource and capital-

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[29] O.E. Williamson, 'Hierarchical Control and Optimum Firm Size' (1967) 75(2) *J. Political Econ.* 123, 126.

[30] *Ibid*, 127.

[31] *Ibid*.

[32] DePamphilis, D. *Mergers, Acquisitions and Other Restructuring Activties* (Academic Press, 2010), 547.

intensive fields such as natural resources extraction, pharmaceuticals and biotechnology, as well as information technology and electronics. These are industries where innovation is a key factor not only to success but also to survival. Thus, when developing new projects, firms in such fields face enormous risks, not least because of the heavy initial investment in both cash and capital. The potential for loss will be even higher where the project is meant to address a market with which the firm is unfamiliar and even more so where the market is entirely new.[33]

Risk lies also in the time it takes for the project to produce something not only marketable but also profitable and in the possibility that a competitor might get there first. This is a major concern in areas that reward first-comers, such as pharmaceuticals and biotechnology, where being the first to patent is crucial for recouping the costs of research and development and, consequently, future growth. The importance of innovation and the ensuing investment in research and development is further underscored by the markets' growing awareness of ever shorter product cycles, as is notoriously the case with information technology.

In addition to its role in innovation, time may pose a further risk by exposing the firm to legal liability where, once marketed, the product eventually reveals actionable faults. The pharmaceutical industry, for instance, has often been the subject of mass tort litigation, because a drug can lead to side effects, undiscovered at the time of its initial development, which affect a large number of people over significant periods of time.[34] The large players in the pharmaceutical industry have long tackled this risk by actively investing in synergies with smaller, more entrepreneurial firms for the development of new drugs. This is because not only are the smaller partners more administratively nimble due to a much smaller management structure, and thus able to pursue new ideas faster, they ultimately shoulder the legal risk of liability as primary developers.[35] At the same time, the larger partner shoulders the risk of the heavy cost associated with the

[33] E.g. consider the tablet market which ballooned over 2010 and 2012, catching many established players in the IT industry by surprise: 'Microsoft's Windows Monopoly now at Risk as Tablet Market sprouts without it', *Forbes Magazine*, 30 April 2010.

[34] Notably, see the Thalidomide litigation which exploded in the 1960's in Europe following the release of the drug for use as a sedative to counter morning sickness during pregnancy. The drug led to major birth defects in infants born to mothers who took it in early pregnancy: see K.I. MacDuff 'Thalidomide-The Aftermath' (1967) 1 *AULR* 53 and A. Bernstein, 'Formed by Thalidomide: Mass torts as a False Cure for Toxic Exposure' (1997) 97 *Colum.L.Rev.* 2153.

[35] See e.g. D.G. Owen, 'Dangers in Prescription Drugs: Filling a Private Law Gap in the Healthcare Debate' (2010) 42(3) *Conn.L.Rev.* 733.

research and development stage, while they both share in the revenue from the drug when it is finally released many years later. This illustrates strongly the role of risk in driving synergies – cooperation allows partners to spread the risk of a large project over several firms and to exploit the strengths of each other's management skills and structural idiosyncrasies.

2.3.2 Deregulation

Another factor encouraging cooperation rather than competition between firms operating in the same or related field is the deregulation drive that has been dominating both developed and developing economies. Heavily regulated industries, such as utilities, insurance, banking and air transport, were traditionally dominated by oligopolies featuring strong vertical integration. However, with their deregulation and ensuing liberalisation the incumbents of these industries, formerly state-owned firms, were faced with competition which opened up new business opportunities. For instance, competition in the airline industry today is based on cooperative strategies between otherwise competing airlines. These strategies involve sharing booking information and flight codes when two airlines operate the same route, allowing one to use the other's excess capacity to satisfy excess demand.[36] Deregulation in the electricity market allowed then newcomer Enron to develop synergies with technology firms ABB and Motorola, whose electronic meters and wireless modem technology respectively allowed Enron to collect and analyse consumer usage data and thus predict electricity demand.[37]

2.3.3 Learning

Finally, the need to learn and develop new expertise is a major incentive for cooperation. Learning new skills or how to reutilise existing ones may not only invigorate a firm's processes, from production to resource management to administration, but can confer significant competitive advantages. For instance, throughout the 1990s Japanese firms would strike synergies with US firms in order to learn their technologies and design processes as well as to streamline their own

[36] See F-C.Y. Chen and C. Chen 'The Effects of strategic alliances and risk pooling on the load factors of international airline operations' (2003) 39(1) *Transportation Research Part E*, 19, 24.

[37] F.J. Contractor and P. Lorange, 'The Growth of Alliances in the Knowledge Based Economy' in Contractor and Lorange (eds), *Cooperative Strategies and Alliances* (Pergammon, 2002) 3, 8.

manufacturing capacity, which allowed for faster marketing timescales.[38] The fact that corporate knowledge has become a major asset for most firms is evident from the increasing emphasis on knowledge management processes. An early example is the technology audit (namely, an inventory of technical assets and strategic capabilities), performed by Dow Chemicals, which produced a knowledge base so valuable that upon licensing yielded an estimated revenue increase of $100 million.[39] The importance of corporate knowledge as an asset is also evident in many firms' strategic emphasis on intellectual property registration and enforcement. The phenomenal surge in patent litigation throughout 2011 and 2012 in the information technology and consumer electronics industries is a vivid illustration of this.[40] This wave of lawsuits and counter lawsuits amongst the primary players in the tablet, smartphone and software markets illustrates that the value of many highly profitable firms has come to depend on tacit knowledge developed through their various operations, so much so that software giants like Microsoft and Google are valued primarily on the strength of their patents and knowledge capital.

2.4 Cooperative strategies in practice: strategic alliances

The factors briefly outlined above have led to a massive increase in cooperative strategies, collectively referred to as business or strategic alliances. A strategic alliance can be broadly defined as 'a voluntary arrangement between two or more firms that involves the exchange, sharing or co-development of products, technologies or services'.[41] Alliances take a myriad forms which, technically, depend on the alliance's ultimate objective. Alliance typology – which could provide a basis for predicting alliance form, its associated costs and, even, output – has become the focus of much research since cooperative strategies entered the mainstream corporate agenda. However, due to the consequent diversity in applied epistemology no definitive alliance typology has emerged. Nonetheless, from this research it is possible to identify elements common to all or most synergies, thus not only building on our understanding of the alliance business model but also mapping out the requisites for its success and

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[38] D. Lei, 'Offensive and Defensive Uses of Alliances' (1993) 26(4) *LRP* 32, 33.

[39] Contractor & Lorange, n.37, 11.

[40] E.g. 'Will Google have to start a patent war to get $9bn of value from Motorola?', *The Guardian*, 29 January 2012; 'Facebook buys 750 IBM patents: but why does it need to fight Yahoo?', *The Guardian*, 23 March 2012.

[41] A. Inkpen and K. Ramaswamy, *Global Strategy* (OUP, 2005), 80

the likely causes of failure. This section will consider the main approaches applied in the examination of alliances in order to identify some of the elements which determine alliance form.

2.4.1 Determinants of alliance form

A major determinant of alliance form can be the partners' relative competitive position in a particular business segment. Examining alliances from this point of view, Lorange and Roos have identified four archetypes – the '*ad hoc* pool', the 'consortium', the 'project based joint venture' and the 'full-blown joint venture'.[42] The '*ad hoc* pool' type tends to be formed between a market leader and a market follower (and competitor) for a highly specific, short-term project and with a minimum set of resources pooled in by both parties. Importantly, the project will pertain to the core business of both partners and its outputs, while the resources committed by each partner will return to them upon completion.[43] The 'consortium' type, on the other hand, is more involved than the *ad hoc* type and tends to arise between partners who are market followers rather than leaders. An example could be a research alliance among several pharmaceutical companies, each having too few resources to carry out the research on its own.[44] Similarly to the *ad hoc* type, consortium alliances also involve projects pertaining to the core business of each partner and even though they entail the commitment of more resources for a longer time period, the outputs are still expected to flow back to each of the partners once the project is completed. 'Project-based joint ventures', however, tend to arise between market leaders in their core business but the project in question is peripheral to the partners' overall portfolio of operations, for instance where the objective is to enter a new market. The outputs in this case, along with the limited resources committed by each partner, remain with the vehicle formed to carry out the objective of the joint venture.[45] This entails a much longer-term arrangement than in the case of *ad hoc* pool and consortium types. Finally, the 'full-blown joint venture' is formed among followers in a business segment and pertains to projects which are peripheral to each partner's overall portfolio of operations. The objective of such arrangements is generally to pool resources in order to catch up with the rest of the

[42] P. Lorange and Roos, n.1, 40.

[43] *Ibid*, 44.

[44] *Ibid*, 46.

[45] *Ibid*, 48.

market or to create more value by making operations more efficient. As a result, these arrangements tend to involve heavy resource commitment, including administrative and managerial resources, on a long-term basis. All project outputs and committed resources remain with the alliance so as to enable its long-term sustainability as a separate operation.[46]

Another key factor liable to determine the form of the alliance is the level of specificity of the resources required to achieve the alliance's objective. It will be remembered that asset specificity refers to the degree to which it is possible to substitute the required asset. For example, an asset of high specificity would be a patented process for the production of a sought-after chemical. According to the resource-based theory of alliance typology, the higher the level of specificity, the more hierarchical the business form of the alliance arrangement. For instance, empirical evidence shows that the higher the proportion of tacit knowledge in a technology the more likely the knowledge transfer will take place through incorporated joint ventures or wholly owned subsidiaries.[47] Ultimately under this approach the partners' goal is to deal with the uncertainty of situations which they cannot control or determine through contract by sharing essential knowledge and competencies and making learning the alliance's priority. Similarly, the manner in which the parties apportion property rights in alliance assets, as well as rents and payoffs, has been identified by the property rights theory as another powerful determinant of alliance form.[48]

The problem of 'non-contractibles',[49] i.e. eventualities whose effect cannot be determined by contract, is also central to the relational contracts theory (see Ch.4), which points to the strength of relational contracts as a determinant of alliance form. According to this approach, parties enter into 'informal agreements and unwritten codes of conduct that powerfully affect the behaviours of individuals within firms'.[50] The purpose of these contracts is to tackle opportunistic behaviour, the costs of information

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[46] *Ibid*, 49.

[47] E. Tsang, 'Motives for Strategic Alliances – a Resource-based Perspective' (1998) 13(4) *SJM* 207, 212.

[48] See generally, G. Baker et al., 'Strategic Alliances: Bridges Between Islands of Conscious Power' (2008) 22 *JJIE* 146.

[49] C. Menard, 'Hybrid Modes of Organisation: Alliances, Joint Ventures and Other Strange Animals' in R. Gibbons and J. Roberts (eds), *Handbook of Organizational Economics* (Princeton UP, 2012), 19.

[50] G. Baker, et al. 'Relational Contracts and the Theory of the Firm' (2002) 117(1) *Q.J.Econ.* 39, 39.

asymmetry among partners or partners and the alliance vehicle, as well as the difficulty of enforcing agreements riddled with non-determinable elements. Relational contracts and their efficacy depend on several components ranging from differences between the partners, such as their respective motivations for the alliance or corporate or national cultures, to their respective bargaining power, to trust.[51] Trust, in particular, is a significant element which encompasses belief that the partner will fulfil its obligations competently and as per its contractual obligations or that it will behave fairly and refrain from engaging in opportunistic behaviour even in unforeseen circumstances.[52] Where an alliance is based on relational contracts, trust will feature more strongly when the levels of uncertainty and/or interdependence between the partners are high, in each case making opportunistic behaviour more likely and/or prejudicial respectively.[53]

However, perhaps the most powerful determinant of alliance form is the *cost* of dealing with uncertainty and the possibility of opportunistic behaviour by a partner. This is the focus of transaction cost economics, the main theory employed in alliance typology in various forms. This approach starts off on the assumption that economic organisation is a problem of contracting and that when the various contracts, whether implicit or explicit, have been put in place in order to accomplish a certain task, the associated costs must be examined.[54] These are collectively referred to as transaction costs and they can be *ex ante* or *ex post*. The former include the costs of researching, negotiating, drafting and safeguarding an agreement, for instance through common ownership of the assets committed to the deal.[55] The latter arise from the difficulty in drafting contracts that cover every possible eventuality and ultimately represent the costs of behavioural uncertainty and non-contractibles. They typically include 'maladaptation costs' incurred when the transaction has drifted out of alignment with the original objective, 'haggling costs' incurred when the parties try to correct the misalignment, 'set up and running costs' pertaining to the dispute resolution mechanisms adopted and 'bonding costs' incurred when seeking to secure commitments from each party to the

[51] P. Kamminga and J. Van Der Meer-Kooistra, 'Management Control Patterns in Joint Venture Relationships: A Model and an Exploratory Study' (2007) 32 *AOS* 131, 134.

[52] *Ibid*.

[53] This is particularly the case in information technology alliances: see C.E. Ybarra and T.A. Turk, 'The Evolution of Trust in Information Technology Alliances' (2009) 20 *JHTMR* 62, 64ff.

[54] O.E. Williamson, *The Economic Institutions of Capitalism* (The Free Press, 1985), 19 [hereafter, 'Williamson(1985)'].

[55] *Ibid*.

renegotiated objective.[56] According to transaction costs economics, it is the level of these costs and the degree to which they can and should be mitigated that will ultimately determine the form of the alliance.

2.4.2 Appropriation concerns and other sources of conflict

In practice, the factors examined above translate into a set of issues which the parties must consider before embarking on a common venture. Naturally, the venture itself may fail for reasons external to the partners' working relationship, but internal conflict will render the failure that much more likely. Here, conflict will invariably stem from the fact that the decision to cooperate by definition entails that the party considering it must relinquish at least some control over the resource it is prepared to commit to the alliance. Such compromise is made on the understanding that the party will benefit from the alliance in a fair, or at least previously agreed, manner. Therefore, from the start, each party is concerned about whether it will be able to secure a fair share of the alliance payoffs.[57] These considerations are known as 'appropriation concerns'. From a transaction costs perspective, they arise at the prospect of *ex post* transaction costs, as described above. From a relational contracts perspective they could arise from a fundamental lack of trust between the partners, especially where the parties had no relationship before considering the alliance or where neither party has past experience in handling alliances.[58] In general terms, appropriation concerns stem from the uncertainty associated with future stipulations in an unavoidably incomplete contract, the associated costs, and the possibility that allies do not comply with agreed contribution levels. The higher the levels of expected interdependence in the alliance, the more profound the appropriation concerns, because of the relational risk inherent in the ensuing relationship. Relational risk refers to the probability that an ally firm doe

s not commit to the alliance in the agreed manner.[59] So, for example, appropriation concerns have been shown to be high when the alliance involves tacit knowledge

[56] *Ibid*, 21.

[57] R. Gulati and H. Singh 'The Architecture of Cooperation: Managing Coordination Costs and Appropriation Concerns in Strategic Alliances' (1998) 43 *Adm.Sci.Q.* 781, 788.

[58] The history of the partner firms' relationships is a significant determinant of the level of cooperation in an alliance: see E. Todev and D. Knoke 'Strategic Alliances and Models of Collaboration' (2005) 43(1) *Management Decision* 123, 128.

[59] T.K. Das and T. Bing-Sheng, 'A Risk Perception Model of Alliance Structuring' (2001) 7 *J.Int.Manag.* 1, 6.

transfer between partners or has a major technology component.[60] In the first case, where the knowledge in question is proprietary, a partner may be reluctant to reveal its true extent, which makes it difficult to assess its value as a contribution to the alliance. In the second case, where the alliance pertains to a technology exchange, appropriation concerns tend to arise from the ambiguity surrounding the technology to be transferred and the extent of its use.[61]

A related source of conflict in alliances is the lack of a common goal for collaboration. A case in point is the 1987 alliance between French company Matra S.A. (Matra) and the Swedish LM Ericsson (Ericsson), who formed Matra Ericsson Telecommunications (MET). For Matra, the purpose of MET was to provide access to Ericsson's technology portfolio, while, for Ericsson, MET was to be a point of access to the then newly privatised French telecommunications market. However, despite being profitable the collaboration between the two companies was dissolved in 1997. The reason was Ericsson's opposition to forming a deeper technological collaboration with Matra, leading Matra to form a new collaboration with Ericsson's competitor Nortel, thus putting serious strain on the Matra-Ericsson relationship.[62] Evidently, the divergence between otherwise complementary strategic goals may induce opportunistic behaviour, i.e. deceitful, self-interested conduct,[63] or even a learning race between the allies, where the firm that acquires the desired knowledge first is the winner. In the latter scenario a firm's entire portfolio of skills, processes and technologies is potentially available to its allies for assimilation. A case in point are the US – Japanese/Korean alliances of the 1980s and 1990s in the power equipment (e.g. Westinghouse with Mitsubishi), consumer electronics (General Electric with Samsung), and office equipment (Kodak with Canon) industries, where the Asian firms not only outlearned their US allies but developed new technologies and applied them to a wider range of uses.[64]

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[60] *Ibid*, 788-789.

[61] *Ibid*.

[62] Inkpen, n.41, 91-92. Note also the Ericsson and Hewlett Packard alliance, who formed Ericsson Hewlett Packard Telecommunications in 1993, with a view to develop and sell network management platforms and network management solutions through two different joint venture companies. The alliance was dissolved in 2001 amidst much conflict, when it became clear that the allies' goals were fundamentally divergent: B. Buchel, 'Joint Venture Development: Driving Forces towards Equilibrium' (2002) 37 *J. World Bus.* 199.

[63] Williamson(1975), n.13, 9.

[64] Lei, n.38, 36.

2.5 Forms of alliances

2.5.1 Equity Alliances

Where appropriation concerns are high, transaction costs economics has identified hierarchical modes of alliance structure as a means to address uncertainty and opportunism.[65] These modes include elements such as a clear command structure and system of authority determining which communications are authoritative, standard operating procedures, dispute resolution mechanisms as well as internal pricing systems, which facilitate the determination of appropriate remuneration levels.[66] Hierarchical governance structures are more clearly implemented in the equity joint venture, which involves two or more firms pooling resources and forming an independent and separate legal entity. The parents of the new entity retain their autonomy and acquire equity in it, the size of the resulting interest usually depending on the level of the parent's contribution to the alliance.[67] Contributions are made for a specific purpose and could take the form of hard finance and assets such as plant and equipment, as well as skilled personnel and IP rights. The joint venture entity may be formed completely anew, i.e. with new plant, personnel, management, etc., or through a divisional merger, whereby parents contribute entire departments of their own operation to the alliance.[68] An example of this is the alliance between Canadian brewers Molson with the Australian Elders IXL, both of which in 1988 contributed their existing Canadian brewing operations to the joint venture.[69] The advantage of an equity joint venture over less hierarchical alliance structures lies in the simplification of the decision making process and the autonomy of the entity itself, who sets out to complete tasks with a view to further its own purposes, which in turn will translate into specified

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[65] *Cf.* K. Langfield-Smith, 'The Relations Between Transactional Characteristics, Trust and Risk in the Start-up Phase of a Collaborative Alliance' (2008) 19 *Mana.Account.Res.* 344, presenting a very successful alliance between a local water authority and a number of construction firms, which adopted some hierarchical elements in its structure.

[66] Gulati, n.57, 785.

[67] Equity joint ventures may take the form of International Joint Ventures (IJV), i.e. alliances based on the formation of a separate entity in a foreign country, either to comply with or bypass national legislation of the host country or to take advantage of the local partner's expertise. The level of equity sharing in the IJV will depend on several factors, including the strategic intentions of the incoming partner for forming the IJV with the local firm in the first place. E.g., were the intention is for the IJV to mitigate and share risk of operational uncertainties with local firms it may be advisable for the incoming partner to acquire a lower equity share; see Y. Luo, 'Equity Sharing in International Joint Ventures: an Empirical Study of Strategic and Environmental Determinants' (2001) 7 *J.Int.Manag.* 31, 39ff.

[68] See generally DePamphilis, n.32, 546ff.

[69] Inkpen, n.41, 82.

payoffs for the parents. Furthermore, it helps alleviate the parents' appropriation concerns by providing a clear and pre-agreed appropriation regime. Normally based on the parents' contributions to the joint venture in the first place, the returns regime in an equity joint venture may be more easily monitored which also allows for more effective enforcement of agreed contribution levels for each parent.

Equity alliances may, however, take the form of mutual equity sharing without the establishment of a separate legal entity. Such alliances are common between established firms and start-ups in technology and research and development intensive industries, such as information technology, biotechnology and pharmaceuticals. In this case, the smaller of the two firms sells a non-controlling equity interest to its more established ally when the relationship is formed. The purpose of this is to give the larger partner a stronger incentive to avoid acting opportunistically during the course of the alliance. In addition to this, the transfer of the minority equity stake is usually accompanied by granting the investing partner representation on the smaller partner's board of directors. This allows the investing partner to monitor its ally's behaviour, which is particularly important when the smaller firm is tasked with the development of a new product. In addition to this, participation on the smaller ally's board of directors provides the alliance with a forum for conflict resolution, as well as the exchange of strategic information and the adjustment of the alliance's strategic goals as contingencies arise.[70]

2.5.2 Contractual Alliances

While the presence of equity is not a prerequisite, all alliances tend to be based on written contracts. In the absence of equity, a contract helps maintain an arm's length relationship between the otherwise autonomous collaborators, while specifying each ally's obligations and entitlements in the relationship. Alliances based solely on contract tend to be project oriented and form when the envisaged relationship is not expected to last for more than three years[71] or does not require close monitoring and coordination by the allies. Most consortia, i.e. loose networks of firms or even entire alliances, are based on contract, as are the project-specific alliances examined in this thesis. Other common forms of contractual alliance include licensing, franchising and

[70] G.P. Pisano, 'Using Equity Participation to Support Exchange: Evidence from the Biotechnology Industry' (1989) 5(1) *J.L.Econ.& Org.* 109, 112.

[71] *Cf.* Joskow, n.21, who shows that most fuel supply relationships tend to be based on long-term contracts of 15 years and more rather than the supplier being integrated into the utility itself.

supply chain systems, all featuring entirely autonomous, self-interested participants constrained only by the alliance agreement.

Licensing involves granting another the right to use an asset (frequently, a trademark, patent or copyright) for a set period of time and in a specified manner (e.g. the licence may be exclusive to the licensee but restricted geographically) in exchange for royalties or a fee. This simple alliance form requires little coordination of the parties' relationship, save for the licensor's monitoring of the licensee's use of their asset. Supply chain systems, on the other hand, function like a vertically integrated operation requiring tight coordination. The supply chain operates through a complex matrix of contracts between autonomous organisations with complementary competencies,[72] comprising all the organisations involved in the making of a product – from extracting and processing the raw materials to final assembly and distribution.[73] Finally, much like licensing, franchising involves a brand owner (franchisor) granting another (franchisee) the right to trade under the franchisor's brand name and business format at a specified geographic location and for a specified term in exchange for an initial fee (representing the franchisee's investment) and royalties, based on a percentage of the franchisee's sales.[74]

These contractual alliances give rise to generally straightforward legal relationships, following set models of rights and duties. There is no such model for the project-specific contractual alliance considered here, which has no separately recognised form, making it a legal quagmire for the allies. The next chapter will examine the law applicable to such alliances, with a view to underscoring its incongruity with what the allies must have intended at the start of their relationship.

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[72] See X. Li and Q. Wang, 'Coordination Mechanisms of Supply Chain Systems' (2007) *EJOR* 1 arguing that because this arrangement allows participants to be entirely self-interested a central coordination mechanism is essential.

[73] See Menard, n.49, 11, and 5-8, describing a complex arrangement in the 1970's French bakery industry loosely combining the contractual matrix of supply chain systems with the equity route.

[74] J.A. Brickley, 'Incentive Conflicts and Contractual Restraints: Evidence from Franchising' (1999) 42 *J. Law Econ.* 745, 748.

3 THE LAW ON CONTRACTUAL JOINT VENTURES

3.1 Introduction

This thesis is concerned with the project-specific type of contractual alliances, and, for the sake of consistency with the existing legal literature in the area, I will refer to them as contractual or unincorporated joint ventures. It should be noted at the outset, that no universally accepted definition of a 'joint venture' has emerged in the law and related literature, even though the term itself has been used (controversially, as will be discussed later) as a term of art in both.[1] The most apt description of the legal position on joint ventures is that provided by Mann J in *Winton v. Rosenthal*:

> 'The expression "Joint Venture" is not a term of art with a fixed meaning and is convenient shorthand to cover a variety of possible arrangements.'[2]

Thus, for the purposes of this thesis, a 'joint venture' is defined as an alliance based on a contract between two or more business concerns with the purpose of combining their resources and capabilities in order to complete a specified project over a limited time period and sharing its outputs. The contract here is of paramount importance as it sets out not only the rights and duties of the members to the joint venture, but addresses everything else from the venture's scope, to its management structure, voting and termination procedures as well as consequences of default on the contract by a member.[3] The contractual joint venture does not generally involve the creation of a separate entity to carry out the business of the joint venture. This tends to be carried out jointly by the venturers either by setting up a committee for the purpose,[4] or by appointing a third party to manage the venture for all of them. The latter option can be particularly useful in addressing 'failures of coordination', that arise from the

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[1] Particularly in American literature and case law: indicatively see J. Taubman, 'What constitutes a Joint Venture' (1956) 41 *CLQ* 640; H.W. Nichols, 'Joint Ventures' (1950) 36 *Va.L.Rev.* 425; W.H.E. Jaeger, 'Joint Ventures: Origin, Nature and Development' (1960) 9 *Am.U.L.Rev.* 1; J.M. Mullen, 'Joint Adventures' (1944) 8 *Md.L.Rev.* 22; *Cf. Mair v. Wood* (1948) SC 83.

[2] [2013] EWHC 502, [77].

[3] See, e.g. for an analysis of different contract terms in context: S.R. Salbu, and R.A Brahm 'Strategic Considerations in Designing Joint Venture Contracts' (1992) *Colum.Bus.L.Rev.* 253.

[4] R.C. Sampson, 'The cost of misaligned Governance in R&D Alliances' (2004) 20(2) *J.L.Econ.& Org.* 484, 488, and note particularly the references to the alliance between Ramtron Inc. and ULVAC (hereafter, 'Sampson(2004)'); and generally W.H.E. Jaeger, 'Joint Ventures: Membership, Types and Termination' (1960) 9 *Am.U.L.Rev.* 111.

autonomous parties in the joint venture 'reading and reacting to signals differently'.[5] In this case, the managing party – who can be one of the co-venturers or a subsidiary, as well as a specially formed company or an outsider – carries out the day-to-day operations of the joint venture business and is, in turn, overseen by a committee of the co-venturers. The duties of this managing party are usually set out in a separate management agreement.[6]

The purpose of this chapter is to argue that the current legal regime governing the contractual joint venture is unfit to give effect to the parties' intentions as economic agents. To demonstrate this, I will examine the legal regime governing contractual joint ventures in light of the economic drivers underlying their growing popularity (see Ch.2). Thus, I will first examine the advantages of the contractual joint venture over its equity counterpart in order to establish its significance as a vehicle for growth and the relevance of an argument supporting the development of a new legal model reflecting the allies' intentions more accurately. Secondly, I will discuss the implications of the contractual route for the allies and their relationship with third parties. Thirdly, I will discuss the fitness of the current law as a governance mechanism for unincorporated joint ventures in light of the alliance drivers examined in Chapter 2. Finally, I will argue that a separate legal model applicable to the unincorporated joint venture is necessary to both realise the parties' intentions and support their growth.

3.2 Why form a contractual joint venture?

At the outset, any lawyer would agree that the equity joint venture confers several legal advantages to the participants,[7] not least of which is the limited liability afforded by the creation of a separate legal entity to carry out the business of the venture. Nonetheless, Sampson reports that contractual joint ventures tend to far outnumber equity-based ones.[8] This is because the equity joint venture is by definition a hierarchical structure with all the administrative and bureaucratic costs that this entails. By contrast the contractual joint venture is closer to the market exchange end of the spectrum, and as a

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[5] O.E. Williamson, 'Comparative Economic Organization: The Analysis of Discrete Structural Alternatives' (1991) 36(2) *Adm.Sci.Q* 269, 278.

[6] I. Hewitt, *Joint Ventures* (Sweet & Maxwell, 2011), [4.10]ff.

[7] See, e.g., D. Yates and G. Cooke, 'Legal Problems in Financing Maritime Joint Ventures' (1989) *JBL* 197, 202-203, who clearly favour the equity form on the strength of its transparency and risk limiting attributes.

[8] R.C. Sampson, 'The Role of Lawyers in Strategic Alliances' (2003) 53 *Case W.Res.L.Rev.* 909, 917.

result it retains the incentive characteristics of markets (i.e. profit seeking, efficiency of resource allocation, etc.), while it allows for a longer term relationship which is better monitored and coordinated through mechanisms adopted in the contract (such as the appointment of a venture manager).[9] In other words, the purely contractual relationship allows the parties to retain their autonomy, only devoting resources prescribed in the contract for the purpose of completing a single project. Additionally, the more elastic nature of the contract allows for easier adaptation of the parties' relationship by amending terms in response to unforeseen changes in the course of the project.[10]

The flexibility of the contractual route aside, according to Oxley 'it is the attributes of the transaction and not firm-level characteristics that determine the type of alliance form chosen'.[11] Thus, if the scope of the venture is multifaceted (e.g. in an R&D joint venture, which involves not only the development of a new technology or material, but also its mass production, marketing and distribution) then an equity joint venture is more frequently chosen.[12] This is also the case where the venture has a heavy international element (despite a much narrower scope).[13] However, where the transaction raises few appropriability concerns, then the contractual route is generally preferred, especially where the implementing legal environment features a strong rule of law and enforcement mechanisms, which is a significant concern where intellectual property is concerned.[14]

Contractual joint ventures (provided they are not treated as partnerships) in some jurisdictions can confer significant tax advantages to participants. In Australia for instance, joint venture participants are treated separately for tax purposes, so that they can selectively offset losses from one project against income from their other projects, independently from the other venture members.[15] Another significant advantage of the

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[9] J. Oxley, 'Appropriability Hazards and Governance in Strategic Alliances: A Transaction Cost Approach' (1997) 13 *J.L.Econ.& Org.* 387, 390.

[10] I. Hewitt, n.6, 62; see also D.G. Smith and B.G. King, 'Contracts as Organizations' (2009) 51 *Ariz.L.Rev.* 1, arguing – similarly to Williamson as to contractual incompleteness – that the relational aspect of contracts must be acknowledged and augmented through an understanding of the parties' goals as organisations.

[11] Oxley, n.9, 405.

[12] Sampson(2004), n.4, 510ff, in the context of R&D in biotechnology. See also Oxley, n.9.

[13] *Ibid*.

[14] *Ibid*, 511.

[15] G.L.J. Ryan, 'Joint Venture Agreements' (1982) 4(1) *AMPLJ* 101, 126-127; A.J. Black, 'Joint Ventures, Partnerships and Fiduciary Duties: *United Dominions Corporation Limited. v. Brian Pty*

contractual route is that it allows the parties to raise finance separately, using separate security and through different financiers. Ladbury, for instance, explains that the unincorporated joint venture can prove an effective vehicle for large-scale project financings, provided the core joint venture agreement is designed to accommodate this route.[16]

3.3 The legal framework on contractual joint ventures

Despite its flexibility, a purely contractual relationship is a distinctly problematic structure, because of the uncertainty surrounding such issues as the status of the undertaking in law and that of the relationship between the parties *inter se*, as well as with third parties. In English law, the contractual joint venture *as envisaged by the parties* does not have distinct legal status with an associated set of default rules, as is the case with, for example, partnerships or agencies.[17] The parties generally envisage the contractual joint venture as a relationship between principals, bargaining at arm's length and, assuming that this is indeed how they conduct their relationship,[18] this is how the courts would approach their arrangement in the event of dispute.[19] Uncertainty, however, ensues where the relationship in reality is much closer than the parties initially claimed it to be. Questions arise as to its true nature and therefore as to the legal consequences in the event of dispute, either between the parties themselves or between the parties and third persons. These questions can be numerous but for the purposes of this thesis, I will focus on the three main ones. First, is the joint venture relationship in fact one of a partnership and is it possible for the parties to define their relationship at the outset, so as to avoid this characterisation? Secondly, if not a partnership, can it be said that the contractual joint venture is a distinct legal category? Thirdly, if not, should

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Limited' (1985-1986) 15 *MULR* 708, 709; By contrast, contractual joint ventures in the UK do not attract special tax treatment, but equity joint ventures do: see Corporation Tax Act 2010, s.450.

[16] E.g. the agreement must support separate security, usually in the form of a lender's charge over a co-venturer's interest in the venture and/or over the venturer's share in the outputs; R.A. Ladbury, 'Mining Joint Ventures' (1984) 12 *ABLR* 312, 331ff.

[17] See *Ross River Limited v. Waveley Commercial Limited* [2012] EWHC 81, [237], per Morgan J, who refused to attach fiduciary duties to the parties' relationship merely on the basis that they were in a joint venture.

[18] The court will examine all the circumstances in the case, to determine whether any extra-contractual rights and duties could be implied, but will generally defer to the contract where the parties are commercial, bargaining at arm's length: *Ross River Limited v. Cambridge City Football Club* [2007] EWHC 2115, [197], per Briggs J.

[19] E.g. *Thames Cruises Limited v. George Wheeler Launches Limited* [2003] EWHC 3093, [49]-[52], per Smith J; *Daniels v. Deville* [2008] EWHC 1810, [36], per Lindsay J.

we acknowledge the contractual joint venture as a distinct legal category, so that associated rules as to rights, duties and liabilities can be developed and applied as a default system for its governance? I will now turn to the first of these questions.

3.3.1 Are co-venturers partners?

In the UK, the definition of a partnership comes from s.1(1) of the Partnership Act 1890 (hereafter, PA(1890)):

> 'Partnership is the relation which subsists between persons carrying on a business in common with a view of profit.'

This definition appears broad enough to cover almost every type of commercial arrangement, short of a corporation (s.1(2)), and certainly one that could cover the type of commercial relationship envisaged by the contractual joint venture. In fact, the definition is broad enough to identify a partnership in the simplest of circumstances – all that is required is two or more persons (legal or natural) embarking on a business together with a view to share profits (the so-called 'partnership at will'). Generally, partnership law is default law and, in the absence of an express agreement between the parties, the PA(1890) will govern their relationship from inception to dissolution. However, this may not be immediately the case with the project-specific contractual joint venture, as defined in this thesis. In order to establish whether the PA(1890) applies to this type of alliance I will now analyse it in light of s.1(1).

3.3.1.1 "... Carrying on a business"

The carrying on of a 'business', which includes every trade, occupation or profession,[20] is central to a partnership. The undertaking must be a commercial one – therefore no partnership will arise if two persons pool their finances and share travel expenses in order to watch a show in London. In this regard the project-specific joint venture clearly satisfies the s.1(1) definition, as its purpose is fundamentally one of commercial gain. There has been, however, some debate as to whether the fact that the scope of the project-specific joint venture is limited to the completion of a single undertaking (e.g. the development of a new material, extraction of ore) falls under the category of 'business' in the first place. The argument goes that the term 'business' denotes some

[20] PA(1890), s.45.

continuity of trade, and therefore a single or *ad hoc* joint undertaking cannot be a business for the purposes of a partnership.[21] First, s.32(b) of PA(1890) on partnership dissolution, provides that a partnership entered into for a single undertaking is dissolved upon the termination of that undertaking, making it clear that the PA(1890) envisaged single undertaking partnerships as well. Secondly, when a similar point was raised by the creditor in *Re Abenheim, ex parte Abenheim*,[22] Phillipmore J held that the word 'business' in the PA(1890) relates 'not merely to a life-long or a universal business or a long-undertaking, but to any separate commercial adventure in which people may embark'. Therefore, the project-specific nature of a contractual joint venture does not preclude it from being a partnership.

On the other hand, in the context of the project-specific joint venture which seeks to develop a capital asset for further exploitation, Merralls argued it would be difficult to maintain that an arrangement of this type was either a business or with a view to profit. He explained that the object of obtaining the capital asset is 'not the kind of systematic activity normally connoted by the word business'.[23] I argue, however, that the meaning of 'business' is broad enough to encompass all types of activity that are intended to generate revenue of any type. For instance, in English law, the parties to a joint undertaking are regarded as trading even though the business concern originally contemplated has not yet been fleshed out. Thus a 'business' is born or starts trading when the parties have embarked and done enough towards their ultimate commercial objective to show their commitment to it. This was established in *Khan v. Miah,*[24] which concerned a joint venture for the launch of a restaurant. The relationship between the venturers collapsed before the restaurant started trading, but at that point over £50,000 had been invested. The parties acquired premises, began to fit them out, and

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[21] The argument has American origins and is considered one of the main reasons for distinguishing between a partnership and a joint venture in North America: see Jaeger, n.1, 13, who offers examples from undertakings in drilling and operating oil wells (*Shell Oil Co. v. Prestidge*, 249 F.2d 413 (1957)), the purchase, development and sale of land (*Lasry v. Lederman*, 147 Cal. App. 2d 480, 305 P.2d 663) and the construction of a garage and storage building (*Matanuska Valley Bank v. Arnold,* 223 F 2d 778 (1955)); *Cf.* R. Flannigan, 'The Joint Venture Fable' (2008-2010) 50 *Am.J.Leg.Hist.* 200, 205, who argues that the trend stems from a misinterpretation of a judgment from the Supreme Court of Pennsylvania allowing two partners to bring an action in law to resolve a dispute about a *single partnership item* (in this case, $12.50), where an accounting would be too long-winded and unnecessary in the circumstances. He explains that the 'single item' became 'single transaction' in subsequent cases contributing to the confusion as to the status of the joint venture in law.

[22] (1913) 109 LT 219, 220.

[23] J.D. Merralls, 'Mining and Petroleum Joint Ventures in Australia: Some Basic Legal Concepts' (1980) 3 *AMPLJ*1, 3.

[24] *Khan v. Miah* [2000] 1 WLR 2123.

purchased tables, table linen and other equipment. Eventually the restaurant opened for business run by three of the former co-venturers. The issue was whether the fourth member of the former joint venture could claim his share in the business, a 50 per cent share as envisaged in the original agreement between them. The House of Lords held that:

> 'the question is not whether [the business] had commenced trading, but whether the parties had done enough to be found to have commenced the joint enterprise in which they had agreed to engage.'[25]

I submit that, by analogy, a joint venture like that contemplated in Merralls' argument certainly gives rise to a business: the parties secure finance, licences, professional advice, specialised equipment, an expert workforce, put operational policies in place and actually start on the work, for which everyone involved is remunerated and tax is paid accordingly. The fact that all this culminates in a capital asset rather than sales revenue should be immaterial. After all, eventually the asset will be exploited in such a way that sales revenue will be the ultimate outcome.

3.3.1.2 "... in common"

The partnership business must be run as a common concern for the joint benefit of the parties, who must show an intention to be partners by accepting either expressly or impliedly *mutual* rights and duties in respect of each other. Thus, in *Hawksley v. Outram*[26] Lopes LJ held that:

> 'the true test of whether a partnership was intended is… whether there was a joint business, or, whether the parties were intending to carry on the business as the agents *of each other*'.[27]

The test was based on the application of the landmark decision in *Cox v. Hickman*,[28] where in exchange for allowing a debtor to continue trading, the debtor's creditors

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[25] *Ibid*, at 2128, per Millett LJ.

[26] [1892] 3 Ch 359.

[27] *Ibid*, 377 (my emphasis).

[28] (1860) 8 H.L. Cas. 268; see also *Mollwo March & Co v. Court of Wards* (1871-73) LR 4 PC 419 (creditor entitled to 20% of profits and given significant control over the firm's management in a deed, even though exercised very little of it, was not a partner).

signed a deed whereby they would be entitled to the part of the profits in discharge of the debt owed to them. It was held that they were not partners of the debtor, as the trade was not carried on by or on account of the creditors, but for the sole benefit of the debtor. 'The debtor was still the only person interested in the profits, save only that he [had] mortgaged them to the creditors'.[29] The intention to be each other's agent was also central to the court's reasoning in *Kilshaw v. Jukes*.[30] There, the three defendants started a land development venture, one of them being an ironmonger to whom the other two had been indebted for goods furnished in previous ventures. The ironmonger, was not deemed a partner of the other two, not having been party to the contracts for purchasing building materials and having given no authority to the other two to purchase materials for him. Instead, the court held that the relationship between him and the other two defendants amounted to a simple loan repayment. In *Bullen v. Sharp*,[31] the trustees under a settlement received the profits of an underwriter's business in order to secure the losses of the business, with any reserve going to the underwriter himself. When the underwriter became bankrupt and could not pay on an insurance policy, the issue was whether the trustees could be recovered from as his partners. They could not; the underwriter was still the only beneficiary of the business' profits as they accrued and therefore the business was not carried out for the trustees but for him alone.

The undertaking to submit to each other's authority denotes that carrying on a business in common for the purposes of a partnership means that the parties have a mutual unqualified legal interest in the management of the business as well as its assets. This is more than a mutual interest in the financial success of the venture. For instance, in *Dollar Land (Cumbernauld) v. CIN Properties*[32] it was held that common economic interest was insufficient to create a partnership between parties, who, on the facts, had no way of binding each other directly to any agreement. Thus, the manner in which the partnership business is managed will be a good (if not conclusive) indication of the status of a party in a relationship. In *Stocker v. Brockelbank*[33] the plaintiff ran a manufacture business for the defendants in exchange for a share of the profits. Because he was to contribute no capital in the business, sustain no loss, his credit was not to be

[29] *Cox*, *ibid*, 307.

[30] (1863) 3 B&S 846.

[31] (1865) LR 1 CP 86, 112.

[32] The Times, 21 April 1995.

[33] (1851) 42 ER 257, 262-263.

pledged, was to manage the business according to the direction of the defendants and had no unconstrained discretion, he was found to have neither the liability, nor the authority or the interest of a partner. Similarly, in *Triffin v. Lester Aldridge*[34] the Court of Appeal affirmed the decision of an employment Tribunal, which held that a solicitor, who, while working at the respondent firm, participated in the management of the firm and was allowed to vote in management meetings, and was entitled to a small share of profits (as well as to a share in surplus assets of the firm on winding up) was a partner in the firm and not an employee. Finally, the level of kinship required of and afforded to partners was illustrated in *M Young Legal Associates. v. Zahid*,[35] where a solicitor who was hired in order to satisfy the supervision requirement of the Solicitors' Practice Rules 1990 and had no share in the profits, was not required to provide capital and was paid a fixed salary, was nonetheless held to be a partner. This is because without the appellant the partnership could not legally operate and therefore his agreeing to be engaged in the firm's business in order to satisfy the Practice Rules indicated clearly his and the firm's intention to establish a partnership.

In light of these authorities, could the contractual joint venture satisfy the 'in common' element of s.1(1)? The answer will depend on the parties' conduct of the joint undertaking, which will indicate their intentions as to the nature of their relationship. On this issue, Ladbury argued that contractual joint ventures are merely exercises in risk and expense sharing. At least in the context of the mining and petroleum joint venture and, I would extrapolate, contractual project-specific joint ventures in general, the manner of its operation should not satisfy the 'in common' requirement. This is because the only common aspects of the typical venture are the parties' contribution to expenses, their use of common assets and their decision making through a joint venture committee, all of which relate to one specific, often narrow, project.[36] In response to these points, Flannigan argued that such an approach disregards the heavy 'in common' element of such arrangements, explaining 'they are each engaged both in their separate businesses and collectively in their shared business'.[37]

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[34] [2012] EWCA Civ 35.

[35] [2006] EWCA Civ 613; see also *Hodson v. Hodson* [2009] EWCA Civ 1042.

[36] R.A. Ladbury, 'Commentary' in P.D. Finn, (ed.) *Equity and Commercial Relationships* (Law Book Co., 1987), 37, 41.

[37] R. Flannigan, 'The Legal Status of the Joint Venture' (2009) 46 *Alta.L.Rev.* 713, 727. [hereafter, 'Flannigan(2009)'].

With respect, I submit that Flannigan missed the point of Ladbury's argument. Ladbury, like many practitioners dealing with project-specific, unincorporated joint ventures,[38] simply deferred to the manner in which *the parties themselves* view their arrangement, which can also be inferred from the strategic alliance drivers discussed in Chapter 2. It will be remembered that the point of going into business with, in effect, a competitor or relinquishing part of one's control of a business opportunity in order to develop it in conjunction with another, is to take advantage of the other party's capabilities without actually having to assimilate them into one's own structure. A legal partnership would effectively do this, as by default one party will be able to bind its partner in affairs that are within the scope of the partnership business. Therefore, should a legal partnership be upheld contrary to the manifest intentions of the co-venturers, the latter will have ended up relinquishing more than control of a business opportunity. They will have relinquished control over their respective businesses; at least as far as the partnership business is concerned. Therefore, if the law is to claim that the parties' intention is what determines its treatment of their relationship, then the economic drivers of their relationship cannot be ignored.

Moreover, Flannigan does not appear to consider that s.1(1) refers to more than the operating arrangements between the co-venturers. The pivotal issue in the case law is the extent to which the parties operate their joint undertaking as agents of each other. A case where the 'in common' element was considerable, but there was no discernible mutual agency is *Thames Cruises v. George Wheeler Launches*.[39] In this case the court considered whether a partnership existed between members of an association (WPSA) of passenger boat operators on the Thames. The WPSA members provided their own boats and crews but otherwise operated as a single entity (in terms of ticket sales and pricing, marketing, operating timetables, staff training and sharing of net profits, with shares calculated according to the number of boats each operated). Despite that, Thomas J held that there was no partnership on the facts.[40] This was so, despite the fact

[38] E.g. G.M. Lewis, 'Comment: the Joint Operating Agreement: Partnership or Not?' (1986) *JERL* 80; M.R.K. Garnett, 'Joint Ventures' (1984) 49(4) *Arbitration* 327.

[39] [2003] EWHC 3093.

[40] *Ibid*, [50]-[51]; See also *Heap v. Dobson* [1863] 143 Eng. Rep. 864 for a similar arrangement, where co-venturers who chartered a cargo ship together and apportioned profits from the sale of the cargo according to the value of cargo each provided, was also held to not be a partnership; *Cf. Fromont v. Coupland* (1824) 2 Bing 170.

that they agreed to bear the losses of operating the WPSA business jointly.[41] The judge pointed out that each of the three WPSA members had their own separate limited company with activities distinct from those of the WPSA, was responsible for providing their own crew and boat at their own risk and there was never any question of being responsible for losses incurred by other WPSA members operating their own boats. Furthermore, the judge observed, they never submitted tax returns as a partnership, each member's share of the profits being accounted for in their respective company accounts.[42]

Conversely, *Russell v. Austwick*,[43] concerned an agreement between the plaintiffs and defendants to carry on the business of common carrier between London and Falmouth, a separate portion of the road being allotted to each, on the proviso that 'each of them, in his separate limit or division, should be considered as conducting an exclusive business, separate and apart from the others'. The defendants entered into an agreement with the officers of the Mint to carry silver coin by the waggons belonging to the different parties to the towns on the London-Falmouth route. Upon payment the defendants accounted to the plaintiffs fully. The defendants by themselves then entered into a second agreement with the Mint to carry coin to towns which were not on the London-Falmouth route, for which they did not account to the plaintiffs and claimed the whole benefit for themselves. It was held that the defendants had to account to the plaintiffs for the second agreement. The court considered the two agreements linked. In both cases the payments were made by cheque to the firm in general. Furthermore, even though the second agreement, being of a riskier nature, was charged at a higher rate, the officers of the Mint readily agreed to it because of their positive reflection on the first agreement. The mutual agency aspect of the relationship is evident from the defendants' brokering the first agreement and its execution by all members of the venture. The court considered this arrangement to be continuous when the defendants relied on the success of the first agreement to secure the second one. I submit, however, that in this case the involvement of the third party, the officers of the Mint, was crucial

[41] Smith J held this to be acceptable in the circumstances, on the basis that it was a reasonable consequence of operating the WPSA service; *ibid*, [50]; see also *Pratt v. Stick (HM Inspector of Taxes)* [1932] 17 TC 459 (an agreement to share in losses was not definitive evidence of an intention to form a partnership).

[42] The WSPA membership changed often, which must also have been a relevant consideration in holding that the WSPA was not a partnership, along the lines of *Daniels v. Deville*, n.19.

[43] (1826) 1 Sim 52.

in the court's decision to order an accounting on the second agreement. Had the client in the second agreement been different, the defendants might well have kept the whole benefit from that deal on the basis that it was outside the scope of the partnership. This was the Court of Appeal's reasoning in *Dean v. MacDowell*,[44] where the former partners of a salt merchant sought an accounting for profits he had gained by becoming involved in a secondary salt manufacturing business, while he was in a partnership with the plaintiffs. It was held that an account would have been available if the defendant had been engaged in business analogous or connected with the business of the firm, which was not the case on the facts.[45]

Finally, the 'in common' element of a partnership was considered in *Spree Engineering & Testing v. O'Rourke Civil & Structural Engineering*.[46] The case involved a joint venture between two companies for the construction of a natural gas compressor station for a third company. The venture was held not to be a partnership. Each co-venturer conducted its own part of the work independently from the other and dealt with the joint client separately. In spite of any joint meetings from time-to-time to review progress and some attempts to show a united front for their client's benefit (e.g. the use of stationary in the joint venture's name), the court held that the undertaking was not run as a single business for the purposes of PA(1890).[47] Flannigan dismissed Stow QC's judgment as misguided, not least because the judge relied on a text of dubious authority on contractual joint ventures to reach his verdict. Thus, despite their distinct roles in the operation of the undertaking, Flannigan observed, the fact that the undertaking was operated in common could not be denied.[48] After all, it is commonplace that parties in a joint undertaking will assume distinct roles and perform their separate parts to achieve their common objective. Otherwise a joint undertaking would have been unnecessary. But I submit that the decision here was in fact correct, despite any misgivings as to the judge's choice of guidance. The parties' approach to their client should be sufficient evidence of their approach to their own relationship. Indeed, despite some attempts to

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[44] (1878) 8 ChD 345.

[45] Cotton LJ, went on to clarify what would amount to a 'connection' between the two businesses: 'if he makes any profit by the use of any property of the partnership, including … information which the partnership is entitled to, then the profit is made out of the partnership property and therefore … it must be brought into the partnership account'; see also *Somerville v. McKay* (1810) 16 Ves. 382; *Trimble v. Goldberg* (1906) AC 494.

[46] [1999] EWHC 272.

[47] *Ibid*, [16]-[17].

[48] Flannigan(2009), n.37, 717.

show a united front in order to facilitate matters for their client, nothing in the operation of the undertaking was, in fact, common. Each venturer would contact the client separately from the other and would not apprise the other of this. It appears that the co-venturers approached their common client as two separate businesses, who happened to operate the client's brief at the same time. In my view, this is a rather strong indication that the co-venturers never intended to submit to the other's authority so as to be bound by the other during dealings with their joint client.[49] They did not intend to be, nor did they become, each other's agent in the joint undertaking and therefore no partnership could arise between them.

3.3.1.3 "... with a view to profit"

Finally, the purpose of the parties embarking on the joint undertaking must be the generation of profit. Generally, profits are defined as the result of deducting total costs (operational and fixed) and expenses from the total revenue of a business. Thus, s.2(3) of PA(1890) provides expressly that receipt of profits in a business, as opposed to gross returns,[50] is *prima facie* evidence of a partnership. This proposition used to be applied strictly so that any share of profits from a business, regardless of the circumstances, would give rise to a partnership.[51] The position changed drastically following the House of Lords' decision in *Cox v. Hickman* considered above, so that the sharing of profits should now be considered fairly together with any other circumstances, 'not attaching undue weight to any of them, but drawing an inference from the whole'.[52] So in *Smith*

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[49] *Cf. Thames Cruises*, n.39, where the co-venturers presented a united front to their customers. However, the customers of the cruise boats were not the only third parties dealing with the co-venturers, each of whom dealt separately with their own distinct suppliers, as they provided their own crews and boats to the venture. The suppliers dealt with each participant in their own distinct capacity and therefore again, the mutual agency requirement is defeated. See also *Barton v. Hanson* (1809) 2 Taunt 48.

[50] PA(1890), s.2(2).

[51] See, e.g., *Grace v. Smith* (1775) 96 ER 587; *Waugh v. Carver* (1793) 126 ER 525.

[52] *Davis v. Davis* (1894) 1 Ch. 393, at 399, per North J; See also *Badeley v. Consolidated Bank* (1888) 38 ChD 238, 258, per Lindley LJ; and see *Mollwo March*, n.28, where the Privy Council held that a lender, who, having started getting involved in the firm's affairs in order to obtain security for the significant outstanding debts to him, became entitled to receiving 20 percent of profits was held not to be a partner. The receipt of profits was a mere repayment on the loan. *Cf. Pooley v. Driver* (1876) 5 ChD 458 and *Ex parte Delhasse* (1878) 7 ChD 511.

v. Watson,[53] an agent receiving a share of profits in lieu of commission was not a partner. Instead, the court held that the profit sharing was intended to be merely a performance incentive for the agent. Generally, the current legal position is that the *prima facie* evidence can be rebutted by other evidence, which, on the balance of probabilities, may show that no partnership was in fact intended.[54] Regardless, the sharing of profits is still a strong indication of the intention to create a partnership as illustrated more recently in *Geary v. Rankine*.[55] In this case, despite the fact that the appellant ran a guesthouse together with the respondent for nearly 12 years, she was held not to be a partner in the business, because, *inter alia*, the business' profit and loss accounts showed no share of profits ever having been paid to the appellant. This indicated that the arrangement was never intended to be a business partnership.

Conversely, sharing gross returns in the business is not evidence of partnership at all[56] and in fact, in practice, tends to point away from it.[57] Indeed, one of the reasons Stow QC rejected the partnership argument in *Spree Engineering* was the fact that the co-venturers shared in gross returns rather than profits. Therefore, in order to ascertain whether a contractual joint venture would give rise to a partnership among its participants, it is important to determine what kind of outputs from the joint venture constitute 'profit' for the purposes of ss.1(1) and 2(3) of PA(1890). These findings along with any observations as to the manner in which the parties conduct their joint undertaking should give us a clear view of the status of their relationship in law.

For these purposes, difficulties may arise when the parties share not in profits (or indeed gross returns, as classically viewed) but in product. For instance, there is some debate in the literature on contractual joint ventures as to whether partnership law would apply to the project-specific joint venture given that many such arrangements involve the

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[53] (1824) 2 B&C 401; see also *Holme v. Hammond* (1871-72) LR 7 Ex 218 (executors of a deceased partner in receipt of profits from the partnership business, as per the partnership deed, were not partners, as they took no part in the business nor had any say in its affairs).

[54] *Phillips v. Revenue and Customs Commissioners* [2010] SFTD 332, [79]-[81].

[55] [2012] EWCA Civ 555.

[56] PA(1890), s.2(2).

[57] *Burnard v. Aaron and Sharpley* (1862) 31 LJCP 334 (joint owners of a ship, where one had exclusive management of it, bore all expenses and paid 1/3 of gross earnings to the other, were held not to be partners); *Dry v. Boswell* (1808) 1 Camp 329 (an owner and a master of a ship who shared gross earnings, were not partners).

sharing of product among the co-venturers rather than profit.[58] This is the case with many joint ventures for natural resources exploration and extraction, where the parties agree to share in the resource (usually for further processing) rather than sell it and share the profits. In this regard, Crommelin went as far as to observe 'the receipt of product is one step further removed from partnership than the sharing of gross returns'.[59]

On the other hand, Flannigan made nothing of this distinction, explaining that whether sharing in product or profit is immaterial, as the product will eventually translate into profit for the receiving venturer in any case.[60] This is, of course, correct, as the co-venturers' paramount objective in pursuing a joint undertaking is always commercial gain, however indirect the means. Nonetheless, I submit that if the drafters of PA(1890) intended that a distinction between receiving net profits and gross returns was to be made in s.2, so that sharing profits is *prima facie* evidence of partnership and sharing gross returns is not, then any similar distinction from receipt of profits should be considered seriously.

The question of partnership is one of both law and fact.[61] It will be remembered that the law's current approach to the application of the partnership regime defers to the intention of the parties as manifest from their conduct of the joint undertaking. The law requires the parties to commit to a high degree of kinship, what Lord Halsbury described as '*community of interest*'.[62] A share of profits, where there are no contradicting circumstances, would, I submit, signify such kinship. Before the co-venturers can share profits, they must first deduct costs and expenses from total revenue. If those costs exceed the total revenue then the alliance has suffered a loss, which at this stage will be born jointly. For if the parties had agreed to bear losses separately, they would have agreed to share the total revenue and deduct their own costs from their respective shares. And such a situation would normally point away from partnership. However, sharing losses, as well as profits, is powerful supporting

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[58] M. Crommelin, 'The Mineral and Petroleum Joint Venture in Australia' (1986) 4 *JERL* 65; Merralls n.23, Ryan n.15, Ladbury, n.16, Lewis, n.38.

[59] Crommelin, *ibid*, 68.

[60] Flannigan(2009), n.37, 728.

[61] *Keith Spicer Ltd. v. Mansell* [1970] 1 All ER 462, 463e, per Harman LJ.

[62] *Adam v. Newbigging* [1888] 13 AC 308, 315 (my emphasis).

evidence of an intention to form a partnership,[63] for there is an evident 'community of interest' in the parties' willingness to address the risks of their venture jointly.[64]

This is not the case where receipt of product is concerned. Naturally, as Flannigan observes, product to be shared has been generated from activities carried on *in common*.[65] But, as *Spree Engineering* and later *Thames Cruises* indicate, an activity carried out in common does not equal community of interest. So, in the contemplated project-specific joint venture, sharing in product entails that each co-venturer acquires a distinct property interest in the quantity of product they receive. This means that they are each entitled to make whatever use of their share as they see fit, without any interference from the others. Any profits generated from the subsequent sale or processing of their share will be theirs alone, as will any losses. In this respect, Lord Cairns in *Syers v. Syers*[66] held that a co-partnership in profits is a co-partnership in the assets by which the profits are made. Therefore, when the assets from which the profit is eventually generated are split before a collective assessment of profit and loss is made, no partnership can subsist on these facts alone, for there is no evident community of interest. This is also supported by Lord Loughborough's dicta in *Coope v. Eyre*,[67]

> 'in order to constitute a partnership, a communion of profit and loss is essential. The shares must be joint, though it is not necessary that they should be equal. If the parties be jointly concerned in the purchase, they must also be jointly concerned in the future sale, otherwise they are not partners'.

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[63] *Moore v. Davis* [1789] 11 ChD. 261; *Green v. Beesley* (1835) 132 ER 43; *In re Howard* [1877] 6 ChD 303. (here, the court noted the distinction between bearing losses and being responsible for the business debts); *Fenston v. Johnstone* (1940) 23 TC 29; *Walker West Developments v. Emmett* (1978) 252 E.G. 1171 (here, an agreement providing for reasonable distribution of financial burden and a degree of sharing overheads between a property developer and a builder was held to be a partnership – no provision on loss-sharing was necessary, as this was to be dealt with under PA(1890), s.24: in the absence of agreement, partners are to share losses equally); *Cf. Walker v. Hirsch* [1884] 27 ChD 460 and *Mair v. Glennie* (1815) 105 ER 323 (But note: in both these cases the plaintiffs had not been allowed any discretion in conducting the business affairs, despite having been given shares in profits and obligations to bear a proportion of the losses), see also *Smith v. Watson*, n.53, as well as *Stocker v. Brockelbank*, n.33 and, more recently, *Wilson v. Dodd* [2012] EWHC 3727 (the plaintiff was held not to be partner, as there was no evidence or suggestion that he was to be directly liable for the losses and debts of the business).

[64] Along the lines of *Reid v. Hollinshead* (1825) 107 ER 1281.

[65] Flannigan(2009), n.37, 728; even in the cost-paid production scenario that Flannigan contemplates, the fact that the parties would eventually receive, in his words, *"net product*" is immaterial when considered in light of the wider community of interest requirement: the economic incentive of entering into the joint undertaking for each co-venturer had been the generation of profit and this is the purpose of generating the product – the fact that the contemplated profit *is not generated jointly* is what indicates lack of community of interest in the larger venture.

[66] (1876) 1 App Cas 174.

[67] (1788) 1 Hy Bl 37, 48.

Coope v. Eyre involved an agreement among a number of merchants to purchase a cargo of oil jointly, but in the name of one of them only, and to take distinct shares of the cargo, to dispose of independently of each other. When the ostensible buyer failed to pay for and take the oil, the rest of the merchants were not liable as partners of the buyer. Similarly, the earlier decision of *Hoare v. Dawes*[68] involved the purchase of large quantities of tea by a broker for several merchants, each, the broker included, to take separate shares and dispose of the tea independently of the others. When the broker borrowed using the tea-warrants as security, the lenders sought to recover from his employers as partners, after the broker had become bankrupt. It was held that the broker was not in partnership with the merchants who brokered the purchase. There was 'no undertaking for one to advance money for another, nor any agreement to share with one another in the profit or loss'.[69] Therefore, merely sharing the product generated from the common activities, assuming that the parties have not been conducting their undertaking in such a way as to manifestly submit to each other's authority within the scope of the venture, entails that there is no community of interest in the joint undertaking and therefore no partnership intended.

3.3.2 Consequences of a partnership finding for the co-venturers

What is the practical effect of the parties to a contractual joint venture being identified as partners? First of all, their relationship, subject to the joint venture agreement,[70] will become subject to PA(1890). The relationship being identified as a partnership will not give rise to a separate legal entity,[71] therefore the parties will continue to be personally liable for debts incurred while conducting the joint venture business. Furthermore, as the law recognises that the parties are carrying on the business in common with a view to profit, it also provides that all parties will have an equal right to participate in the joint venture's management[72] and be entitled to share in the profits,[73] as well as bear any losses jointly.[74] Therefore, thus far, a partnership characterisation would not

[68] (1780) 1 Dougl 371.

[69] *Ibid*, 373, per Lord Mansfield.

[70] PA(1890), s.24.

[71] With the exception of Scotland, where a partnership is a legal person distinct from the partners, although individual partners may still be liable for debts of the partnership; PA(1890), s.4(2).

[72] PA(1890), s.24(5).

[73] PA(1890), s.24(1).

[74] *Ibid*.

significantly alter the mechanics of the joint venture relationship, given that the manner in which the venture's outputs (or any losses) are apportioned was to be determined by the joint venture agreement anyway.

What changes is the *foundation* of the joint venture relationship; the joint enterprise is now carried on by the parties not only as principals in a contractual relationship, but also as each other's agent.[75] In other words, the parties run the business for each other's benefit and bind each other in all matters within their authority.[76] Four consequences stem from this:

a) Joint and several liability

First, the parties are now jointly and severally liable for the alliance's liabilities and obligations.[77] This is especially significant, as any one venturer could become liable for the whole of the business' debts, regardless of any agreement among the parties as to the proportion of liability each is to bear.[78] In this case, the venturer would be entitled to an indemnity from his co-venturers,[79] although this would be pointless where the latter have become insolvent.

b) Default fiduciary status

Secondly, the once purely contractual relationship will take on a fiduciary character, which arises automatically from the parties' now established mutual agency status. For the parties, this entails mutual duties of the highest standard of conduct, such as duties of utmost loyalty and good faith and to avoid conflicts between their own interests and those of the alliance. The operation and effect of such duties on the relationship will be examined in Chapters 5 and 6. However, for the purposes of this section, it suffices to observe that following a partnership finding the co-venturers will become subject to a set of duties, which they may not have accounted for when they agreed to the joint undertaking.

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[75] PA(1890), s.5.

[76] *Ibid*; PA(1890), s.6.

[77] PA(1890), ss.9-10, 12.

[78] Although it may be possible to avoid liability where the debt was incurred by a partner outside of his agreed authority and the affected third party had notice of this; PA(1890), s.8.

[79] PA(1890), s.24(2).

c) Partnership property?

Thirdly, as partners, the co-venturers own the joint venture business as joint tenants, having 'a beneficial interest in the form of an undivided share in the partnership assets'.[80] The partnership assets comprise 'all property and rights and interests in property originally brought into the partnership stock or acquired, … on account of the firm, or for the purposes and in the course of the partnership business'.[81] In principle, therefore, the assets originally brought into the joint undertaking by each co-venturer become partnership property. Consequently, individual co-venturers may end up relinquishing control over major and/or sensitive assets, particularly where these are knowledge based, such as proprietary technology or processes, which up to that point gave the proprietor a competitive advantage in the industry and over its co-venturers. This may be particularly problematic where the asset in question is not protected by a registered property interest, such as a patent (which by default has a finite duration), but by a matrix of confidentiality agreements, if at all.

Having said that, in anticipation of their relationship being identified as a partnership, it might be possible for the parties in the contractual joint venture to ensure that they retain sole ownership of the asset, along the lines of the decision in *Yafai v. Muthana*.[82] The issue in this case was whether the property from which a car servicing business was being conducted constituted partnership property. The property was bought in the name of the appellant only and the partnership deed referred to it throughout as being the property of the appellant, who was leasing it out to the business. The definition of the business itself did not include the property either. On these facts, the Court of Appeal held that the property in question was not partnership property.[83] It should be possible therefore to draft the joint venture agreement in such a way as to assert exclusive ownership of particularly sensitive assets for individual co-venturers, in anticipation of a partnership finding. On the other hand, I contend that such a provision might be of little use where the sensitive asset, e.g. an industrial process, is integral to the conduct of the business. Arguably, the property in *Yafai v. Muthana* was not integral to the car servicing business as the business could be carried on from other premises if

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[80] *Memec Plc v. The Commissioners of Inland Revenue* (1998) I TLR 3, 16, per Peter Gibson LJ.

[81] PA(1890), s.20.

[82] [2012] EWCA Civ 289.

[83] *Ibid*, per Sir Andrew Morritt C, [28]-[31].

necessary. This will not be so where the business is thoroughly dependent on the availability of an industrial process or sensitive technology. An inability to separate the asset from the joint venture business may mean that the asset becoming partnership property may not be avoided.

d) Remedies in the event of default

Fourthly, once the co-venturers are identified as partners their remedy options in the event of default by a co-venturer become significantly limited. This is because the courts are generally reluctant to intervene in the affairs of a partnership unless the parties are in fact seeking the dissolution of the partnership.[84] Moreover, a consequence of partnership is that partners cannot sue each other in contract, and therefore they cannot claim damages for another partner's breach of the partnership agreement.[85] This is because partners cannot be in a relationship of debtor and creditor.[86] Thus, while the partnership subsists, the remedies available to partners as against each other are strictly equitable.[87] These include an injunction to stop a partner's offending conduct (e.g. where the partner is involved in a competing business or is using partnership assets, including information, for their own gain or is excluding other partners from the management of the business); specific performance of certain obligations in the partnership agreement (e.g. to compel a partner to make the partnership books available for inspection); rescission of a partnership agreement where it was entered as a result of fraud or misrepresentation; appointment of a receiver; an order for an account of the partnership affairs; and/or an order for dissolution of the partnership following an account.

Contractual damages are only available to partners as against each other following an account of the partnership affairs and the dissolution of the partnership.[88] Thus, in the

[84] See Lord Lindley's comments in R. I'Anson Banks, *Lindley and Banks on Partnership* (Sweet & Maxwell, 2010), [23.16].

[85] See, e.g., the discussion of the rule in *Rosenberg v. Nazarov* [2008] EWHC 812, [48]-[56], per Thomas Ivory QC.

[86] *Hesketh v. Blanchard* (1803) 102 ER 785; *Clark v. Glennie* (1820) 3 Stark 10; *Fromont v. Coupland* (1824) 2 Bing 170; *Bovill v. Hammond* (1827) 6 B&C 149; *Richardson v. Bank of England* (1838) 4 My&Cr 165; *Carr v. Smith* (1843) 5 QB 128; *Meyer and Co. v. Faber* (No 2) (1923) 2 Ch 421.

[87] See I'Anson Banks, n.84, [23.15]ff.

[88] I'Anson Banks, *ibid*, [23.210], contends tentatively that an action in damages can be available as against partners and cites *Trimble v. Goldberg* (1906) AC 494, where, at 500, Lord Mcnaghten remarked *obiter* that "[had the partnership agreement expressly forbidden the purchase of certain land] the other … partners discovering the breach of contract might have claimed immediate dissolution, or even

case of a contractual joint venture identified as a partnership, damages against a co-venturer who breached the joint venture agreement causing loss to one or more of the others would be available only once an account of the joint venture affairs is complete, i.e. once all external obligations have been met, the co-venturers have been apportioned their due from the joint outputs and assets and the joint undertaking has been dissolved.[89] This is also the case where the co-venturers seek to expel one of their number from the joint undertaking for frequent or severe breaches of the joint venture agreement. If the relationship is deemed to be a partnership, it must be dissolved, all assets sold off[90] and an account taken, before it can be reconstituted, if at all, between the co-venturers who wish to continue the joint undertaking without the offending party.

I submit that, more than anything else, it is this consequence of the partnership form that renders it unfit as a governing mechanism for the contractual joint venture. Considering the tenets of rational bargaining in the context of cooperation and the widely accepted drivers of synergy, examined in Chapters 1 and 2 respectively, it should be clear that the primary objective of the joint undertaking and – I would extrapolate – the joint venture agreement, is the preservation of a working relationship between the co-venturers. The courts' prioritising the dissolution of the relationship, where it should be presumed that the parties' intention is to preserve it, makes the partnership form a patently unsuitable regime to govern contractual joint ventures.

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damages, on proof of actual loss to the partnership". However, I contend that this point only confirms that damages cannot be available without prior dissolution of the partnership. Given the subsequent development of the law on this issue, it is more plausible to interpret these *dicta* as damages being claimed *in addition to* dissolution. Therefore, unless other equitable remedies are more appropriate, dissolution appears to be a compulsory route for the parties seeking recourse against each other. This was also the case in *Broadhurst v. Broadhurst* (2006) EWHC 2727 (damages were available as against a former partner, but the partnership had already been dissolved and an account agreed to be taken. The court did not need to consider the alternative, i.e. whether damages would have been available if the partnership was ongoing).

[89] *Hurst v. Bryk* (2002) 1 AC 185, 194 (on the special nature of the partnership contract), and 199-200 (on the nature of the remedies available as against partners, and in particular the applicability of the doctrine of repudiation and its effect on a partner's obligation to contribute towards the liabilities that the partnership incurred while they had been a partner), per Lord Millett; see also *Cowan v. Wakeling* (2008) EWCA Civ 229, where the Court of Appeal held that the judge at first instance had no basis to award damages as against a partner. The damages award was instead to be treated as constituting the taking of an account of what the defendant owed the claimant.

[90] Although, a *Syers v. Syers* order, n.66, (i.e. where a partner's interest in the business is small enough so that it may be bought out by the other partners without the partnership business being dissolved and its assets sold off) may be available in the circumstances.

In addition to this, the inability of the parties to rely on the provisions of the joint venture agreement to effectively curtail opportunistic behaviour from co-venturers increases the risks of cooperation to a degree where, realistically, it could be imprudent to pursue a relationship in the first place. Granted, it may be possible for co-venturers-turned-partners to take out insurance against the consequences of joint and several liability for obligations incurred or wrongs committed, while conducting the joint venture-turned-partnership business. However, not being able to enforce the letter of the joint venture agreement itself, and particularly the provisions on party default, entails the parties' losing more control than they were prepared to relinquish originally. This could render the contractual joint venture route unduly risky with wider knock-on effects on its employment as a vehicle for growth. Indeed, aside from the higher degree of financial risk, it could also prove fatal for the securing of finance for individual co-venturers. For instance, it will be remembered that in return for providing finance to individual co-venturers, lenders may insist on being assigned choses in action based on the joint venture agreement.[91] Therefore, in addition to the joint venture members, lenders also have a vested interest in the enforceability of the agreement against all relevant parties, including parties to the joint venture itself. In the absence of such a right, a loan may be more expensive or even improbable. For these reasons, I submit that the difficulties arising from the partnership form in this context are precisely what a legal regime fixated on the integrity of the commercial bargain should seek to avoid.

3.3.3 Excluding partnership in contract?

Could the co-venturers overcome the difficulties considered above by including in the contract a declaration that they intend no partnership? The rule in this case is rather clearly stated by Cozens-Hardy MR in *Weiner v. Harris:*

> 'Two parties enter into a transaction and say "it is hereby declared there is no partnership between us." The Court pays no regard to that. The Court looks at the transaction and says "is this, in point of law, really a partnership? It is not in the least conclusive that the parties have used a term or language intended to indicate that the transaction is not that which in law it is.' [92]

Regardless, it is common practice in commercial joint venture contracts to include clauses which specifically deny the creation of a partnership or agency between the

[91] Ladbury, n.16, 332.

[92] [1910] 1 KB 285, 290.

parties.[93] In *Ketteringham v. Hardy*[94] a clause of this type was successful. The case involved a joint venture between two lifelong friends one of whom passed away and his estate was then sued by his co-venturer, who claimed that the estate had to contribute to the significant losses of the venture because he and the deceased had been partners. The no-partnership clause was upheld, on the basis that it had been drafted by the defendant's lawyers and, in contrast to past dealings, the defendant and the deceased bought the development land in the defendant's sole name, who alone had been responsible for the mortgage payments. It is clear then that the clause was simply used as a means of confirming the parties' intentions as manifest from their conduct of the joint venture up to the point of the dispute. Similarly, a no-partnership clause may be useful for ascertaining the nature of the parties' relationship when the agreement on which they conduct their joint undertaking is vague or simply badly drafted. This was the case in *Macintyre House v. Maritsan Developments*,[95] which concerned the treatment of VAT in a joint venture between a land developer and a consultant. The court held that the way the agreement was drafted made no business sense and relied on the clause to confirm that the parties never in fact intended to form a partnership.

These cases illustrate the fact that the Court will look into the reality of the parties' relationship and any clause that seeks to define it will be used as a mere tool for ascertaining their intentions. The question then becomes one of whether the court *should* take this statement of intent by the co-venturers at face value, given the commercial nature of the contract and the courts' general aversion to interfering into commercial bargains negotiated at arm's length.[96] Flannigan contends[97] that where the status assertion clause is clearly worded, it should duly bind the parties who have agreed to it. In the interests of commercial certainty and consistency with past court practice regarding commercial bargains, I agree. It is of course trite law that a clause of this type cannot bind third parties, because they are not privy to the contract between the co-venturers.[98] Thus, following such cases as *Waugh v. Carver*,[99] there may be a

[93] Early examples include *Waugh v. Carver*, n.51; *Russell v. Austwick* (1826) 1 Sim 52; *Bullen v. Sharp*, n.31.

[94] [2011] EWHC 162.

[95] [2011] CSOH 45.

[96] Considered at length in Ch.4.

[97] R. Flannigan, 'The Limits of Status Assertion' (1999) 21(4) *A.Q.* 397 (hereafter, 'Flannigan(1999)')

[98] See e.g. the comments of Blackburn J in *Bullen v. Sharp*, n.37, 113.

[99] (1793) 126 ER 525.

distinction drawn between how the co-venturers conduct their relationship *inter se* and the co-venturers' relationship with regard to third parties. *Waugh v. Carver* concerned a joint venture between two well-established shipping agents at different ports who agreed to share in certain proportions the profits of their respective commissions and the discount on the tradesmen's bills employed by them in repairing the ships entrusted to them. The agreement included a detailed provision, which essentially denied all incidents of partnership between them. Eyre LCJ held that they were not partners *inter se*, but were liable as partners with reference to third parties.[100] This reasoning was employed later in *Hesketh v. Blanchard*[101] and in *Smith v. Watson*,[102] both of which did not concern no-partnership clauses, but it was evident from the facts that the parties never intended to be partners *inter se* although their relationship could be perceived as such by third parties.[103]

Therefore, in practice, any difficulty regarding such clauses would normally arise in disputes between co-venturers who wish to declare the clause void. There may be a number of reasons for this. Following on from the last section, the party asserting partnership may wish to avail itself of the pervasive proprietary interest in the business, which comes with being a partner in it.[104] Alternatively, the partnership hopeful may wish to avoid an action in damages for the breach of the joint venture agreement, given that partners are not in a position to recover debts from their co-partners. For instance, in *Green v. Beesley*[105] the plaintiff sued on an agreement for the transport of mail between Northampton and Brackley, which entitled him to a yearly payment of £9 per mile. The agreement also provided that the plaintiff was to pay his proportion of the expense of the cart, money to be received for the carriage of parcels to be divided between the parties and the damage occasioned by the loss of parcels to be borne in

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[100] They were liable on the basis that they shared profits. This side of the Court's reasoning was discredited later in *Cox v. Hickman*, n.28.

[101] (1803) 102 ER 785.

[102] n.53.

[103] This line of reasoning could also be another way of justifying the court's approach to the ship operators' alliance in *Thames Cruises*, n.39.

[104] See e.g. *Reynolds v. Bowley* (1866-67) LR 2 QB 474, concerning the interest of a dormant partner, where a brother and sister owned a farm in partnership, the business of which was run by the brother as his own, the sister assisting him. Upon the brother's bankruptcy, the question arose as to whether the farm assets could be transferred to his trustee in bankruptcy. Kelly CB held that this was a partnership with a dormant partner and that since the farm was partnership property, *both* partners were owners, so that there could be no property transfer in the circumstances.

[105] (1835) 132 ER 43.

equal proportions. On these facts, the court held that the plaintiff and defendant were in fact partners and therefore the plaintiff was not entitled to sue the defendant for the agreed £9 per mile. Another example would be the attempt to establish a partnership, despite having agreed to a no-partnership clause, in order to benefit from tax relief afforded specifically to partnerships. Thus, in *Fenston v. Johnstone*[106] the plaintiff sought a declaration that the tax commissioners assessed his income tax erroneously as remuneration for services rendered rather than as income from a partnership interest. The business in question was the purchase and development of land, in which the plaintiff was to receive one half of the profits in consideration for his assistance in the purchase (he introduced the land to his co-venturer), development and sale of the land. The agreement contained a no-partnership clause. The court held that on its true construction the agreement created a partnership, even though the third party, the tax commissioners, relied on the no-partnership clause to perform their assessment of the plaintiff.

I submit that it is in such cases that the courts tend to lose sight of the interests they wish to protect. For, by the courts' own admission on numerous occasions, a commercial bargain must remain intact so as to ensure certainty in commercial matters and to give effect to the parties' intentions. For instance, the court will not alter a contract in order to correct a bad bargain. At the same time, third parties are protected in any case, since there is a clear set of rules as to when they may be given recourse against one or more partners. Thus, if the co-venturers are in fact partners *inter se*, or have held themselves out to be partners (in cases such as *Smith v. Watson* and *Waugh v. Carver*, considered above), or the party who has held himself out to be a partner is, in fact, the other(s)' agent,[107] then the wronged third party will have recourse against the offending partner, ostensible or not, and his co-partner. A no-partnership clause between the co-venturers cannot affect that. Therefore, the only parties these no-partnership clauses affect are the parties to the joint venture agreement. Why, then, disregard a provision in an agreement between commercial parties when both have voluntarily conceded it? My contention is that there are no applicable policy reasons for dismissing no-partnership clauses and that the parties should not be allowed to use the judicial process to alter an agreement merely because it would suit them in future

[106] (1940) 23 TC 29.

[107] See *Gosling v. Gaskell* [1897] AC 575.

circumstances. However, my contention is subject to the proviso that a no-partnership clause is not to be synonymous with a clause disclaiming the existence of all fiduciary duties. The jurisprudence and mechanics of individual fiduciary duties (generally arising from agency) are quite distinct from the partnership regime, which operates autonomously, where the circumstances so warrant. The criticism in this chapter is restricted to the law of partnership governing the contractual joint venture by default and does not extend to the latter being subject to the fiduciary doctrine in general.

3.4 The joint venture as a distinct legal category?

In this section I will argue that the contractual joint venture should be acknowledged as a distinct legal category, so that a default governance model can be developed which accurately reflects the co-venturers' intentions. Thus, I will first consider the status of the contractual joint venture in different common law jurisdictions, where it has been addressed with varying degrees of clarity. Secondly, I establish that given the tenets of rational bargaining in the context of cooperation and the economic drivers behind collaborative market relationships considered in Chapters 1 and 2, a separate joint venture category is defensible.

3.4.1 The position in the UK

It is plain that in the UK the unincorporated joint venture does not comprise an autonomous legal category.[108] Regardless there have been instances where the courts have identified the contractual joint venture as something other than a partnership governed by default partnership law. In some of these cases the court was prepared to affix to the joint venture duties of honesty and good faith seemingly beyond those contracted for in the joint venture agreement. One such case was *Hampton & Sons v. Garrard Smith (Estate Agents)*,[109] where the Court of Appeal considered a dispute between estate agents for the accounting of commission on the sale of a number of flats. Dillon LJ held that 'this [was] not a partnership, but it [was] a joint venture raising obligations of good faith [towards the plaintiffs]'.[110] He did not explain why this was not a partnership nor what was the basis for a duty of good faith, especially since there

[108] See *Mair v. Wood*, n.1, 84: 'A joint adventure is simply a species of the genus partnership'.

[109] [1985] 1 EGLR 23.

[110] *Ibid*, 24.

is no such default duty in English contract law.[111] Nonetheless, in *Ross River v. Cambridge City Football Club*[112] the court was prepared to distinguish between a partnership and a joint venture holding that the sale agreement at issue 'had enough about it in the nature of a joint venture to require the parties to conduct themselves with mutual good faith'.[113] Again, there was no explanation as to the basis of the good faith obligation. This was also the case in *Rosenberg v. Nazarov,* where Thomas Ivory QC held that

> 'one can have a joint venture which is not strictly a partnership governed by the Partnership Acts, but which (depending on the circumstances) could give rise to duties of honesty and good faith similar to that of a partnership.'[114]

At any rate, these cases serve to illustrate that, in the UK, while the contractual joint venture is by no means an established legal category in its own right, the courts have started to recognise that default partnership law can be an inappropriate means of joint venture governance, because of the different drivers behind traditionally perceived partnerships and many contractual joint ventures. In *Daniels v. Deville*,[115] for instance, Lindsay J was prepared to accept that the relationship between a property developer and a solicitor, via his various companies, was not a partnership but 'instead was a *hybrid form* consisting of both individuals and companies'.[116]

3.4.2 The position in the USA

In the USA, the courts have been far more willing to distinguish between a partnership and a contractual joint venture, so as to almost afford the latter separate legal category status, even though, in practice, the result for the parties may well have been the same, if they had been identified as partners. For instance, in 1928 Justice Cardozo in the New York Court of Appeals equated co-venturers to 'copartners [owing] to one another, while the enterprise continues, the duty of finest loyalty' but did not label the relationship between the land developer and financier as a partnership, but went on to

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[111] Good faith in contract will be considered in Ch.5. For the moment, it should be noted that the lack of any analysis in *Garrard Smith* makes it a highly doubtful authority for the joint venture as a separate legal category: see Smith J's comments in *Thames Cruises*, n.39, [65].

[112] n.18.

[113] *Ibid*, [229].

[114] n.85, [58].

[115] n.19.

[116] *Ibid*, [36] (my emphasis).

treat it as a 'joint venture'.[117] This attitude is more clearly evident in an even earlier decision where the court explained that the growing popularity of the joint venture '[arose] from a desire to find words descriptive of joint enterprise yet not amounting to a partnership'.[118] The result of this judicial trend was polarising and produced a rather confused jurisprudence on the nature and status of joint ventures.

On the one hand, there are several American courts and legal scholars who treat the joint venture concept as distinct from a partnership. This faction has developed a list of criteria on what makes a collaborative relationship a 'joint venture' as opposed to a partnership but which does not help in drawing any clear-cut distinctions, not least because all of these are in fact attributable to partnerships as well. Thus, Jaeger summarises the essential elements of the 'joint venture' as follows:

> '(a) A contribution by the parties of money, property, effort, knowledge, skill or other asset to a common undertaking;
>
> (b) A joint property interest in the subject matter of the venture;
>
> (c) A right of mutual control or management of the enterprise;
>
> (d) Expectation of profit, or the presence of 'adventure'… ;
>
> (e) A right to participate in the profits;
>
> (f) Most usually, limitation of the objective to a single undertaking or *ad hoc* enterprise.'[119]

Most importantly, however, the joint venture must be founded on contract, express or implied, and the parties to it must make their intention to form a joint venture clear.[120]

The similarities of the joint venture, as described here, to the partnership form examined earlier are overwhelming. It is for this reason that the other side of the debate tends to be unrelentingly dismissive of the distinction between the two concepts. For instance, Mechem argued that if the legal consequences of being in a joint venture are the same

[117] *Meinhard v. Salmon*, 249 NY 458 (1928), 464.

[118] *Joring v. Harriss*, 292 Fed. 974 (2d Cir. 1923), 978.

[119] *Ibid*; see also *United States v. Standard Oil Co*., 155 F. Supp. 121 (D.C.S.D.N.Y.)

[120] *Learning Annex Holdings, LLC v Whitney Educ. Group Inc*., 765 F. Supp. 2d 403, at 412, (S.D.N.Y. 2011).

as being in a partnership then joint ventures and partnerships must be the same thing.[121] The circular logic of this argument is problematic as it assumes the very thing it seeks to establish, but I submit that in the circumstances it is reasonable. For instance, one of the main arguments in American literature supporting the distinction between the two concepts is that, in contrast to partners, co-venturers can sue each other in contract.[122] Naturally, one has to establish that the relationship before the court is not one of partnership, before the parties can be allowed to proceed with their case in law. Therefore, simply observing that co-venturers can sue each other in contract cannot assist in distinguishing the relationship from a partnership beforehand, for the ability to sue depends on a finding that the relationship is not in fact a partnership. Regardless, when dealing with the 'joint venture', American courts have on multiple occasions awarded co-venturers equitable remedies normally available to partners, and legal remedies (albeit in very limited circumstances) to partners, who as a rule, cannot sue each other in law.[123] More tellingly, co-venturers may also be jointly and severally liable with respect to third parties if they have held themselves out to be in a 'joint venture'. This was the case in *Shell Oil Company v. Prestidge*,[124] where Shell was found liable for the accident suffered by a third person at the work site of its drilling contractor, Rocky Mountain, and caused by the recklessness of one of Rocky Mountain's employees. Counsel for Shell argued that Rocky Mountain's relationship to Shell was that of an independent contractor. The Court of Appeals held that on the true construction of the agreement between them, it was obvious that the parties had joint control of the project and therefore were in a 'joint venture'. Consequently, Shell's vicarious liability for the actions of Rocky Mountain's employee was upheld, as it would have been, if the relationship had been approached as one of partnership.

Furthermore, it will be remembered that the joint and several liability of partners for acts committed within the scope of the partnership business stems from the fact that partners run the business as principals and agents of each other. However, some American courts have displayed confusion on this front when seeking to distinguish the

[121] F.L. Mechem, 'The Law of Joint Adventures' (1931) 15 *Minn.L.Rev.* 644.

[122] *Joring v. Harriss*, n.118; *cf. Ellis v. Frawley*, 165 Wis. 381, 161 N.W. 364 (1917), where the court ordered an accounting despite dealing with a 'joint venture' because of the complexity of the financial transactions involved.

[123] See a discussion of this in G.W. Miller, 'The Joint Venture: Problem Child of Partnership' (1950) 38 *Cal.L.Rev.* 860, 864ff.

[124] 249 F.2d 413 (1957).

joint venture from a partnership. Thus, in *Matanuska Valley Bank v. Arnold* the Court of Appeals held that:

> 'a joint venture is distinguished from a partnership in that one member cannot bind another unless he has either express authority or authority implied from the necessities of the particular transaction with which the joint venture is concerned'.[125]

With respect, this is precisely the basis upon which a partner may bind the firm as per s.5 of the UK's PA(1890), which was reproduced in s.9 of the Uniform Partnership Act (1914) in the US. [126]

Taubman attempted to establish a distinction between the two concepts by identifying several incidents characterising the joint venture, which purport to set it apart from partnerships and would explain the American courts' approach to it. These are:

1. Mobility of Association
2. Frequency
3. Diversity of factual patterns,
4. Confusion with other relationships,
5. Use of this resulting confusion for hindsight legal manoeuvring,
6. Incomplete formulation of its principles of law
7. Lack of planning for the joint venture.[127]

With respect, the incidents contemplated are not points of law in themselves, but observations from the employment of the joint venture concept in different contexts. This does not serve to distinguish the joint venture from partnership but rather to establish that 'joint venture' is such a generic term that could be applied to virtually any commercial activity which involves interaction between multiple economic agents: agency, lease, licence, partnership, contract for services, etc. From the proposed list, I can discern no reason for the American Courts' resistance to simply applying long

[125] 223 F.2d 778 (1955), 780.

[126] Now s.301 of the Uniform Partnership Act (1997).

[127] Taubman, n.1, 649; see also Weissburg, A. B. 'Reviewing the Law on Joint Ventures with an Eye Toward the Future' (1990) 63 *S.Cal.L.Rev.* 487.

established partnership law principles on the basis that the relationship under examination is in fact a partnership. Regardless, the treatment of joint ventures as distinct from partnerships has endured, despite the consequences for co-venturers being the same as those for partners. More recently this was demonstrated in *Excalibur Ventures v. Texas Keystone*,[128] where the High Court of England and Wales sought to apply New York law in a dispute between international parties in an oil and gas joint venture. In that case, Clarke LJ remarked that the US joint venture is in essence a partnership for a limited purpose.[129] Ladbury observes that this is certainly the case with the way the American courts treat the joint exploration or production of oil and gas, which tends to not attract partnership-like status at all.[130]

3.4.3 The position in Australia

In Australia, the courts' position on the joint venture/partnership debate is closer to that of the UK with the exception of the mining joint venture, which like its counterpart in the USA, appears to have taken a status of its own.[131] This is because joint venture arrangements in the resources industries are meant to avoid the tax implications of partnerships, but most importantly to allow individual co-venturers to raise finance from separate lenders.[132] This is possible because of the different ownership structure achieved through a contractual relationship among principals, where individual parties have identifiable shares in joint venture assets as specified in the joint venture contract. This is not the case with partners, who have joint ownership over the entirety of the business and the firm's assets.[133] Thus, Merralls observed that the distinguishing characteristics of a standard mining and petroleum joint venture are that:

> 'first that the participants hold their interests in the assets of the venture in common and their liability is several, second that an operator or a manager is

[128] [2013] EWHC (Comm) 2726

[129] *Ibid*, [1157]-[1161]; note also the discussion of the 'single transaction' argument in *3.3.1.1.*

[130] Ladbury, n.16, 322.

[131] See *Mount Isa Mines Ltd. v. Seltrust Mining Corp.*, 5 July 1985, (1994) 13(4) AMPLA Bulletin 172; *Red Hill Iron Ltd. v. API Management Pty Ltd.* [2012] WASC 323, where the Supreme Court of Western Australia rejected all assertions of a fiduciary relationship between parties in a joint venture concerned with the exploration for iron ore; see also the NSW Court of Appeal decision in *Brian v. United Dominion Corporation* (1983) 1 NSWLR 490, 506, where Samuels JA adopted the US definition of joint ventures.

[132] Ryan, n.15, 122-124.

[133] See *3.3.2(c).*

> interposed between the participants and the operation and third that the participants receive the fruits of the venture separately and in kind'.[134]

However, outside the natural resources realm, the Australian position on the status of joint ventures is well illustrated by the decision of the High Court in *Canny Gabriel Castle Jackson Advertising v. Volume Sales (Finance).*[135] Here, the High Court of Australia considered an agreement between Fourth Media Management (FMM), a music promoter who held contracts for appearances by Cilla Black and Elton John, and Volume Sales (VS), a financier. Under the terms of the agreement, VS undertook to finance FMM's contracts to the tune of $70,000, in consideration of which VS was to take a half interest in FMM's contracts. The agreement further stipulated that the advance was to be treated as a loan and repaid to VS prior to the distribution of profits (and in full, with no deductions, should the FMM contracts fail), the profits were to be divided equally between FMM and VS, and the policy of the joint venture was to be decided jointly by them. Finally, all proceeds on the FMM contracts were to be paid into a bank account to be set up solely in VS' name. At first instance, the Supreme Court of New South Wales held that the arrangement between FMM and VS was a joint venture, which did not constitute a partnership but did provide VS with an equitable interest in the joint venture proceeds as they accrued. On appeal, the High Court upheld the judge's declarations as to VS' equitable entitlements but on the ground that the joint venture between FMM and VS was in fact a partnership. This was because the parties were co-venturers in a commercial enterprise with a view to profit; they were to share the profits; the policy of the joint venture was a matter of joint agreement; and the parties were concerned with each other's financial stability, which is generally common with partners.

A few years later, the High Court solidified its approach towards collaborative commercial relationships in *United Dominions Corporation v. Brian.*[136] The case concerned a joint undertaking for the development of certain land between United Dominions (hereafter, UDC), the primary lender, SPL, the venture manager in whose name the land was purchased, and Brian, an investor. Prior to completion of their formal

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[134] Merralls, n.23, 2. See also M.C. Chetwin, 'Joint Ventures – A Branch of Partnership Law?' (1990-1991) 16 *UQLJ* 256, 266, who observes that interposing the manager/operator between the co-venturers and the operation can avoid the co-venturers' acting as each other's agents; for an account of the typical main provisions of such an agreement see Ryan, n.15, 122-124.

[135] (1974) 131 CLR 321.

[136] [1985] HCA 49.

agreement, SPL took out a mortgage on the land for the benefit of UDC in order to secure the money it lent to the venture. The land was successfully developed and sold. UDC then sought to rely on a collateralisation clause and cash in on the mortgage in order to satisfy debts owed to it by SPL in respect of past dealings between UDC and SPL, which were in no way related to the venture between UDC, SPL and Brian. Thus, UDC placed a claim on the profits of the development, which otherwise would have been distributed among the co-venturers. Brian sued for breach of fiduciary duty, on the ground that it was inequitable for UDC to take out the mortgage against the land in order to recoup money owed to it by SPL without first disclosing its intentions to the other co-venturers. Because of the scarce Australian authority on the distinction between joint ventures and partnerships, the New South Wales Court of Appeal relied on American authority and held that there was a joint venture between the parties, which by default raised fiduciary duties, similar to those of partners, extending from the negotiation stage through to the completion of the venture. However, the High Court held that the parties had in fact formed a *partnership*, which was limited to the joint undertaking and therefore there was a fiduciary duty to disclose by default. In other words, the High Court refused to attribute separate legal status to the joint venture concept. However, the High Court accepted that whether fiduciary duties arise between parties in a commercial agreement is not always a question of the status of their relationship in law (namely, partnership, agency, etc.), but whether the circumstances pointed to a fiduciary relationship between them[137] (see Ch.6). In *Brian* the fiduciary relationship happened to stem from the parties' being in a partnership. As with *Canny Gabriel*, the High Court relied on the fact that the agreement between the parties involved common participation in a commercial enterprise with a view to sharing the profit; the joint venture property, which was bought in SPL's name alone, was to be held in trust for the benefit of all the parties; and the undertaking was to be managed jointly by the parties.

3.4.4 The position in Canada

Canadian courts appear to have taken the US approach to the joint venture concept, as illustrated by the Nova Scotia Supreme Court decision in *Central Mortgage & Housing*

[137] The High Court took the same approach in *Hospital Products Ltd v. United States Surgical Corporation* [1984] HCA 64 (see Ch.6).

Corporation v. Graham.[138] Here, the plaintiff (CMHC), a social housing financing company, contracted with a builder to build a number of houses for low-income buyers, CMHC to cover the full cost of the construction and also provide the mortgages for prospective buyers, whom CMHC alone would approve. The defendant purchased one of the houses with the help of a mortgage provided by CMHC but refused to continue with the mortgage repayments, when the house he moved into developed serious defects. CMHC sought to foreclose on the house and the defendant countersued seeking damages on the basis that CMHC was liable for the defective construction of the houses because it was in a joint venture with the builder. Jones J held that:

> '… there was a *contribution by both parties of money, property, skill and knowledge to a common undertaking*. There was a *joint property interest* in the subject matter even though evidenced only in the mortgages. The parties had a *mutual control and management of the enterprise* during the construction of the houses and in the sales. The arrangement was limited to this project. *There is no doubt that [the builder] intended a profit from the project.* While there was not a mutual sharing of the profits, Central Mortgage clearly had a financial interest at stake and *was vitally concerned with the successful completion of the venture* … Based on the evidence, the arrangement between Central Mortgage and [the builder] can be characterized as a joint venture. To the extent that [the builder] in carrying on the venture incurred liabilities then both parties were bound.'[139]

According to the judge, the parties clearly displayed the requisite kinship of interest in the undertaking to be partners and were therefore jointly and severally liable for wrongs committed in the scope of the partnership business. Yet, he did not acknowledge the relationship as a partnership, but rather identified it as a joint venture, which unaccountably gave rise to joint and several liability. The reason for this may have been that, from his own analysis, Jones J was not comfortable with declaring the arrangement a partnership because the dissonance in objectives between the builder (who sought to profit) and CMHC (whose priority was the construction of homes for low-income families) pointed away from the community of interest expected of partners. However, if that was the case Jones J should have explained that CMHC's liability towards the defendant, a third party, was founded on CMHC's holding itself out to be in a partnership with the builder or that the builder was in fact CMHC's agent, along the lines of *Gosling v. Gaskell*.[140]

[138] (1974) 43 DLR (3d) 686.

[139] *Ibid*, [70], my emphasis.

[140] n.107; see *3.3.3*.

Otherwise, in the absence of a contractual guarantee by CMHC, there was simply no ground for CMHC's liability for defects in the houses' construction.

Graham became a much-cited authority establishing the joint venture as a separate legal category in Canada, at least with respect to single-project arrangements, placing the Canadian joint venture on all fours with the US model.[141] The Alberta Law Reform Institute (ALRI) sought to take this approach further by proposing a statute allowing parties in single-project joint ventures to opt out from the application of partnership law.[142] They will be able to do this by declaring in their contract that their arrangement is not a partnership and by carrying on the business under a name that includes the term 'joint venture' or 'JV'.[143] The ALRI's proposal envisages the joint venture as a separate legal form, which will be entirely governed by the contract between the parties and the general principles of contract law. The ALRI however does not propose to change matters with respect to the co-venturers' relations with third parties, so that members of a joint venture will still be jointly and severally liable for debts incurred and wrongs committed within the scope of the joint venture.[144] Similarly, the ALRI does not propose statutory intervention with respect to the possibility of fiduciary duties being implied into the joint venture relationship, despite the parties including a no-partnership clause in their agreement.

The ALRI report on joint ventures is hardly a dependable document, despite the authority of its source.[145] For one it does not justify with any conviction the statutory establishment of the single-project-joint-venture as a separate legal form. It relies on vague statements by an Advisory Group, made up of professional legal counsel

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[141] This also appears to be the case in New Zealand, where the courts appear to treat the joint venture as a legal form akin to a partnership: In *Chirnside v. Fay* [2006] NZSC 68, esp. [92], the Supreme Court ruled that the parties' relationship was not a partnership, but a joint venture analogous to a partnership and as such raised fiduciary duties; see also *Paper Reclaim Ltd. v. Aotearoa International Ltd.* [2007] NZSC 26, esp. [31], where the Supreme Court chastises the Courts below for being too ready to find a joint venture when interpreting a contractual relationship between parties who had been collaborating for over 16 years:; similarly in *Maruha Corporation v. Amaltal Corporation* [2007] NZSC 40, esp. [20], the Supreme Court treated the 'joint venture' concept as something more than a generic description of a collaborative relationship, to the effect that former partners who continued the partnership business through a corporate vehicle to which they were both shareholders, were not in a joint venture for the purpose of establishing a fiduciary relation.

[142] Alberta Law Reform Institute, *Joint Ventures*, Final Report 99, May 2012, esp. [47] for a feeble justification of the 'single project' aspect.

[143] *Ibid*, [37]-[39].

[144] *Ibid*, [65]-[66].

[145] Hence the scathing commentary in R. Flannigan, 'Joint Venture Theurgy' (2013) *Can.Bus.L.J.* 368.

to major industry, as to the uncertainty of the law on joint ventures and the dangers of a joint venture being found a partnership. The ALRI does not elaborate as to what these dangers are but merely acknowledges 'the problem' in a vague, if rather urgent, tone.[146] It does not explain why clear and long established partnership law principles should not apply to single-project contractual joint ventures, especially since many of the arguments purporting to distinguish them from partnerships have been addressed in the case law.[147] However, if the ALRI report does reflect one thing accurately, this is the fact that parties in commercial joint ventures (particularly project-specific ones) do not generally perceive their relationship as one of partnership but simply as a risk-and-expense-sharing affair. And while this may not be enough to readily deviate from established law, it should give justices cause to reconsider the traditional approach to collaborative relationships and start contemplating the economic drivers behind them.

3.5 Conclusion

In summary, the default legal regime for contractual joint ventures is that of partnerships. Co-venturers pool resources in order to carry on a business in common with a view to profit. At the outset this is the very definition of a commercial partnership. However, the story told by the courts in different common law jurisdictions suggests that matters are rather more complicated. At varying degrees many of these courts recognise that co-venturers do not perceive their relationship as having the kind of kinship required of partners. For one, they rarely submit to each other's authority, expressly or impliedly,[148] so as to be bound by the others' actions. For another, they tend to do everything possible to avoid their relationship being identified as a partnership, such as sharing in outputs (including gross returns) rather than profits, expressly disclaiming partnership (or other) status in their agreement and filing separate tax returns. To my mind, it is this resistance to partnership status that drove courts in such jurisdictions as the USA and Canada to move towards recognising joint ventures as an autonomous legal form – one that looks remarkably like a partnership.

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[146] n.142, [28].

[147] As the ALRI itself acknowledges: *ibid*, [22]-[25]; and see generally *3.3.1.*

[148] It will be reminded, for instance, that the natural resources joint venture tends to be structured around an operator/ manager who acts as an agent for each individual co-venturer. This serves to insulate the co-venturers from each other.

I contend that the partnership regime, a long- and well-established body of law, is not, and has never been, an appropriate means of governing contractual joint ventures. Not because, as the ALRI contends in its reform proposals, the form and scale of such joint ventures has changed so dramatically in modern times that the law has become dated in comparison. Rather, it is because partnership law, founded in equity, did not develop with the concept in mind of separate business concerns cooperating in a relatively narrow regard. I submit that this was also evident to the Courts as early as *Waugh v. Carver*[149] where even though it was held that the shipping agents were partners by virtue of sharing profits, the Court was happy to accept that they were not partners *inter se*, but only with regard to their joint relationship with the world. Presumably then the parties in *Waugh v. Carver* would have been able to sue each other on the agreement between them, even though they would have to face joint and several liability with respect to third parties.

Establishing a new legal category to accommodate this type of collaborative relationship would go a long way in addressing the uncertainties complained of by the ALRI's Advisory Group. The ensuing legal model would recognise the lack of mutual agency in the parties and have the distinct advantage of implementing and enforcing the agreement underlying the parties' relationship, without first causing its dissolution. Naturally, by operation of estoppel they would still be subject to joint and several liability for debts incurred and wrongs committed in the course of joint venture business as against third parties. In other words, the new category would reflect the arrangement in *Waugh v. Carver*, where the parties are jointly liable as against the world but still not partners *inter se*.[150]

In the following chapters, I examine the mechanics of the contractual joint venture as a separate legal category. Specifically, I argue that, in addition to the contract between them, the new legal category should carry default rights and obligations for the parties, along the lines of partnership law. This is especially relevant since one of the reasons co-venturers seek to disclaim partnership status is to avoid the pitfalls of the equitable

[149] n.51.

[150] E.g. this prospect is acknowledged expressly in cl.1.05A of the CAPL [Joint] Operating Procedure, (CAPL, 2015)

remedies that come with a fiduciary relationship.[151] Thus, the purpose of the next chapter is to discuss the implication of an extra-contractual standard of conduct into the joint venture relationship in light of prevalent contract and economic theory.

[151] E.g. cl.6.2.4, Model Joint Operating Agreement for the UK Continental Shelf (UKOOA, 2002) excluding the Operator's liability for consequential loss, defined *inter alia* as loss resulting from breach of fiduciary duty – cl.1(b).

4 EXTRA-CONTRACTUAL STANDARDS OF CONDUCT

4.1 Introduction

The previous chapter demonstrated that identifying the contractual joint venture as a separate legal category, rather than subjecting it to default partnership law where the circumstances so require, would best align the objectives of English commercial law with those of the co-venturers, for it would reflect the tenets of rational bargaining in the context of cooperation and the economic drivers behind the co-venturers' synergy examined in Chapters 1 and 2, respectively. The crux of the new legal model would be to ensure that the agreement remains both central to the alliance and enforceable as between co-venturers, without prior dissolution of the venture. Yet, there are limitations to relying solely on the joint venture agreement to address tensions between co-venturers, because it is impossible to contract in the present about every eventuality that befalls the relationship in the future. I will refer to this issue as the problem of 'incomplete presentiation'.[1]

Partnership law addresses incomplete presentiation by subjecting the partners to specific rights and duties by default. These duties stem from the partners' status as agents of each other. I have argued, however, that mutual agency is unlikely to feature in contractual joint ventures, as their advantage lies in the preservation of the parties' autonomy (see 2.5.2 and 3.2). Thus, in order to preserve the joint venture relationship and to address the problem of incomplete presentiation, I contend that rights and duties akin to those of partners must be implied into the relationship by default. Such duties would represent an enforceable framework for appropriate co-venturer conduct (as determined by Gauthier's principle of constrained maximisation – see Ch.1), in effect forestalling opportunistic, or outright freeloading, behaviour. A gap-filling set of defaults would then effectively address the co-venturers' appropriation concerns (see 2.4.2), which is one of the foremost sources of conflict leading to alliance failure.

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[1] Defined as the parties' attempt 'to bring all the future relating to [the transaction] into the present, or,…, to presentiate. [The parties] can then deal with the future as if it were in the present'; I.R. Macneil, *The New Social Contract: An Inquiry into Modern Contractual Relations* (Yale UP, 1980), 19 (hereafter, 'Macneil (1980)'). Incomplete presentiation is discussed in *4.4*, but for a general discussion, see D. Campbell and J. Harris 'Flexibility in Long-term Contract Relationships: the Role of Cooperation' (1993) *J.L.& Soc'y* 166, 169.

There are three main objections to such thesis. First, if the relationship is to be governed solely by the parties' contract, then the contract must not be interfered with by introducing duties on which the parties never agreed. This would limit their ability to govern their own relationship and would introduce new unaccounted for transactional costs. This reflects the founding principle of English contract law, namely, that within the bounds of the law, parties are entitled to contract on anything they wish and when they do so freely, their bargain must be upheld intact. Therefore, English contract law would itself be an obstacle to the implication of extra-contractual duties into the co-venturers' relationship. Secondly, the problem of incomplete presentiation may be properly addressed through existing contract mechanisms, such as the use of adjustment clauses in the joint venture agreement. Furthermore, in the event of dispute, tension or even doubt over the correct interpretation of a contract term, the relationship itself may be refereed through the intervention of a neutral third party such as a mediator or an arbitrator. Therefore, the contract itself, through the use of an arbitration or third-party intervention clause, may protect the joint venture relationship without the need for extra-contractual duties. Thirdly, by definition, the joint venture represents a relational contract, namely a contract, which goes beyond the on-off exchange of promises and involves a relationship between the parties.[2] Parties in such contracts are best equipped to deal with whatever befalls their relationship on an *ad hoc* basis. Therefore, extra-contractual intervention is unnecessary to address the problem of incomplete presentiation – the co-venturers will solve any issues as and when they arise depending on the circumstances at the time. Furthermore, given that the preservation of the relationship is at the core of a relational contract the parties will address any issues with that aim in mind, *if* they still wish their relationship to subsist. Any further intervention in the form of default duties would be protectionist and burden the relationship with unnecessary hardship and may even introduce an extra degree of animosity in the event of dispute.

This chapter will address each of these objections in turn. Ultimately, I conclude that English contract law need not be an obstacle to the implication of extra-contractual duties into the joint venture relationship, so that a set of default duties can and should be a feature of a new legal category of contractual joint ventures. Their aim will be to ensure a minimum standard of conduct for parties in a contractual joint venture,

[2] See M.A. Eisenberg, 'Relational Contracts' in J. Beatson and D. Friedman (eds.), *Good Faith and Fault in Contract Law* (Clarendon Press, 1995).

concurrently addressing the problem of incomplete presentiation which is inherent in the strict operation of classical contract theory (objections 1 and 2), as well as the freeloader problem, which is the foil to relational contract theory (objection 3).

4.2 Objection 1: The prevalent contract theory in the UK forbids the implication of extra-contractual duties

4.2.1 The Objection: Freedom and Sanctity of Contract are paramount

The first argument against the implication of extra-contractual duties in the joint venture contract is as follows:

> 'The court cannot intervene into a relationship between commercial parties by implying into it duties, on which the parties have not agreed, or which they have expressly discounted in a contract'.[3]

This statement is firmly footed on English contract law. Classical contract theory holds that, within the bounds of the law and subject to some well-defined limitations, 'parties are free to contract as they may see fit'.[4] This rule applies to all contracts, apart from those whose subject matter is governed by a specific statutory regime (such as contracts for the conveyance of land, employment, consumer credit, etc.).

There are two principal consequences of classical contract theory in practice. First, as regards the *enforceability* of the contract, unless there is a defect in the bargaining process (such as fraud, misrepresentation, mistake, duress or undue influence) which would undermine the validity of the parties' consent to the bargain,[5] courts do not have a general power to alter a contract, for instance, in order to address a fundamental

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[3] See e.g. *Re Goldcorp Exchange Ltd.* [1995] 1 AC 74, 98, per Lord Mustill.

[4] *Suisse Atlantique Société D'Armement Maritime SA v. Rotterdamsche Kolen Centrale* [1967] 1 AC 361, 399D, per Lord Reid.

[5] E.g. in *National Westminster Bank Plc. v. Morgan* [1985] AC 686, 708, Lord Scarman pointed to a number of statutes (the Supply of Goods (Implied Terms) Act 1973, Consumer Credit Act 1974, Consumer Safety Act 1978, Supply of Goods and Services Act 1982 and Insurance Companies Act 1982) enacted to ensure rudimentary fairness in the bargaining process, so much so that he saw no reason for the courts to intervene further (by developing a doctrine of 'inequality of bargaining power', where no actionable undue influence could be made out).

change in the circumstances of the original bargain.[6] Neither can they refuse to enforce an otherwise valid contract (i.e. where there are no questions as to the capacity of the parties or the legality of the subject matter), even where its effect is unreasonable or unconscionable.[7] In the words of Jessel MR:

> 'if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice. Therefore, you have this paramount public policy to consider – that you are not lightly to interfere with this freedom of contract'.[8]

The second practical consequence of classical contract theory concerns the parties' *performance* of the contract. Thus, when performing their respective obligations, generally speaking, the parties cannot deviate from what the contract specifies. Any such deviation would technically amount to a breach of the contract and expose the 'non-performing' party to liability in damages. For example, in *Arcos v. Ronaasen*,[9] the House of Lords upheld the buyer's strict right to reject goods for not complying with their description in the contract, despite their only negligible deviation from the contract specification. The case concerned an agreement for the sale and transport of Russian timber to an English buyer, who intended to use the goods for the construction of cement barrels with the seller's knowledge of this. The agreement stipulated the length, breadth and thickness of the staves to be delivered, and allowed for variation of the breadth and length of the staves, but not of their thickness, stipulated at a half inch. The staves the seller sought to deliver deviated from that specification by various degrees but in every case no more than a fraction above or below the specified half inch. Regardless, the buyer sought to reject the goods outright. The matter was referred to an umpire who determined that the staves were still suitable for the construction of barrels and, when shipped, the timbers had been merchantable under the agreed specification. When the issue reached the House of Lords, it was held that the buyer was entitled to demand goods answering the description in the contract. According to Lord

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[6] See *British Movietonews Ltd. v. London and District Cinemas Ltd.* (1952) AC 166.

[7] See, *ibid*, in the context of exclusion or exemption clauses; *Photo Production Ltd. v. Securicor Transport Ltd.* [1980] AC 827, 848, per Lord Diplock. On the implication of terms into a contract: *The Moorcock* (1889) 14 PD 64, 68, per Bowen LJ and *Luxor (Eastbourne) Ltd v. Cooper* [1941] AC 108, 137, per Lord Wright. *Cf. Ingham v. Emes* [1955] 2 All ER 740, where the Court effectively invented a good faith obligation in order to deny a frivolous claimant a remedy.

[8] *Printing and Numerical Registering Co. v. Sampson* (1875) LR 19 Eq. 462, 465.

[9] [1933] AC 470; *Cf. Cehave NV v. Bremer Handelsgesellschaft m.b.h.* (*The Hansa Nord*) [1976] QB 44.

Buckmaster,

> 'If the article they have purchased is not in fact the article that has been delivered, they are entitled to reject it, even though it is the commercial equivalent of that which they have bought'.[10]

In other words, with respect to the performance of contractual obligations, classical contract theory translates into a regime of strict liability.[11]

4.2.2 Parties dealing at Arm's Length

4.2.2.1 The principle

Classical contract theory is at its purest in the context of commercial contracts, i.e. contracts between commercial concerns as distinct from contracts between, say, a business and consumer, or between family members.[12] In this case the attitude of the courts is effectively summarised in the following statement by Lord Steyn:

> 'Commercial men must be given the utmost liberty of contracting. They must be left free to decide on the allocation of commercial risks.'[13]

Commercial parties are thus said to be dealing at arm's length, that is to say they have no legal relationship or connection other than the contract between them. Atiyah explains that in this case 'neither party owes any duty to volunteer information to the other, nor is he entitled to rely on the other except within the narrowest possible limits'.[14] Commercial parties are presumed to have entered the contract freely, having weighed the benefits against the costs, and mitigated any associated risks by adapting

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[10] *Ibid*, 474.

[11] Having said that, it is now established that remedies for breach will depend on its seriousness. This is determined by how far the performance has deviated from what was contracted, i.e. whether the breach is one of a 'condition' or a 'warranty', as per s.15A Sale of Goods Act 1979 (as amended by the Consumer Rights Act 2015), or of something in-between (see *Hong Kong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd.* [1962] 2 QB 26, 71, per Lord Diplock), the consequences of which are to be determined by the *effect* the breach has had on the contract, i.e. the extent to which the breach went to the 'root' of the contract (*The Hansa Nord*, n.9, 61, per Lord Denning MR). Accordingly, the task for the court is 'to ask whether a particular item in a description constitutes a substantial ingredient of the "identity" of the thing sold, and only if it does to treat it as a condition': *Reardon Smith Line Ltd v. Yngvar Hansen-Tangen* [1976] 1 WLR 989, 998, per Lord Wilberforce.

[12] Because of the sensitive nature of certain contracts, public policy required that Parliament intervened into the contracting process so as to protect the more vulnerable party from unconscionable or speculative behaviour: see the Unfair Contract Terms Act 1977 and the Unfair Terms in Consumer Contracts Regulations 1989.

[13] *Homburg Houtimport BV v. Agrosin Private Ltd (The Starsin)* [2003] UKHL 12, [57].

[14] P.S. Atiyah, *The Rise and Fall of Freedom of Contract* (Clarendon Press, 1979), 403.

prices accordingly.[15] This presumption stems from the fact that commerce runs on speculation, and commercial people are expected to be aware of this first and foremost, otherwise the whole mechanism would collapse for want of participation.[16] Against this background, the essence of the arm's length principle is that the courts will not intervene to alter a bargain struck *freely* by parties dealing at arm's length. In the words of Lord Wilberforce:

> '[I]n commercial matters generally, when the parties are not of unequal bargaining power, and when risks are normally borne by insurance, not only is the case for judicial intervention undemonstrated, but there is everything to be said, … for leaving the parties free to apportion the risks as they think fit and for respecting their decisions.'[17]

This is because parties in commercial transactions need the certainty of an expressly agreed bargain, so that they can plan ahead and calculate risks.[18] Consequently, when commercial parties decide to enter into a legally enforceable contract they will generally be held bound whatever the outcome.[19] Conversely, if such parties decide *not* to enter into a legally binding arrangement, the courts will generally assume that this was the intention all along and will treat the arrangement accordingly.[20]

Consider the following scenario involving two companies, Acorn and Brazilnut. Acorn owns a copper mine, which it operates partly with Brazilnut's equipment and staff. There is no formal agreement between them – simply an understanding that at the end of each fiscal quarter Brazilnut is entitled to a percentage of the ore produced from the mine in return for the use of its equipment and staff.[21] The arrangement continues for

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[15] E.g. see *E. A. Grimstead & Son Ltd. Francis Patrick McGarrigan*, unreported: Westlaw transcript, 27 October 1999, 32, per Chadwick LJ; Atiyah posits that such expectations are largely intuitive: 'we expect people to act rationally and not to give up something they own without something of equal or comparable value in return': P.S. Atiyah, 'Contract and Fair Exchange' (1985) 35(1) *UTLJ* 1, 14.

[16] See Lord Neuberger writing extra-judicially in 'The Stuffing of Minerva's Owl? Taxonomy and Taxidermy in Equity' (2009) *CLJ* 537, 542.

[17] *Photo Production Ltd. v. Securicor Transport Ltd*, n.7, 843.

[18] E.g. see *Scandinavian Trading Tanker Co. AB v. Flota Petrolera Ecuatoriana* [1983] QB 529, 540-541, per Goff LJ approved on appeal in [1983] 2 AC 694, 704, by Lord Diplock; see also *Daniel Stewart & Co Plc v. Environmental Waste Controls Plc* [2013] EWHC 1763, in the context of implied terms.

[19] E.g. commodity sales under standard contracts, which themselves tend to become the subject of string trades under contracts for differences; see the analysis in M. Bridge 'Good Faith in Commercial Contracts' in R. Brownsword et al. (eds), *Good Faith in Contract: Concept and Context* (Ashgate, 1999).

[20] See the 'subject to contract' cases below.

[21] The lack of a formal agreement in such a case is not as difficult to believe as one may think; see, e.g., S. Macaulay 'Non Contractual Relations in Business: A Preliminary Study' (1963) 28(1) *Am.Soc.Rev.* 55.

several years. In a permit renewal application to the local authority, Acorn lists Brazilnut as a co-Applicant, noting that the Applicant's status in relation to the mine is as 'site-owner'. Since then, Brazilnut's board of directors operates under the assumption that the company has or will be awarded a proprietary interest to the part of the mine, which is operated with Brazilnut's resources. Because of this assumption, Brazilnut invests in new equipment, specific to the mining and processing of copper ore. Acorn subsequently merges with another company to form Coconut, which promptly terminates the arrangement with Brazilnut and advertises for bids from other contractors.

Applying classical contract theory, Brazilnut's relationship with Acorn is made up of a series of *ad hoc* contracts, each completed when Brazilnut collects its share of the ore at the end of each fiscal quarter.[22] So, if Coconut terminated the arrangement partway through the fiscal quarter, Brazilnut's remedy would lie in damages for breach of contract, the terms of the contract to be gleaned from the past transactions between Acorn and Brazilnut.[23] Such damages would be calculated based on the value of the share of the ore that Brazilnut would have extracted had it been allowed to operate its part of the mine until the end of the fiscal quarter. On the other hand, if Coconut terminated the arrangement as soon as Brazilnut collected its share of the ore for that fiscal quarter, then the contract would be complete and Brazilnut will have no further recourse in contract against Coconut.[24] Any expenditure Brazilnut incurred as a result of an expectation created by Acorn's conduct would not be relevant in common law (unless Brazilnut could show that Acorn received a benefit from Brazilnut's reliance on Acorn's conduct, in which case Brazilnut might be entitled to a remedy in restitution).

4.2.2.2 A practical illustration of the Arm's Length Principle

The arm's length principle is triggered when the parties attempt to displace classical contract theory by arguing the application of some equitable doctrine. For instance, Brazilnut could try to claim a proprietary interest over the part of the mine it had been operating with its resources on the basis of the equitable doctrines of proprietary

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[22] *Baird Textile Holdings Ltd. v. Marks & Spencer Plc.* [2001] EWCA Civ 274.

[23] *Mamidoil-Jetoil Greek Petroleum Co SA v. Okta Crude Oil Refinery AD* [2003] EWCA Civ 1031.

[24] There is no presumption that continuous dealings are indicative of an implied long-term contract: see *Baird Textile Holdings*, n.22.

estoppel or constructive trust. Brazilnut's argument would be that it suffered loss by purchasing copper-processing equipment having relied on Acorn's conduct, which created the reasonable impression that Brazilnut was part owner of the mining site. Due to the arm's length principle, Brazilnut's claim is unlikely to succeed because Brazilnut is a commercial entity involved in a commercial transaction. Indeed, courts have been extremely reluctant to award equitable remedies to commercial entities dealing at arm's length, which is amply evidenced from their approach to the 'subject to contract cases'.

These cases tend to revolve around 'agreements to agree' or agreements in principle, which are not enforceable in law. However, in every case, one of the parties acts on the agreement to their detriment and consequently seeks a remedy in equity, invariably by trying to establish a proprietary estoppel or the existence of a constructive trust. Proprietary estoppel involves preventing a party (A) from asserting their proprietary rights against another party (B), where B has suffered loss by relying on A's conduct to the effect that A would not assert their rights against B, or that B would be granted a proprietary interest by acting on A's conduct.[25] What is interesting in these cases, is the difference in approach taken by the courts where the basis of the relationship contains a degree of commercial speculation, or operates at arm's length.

Thus, in *Attorney-General of Hong Kong v. Humphreys Estate*[26] the Privy Council considered a dispute between the Government of Hong Kong (HKG) and a group of companies of which the respondent, HE, was a member. HKG and HE entered into an agreement in principle and 'subject to contract', for HKG to acquire 83 flats owned by HE, in exchange for granting HE a Crown lease of government property with the right to develop it and HE's adjoining property. The agreement provided that the terms could be varied or withdrawn and that *it was subject to the necessary documents giving legal effect to the transaction being executed and registered*. Accordingly, HE permitted HKG to take possession of the flats, while HE received permission to enter the lease property and demolish the existing buildings in preparation for redevelopment. Furthermore, HE paid HKG roughly $104 million, being the agreed difference in value between the two properties. Having taken possession of the property, HKG spent money on the flats, moved senior civil servants in them and disposed of their former

[25] See *Ramsden v. Dyson* (1866) LR 1 HL 129, per Lord Kingsdown on the requirements for triggering an equity; *Inward v. Baker* [1965] 2 QB 29; and also *Willnott v. Barber* [1880] 15 ChD 96, 105-106, per Fry J, on the requirements of establishing an estoppel by acquiescence.

[26] [1987] AC 114.

residences. Two years later, HE decided to withdraw from negotiations and served notice to HKG terminating its licence to occupy the flats. HE then obtained a court order for the return of both the flats and the $104 million. On appeal, the Privy Council rejected HKG's argument that HE was estopped from enforcing their property rights in the flats against HKG, because of HKG's expenditure on them. Such an argument would only succeed if HKG had demonstrably relied on an expectation or belief, *encouraged by HE*, that HE would carry out the agreement and transfer the flats to HKG. Nothing in the facts suggested that this was the case. If anything, HKG had been aware from the beginning that the agreement in principle with HE was not binding, until the relevant documentation had been executed. This never happened and therefore HE was not bound to uphold the arrangement.

Humphreys Estate provides a solid example of the courts' approach towards the majority of commercial relationships: where the parties in a commercial transaction have omitted to protect their interests in law, equity will not intervene to remedy any subsequent harm. The operation of classical contract theory here is clear; as a rule, the sanctity of the contract between commercial entities will not be disturbed. Therefore, when it comes to the question of extra-contractual duties being implied into the joint venture, the response of the orthodox approach under English contract law would naturally be in the negative. However, there are limits to this proposition. These limits should become clear by considering two 'subject to contract' cases with similar facts but with drastically different outcomes. The first is *Crabb v. Arun District Council*,[27] where the court did permit the invocation of an equitable remedy despite a degree of commercial speculation in the circumstances. The second case is *Cobbe v. Yeoman's Row Management*,[28] where the rule regarding arm's length relationships as expressed in *Humphreys Estate* prevailed.

In *Crabb*, the plaintiff and defendant District Council (the Council) were adjoining landowners. The dispute arose because the plaintiff claimed a right of way over the Council's land giving him access to the public highway. Crucially, without this access the plaintiff's land was landlocked. The issue arose as a result of the plaintiff's selling the portion of his land that did have access to the highway without, in the conveyance, reserving a corresponding right of way. An easement of necessity could not be

[27] [1976] Ch 179.

[28] [2008] UKHL 55.

established (because the plaintiff operated on the assumption that his land had an alternative access point through the Council's land). The plaintiff acted on the belief that the Council had agreed to grant him a right of way over its own land in an agreement in principle reached at a meeting with the Council's agent, although no official action or other formalities followed to that effect. On the facts, the Court of Appeal found that: (a) the Council's actions had not only created the plaintiff's belief, but actively encouraged it by acting on all of the points raised in that agreement, e.g. erecting a fence between the two adjoining properties but leaving a gap for the plaintiff to access the public highway; (b) the Council never corrected the plaintiff's belief at any point after the agreement in principle had been reached, even though there had been plenty of opportunity to do so; and, (c), the Council (through its agent) *had knowledge* of the plaintiff's intention to sell the portion of his land with access to the highway, that he would rely on the mistaken belief that he had a right of way over the Council's land and that, consequently, he would suffer detriment. Based on these three points, the Court held that there was an equity in favour of the plaintiff, whose land had become sterile as a result of the Council's refusal to allow access from its own land. Ultimately, the Council was estopped from asserting its proprietary rights against the plaintiff who was granted a right of way over the Council's land.

An agreement in principle was also the subject of the House of Lords' decision in *Cobbe*. The agreement was between the defendant, who owned a block of flats with potential for residential development, and the claimant, an experienced property developer. The agreement provided, *inter alia*, that the defendant would sell the property to the claimant at an agreed up front price of £12 million, while the claimant would apply for planning permission and develop the land accordingly, at his own expense. Pursuant to that agreement (and before any official paperwork was executed) the claimant expended a considerable amount of money and time to obtain planning permission. The defendant however sought to renegotiate the financial terms of the agreement and refused to sell on the originally agreed terms. The claimant sued on the ground that the agreement with the defendant gave rise to a constructive trust or a proprietary estoppel. The House of Lords dismissed this argument. While the defendant's conduct was indeed unconscionable, unconscionability alone was not enough to give rise to a remedy in equity. Lord Scott, in particular, noted that both the claimant and defendant were experienced business people, the claimant himself a seasoned property developer, who was aware that until any formalities were executed

his actions were entirely speculative.[29] Therefore, the House of Lords reaffirmed the principle that the court will not rush to the aid of commercial people, who having knowingly taken a risk end up suffering loss as a result of admittedly unconscionable behaviour.[30]

At the outset, the similarities between these cases are striking. In both cases, the claimant acted on the mistaken belief that they had been granted or would acquire a property right as a result of the agreement in principle; the defendant had knowledge of these beliefs and did nothing to contradict them; and both claimants acted on their mistaken beliefs consequently suffering detriment. Therefore, in light of the House of Lords decision in *Cobbe*, does *Crabb* remain good law? Writing extra-judicially Lord Neuberger suggested that the decision in *Crabb* might well not survive *Cobbe* if the plaintiff's belief stemmed primarily from the agreement in principle (which was the case in *Cobbe*) rather than being encouraged by the actions of the Council and *with its knowledge*.[31] With respect I disagree. Factually *Cobbe* is indeed analogous to *Crabb*: the defendant knew of Cobbe's intentions and encouraged him to proceed with the planning application having created in him the mistaken belief that he would honour the agreement in principle.[32] As Lord Scott emphasised, however, the elements of a proprietary estoppel (or indeed a constructive trust) simply did not arise in *Cobbe*: the defendant in *Cobbe* did not need to be estopped from asserting its proprietary rights against the claimant. The claimant in *Cobbe* had *no rights* under the agreement in principle, which itself could not be the basis of a claim. By contrast *Crabb* did present all the elements for a proprietary estoppel, so much so that whether the plaintiff's case stemmed from an agreement in principle, should be immaterial. The defendant's actions in *Crabb* rendered it unthinkable that they would not uphold their end of the bargain. Moreover, the consequences of the defendant's actions in *Crabb* went further than pecuniary loss, the possibility of which is inherent in commercial speculation anyway. In *Crabb* the claimant was completely denied the enjoyment of his proprietary rights, his land becoming sterile for a number of years due to the Council's refusal to allow access. This point was emphasised by the Court of Appeal when deciding the issue of

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[29] *Ibid*, [27].

[30] In *Cobbe*, the claimant was, instead, awarded compensation on the ground of unjust enrichment.

[31] Lord Neuberger, n.16, 544.

[32] After all, a similar interpretation of the defendant's behaviour in *Cobbe* drove the Court of Appeal to find a proprietary estoppel in favour of the claimant: *Cobbe v. Yeoman's Row Management Ltd* [2006] EWCA Civ 1139, [46], per Mummery LJ.

compensation.[33] It is difficult to imagine the court allowing a piece of land, which is by definition a finite resource, to become sterile[34] merely because the plaintiff's case *could* have been based on the agreement in principle rather than the defendant's conduct.[35]

Turning back to the operation of classical contract theory, at least in the context of commercial contracts, the rule may therefore be displaced in the right circumstances. In light of this, could Brazilnut rely on the *ratio* in *Crabb* to support its claim against Coconut? I submit not, because I regard *Crabb* as exceptional. The plaintiff in *Crabb* sold off pieces of his land for commercial gain. Had he not eventually become the owner of landlocked land as a result of his reliance on the defendant's conduct, there might have been deeper scrutiny into whether his reliance on the Council's conduct was reasonable in the circumstances, as was the case in *Humphrey's Estate* and *Cobbe*.[36] This would not necessarily alter the original outcome in favour of the Council.[37] However, deeper scrutiny might have been warranted in light of the speculative element in the plaintiff's actions, which would, in most other cases, raise a presumption of his willingness to shoulder risk.[38] What becomes clear following *Crabb* is that where the constituent elements for establishing an equity are present, or where public policy

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[33] *Crabb*, n.27, 189H, *per* Lord Denning MR.

[34] The House of Lords have condemned allowing resources to become sterile by virtue of unfair reliance on another's strict legal rights as contrary to the public interest: *A. Schroeder Music Publishing Co Ltd. v. Macaulay* [1974] 1 WLR 1308 (restraint of trade clause imposed on a musician).

[35] See also *Salvation Army Trustee Co Ltd. v. West Yorkshire Metropolitan County Council* (1980) 41 P & CR 179, where reliance on a 'subject to contract' agreement in principle was immaterial in the circumstances. The plaintiff went into the expense of building on the defendant's land (with the latter's knowledge) not speculatively, but because the defendant had expressed the intention to acquire the plaintiff's property *pursuant to its compulsory acquisition powers* as part of a scheme to widen a local road.

[36] Uguccioni points out that the proprietary estoppel in both *Crabb* and *Salvation Army Trustee* arose from conduct by public authorities, i.e. bodies who are typically held to higher standards of conduct than private parties and therefore it cannot be said that the relationship in these cases was truly at arm's length; J. Uguccioni 'Buyer Beware: Failed Joint Venture Negotiations and Involuntary Business Partnerships' (2011) *JBL* 160, 165. This argument is certainly supported in *Salvation Army Trustee*, where the claim arose out of the public authority's ultimately erratic exercise of its statutory powers. But I submit that this is not the case with *Crabb,* where the identity of the defendant as a public body did not appear to play a role in the court's reasoning. Rather, the court focused on the impact of the defendant's actions on the plaintiff (and, arguably, his land), and their knowledge of this.

[37] In fact, given that the relationship in *Crabb* featured no 'subject to contract' stipulation, there is little to suggest that, ultimately, commercial speculation would have altered the outcome in favour of the Council. The plaintiff here was perfectly entitled to glean the Council's intentions from the actions of its agents. On the effect of a 'subject to contract' stipulation see *London and Regional Developments Ltd. v. TBI plc.* [2002] EWCA Civ 355, [38], per Mummery LJ.

[38] See e.g. *Laskar v. Laskar* [2008] EWCA Civ 347, where Lord Neuberger treated as irrelevant the fact that the property at issue was purchased by a mother and her daughter, because the property was purchased primarily as an investment and therefore the purchase was speculative in nature. This approach was affirmed by the Supreme Court in *Jones v. Kernott* [2011] UKSC 53.

would so dictate, the court may well intervene in a relationship which is otherwise identified as being arm's length.[39] Nonetheless, Brazilnut's predicament is closer to *Cobbe* than it is to *Crabb*; for it does not appear to give rise to any issues of public policy, nor was there an express bargain with Acorn that Brazilnut would be awarded a proprietary interest in the mining site.[40] In *Cobbe* the claimant was allowed to recover the cost of obtaining planning permission as a result of his reliance on the agreement in principle with the defendant. The rationale behind this conclusion was that the defendants' unconscionable behaviour resulted in their being unjustly enriched (to an amount equal to the cost of obtaining planning permission), at the expense of the claimant. Acorn benefited from no such enrichment as a result of its conduct; Brazilnut acquired the copper-specific processing equipment on its own accord and for its own benefit, and therefore it has no remedy in that regard.

From the above it should be clear that equity might intervene in commercial transactions, in exceptional circumstances, to displace the strict application of classical contract theory as expressed in the arm's length principle. By way of contrast, the arm's length principle becomes irrelevant and equitable intervention much more frequent when the court is faced with agreements between parties in a domestic, or at least non-commercial, setting. One such example is *Thorne v. Major*,[41] which, I submit, shares many of the characteristics of Acorn and Brazilnut's relationship but without the commercial backdrop. The case concerned an appeal from a decision that the claimant could not inherit the estate of his deceased uncle, who died intestate but in possession of a farm of considerable value. The claimant had been working at his uncle's farm since the mid 1970s for no remuneration, but by the 1980s he had come to hope that he might inherit. In 1990, an incident, whereby the claimant's uncle presented the claimant with two policies on his life saying 'this is for my death taxes', turned this hope into expectation. Nevertheless, his uncle made no direct statements, nor did he take any

[39] This is also indicated in *Afia v. Mellor*, unreported, 4 November 2013, where a shareholder in a company subject to a takeover could benefit from a guarantee by the defendant (the acquiring company) that it would buy existing shareholders' shares, despite the claimant's notice of intention to sell being out of date. This was because the claimant could rely on an estoppel arising from the assurances made by the defendant's solicitor that his client would not take the date of the notice into account. I suggest that the public policy issue here would be ensuring that third parties are entitled to rely on the conduct of a solicitor acting as agent for another. *Cf. Western Fish Products v. Penwith DC* [1981] 1 All ER 204, 217- 219, per Megaw LJ.

[40] Note the relevance of such express stipulation in *Kilcarne Holdings Ltd. v. Targetfollow (Birmingham) Ltd.* [2005] EWCA 1355, [21]-[22], per Sir Martin Nourse.

[41] [2009] UKHL 18.

formal action to the effect that the claimant would inherit. At first instance the judge held that there was enough evidence from the various witness statements that the claimant had reasonably understood his uncle's words and acts as being an assurance that the claimant would inherit the farm and that his uncle intended it to be so. Accordingly, the judge established a proprietary estoppel for the claimant's benefit. The Court of Appeal reversed this decision on the ground that the 1990 incident was not enough to establish the basis of an estoppel. The House of Lords allowed the claimant's appeal. The evidence available to the trial judge showed *a continuing pattern* of conduct in the 15 years before his uncle's death, which clearly indicated his uncle's intention with regard to the farm. It would not be helpful to try and break down that pattern into discrete elements and then treat each as being insignificant.

Thorne v. Major is significant in that it addresses the issue of the type of conduct that can be reasonably relied on to justify the establishment of proprietary estoppel. For the purposes of this section however it serves to indicate the disparity in the law between familial and arm's length relationships: there appears to be little expectation of formality in the familial relationship. But if commercial parties choose to dispense with such formality, then the law will regard it as a risk they chose to take and treat them accordingly when considering appropriate remedies, whatever the pattern in previous dealings between them.[42] This point establishes that classical contract theory would be stoutly against the implication of extra-contractual duties into the joint venture relationship, especially if such duties are implied in order to protect the parties from opportunistic behaviour; commercial parties are constitutionally expected to secure their interests and to do so clearly in the contract between them.

4.2.3 Is a blanket application of the Arm's Length principle justified?

This presumption, demonstrated in the previous section, that (prudent or reasonable) commercial parties will seek to legally protect their respective interests in the context of a bargain raises two questions. First, is this expectation on the part of the courts justified in light of the complex financial and commercial realities facing economic agents? This is especially relevant with the varying sophistication of economic agents.

[42] This point was confirmed by Etherton LJ in *Crossco No 4 Unlimited v. Jolan Unlimited* [2011] EWCA Civ 1619, [85]-[87].

Secondly, does it actually reflect business practice or is it how the law considers business practice should operate?

4.2.3.1 The role of party sophistication

The development of the arm's length principle reveals that it is largely a product of intuition, on the part of society and by extension, judges. Commerce is a speculative enterprise and those who participate are expected to be aware of its nature and to take risks accordingly when engaging in commercial activity. Not doing so would be irrational and, therefore, in the absence of a defect in the bargaining process, the law is not equipped to intervene otherwise than to give effect to the bargain as originally expressed in the parties' contract, whether express or implied. Notably, the law's criterion of what constitutes rational conduct in contracts, commercial or otherwise, is that of prudence, i.e. the pursuit of self-interest.[43] It is beyond the aims of this thesis to examine *why* the law, as an expression of society's expectations, applies this criterion of rationality to economic agents. The aim of this thesis is to demonstrate that *if* the criterion of rationality applicable to economic agents is that of self-interest maximisation, then extra-contractual duties must be implied into the contractual joint venture to safeguard the joint venture relationship, which itself embodies the paradigm for economic growth. In this section, I will demonstrate that the arm's length principle, as applied to commercial parties, is distinctly problematic, for it assumes that a party's *aim* to act rationally is synonymous to that party's *ability* to do so effectively. Consequently, it should not be treated as a catch-all ground for refusing parties in commercial contracts the intervention of the law (in the absence of consent-invalidating facts), because to do so would result in injustice.

The problem in the application of the arm's length principle stems from the fact that parties in a commercial contract are credited from the outset with an ability to safeguard their own interests in a bargain.[44] They are treated as 'sophisticated' parties, as opposed to those who are, from the outset, regarded as weaker parties in an exchange, such as

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[43] See Atiyah, n.14; J. Steyn, 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) *LQR* 433, at 434.

[44] E.g. *Springwell Navigation Corporation v. JP Morgan Chase Bank* [2010] EWCA Civ 1221, [183], per Aikens LJ, on the issue of the 'reasonableness' of a contract term exempting an investment bank from liability for the purposes of ss. 3, 11 and Schedule 2 of the Unfair Contract Terms Act 1977. See also *IFE Fund SA v. Goldman Sachs International* [2006] EWHC 2887, [53]-[54]; *Perpetual Trustee Co. Ltd. v. BNY Corporate Trustee Services Ltd.; Butters v. BBC Worldwide Ltd.* [2009] EWCA Civ 1160, [92], per Neuberger MR.

consumers dealing with merchants or employees dealing with employers.[45] The 'weaker' type of contracting party tends to be specifically protected by statute (as is the case with both consumers and employees), while the courts will also intervene to interpret contracts or set aside bargains in favour of the weak in the interests of fairness.[46] Commercial parties are afforded no such protection by the courts,[47] bar some highly contentious examples to be considered later. Yet, while party sophistication plays an important role in the courts' approach to a commercial contract, rarely is the nature of sophistication actually discussed.[48] Against this background, a sophisticated party appears to be one who has the transactional experience (especially if they are 'a repeat player'),[49] business judgment, access to legal or other professional advice[50] and, in general, an ability to allocate specific resources into evaluating a prospective bargain and calculating the risks. In certain contexts, any commercial connection will be enough to trigger a characterisation of 'sophistication' for the purposes of excluding statutory intervention to protect the rights of a party in an exchange.[51]

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[45] However, this attitude is not entirely consistent, see R.P. Austin 'Commerce and Equity – Fiduciary Duty and Constructive Trust' (1986) 6 *OJLS* 444, esp. 448-449, discussing the disparate approaches of the Australian High Court in *Hospital Products Ltd v. United States Surgical Corporation* [1984] HCA 64 and *United Dominions Corporation Limited v. Brian Pty Ltd* [1985] HCA 49, both of which involved experienced commercial parties with access to expert advice.

[46] In the context of contracting parties of lower income groups or of low intelligence or little education, see: *Fry v. Lane* (1888) 40 ChD 312, 322; *Cresswell v. Potter* [1978] 1 WLR 255, 257; *Backhouse v. Backhouse* [1978] 1 WLR 243, 252. On the subject of illiteracy as a relevant factor see P. Michell 'Illiteracy, Sophistication and Contract law' (2005) *Queen's L.J.* 311; In the context of the courts' intervening where one unconscionably asserts their strict legal rights, see *Shaw v. Applegate* [1977] 1 WLR 970, 977-979, per Buckley LJ; *Taylor Fashions Ltd. v. Liverpool Victoria Trustees Co Ltd.* [1982] 1 QB 133, 147.

[47] The Unfair Contract Terms Act 1977 applies to business contracts, where one of the parties is dealing with the other's standard terms to the effect that terms which are deemed 'unreasonable' will be void: s.11. The reasonableness of a term is judged according to a non-exhaustive list of criteria set out in Sch.2. Needless to say, the reasonableness of a term will rarely be challenged in the context of sophisticated parties: see *Springwell Navigation*, n.44, and the discussion in *Watford Electronics v. Sanderson CFL* [2001] EWCA Civ 317, [54]-[57], per Chadwick LJ.

[48] For a comprehensive study of the American case law and literature see M.R. Miller 'Contract Law, Party Sophistication and the New Formalism' (2010) *Mo.L.Rev.* 493 and also A. Schwartz and R. Scott 'Contract Theory and the Limits of Contract Law' (2003) 113 *Yale L.J.* 541, 546-547, who devised a theory of identifying 'obviously sophisticated' parties determined by number of employees, organisational form and type of commercial activity (e.g. a law firm being arguably better placed to vet a deal than a construction firm; *cf. Feldman v. Google Inc.* 513 F Supp 2d 229 (ED Pa 2007)).

[49] E.g. *Titan Steel Wheels Limited v. The Royal Bank of Scotland Plc.* [2010] EWHC (Comm) 211, [94], per David Steel J; Miller, *ibid*, 532.

[50] E.g. see the 'assessment and understanding' clause signed by the defendant in *UBS AG (London Branch) v. Kommunale Wasserwerke Leipzig GmbH* [2014] EWHC 3615 (Comm), [207].

[51] Note, e.g., the definition of 'private person' in the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001/2256, reg.3(1)(b), to the effect that, if the loss complained of was suffered in the course of business activity *of any kind*, an undertaking cannot sue, under s.138D Financial Services and Markets Act 2000, an 'authorised person' in damages for breaching their statutory duty. In a wider

The problems associated with a blanket application of the 'sophistication' label become all too clear in light of the recent debacle concerning the mis-selling by British banks of certain financial products, known as Interest Rate Hedge Products or interest rate swap agreements ('Swaps').[52] These products were sold to businesses of various sizes, as part of loan agreements and were marketed as a way of mitigating the risk of rising interest rates. In 2012, the Financial Conduct Authority ('FCA')[53] conducted a pilot review of a sample of 173 Swap sales and discovered serious failings on the part of the banks in more than 90 per cent of the cases reviewed. In many cases, the customers did not fully appreciate the financial commitment they were taking on. For instance, on several occasions the banks failed to make clear that, should the interest rates drop (which they did due to the 2012 credit crunch), the customer would end up owing the bank. Furthermore, in many cases the Swaps came with exorbitant break costs or exit fees, which the customer had to pay in order to terminate the agreement. In some cases these costs exceeded 40 per cent of the value of the loan.[54] As a result of the FCA's pilot review findings, eleven banks agreed to review some 40,000 Swap sales to 'non-sophisticated' customers and set up a compensation scheme for those who suffered loss as a result of the sale, or who would not have agreed to the sale had the banks conducted themselves according to the FCA rules when promoting those products.[55]

Crucially, a large number of businesses were not included in the review, and they were therefore excluded from the compensation scheme, because they were deemed 'sophisticated' customers by the banks. This determination was supported in most cases by the independent reviewer engaged by the FCA to monitor the banks' conduct with

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context, a mercantile connection will displace the operation of a claim to title based on constructive notice, both in common law (*Re Wait* [1927] 1 Ch 606, 635) and in equity (*Swiss Bank Ltd v. Lloyds Bank Ltd* [1982] AC 584).

[52] K. Loizou 'Taxpayer May Face £2bn Bill over Swaps Mis-selling Scandal', *The Sunday Times*, 25 January 2015; 'Still Hedged in by Mis-selling: Thousands of Businesses that Were Sold Costly Financial Products by Banks Fear that they will Miss out on Compensation', *The Sunday Times*, 24 August 2014.

[53] The FCA is the former Financial Services Authority ('FSA'), which was renamed by s.6, Financial Services Act 2012 with effect from 24 January 2013. The Swaps mis-selling review was conducted in the transitional period between the FSA becoming the FCA. For the sake of simplicity, all references to the FCA are therefore both to the FSA and the FCA, unless the context requires otherwise.

[54] Financial Services Authority (hereafter, 'FSA'), 'Interest Rate Hedging Products: Pilot Findings', March 2013, 13, http://www.fca.org.uk/static/pubs/other/interest-rate-swaps-2013.pdf (accessed 14.8.18); One company was quoted a £9m break fee when it asked to terminate the swap – the swap itself was for 30 years on a three year loan: *The Sunday Times* (22 August 2018), *ibid*.

[55] FSA, *ibid*, 14; The rules in question are set out in the FCA Handbook, Conduct of Business Sourcebook ('COBS'), http://fshandbook.info/FS/html/FCA/COBS/ (accessed 14.8.18).

respect to the review.[56] For the purposes of the pilot review, the sophistication of customers was assessed according to the test for small companies set out in s.382 CA(2006). Thus, a sophisticated customer was one who satisfied at least two of the following requirements: (a) more than 50 employees, (b) a turnover of more than £6.5m and (c) a balance sheet total of more than £3.26m.[57] Furthermore, a customer would 'also be deemed sophisticated if the bank could demonstrate that the customer had the necessary experience and knowledge to understand the service to be provided and the type of product or transaction envisaged, including its complexity and risks'.[58] However, following the pilot review, the FCA altered the sophistication test so that businesses, which exceeded the balance sheet and employee number thresholds (but not the turnover threshold) would be considered non-sophisticated and therefore would be included in the review, provided that the total value of their swaps did not exceed £10m.[59] Businesses whose swaps value exceeded £10m, were expressly excluded from the review, even where their employee numbers and annual turnover were comparatively low, as were businesses which belong to, or have a connection with, a corporate group, if that group was *collectively* deemed sophisticated under the new test.[60] So, for instance, a business in the property sector, where businesses tend to have significant property portfolios and were therefore likely to have swaps well exceeding £10m, would be excluded from the review even if it employed 5 people and had a turnover of £2m (and for the purposes of CA(2006) would only qualify as a 'small company').

The FCA's rationale behind the new rules was that the review should 'focus on those small businesses that were unlikely to have had the specific expertise and skills needed to understand the risks associated with these products'.[61] The operative word here is 'unlikely', for, as Zepeda observes,[62] it indicates that the FCA did not investigate whether a business, which has suffered loss due to the banks' misconduct, actually had

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[56] The decision of the independent reviewer may now be the subject of a judicial review: *R (On the application of Holmcroft Properties Ltd) v. KPMG LLP*, unreported, 25 April 2015.

[57] FSA, n.54, 10.

[58] *Ibid*, 11.

[59] *Ibid*.

[60] Determined according to the criteria in s.382 CA(2006), on parent companies qualifying as 'small'.

[61] n.54, 12.

[62] R. Zepeda, 'Derivatives Mis-selling by British Banks and the Failed Legacy of the FSA' (2013) *JIBLR* 209, 217.

the necessary resources and access to expert advice to vet the proposed deal. Instead, the FCA relied on the *likelihood* of a business having the ability to appreciate the associated risks, by arbitrarily applying a set of criteria whose ultimate purpose was to limit the exposure of banks rather than to facilitate the administration of justice.[63] Granted, being labelled 'sophisticated' does not prevent the excluded businesses from making their case in court. It did, however, remove a major avenue for redress. This is because by virtue of s.138D of Financial Services and Markets Act 2000 ('FSMA 2000') those businesses were excluded from suing the banks for breach of statutory duty.[64] Moreover, they could not generally sue the banks for negligent misstatement and breach of duty of care,[65] for there is no common law duty (extending from their statutory duty under the FSMA 2000) on the part of the banks to advise on the risks of a recommended financial product.[66] The contractual route is also riddled with complexity, because a misrepresentation claim against the bank is likely to fail in light of the courts' increasing tendency to uphold non-reliance or entire agreement clauses, a staple of banking agreements.[67] Ultimately, businesses that have been labelled 'sophisticated' on a catchall, largely arbitrary basis will likely have no redress against institutions, who have failed to act by their own regulator's standards.

The exploitation of thousands of businesses by banks during the 'swaps' debacle serves to illustrate that being a commercial undertaking, even one with years in the trade and

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[63] FCA's Chief Executive, Martin Wheatley, admitted that this rule ended up excluding about a third of the businesses' sold interest rate hedging products: 'Regulators struck secret deal to dilute damages paid by big banks', *The Times*, 12 February 2015.

[64] Because they fail the 'private person' test: see n.49.

[65] Unless the bank has specifically undertaken to advise the customer on the particular deal, thus assuming, in the circumstances, a duty of care: *Hedley Byrne & Co Ltd. v. Heller & Partners Ltd.* [1964] AC 465.

[66] *Green v. Royal Bank of Scotland Plc.* [2013] EWCA Civ 1197, [23], per Tomlinson LJ; in the absence of a private right of action created by statute, the existence of a statutory duty does not give rise to a duty of care in common law: *Desmond v. Chief Constable of Nottinghamshire* [2011] EWCA Civ 3, [38].

[67] The aim of such clauses is to assert that the parties have *not* relied on representations by the other before entering the agreement between them: on their effect see *Watford Electronics*, n.45, [40]-[41]. A misrepresentation claim requires reliance on a false representation inducing the claimant to enter into a contract with the defendant. Therefore, if successful, 'non-reliance clauses' are an effective defence to misrepresentation claims: *Peekay Intermak Ltd. v. Australia and New Zealand Banking Group Ltd.* [2006] EWCA Civ 386; *Springwell Navigation Corporation v. JP Morgan Chase Bank*, n.44; *Titan Steel Wheels Limited v. The Royal Bank of Scotland Plc.*, n.49. These decisions support the concept of 'contractual estoppel', i.e. that parties to a contract are entitled to rely on the signed contractual document to the exclusion of any pre-contractual representations. For further comment see G. McMeel, 'Documentary Fundamentalism in the Senior Courts: the Myth of Contractual Estoppel' (2011) *LMCLQ* 185 and A. Trukhtanov, 'Misrepresentation: Acknowledgment of Non-reliance as a defence' (2009) *LQR* 648.

significant assets to its name, cannot by itself demonstrate sophistication for the purposes of the arm's length principle. In many cases, the swaps in question were traded in by experienced investors who had been involved in the purchase of complex derivatives several times before and had gained significant profits from these trades.[68] In other cases, however, complex swaps were attached to loan agreements as 'insurance policies' against rising rates, with little to no explanation of the associated risks and costs.[69] Yet, through a blanket application of the sophistication label, these two classes of bank customer are treated the same with profoundly unjust results, for, in the case of a small business, being at the mercy of swap charges or exit costs can affect its very future.

Extrapolating from the swaps mis-selling analogy, application of the sophistication label on a commercial party, without further inquiry as to its particular circumstances can only lead to injustice. Smaller businesses will be the ones to suffer the brunt of this attitude. Garvin notes, for instance, that the dichotomy in the treatment of sophisticated, as opposed to unsophisticated, parties has a particularly negative effect on small businesses. These entities are commonly treated as sophisticated parties by virtue of their mercantile status when, in reality, they can be just as unsophisticated as a consumer, in the sense that they lack the resources, expertise and bargaining power necessary to protect their interests as against a larger, wealthier or more experienced party. [70] This fact has not escaped the notice of European legislators. Thus, developments in European contract law suggest that even parties in purely commercial relationships may benefit from the type of protective regulation that normally benefits consumers. Notable examples of this are the Commercial Agents directive[71] and the Directive on Combating Late Payment in Commercial Transactions,[72] both of which take into account the varying degrees of vulnerability economic agents may face in a market exchange. In the case of commercial agents, for instance, the directive secures

[68] E.g. As in *Springwell* and *Titan Steel*, *ibid*.

[69] E.g. the featured case of a tile manufacturer who got a £2,6m loan to expand its business and signed on to the swap offered by the lending bank: M. Scuffham, 'Special Report – UK Banks say "Smart" clients don't deserve compensation' Reuters, 25 November 2014.

[70] L. Gravin 'Small Business and the False Dichotomies of Contract Law' (2005) 40 *Wake For.L.Rev.* 295.

[71] Directive 1986/53/EEC; implemented in the UK through the Commercial Agents (Council Directive) Regulations 1993, SI 1993/3053 (in force, 1.1.1994).

[72] Directive 2011/ 7/EU; implemented in the UK through the Late Payment of Commercial Debts Regulations 2013, which amended the Late Payments of Commercial Debts (Interest) Act 1998 (in force, 16.3.2013).

the agent's right to a minimum period of notice of termination of the agency agreement, as well as the agent's right to commission and to indemnity or compensation (left to the discretion of individual Member States) in the event of termination. The directive demonstrates awareness that commercial agents may be particularly vulnerable to their principals, since in many cases they become bound to them for long periods of time and often operate under some form of exclusivity.[73]

In the Late Payment in Commercial Transactions Directive, the EU Council goes even further to acknowledge that the manner in which most mercantile transactions operate gives rise to undisputable vulnerability, no matter the size or 'sophistication' of the individual actors.[74] This is because most transactions between commercial undertakings operate on a deferred payment basis with one party supplying the goods or services under the contract, while the other is given a specific time period, in which to pay, which is either set by statute or by the supplier. It goes without saying that late payment here would have serious financial repercussions for the supplier, whose liquidity and financial planning will be affected and who may even have to resort to getting external credit so as to meet its obligations.

Roppo[75] posits that the rationale behind such protectionist intervention lies in the asymmetries, whether in terms of information or bargaining power, inherent in most commercial relationships. For instance, in the case of commercial agents, the asymmetry works in favour of the principal who is in control of the relationship, especially in the case of an exclusive distribution agreement where the principal would regulate the availability and flow of merchandise to the agent. In Roppo's view, the weaker party in a business-to-business supply contract tends to be the 'customer', since the supplier is the one in control of the elements of the substantive performance of the contract. The supplier has all pertinent information, while the customer is generally an

[73] E.g. The EU Commission's criteria on the calculation of indemnity following termination include taking into account such factors as whether the agent is retained exclusively by the principal and/or whether the agent is subject to a restraint of trade provision; see EC Commission, 'Report of the Application of Article 17 of Council Directive on the Coordination of the Laws of the Member States Relating to Self-Employed Commercial Agents (86/653/EEC)', COM(96) 364 Final, 23.07.1996.

[74] Recitals to Directive 2011/7/EU, n.40, [2]-[3].

[75] V. Roppo 'From Consumer Contracts to Asymmetric Contracts: a Trend in European Contract Law? (2009) *ERCL* 304.

outsider.[76] In other words, the business customer in this case displays the vulnerability attributed to consumers in their transactions with merchants. But such asymmetries are not necessarily confined to the *supply* of goods or services. They apply as a matter of course in every contractual relationship. It is common ground that in every contract each party has control over the technical and organisational aspects of their respective obligations under the contract, while the other party is in every case an 'outsider'. Consider for instance the project-specific contractual joint venture, which is an on-going relationship rather than a one-off exchange. It could well feature such asymmetries, particularly where each party has undertaken to complete distinct parts of the project dependent on their respective competencies. In conclusion, it is possible for 'sophisticated' parties to be vulnerable to contractual asymmetries, analogous to those faced by consumers, and therefore to merit the protection of outside intervention. The arm's length rule should not, without further scrutiny be used as the basis for refusing intervention into a contract.

4.2.3.2 Party Sophistication and Business Practice

The previous section demonstrated that the arm's length principle, with its basis in the presumption that commercial parties are by default sophisticated, could yield unjust results if applied indiscriminately and without proper inquiry into the circumstances of the parties in the dispute. In this section I will establish that, even if, following an inquiry, the application of the sophistication label is in fact appropriate, it would be inaccurate to assume that sophistication is synonymous with (a) equality of bargaining power, when dealing with arm's length transactions or (b) an ability to effectively safeguard one's own interests once the parties have embarked on a commercial relationship.

With regard to point (a), let us consider a contract for the sale of iron ore, between Goldie, the buyer, and Irony, the vendor. Both are sophisticated in the sense that they are able to apply specific resources into assessing a prospective deal. The balance of bargaining power among them will be largely determined by the information at each party's disposal. Relevant information for instance would be how much iron ore Irony has available, whether Goldie can source iron ore elsewhere and how soon Goldie needs

[76] *Ibid*, 315; however, once the supplier has substantively performed the contract, the asymmetry would then work in favour of the customer, who is given a grace period to pay and is then subject to the controls of the Late Payment legislation.

it. Either party may signal this information to the other by various means throughout contract negotiations (e.g. a specification by Goldie that time of delivery is of the essence of the contract will signal the importance of the iron to Goldie),[77] so that bargaining skill may affect the balance of power.[78] To a wider extent, bargaining power will largely be affected by the state of the market at the time of bargaining,[79] so that a global shortage in iron ore would limit Goldie's options significantly. The effect of this is that, regardless of Goldie's sophistication, Irony would still be able to frame the bargain to its utmost advantage, e.g. shifting most of the risk to Goldie by insisting that the iron is delivered Ex Works rather than, say, on the more balanced Cost Insurance Freight basis.

With regard to point (b), the absurdity of the presumption that commercial sophistication is synonymous with the ability to protect one's own interests in a joint venture is evident in the cases heard by the Court of Appeal following its ruling in *Pallant v. Morgan*.[80] The facts of the *Pallant v. Morgan* cases demonstrate that sophisticated parties may easily become objects of opportunistic behaviour particularly when they are at the cusp of an alliance. Yet, with the courts' traditional adherence to the arm's length principle there has been little opportunity to develop a coherent, objectively justifiable principle upon which the law may award a remedy to the aggrieved party. Consequently, when the courts decide to forego the application of the arm's length principle in favour of more 'just' outcomes, the result can be devastating to the understanding of contractual doctrine.

The *Pallant v. Morgan* line of cases is the basis for the 'failed-joint-venture' constructive trust. The extraordinary feature of this particular equitable jurisdiction is

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[77] For a discussion of signalling games see, e.g., K. Spier, 'Incomplete Contracts and Signalling' (1992) 23(3) *RAND J.Econ.* 432, who demonstrates that in principal-agent contracts, the pursuit of a complete contract can be a signal in itself. In Spier's model, a complete contract is one that makes provision for the agent's wage being proportional to the output yielded by operating the principal's productive asset. When certain parameters are at play (i.e. asymmetrical information as to the principal's type, high *ex post* transaction costs, and lower *ex ante* transaction costs) by pursuing a complete contract, the principal signals her 'type', in the sense that, on average, a 'good' principal yields a higher output than a 'bad' one. See also B.E. Hermalin and M.L. Katz, 'Judicial Modification of Contracts between Sophisticated Parties: A more complete View of incomplete Contracts and their Breach' (1993) 9 *J.L.Econ.& Org.* 230, at 233.

[78] E.g. note the assessment of the parties' relative bargaining position in *Watford Electronics Ltd. v. Sanderson CFL Ltd.* [2000] 2 All ER (Comm) 984, [121].

[79] E.g. *ibid*, [126].

[80] [1953] Ch 43.

that the court does not intervene into the relationship so as to give effect to the intention of the parties, as is the case with incorporating or implying terms into a bargain, or to enforce a bargain that is otherwise unenforceable. Indeed, a common feature of these cases is that there is *no* bargain to be enforced. Rather, the court intervenes because

> 'the defendant has acquired property in circumstances where it would be inequitable to allow him to treat it as his own; and where, because it would be inequitable to allow him to treat the property as his own, it is necessary to impose on him the obligations of a trustee in relation to it.'[81]

Pallant v. Morgan itself concerned two neighbouring landowners who wished to purchase for conservation a piece of woodland adjacent to both their properties. At the relevant auction and having agreed not to bid against each other so as to avoid driving the property's price up, the plaintiff's agent refrained from bidding on the understanding that should the defendant's agent win, the defendant would transfer such part of the land to the plaintiff, as the parties would later agree. There had been previous discussions between the plaintiff and the defendant on the formula to be used for the division of the land but no agreement in writing. The defendant's agent entered the auction and won the property, but the defendant subsequently refused to transfer any part of it to the plaintiff. The court held that although specific performance was not available because the agreement between the parties was too uncertain, the plaintiff was still entitled to part of the land on the ground that the defendant's agent bid for both himself and the plaintiff's agent. Therefore, the defendant held the land on trust for both himself and the plaintiff.

The parties in *Pallant v. Morgan* were not acting in a commercial context, so the arm's length principle would not necessarily apply, although it could be argued that the parties were sophisticated as they had access to professional advice and representation with respect to the auction. However, the Court of Appeal in *Banner Homes Holdings v. Luff Developments*[82] extended the *Pallant v. Morgan* doctrine to commercial parties. The Court held that for the equity to arise it was necessary to establish *either* a benefit to the acquiring party *or* a detriment to the non-acquiring party. Furthermore, it was neither necessary for the arrangement between the parties to be contractually enforceable, nor was it essential for the non-acquiring party to have agreed not to

[81] *Banner Homes Holdings Ltd. v. Luff Developments Ltd.* [2000] Ch 372, 400.

[82] [2000] Ch 372.

compete with the acquiring party. However, what had to be established was that on the facts it would be inequitable for the acquiring party to retain the property for itself in a manner inconsistent with the arrangement on which the non-acquiring party had acted. The facts in *Banner Homes* were similar to those of *Pallant v. Morgan*. The arrangement here involved the claimant pulling out of the competition for a property in favour of the defendant, so as to develop the property together with the defendant through a joint venture company, which had yet to be formed. When the defendant changed its mind, the Court of Appeal held that the defendant held the property on constructive trust for itself and the claimant.

This outcome should be contrasted with the ruling of the Court of Appeal in *London and Regional Developments v. TBI*,[83] where the Court rejected the claimant's argument that in circumstances similar to those of *Banner Homes* it was entitled to a constructive trust over the property acquired by the defendant. The reason for this was because the arrangement between the claimant and the defendant was recorded in a note as being 'subject to contract'. This, Mummery LJ held, placed the claimant's case firmly within *Cobbe* and *Humphreys Estate* territory (see *4.2.2.2*) and demonstrated that the claimant *knew* that the arrangement with the defendant was never meant to be binding until a contract was duly concluded. Therefore, the claimant's actions prior to a binding agreement being concluded were purely speculative.

At first glance, this curious distinction between an equity arising where there is no contract, but none arising where the arrangement is *subject to* contract, would appear to limit the *Pallant v. Morgan* jurisdiction to the specific facts of *Pallant v. Morgan* itself and those of cases like *Banner Homes*. However, the High Court's approach to the *Pallant v. Morgan* trust in *Kearns Brothers v. Hova Developments*[84] indicates that, if anything, this particular equitable jurisdiction is poised to become wider.[85] In *Kearns Brothers*, the judge described the *Pallant v. Morgan* equity as the constructive trust arising out of failed joint ventures for the development of land.[86] Accordingly, he held that a *Pallant v. Morgan* trust existed with respect to a property bought by the defendant

[83] n.37.

[84] [2012] EWHC 2968.

[85] See also *Credit & Mercantile plc v. Kaymuu Ltd* [2014] EWHC 1746, where a beneficial interest under a *Pallant v. Morgan* trust was considered in terms of priority over the interest of a registered charge holder.

[86] n.84, [120].

as part of a tentative agreement under which the claimant was to demolish the existing buildings and develop the site. The judge held that the *Pallant v. Morgan* jurisdiction does not necessarily arise from an arrangement or understanding as to the acquisition of a specific proprietary interest in the property *for the joint benefit* of the parties. The equity may also arise from an arrangement *to utilise or exploit* a property for such joint benefit.[87] Therefore, when the defendant decided to sell the property on, rather than having it redeveloped, and offered the claimant a 2% finders' fee, the judge evidently found the outcome inequitable for the claimant and duly awarded him a share of the proceeds of sale, despite the fact that the claimant put up no funds for the purchase of the site nor was he ever intending to do so.

The *Pallant v. Morgan* jurisdiction, therefore, raises several questions. Its basis appears to be the sentiment expressed by Millet J below:

> 'It is the independent jurisdiction of equity, as a court of conscience, to grant relief for every species of fraud and other unconscionable conduct. When appropriate the court will grant a proprietary remedy to restore to the plaintiff property of which he has been wrongly deprived, or to prevent the defendant from retaining a benefit which he has obtained by his own wrong.'[88]

When applied to common business practice however, it appears to completely disregard established contractual doctrine. Consider for instance Lord Ackner's famous statement in *Walford v. Miles*[89] addressing counsel's argument that contractual bargaining must be done in good faith [*sic*]:

> 'The concept of a duty to carry on negotiations in good faith is inherently repugnant to the adverserial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations.'

Here lies the crux of the argument against the broadening of the equitable jurisdiction established by *Pallant v. Morgan* to cover commercial transactions. In the absence of fraud, there is little to justify the intervention of equity, for the courts *expect* parties in purely commercial transactions to know that their opposite number is not acting altruistically but is pursuing its own self-interest. Without a clear basis explaining the deviation not only from legal principle but also perspective (i.e. what made these

[87] *Ibid*, [117].

[88] *Lonrho Plc v. Fayed (No2)* [1991] All ER 961, 969.

[89] [1922] 2 AC 128, 138E.

particular commercial parties worthy of equitable intervention, when the court cannot clearly identify the equitable doctrine applicable in the circumstances?), the results appear distinctly inequitable. As Uguccioni astutely points out, for instance,[90] the non-acquiring party in the *Pallant v. Morgan* scenario is put in the position to cherry pick whether to pursue a claim if the property acquisition proves profitable for the acquiring party and to refrain from action if not.

In *Banner Homes* Chadwick LJ considered a series of cases, which raised issues similar to those in *Pallant v. Morgan* in a commercial context.[91] In every case, a constructive trust was imposed against a party who, in a commercial understanding with another, caused the other to rely on a promise and as a result acquired a benefit at the other's expense. Oliver J in *Time Products v. Combined English Stores*[92] pointed out that the value of the benefit is immaterial. What is relevant, is that for the defendant to retain for himself the benefit of the understanding obtained with the other party's assistance (whether or not such assistance was rendered based on an erroneous belief or on a promise) would be tantamount to fraud. This may very well be, but it still does not explain why commercial parties, who by the courts' own declaration[93] are expected to be aware of the *speculative* nature of all their dealings should be afforded proprietary relief in a bargain they knew, in the eyes of the law, was not binding or enforceable. The claimant in a *Pallant v. Morgan* scenario generally loses nothing more than an opportunity, which is the essence of commercial speculation. If they were to lose something more, then another head of relief could apply, such as unjust enrichment or specific performance, if there had been an enforceable bargain. There is no relationship between the parties other than a tentative understanding. Yet the basis for proprietary relief in such scenarios has never been clearly established, beyond the observation that letting the defendant keep the benefit would be objectionable.

In *Crossco No.4 v. Jolan*,[94] Etherton LJ posited that in the *Pallant v Morgan* line of cases the basis for proprietary relief was breach of fiduciary duty. He did not clearly

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[90] n.36, 165.

[91] *Holiday Inns Inc. v. Broadhead* [1974] 232 EG 951; *Time Products Ltd. v. Combined English Stores*, unreported, 2 December 1974; *Island Holdings Ltd. v. Birchington Engineering Co. Ltd.*, unreported, 7 July 1981.

[92] *Ibid*.

[93] See *Cobbe,* n.28, *Humphreys Estate*, n.26, *London Regional Developments Ltd*, n.37 etc.

[94] n.42, [88].

identify the basis upon which the fiduciary duty arose, but, in my view, the simplest and most reasonable explanation would be that it arose out of agency: the defendant in every case undertook to bid for the property on behalf of the claimant, as well as for himself.[95] *FHR European Ventures LLP v. Cedar Capital Partners LLC*[96] would arguably support this conclusion. In this case, the Supreme Court settled the debate on the appropriate relief to be afforded a principal when its agent has accepted a bribe or secret commission in the course of its agency. It is now established that in such circumstances the agent holds the bribe on trust for its principal, in the sense that the principal has a proprietary rather than a personal claim over the property acquired by the agent. However, the matter *of the basis* of the *Pallant v. Morgan* trust is far from settled. For instance, Arden LJ in *Crossco*[97] appears to interpret the *Pallant v. Morgan* equity as a common intention constructive trust.[98]

The confusion over the *Pallant v. Morgan* jurisprudence has had two effects. First, it demonstrates that the courts themselves can be uncomfortable with the sweeping application of the arm's length principle. This is because the expectation that commercial parties are always aware of the speculative nature of their dealings can be simply unrealistic. Sometimes business people, no matter their degree of sophistication, feel entitled to place their trust in others when seeking to develop opportunities. This is amply evident in *Banner Homes*, where the claimant's solicitors were in the process of fine-tuning the proposed joint venture agreement before the defendant backed out after bidding for and winning the site at issue. Secondly, the *Pallant v. Morgan* jurisprudence has produced the absurd outcome by which prospective co-venturers would be more protected (in the sense that they have access to proprietary relief rather than just damages) if they have no express agreement whatsoever.[99] Therefore, *Pallant v. Morgan*, as expanded in *Banner Homes*, is in direct conflict with the arm's length

[95] This interpretation is also adopted by Mummery LJ in *Beddow v. Gayzer* [2007] EWCA Civ 644, [78]-[79].

[96] [2014] UKSC 45.

[97] n.42, [129].

[98] Namely, a trust imposed over property (in a domestic context) to reflect the shared intentions of the parties as to ownership at the time of the property's acquisition; see *Stack v. Dowden* [2007] UKHL 17 (providing a non-exhaustive list of factors relevant to ascertaining the parties' intentions) and *Jones v. Kernott*, n.38 (establishing that the parties' intentions may change over time and this will be relevant to the disposition of the trust); *cf.* the analysis in M. Yip, 'The *Pallant v. Morgan* Equity Reconsidered' (2013) 33(4) *LS* 549.

[99] See *Benedetti v. Sawiris* [2009] EWHC 1330, which established that the existence of a binding contract is fatal to the *Pallant* equity; [513]-[526].

principle. This introduces an unacceptable degree of uncertainty in the law and operation of joint ventures, the paradigm vehicle for growth (see Ch.2). If default extra-contractual duties were to be implied into project-specific contractual joint ventures, the courts might feel less inclined to disregard doctrine they otherwise fight to safeguard in order to contain objectionable conduct.

4.3 Objection 2: There is no need for an extra-contractual standard of conduct in the form of default other-regarding duties, because English contract law already provides the parties with the means by which to protect the joint venture relationship.

The foregoing sections demonstrated that the commercial nature of parties to a joint venture (however 'sophisticated') is not a sound basis for opposing the implication of default other-regarding duties into the contract. If anything, there are several examples of English courts intervening in commercial dealings when the interests of justice so required. The problem with such intervention is that it tends to take place on an intuitive basis, which can only harm the interests of legal certainty in the long run. Default other-regarding duties are a practical response to this problem and at the same time provide a minimum standard of conduct justifiable on what rational commercial parties would have intended if they had reflected on what their self-interest requires.

But there is another argument to contravene such thesis: English contract law already provides commercial parties (generally conceived as straightforward maximisers) with the means to express their intentions to mutually constrain their self-interest and to address the problem of incomplete presentiation (i.e. their inability to contractually address in the present whatever befalls their relationship in the future). As regards the first point, they can do so by including clauses into their contract, which expressly reflect their intention to become constrained maximisers. As regards the second point, incomplete presentiation may be addressed either through the doctrine of frustration or by the parties' themselves making provision for adjusting their respective contractual obligations when certain events come to pass, thus effectively building into their contract the flexibility necessary to deal with future uncertainty. Either way, extra-contractual intervention through the imposition of default duties is neither desirable nor necessary. In this section, I will address each of these points in turn.

4.3.1 The parties expressing constrained utility maximisation by outright accepting other-regarding duties in contract: is it probable?

To a certain extent, a joint venture contract will necessarily represent the parties' intention to be constrained maximisers. If we examine a joint venture in light of Gauthier's methodology on rational cooperative bargaining, we must presume *ex hypothesi* that the collaborating parties have accepted Gauthier's premise of rationality as utility optimisation, otherwise a joint venture would be logically impossible.[100] It follows that the arrangement between the parties must be presumed to implement, at least to some degree, elements of Gauthier's rational bargaining process, namely that all involved partake of the cooperative surplus and no one becomes worse off as a result of the bargain.[101] The question then for the purposes of my thesis is whether, when recording their bargain in the contract, the parties would go as far as to expressly commit to duties whose *legal* effect could be to prioritise the interests of the other party ahead of their own. Evidence from practice suggests that they would not, if the widespread use of 'status clauses' in joint venture agreements (see 3.3.3) is any indication.[102]

My thesis, it will be remembered, holds that constrained maximisation of self-interest in legal terms translates into enforceable other-regarding duties establishing a minimum standard of conduct expected of the collaborators, on the ground that this is what their rational self-interest requires. But if being rational requires collaborators to submit to other-regarding duties, why would they routinely either avoid acknowledging their acceptance of such duties (beyond what is already recorded) in the contract, or even go as far as rejecting them expressly? I submit that this is a direct result of the operational and philosophical dichotomy between the commercial and legal aspects of the joint venture. The commercial aspect refers to the economic basis of the venture and its various objectives for the collaborators, individually and collectively. The legal aspect refers to the organisational form, which the parties apply to the joint venture relationship and determines the legal regime applicable to it. In turn, this regime

[100] This is because the (presumed) common knowledge of rationality would not allow the parties to go past the negotiation stage (see Ch.1).

[101] Whether optimally or not will depend on whether all parties managed to limit their constraint according to the minimax relative concession (see Ch.1).

[102] E.g. see cl.3.4(d), Model Petroleum Exploration Joint Operating Agreement (AMPLA, 2011) and cl.21.2.1, Standard Joint Operating Agreement for the UK Continental Shelf (UKOOA, 2002).

determines how the venture is to be operated in two respects: a) with reference to third parties (including the state, customers and suppliers); and b) with reference to the co-venturers and their individual roles and expectations. In an ideal world, the commercial and legal aspects of a joint venture should be perfectly congruent, in the sense that the latter should be simply another lens through which to express the commercial expectations of the parties.

Alas, in the eyes of the commercial world, this is generally not the case. The reason for this is that the legal dimension does not just translate the parties' respective obligations in the arrangement. It also seeks to mitigate risk so as to introduce a degree of predictability in the relationship by stipulating what is to happen when specified events arise in the future. This will invariably involve stipulations with regard to party default, which by definition introduce an adversarial element to the arrangement. However small, this element contrasts with the hopeful amicability that the parties enjoy at the beginning of the venture (or, later on, while it operates smoothly) and this is where the operational and philosophical dichotomy between the legal and commercial aspects of a joint venture arises. On the one hand, the commercial aspect of the joint venture looks to the present and relies operationally on social interaction between the venturers, its philosophy being one of informality, amiability and swiftness. On the other hand, the legal aspect of the venture looks to the future, is operationally geared toward risk mitigation, its philosophy being one of formality, detachment and wariness. The result of this dichotomy is that commercial parties tend to get on with their ventures addressing any problems on an informal basis and only turn to the legal aspect of their arrangement as a last resort, when all other forms of interaction have proven unsuccessful.[103]

How does this all relate to a joint venture contract being silent on, or expressly dismissing, duties prioritising the interests of the collective? The operational and philosophical dichotomy as presented above is relevant because on the informal or personal level, parties may be willing to compromise their immediate interests so as to salvage an otherwise fruitful relationship.[104] But things change at the formal level, for the contract is the tangible product of the legal aspect of a joint venture. By definition,

[103] E.g. note the studies of the commercial use of contracts in Macaulay, n.21, and H. Beale and T. Dugdale, 'Contracts between Businessmen: Planning and the Use of Contractual Remedies' (1975) 2 *Brit.J.L.& Soc'y* 45.

[104] See Macaulay, *ibid*.

therefore, to some degree it must represent the operational basis of legal planning, which is the mitigation of risk, whatever its nature. Consequently, what prevails in the joint venture contract is the cautious nature of legal counsel, rather than the optimism of the entrepreneur. This cautious approach is amply summarised in Margaret Moore's[105] critique of Gauthier's theory: it is one thing to expect an economic agent (traditionally perceived as a straightforward maximiser) to become a constrained maximiser because this is what their self-interest requires in a certain instant, and quite another to expect them to become *disposed* to being a constrained maximiser. There is no rational reason for an individual whose *disposition* is to constrain maximisation of their self-interest (so as to achieve maximum utility *overall*) to balk at expressly submitting to (limited) other-regarding duties in contract, because their disposition effectively requires them to implement other-regarding imperatives anyway (to the extent that doing so will benefit them in the long run). But economic agents are not so disposed.[106] If anything collaborators tend to expect that their counterparts will act opportunistically when their actions are likely to go undetected.[107] On that basis, avoiding outright acceptance of, or even expressly dismissing, other-regarding duties in the contract represents the legal counsel's effort to provide a collaborator with an exit strategy, in the event that they or their counterpart decide to eschew their contractual obligations or the relationship instead.[108] In other words, it would be

[105] See Ch.1.

[106] E.g. S. Macaulay, 'An Empirical View of Contract' (1985) *Wis.L.Rev.* 465, at 471ff.

[107] E.g. M.E. Schweitzer and T.H. Ho, 'Trust but Verify: Monitoring in Interdependent Relationships' in *Experimental and Behavorial Economics* (*Advances in Applied Microeconomics*, vol.13) 87-106. The study demonstrates that collaborators tend to act in a trustworthy manner when they expect their actions to be monitored and that they systematically expect their counterpart to act in an untrustworthy manner, when not monitored (which, arguably, can be viewed as a product of the 'common knowledge of rationality' presumption – see Ch.1).

[108] A co-venturer might decide to eschew their contractual obligations pursuant to a wider strategy based on the 'efficient breach' concept. This concept holds that when the time comes for the promisor to perform their obligation under the contract, if it transpires that they would lose more than what the promisee would gain from the promisor's performance, then the promisor should refuse to perform and, instead, pay the promisee either a pre-agreed or court-determined value (i.e. liquidated damages or damages, respectively) representing the promisee's expectation interest; see R.L. Birmingham, 'Damage Measures and Economic Rationality: the Geometry of Contract Law' (1969) *Duke L.J.* 49, proposing an economic approach to rationalise the US courts' response to 'wilful' breaches of contract, of which radically conflicting examples are the decisions in *Groves v. John Wunder Co.* 205 Minn 163, 286 NW 235 (1939) and *Peevyhouse v. Garland Coal & Mining Co.* 382 P2d 109 (Okla. 1962), *affd*. in 382 P2d 116 (Okla. 1963). The concept of efficient breach lies at the heart of the debate on the nature and role of contract law and its underlying jurisprudence. Indicatively see: R.L. Birmingham, 'Breach of Contract, Damage Measures and Economic Efficiency' (1970) 24 *Rutg.L.Rev.* 273 (advocating an impassive response to instances of wilful breach viewing the contract for what it is – an expression of the market and no more); and on a more moderate note: C.J. Goetz and R.E. Scott, 'Liquidated Damages, Penalties and The Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach' (1977) 77 *Colum.L.Rev.* 554 (arguing that 'efficient breach' should only be implemented if the rule on prohibiting penalty clauses [i.e. liquidated damages which lead to 'over-compensation' of the

unrealistic for the English legal system to refuse to imply other-regarding duties into the joint venture relationship on the ground that, if they so wished, the parties would have recorded their intention to submit to such duties in their contract. This is because, the joint venture contract does not necessarily express what the parties would have intended if they had reflected on what their self-interest requires.

4.3.2 Existing contractual mechanisms adjusting the parties' obligations in response to changes in circumstances: are they adequate?

Regardless of my argument in the previous section, the presumption in English law is that a contract reflects the relationship between the parties perfectly or should be treated as such. On this basis, for instance, the court will refuse to imply a term into a contract, which contravenes an express contractual term,[109] commercial common sense not being a sufficient justification for undercutting the significance of the actual words the parties used.[110] Thus, the orthodox approach to a joint venture holds that it is up to the parties to ensure that the contract reflects the reality of their relationship. They need only look to the existing tools provided by contract law to ensure that this is the case and in so doing they can rely on the contract both as a primer for their relationship and as an effective risk mitigation device. Thus, systemic intervention through the implication of extra-contractual other-regarding duties is unnecessary.

In this section I argue that there are two problems with this view. The first is the problem of the strict liability foundation on which the contract operates (see 4.2.1). Accordingly, unless the circumstances are so extreme that they have fundamentally altered the basis of the contract, or the essence of the parties' obligations thereunder, the parties will be expected to perform their respective obligations to the letter. Such extreme circumstances may range from the elimination of the subject matter of the

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promise] is sufficiently relaxed, so as to protect promisees from frivolous, and therefore inefficient, breaches.); *Cf.* D. Markovits & A. Schwartz, 'The Myth of Efficient Breach: New Defences of the Expectation Interest' (2011) 97 *Va.L.Rev.* 1939 (based, *inter alia*, on what they term 'dual performance hypothesis' [i.e. that contractual performance means that the promisor can either trade as per the agreement or refuse to trade and pay damages instead – either way the contract is performed] the authors dismiss the 'efficient breach' concept entirely).

[109] E.g. see *Arnold v. Britton* [2015] UKSC 36, [47]-[56].

[110] *Cf. Rainy Sky SA v. Kookmin Bank* [2011] UKSC 50, where good commercial sense was the basis for choosing between two conflicting interpretations of a clause; *Aberdeen City Council v. Stewart Milne Group* [2011] UKSC 56.

contract itself[111] or render its performance impossible,[112] whereupon the contract is said to be 'frustrated'. In Lord Radcliffe's words:

> 'Frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. *Non haec in foedera veni*. It was not this that I promised to do.'[113]

The effect of frustration is to excuse the parties from further performing their obligations under the contract,[114] thus bringing the contract to an automatic and immediate end.[115] However, the circumstances where a contract may be terminated due to a frustrating event are notoriously limited,[116] and so the parties may well find themselves trapped in a relationship, which is no longer beneficial for at least one of them. The second problem arising from the orthodox approach to the management of long-term contracts is the problem of incomplete presentiation, which refers to the parties' inability to address in the present whatever befalls their relationship in the future.

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[111] E.g. *Taylor v. Caldwell* (1863) 3 B&S 826 (an accidental fire destroyed a music hall which was hired out for the purpose of giving concerts); *Howell v. Coupland* (1876) 1 QBD 285 (a contract for the sale of 200 tons of potatoes to be grown on specific land over a specific period was discharged when a disease on the crop significantly reduced the amount of potatoes the seller could deliver.) *Cf.* the case with unspecified or unascertained goods: *Blackburn Bobbin Co. Ltd. v TW Allen & Sons Ltd.* [1918] 2 KB 967 (the outbreak of war preventing the seller from procuring timber from the intended source –Finland – was not enough to excuse their obligation to perform under the contract); *The Mary Nour* [2008] EWCA Civ 856 (seller of cement let down by their supplier, not excused from their contractual obligation as they could source the goods from somewhere else).

[112] E.g. *Pioneer Shipping Ltd. v. BTP Tioxide Ltd, The Nema* [1982] AC 724.

[113] *Davis Contractors Ltd v. Fareham UDC* [1956] AC 696, 729.

[114] E.g. *Knell v. Henry* [1903] 2 KB 740 (a contract for hiring of a flat from which to view the coronation processions was frustrated when the processions were not carried out on the days originally fixed and therefore the defendant was not liable for the remaining rent, beyond the deposit already paid to the plaintiff).

[115] *Joseph Constantine Steamship Line Ltd. v. Imperial Smelting Corpn Ltd* [1942] AC 154.

[116] Indicatively, see *British Movietonews*, n.6 (a contract may not be frustrated merely because it turns out to be difficult or onerous to perform); affirmed again in *Davis Contractors Ltd v. Fareham UDC*, n.113, 716, per Viscount Simonds. See also *Tsakiroglou & Co. Ltd. v. Noblee Thorl GMBH* [1962] AC 93 (seller still expected to deliver despite the closure of the Suez Canal meaning having to employ a shipping route twice as long and costly than originally contemplated). Generally, English law is inclined to uphold the bargain as is, notwithstanding hardship, unfairness or unconscionability: see *National Westminster Bank Plc v. Morgan*, n.5, 707-709, per Lord Scarman.

In response to the first problem comes the argument that the solution lies in contract law itself. On this view,[117] the parties must be proactive in drafting their long-term contract so as to avoid having to rely only on the rules of frustration, when a future event affects the performance of their respective obligations. Thus, they can introduce flexibility into their contract through various clauses re-adjusting their obligations in response to future events. The most common type of adjustment clause is one dealing with acts of God or *force majeure*, namely events which are outside the control of the parties. The presence of such a clause will not preclude the doctrine of frustration from applying,[118] even if the clause had foreseen the frustrating event and, in its advent, provided a right to cancel further performance, which the parties did not ultimately exercise.[119] However, as McKendrick observes,[120] used correctly, these clauses may serve to indicate to the court how the parties originally wished to proceed with their contract in the event of force majeure, which should not necessarily involve the termination of the contractual relationship. Thus, in contrast to contract frustration, a force majeure clause may simply modify or postpone performance of the parties' respective obligations in response to or until the force majeure event has been resolved.[121] Similarly, parties to long-term contracts could ensure that performing their respective obligations does not actively end up causing them loss by employing 'hardship clauses', which require that parties renegotiate certain parts of the contract where events – unforeseen at the time of contracting – are likely to substantially affect

[117] See E. McKendrick, 'The Regulation of Long-Term Contracts in English Law' *in* Beatson and Friedman, n.2, 305.

[118] E.g. *F.A. Tamplin Steamship Co. v. Anglo-Mexican Petroleum Products Co.* [1916] 2 AC 397, 406, per Viscount Haldane.

[119] *Bank Line v. Arthur Capel & Co*. [1919] AC 435.

[120] McKendrick, n.114, 325.

[121] Generally, if the parties have addressed the precise event (or events of similar nature) in the contract and have indicated that they wish the contract to continue regardless, the court is inclined to honour this intention – see *Pioneer Shipping Ltd v. BTP Tioxide Ltd*, n.112*,* and *Joseph Constantine Steamship Lire Ltd. v. Imperial Smelting Corpn Ltd.*, n.115, 163 – but the content of the clause is likely to be construed narrowly (see *Bank Line v. Arthur Capel & Co,* n.119*,* 455*; Countess of Warwick Steamship Co. v. Le Nickel Societe Anonyme* [1918] 1 KB 372 and, especially, *Tandrin Aviation Holdings Limited v. Aero Toy Store* [2010] EWHC 40*),* and therefore careful drafting is essential*. Cf. Fibrosa Spolka Akeyjna v. Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32, where a clause providing for reasonable extension on delivery of the goods in the event of delay caused, inter alia, by war was held not to refer to the prolonged and indefinite delay caused by World War II. This confirms that frustration may occur regardless of stipulation, where the force majeure event effectively renders the contract completely different to that which the parties originally contemplated.

the 'equilibrium of the contract'[122] by making performance more onerous than otherwise anticipated.[123]

Building flexibility into a long-term contract through the use of appropriate clauses and careful wording can certainly address some of the issues arising out of the strict liability foundation of contract law. In fact, my thesis supporting the implication of limited default duties into the relationship does not refute this observation, nor does it in any way interfere with the parties' ability to use the tools that contract law provides in this respect. If anything, the parties may well use the same tools to tweak or further define those duties to better suit their relationship (see Ch.6). However, striving for built-in flexibility, however prudent and useful, does not address the paradox of incomplete presentiation; parties simply cannot address in the contract every future eventuality. Price adjustment clauses, for instance, routinely 'fail' because of this simple fact.[124] In the context of contractual joint ventures, I will refer to such an event as a 'tension-point', in the sense that it can change the dynamic of the joint venture dramatically and can trigger opportunistic behaviour. Thus, when a tension-point materialises, if the joint venture contract is not frustrated (which is likely, given the narrow application of the doctrine) and there is no applicable adjustment clause, incomplete presentiation may expose at least one of the co-venturers to opportunism from the other(s). However, were default other-regarding duties to be implied into the relationship, the spectre of opportunism becomes less daunting, encouraging the co-venturers to re-evaluate their relationship (if appropriate) in light of the tension-point, on an equal footing.

In sum, the second argument against my thesis holds that contract law already provides the parties with the tools to protect their relationship, if they so wish, and therefore extra-contractual intervention is neither necessary nor helpful. My response is that systemic intervention by way of default other-regarding duties need not oppose the

[122] See comment no.2 to art.6.2.2. (Hardship Clauses) in the UNIDROIT Principles of International Commercial Contracts 2010 (UNIDROIT, 2010).

[123] Common examples are a sharp increase in the cost of performance for the promisor or a decrease in the value received by the promisee – see *ibid*, paras. 2(a) and 2(b). English law would not consider an increase in price as a hindrance to a party's ability to perform, even in the context of a force majeure clause: *Tennants (Lancashire) Limited v. CS Wilson and Company Limited* [1917] AC 495). In any case, parties tend to employ price escalation clauses to address this issue. But where price escalation clauses prove inadequate to cover the losses of the promisor, following *Tennants (Lancashire)* they can be an obstacle to the defaulting party's claiming either frustration (*Wales Ltd. v. Greater London Council* [1984] 25 BLR 1) or force majeure (*Thames Valley Power Limited v. Total Gas & Power Limited* [2005] EWHC 2208).

[124] *Ibid*.

purposes or operation of contract law. Default duties can work in tandem with extant law to ensure that the parties remain true to the cooperative spirit they originally displayed, or that they at least do not fall victim to opportunism triggered by a tension-point they could not have predicted at the start of the relationship. If anything, awareness of default duties applying specifically to joint ventures, may encourage co-venturers to use the very same legal tools to best adjust the implied duties to their relationship (e.g. by clearly defining the scope of the joint enterprise – see 3.3.2).

4.4 Objection 3: As parties to a 'relational contract', co-venturers can be expected to address any and all issues as they arise and, failing that, a contextual interpretation of their relationship would resolve any dispute without the need to introduce default rules into the contract

4.4.1 Relational Contracts – a brief background

The third argument against my thesis stems from the relational theory of contract law. Defining contract as 'exchange relations',[125] namely 'relations among people who have exchanged, are exchanging, or expect to be exchanging in the future',[126] the theory centres upon the *relationship*[127] created by an exchange of promises between two or more individuals. It is this relationship, which distinguishes this exchange from those which are 'discrete', namely bargains made on an one-off basis and are deemed concluded,[128] where performance of the parties' respective obligations is completed on the spot or at a specific future point.[129] A contract, which creates a relationship *beyond*

[125] I.R. Macneil, 'Relational Contract Theory: Challenges and Queries' (2000) 94 *N.W.U.L.R* 877, 877.

[126] *Ibid*.

[127] See M.A. Eisenberg, 'Relational Contracts' in Beatson and Friedman, n.2; but note: Eisenberg does not define 'relationship' beyond the term's everyday meaning and therefore he does not attempt to distinguish when a 'relationship' borne out of a series of discrete exchanges, as per the facts of *Baird Textile Holdings Ltd. v Marks & Spencer Plc.*, n.22, gives rise to legally binding rights and duties, if at all.

[128] E.g. see Goldberg's definition of the paradigmatic discrete transaction, as one 'in which no duties exist between the parties prior to the contract formation and in which the duties of the parties are determined at the formation stage. Prior to their contract, Smith has no duty to Brown; at the time they enter their agreement, in a single joint exercise of their free choice, they determine their respective duties to each other for the duration of the agreement; completion of the promised performance terminates that party's obligation': V.P. Goldberg, 'Toward an Expanded Economic Theory of Contract' (1976) 10(1) *J. Econ. Issues* 45, at 49.

[129] Specificity, either of timing or other performance-related characteristics, being a major characteristic of 'complete' contracts: see the analogy, e.g., in G.K. Hadfield, 'Problematic Relations: Franchising and the Law of Incomplete Contracts', (1990) 42 *Stan.L.Rev.* 927. By contrast, relational contracts are not, and cannot be, complete and therefore lack of specificity is their defining characteristic: see C. J. Goetz and R.E. Scott, 'Principles of Relational Contracts' (1981) 67 *Va.L.Rev.* 1089, at 1091.

the elementary interaction necessary[130] for the *one-off* exchange and performance of mutual promises, is a 'relational contract'.[131] On this foundation, relational contract theory holds that when the law undertakes to construe and enforce a relational contract, it must take into account the (social, cultural and financial) context of the parties' bargain as well as its surrounding circumstances, so as to properly comprehend the relationship and give effect to the parties' intentions. On this view, therefore, the formal contract between the parties is only one of the factors that determine the parties' respective rights and duties.

The relational theory of contracts developed as a response to the perceived failings of classical contract law,[132] which holds the content of the bargain as paramount. Classical theory thereby excludes the surrounding circumstances and the parties' subjective intentions or understanding at the time of contracting, unless expressly given effect by the contract itself (see 4.2.1).[133] According to relational theory, classical contract law is too rigid and its insistence on upholding the bargain as recorded in the parties' express agreement fails to take into account their actual contractual behaviour[134] and the problem of 'incomplete presentiation', which *ex hypothesi* renders, particularly long-term, contracts incomplete.

For an illustration of the difference in approach between relational and classical theories of contract, let us consider the following example. Say that I have a favourite

[130] E.g. for Komhauser, an additional defining characteristic of a relational contract is that of *extended interdependence*, in the sense that 'the interdependence of the parties to the exchange extends at any given moment beyond the single discrete transaction to a range of social interrelationships'; L. Komhauser, 'Book Review: The Resurrection of Contract' (1990) 82 *Colum.L.Rev.* 184, at 188.

[131] To be sure, this is an unfairly simplistic account of relational contracts and is presented here in these terms for the sake of brevity. It should be noted that, if anything, the most debated and problematic issue in relational contract theory lies in the very definition of a relational contract: see, for instance, R.E. Speider 'The Characteristics and Challenges of Relational Contracts' (2000) 94 *N.W.U.L.R* 823.

[132] E.g. see I.R. Macneil, 'Contracts: Adjustment of Long-term Relations Under Classical, Neoclassical and Relational Contract Law' (1978) 72 *N.W.U.L.R* 854 [hereafter, Macneil (1978)].

[133] See, e.g., *Arnold v. Britton*, n.109, where the Supreme Court considered the interpretation of wording concerning a service charge in a 99-year lease.

[134] See I.R. Macneil, 'Relational Contract: What We Do and Do Not Know' (1985) *Wis.L.Rev.* 483; See also Goldberg, n.128, who argues along similar lines from an economic perspective and challenges economic theory's assumptions regarding the attributes of parties to commercial contracts and their behaviour; In the context of 'fallacious' economic analysis of legal remedies, see also I.R. Macneil, 'Efficient Breach of Contract: Circles in the Sky' (1982) 68(5) *Va.L.Rev.* 947 [hereafter, Macneil (1982)], where he challenges the efficient breach theorists' insistence on damages as being the most efficient outcome (where performance of the contract would produce inefficiency, n.108) and presents specific performance as the alternative offered by relational theory, one which seeks to minimise *inter alia* relational costs (Macneil (1982), *ibid*, 959) by encouraging consultation and negotiation, for this is the expectation that real-world contract behaviour tends to raise.

greengrocer whom I visit after work every day and from whom I obtain all my cooking supplies. I have been doing this every weekday for several years. The greengrocer has come to know my habits, likes and dislikes and even what I cook on particular days. In anticipation of my arrival, without me expressly asking her for it, she puts aside the groceries she knows from experience I will require on each particular day. This is to make sure that I will find what I need when I visit her store at the end of my workday and that other customers will not beat me to them. Indeed, I am grateful for this initiative on her part and gladly pay for the groceries she sets aside for me daily. Recently, however, a new grocery store opened close to my workplace and visiting it cuts my commuting time down by over 30 minutes. Thus, I start using the new grocery store. I do not inform my old greengrocer, who, for the first several days, continues to set aside the usual groceries for me every day. However, since I do not visit her store any more, the groceries remain uncollected and she has to sell them the next day at a significant discount. Some of these groceries she has had to order in especially for me, not at my express request but based on orders I have repeatedly asked her to place for me in the past. Say that she now wants to recoup from me the losses she incurred by ordering in expensive specialty ingredients, which I did not collect and, therefore, did not pay for and which she has not been able to sell (or has had to sell at a discount).

Under classical contract theory, the greengrocer has no case. Our interaction becomes a contract once the greengrocer has offered the groceries she has set aside for me and I have accepted and paid for them. Each day therefore gives rise to a new discrete contract – before the contract is formed, she has no duty to set aside any groceries for me and I have no duty to accept those that she has. Consequently, if she has ordered in products for me on her own initiative, I am under no duty to accept or pay for them. Our numerous past interactions give rise to no enforceable expectations on her part.[135] By contrast, under relational theory, the transaction would be examined in the context of the relationship I have built with the greengrocer over the many years of my being her customer. The argument here is that my frequent custom and the greengrocer's response to it (with my implied consent) has created a relationship, which has in turn given rise to an implied long-term contract whereby the greengrocer has a duty to order in or set aside the groceries I need on specific days, and I have a duty to accept or pay

[135] See *Baird Textile Holdings*, n.21.

for them, unless either one of us notifies the other otherwise. On a relational interpretation, therefore, the greengrocer may well have a viable case against me.[136]

4.4.2 The relational 'objection' to my thesis.

Given this background, what is the relational theorist's objection to my thesis advocating the implication of default other-regarding duties in contractual joint ventures? The answer is that my thesis reflects too much of the 'abstraction'[137] of classical contract law in its treatment of contracts. Relational theory advocates contextualism. In Hillman's words, 'the thrust of relationalism is its description of reality'.[138] Thus, adapting Hillman's formulation of the relationalist premise, when faced with the example of my thoughtless treatment of a perfectly nice greengrocer, a relationalist would ask first 'what are the facts? Did the greengrocer and I have "relational intentions"'?[139] If so, then I should be liable for the greengrocer's losses as a result of my failure to give her reasonable notice of my intention to stop collecting the groceries. This is because – based on our numerous past interactions – I should have foreseen that the greengrocer would have set aside the groceries for me and that my failure to collect them (or to notify her of my intention to stop visiting her shop) would cause her loss. In other words, the relational approach has no use for *a priori* implied extra-contractual duties. This is because if an examination of the context informing the parties' relationship so warrants, a relational interpretation of contract rules could well afford the injured party with an appropriate remedy where the bargain is incomplete on that front or, theoretically, even where no express bargain had been previously hammered out.[140]

Adapting this reasoning to contractual joint ventures, the third argument against my thesis could be formulated as follows: if contractual joint ventures are interpreted for

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[136] See e.g. the relational analysis of *Baird Textile Holdings*, n.21, by L. Mulcahy and C. Andrews, '*Baird Textile Holdings v. Marks and Spencer plc.* Judgment' in R. Hunter et al. (eds), *Feminist Judgments: From Theory to Practice* (Hart, 2010) 189.

[137] I am borrowing the term from Beale who uses it to describe the tendency in the law to treat 'the contract in an abstract way, taking little account of the context in which it is made': H. Beale, 'Relational Values in English Contract Law' in D. Campbell et al. (eds), *Changing Concepts of Contract: Essays in Honour of Ian Macneil* (Palgrave Macmillan, 2013) 116, 117.

[138] R.A. Hillman, *The Richness of Contract Law: An Analysis and Critique of Contemporary Theories of Contract Law* (Kluwer, 1997), 265.

[139] *Ibid*.

[140] Which should also correspond to the relational characteristics of the contract at issue and therefore the needs of the parties – see Macneil (1982), n.132.

what they are, i.e. as paradigmatic relational contracts, then there is no need for a systemic intervention through a one-size fits-all solution in the form of other-regarding duties implied into such relationships by default. This would be cumbersome and ignore the reality of the parties' relationship and *actual* (as opposed to attributed – as per my thesis) intentions. Thus, in the event of a dispute, the parties can be reasonably expected to settle their differences through negotiation and compromise, rather than through formal means.[141] But should attempts at an amicable solution fail, the court can and should settle the dispute by examining the specific circumstances underlying the parties' agreement and the overall context informing their relationship. Rather than attempting to regulate the conduct of contractual parties (for instance, in an attempt to protect the vulnerable following an unforeseen, or inadequately planned for, tension-point – see 4.3.2) through *a priori* implied duties specific to the contractual joint venture as a *class* of commercial relationship, the interests of commercial actors would be better served by giving effect to their bargain as informed by the circumstances specific to each relationship. This approach, therefore, affords the parties and the courts the flexibility necessary to address one important empirical observation: the more 'relational' the exchange the more unlikely it is that the parties will have planned and allocated risks effectively.[142]

In the same vein, relational theory can arguably provide an effective solution to the freeloader problem, which inevitably faces rational commercial parties involved in a collaborative relationship.[143] This proposition engages directly the core premise of my thesis. In particular it will be remembered that the purpose of my thesis is to provide a

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[141] See e.g. the findings in Macaulay and Beale's respective studies, n.21 and n.103. See also the findings of M. Crystal's survey of cases brought under art.2 of the United States Uniform Commercial Code (which imposes *inter alia* a duty of good faith on parties to commercial contracts and includes 'past dealings' as a factor to be considered in the interpretation of such contracts – a distinctly relational approach) demonstrating that the majority of litigated cases over a period of two decades involved 'discrete' contracts: N.M. Crystal, 'An Empirical View of Relational Contracts Under Article Two of the Uniform Commercial Code' (1988) *Ann.Surv.Am.L.* 293; the author applied the following definition of relational and discrete contracts: 'A case was classified as *relational* if the facts reported in the opinion showed that the parties had entered into more than one contract over a period of time or if the facts showed that the parties had entered into a long-term contract with repeated occasions for performance. A case was classified as *discrete* if the facts showed that parties had entered into a single contract not involving repeated occasions for performance.' Crystal, *ibid*, at 299.

[142] In contrast to the values in operation when the exchange is on the 'discrete' side of the spectrum: for an analysis along these lines, see I.R. Macneil, 'Values in Contract: Internal and External' (1983) 78 *N.W.U.L.R* 340 [hereafter, Macneil (1983)].

[143] See 1.3.1 and 1.3.2. It will also be remembered that, in the case of the powerful freeloader, whether rationality is defined as the maximisation of long-term – as opposed to short-term – self-interest is immaterial; the powerful freeloader is logically expected to act opportunistically if they can get away with the consequences, either now or in the future.

methodology by which to address opportunistic behaviour in contractual joint ventures in a predictable and replicable manner, based on objective and therefore uniformly applied criteria. My argument is that the *a priori* implication of extra-contractual duties into the contractual joint venture can be justified on the premise that it reflects what the parties, as presumed constrained maximisers, would have desired, if they had properly reflected on what their (long-term) interest required. However, in contrast to my quest for objectivity, the relational theory of contract law insists on the importance of subjectivity – *ex hypothesi* each case must be examined on its own facts and the application of contract law, as well as the award of any remedies, must reflect the context of the particular relationship.[144] Thus, should a contractual joint venture break down as a result of opportunism, the relational interpretation of the agreement would take into account both the specific circumstances underlying the agreement and the overall context of the joint venture relationship. On this basis, the court would be better placed to identify actions as opportunistic, which in other contexts might have been treated as both reasonable and foreseeable (and, therefore, preventable).[145] Therefore, a relational application of contract law would be better placed overall to protect the vulnerable party and deter opportunistic behaviour by a freeloader, because its subjective approach would more accurately reflect the reality of the joint venture relationship.

4.4.3 My thesis: a *qualified* relational analysis of contractual joint ventures?

At the outset, I do not inherently disagree with the premise of a relational interpretation of contract law, particularly in the context of addressing contractual incompleteness. If anything, to an extent my thesis embraces the contextualism underlying relational contract theory, in that it advocates re-interpreting contract law so as to take proper account of the context informing contractual joint ventures in the interest of both commercial and legal certainty. Relational contract theory has also been embraced from an economics point of view as well, as the optimal means of handling hybrid

[144] Note, for example, Macneil's critique of the objective theory of contract (as applied in classical and neo-classical contract law) whereupon the parties' necessary consent to the contract terms is deduced not from reality but from 'objective manifestations of intent', rendering the whole established approach to consent fictitious: see Macneil (1978), n.132, 883-884. *Cf.* R.E. Barnett 'Conflicting Visions: A Critique of Ian Mcneil's Relational Theory of Contract' (1992) 78 *Va.L.Rev.* 1175, 1189-1190.

[145] *Cf.* J. Adams and R. Brownsword, *Key Issues in Contract* (Butterworths, 1995), 229-230, observing that the opportunism displayed by the plaintiff in *Arcos v. Ronaasen* was not recognised as bad faith. The facts in *Baird Textiles* are a good example of this.

organisational forms, such as contractual joint ventures. Indeed, seeking to identify the most economically efficient way of regulating long-term contractual relations, Williamson concluded that a more relational application of contract law (in contrast to its classical and neo-classical versions[146]) would be the most efficient way of regulating long-term (or relational) contracts, with efficiency being defined as the minimisation of transaction costs.[147]

Notably, Williamson approaches contracts purely as transactions, rather than as relationships with a legal (and financial) component. For Williamson, transactions can be simple or complex and their ultimate designation will depend on the degree to which they present each of the three major factors giving rise to transaction-generated costs: uncertainty, frequency, and the incidence of transaction-specific expenditure. Thus, Williamson views 'relational contracts' as those transactions, which present comparatively high degrees of *uncertainty* (i.e. not all contingencies have been hammered out before agreement to transact takes place), *frequency* (i.e. they are frequently concluded among the same parties) and, most importantly, *transaction-specific expenditure*. The reason why transaction-specific expenditure is so crucial in the ultimate designation of the transaction itself is that this expenditure is made specifically to accommodate the transaction at issue and therefore it is non-marketable.[148] Ultimately, the higher the degree of transaction-specific expenditure, according to Williamson, the more complex the transaction and therefore the more appropriate the relational interpretation of contract rules in the event of a dispute.[149]

Williamson's approach to relational contracts, which consists in examining hard, transaction-specific data (as opposed to, say, observing the content of the parties'

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[146] Macneil utilised this classification in 'The Many Futures of Contract' (1974) 47 *S.Cal.L.Rev.* 691 and is what Williamson bases his economic analysis of contract law on.

[147] O.E. Williamson 'Transaction-Cost Economics: The Governance of Contractual Relations' (1979) 22 *J. Law Econ* 233.

[148] A classic example of transaction-specific investment is of course the purchase of specialised plant and machinery. However, Williamson observes that what drives the transaction's complexity factor even further is where the investment involves the acquisition of not physical but human capital – i.e. the deployment of individuals with specialised knowledge, often with regard to the operation of the machinery purchased specifically to accommodate the transaction. In this case, the complexity factor of a transaction increases, because the *identity* of the individuals involved in it becomes relevant to the transaction's success. In other words, the success of highly complex (or 'idiosyncratic') commercial transactions is dependent on the *preservation of the relationship* between the individual elements of the transacting parties; *ibid*, 242-245.

[149] *Ibid*, 239.

interactions, the cultural context and the social/professional norms at play), may also serve as a response to a major criticism of relational contract theory, namely the apparent impossibility of identifying relational contracts. The argument here holds that if we cannot conclusively determine what makes a contract 'relational' then we cannot realistically be expected to develop a corresponding relational contract law. Eisenberg, for instance, observed that it is as difficult to define 'discrete' contracts, as it is to define 'relational' contracts, articulating the problem as follows:

> 'if there is to be a body of contract-law rules to govern relational contracts, it is imperative to establish a definition of relational contracts that centers [sic] on one or more characteristics that meaningfully distinguish relational and discrete contracts, and the definition must do so in a way that justifies the application of a special body of contract rules to relational contracts as so defined.'[150]

Eisenberg ultimately argues that *all* contracts are at least to some extent relational and therefore classical contract law rules should be adjusted so as to address the inefficiencies associated with their axiomatic and rigid nature, rather than develop a separate body of legal rules, which specifically addresses 'relational contracts'.[151] Similarly, Macneil reasons that not only are *all* contracts-as-transactions inevitably relational, but that the values underlying the contract as an institution are fundamentally relational as well. As an example of this, he points to the doctrine of consideration – the very cornerstone of contract law – which in effect institutionalizes the distinctly 'relational' concept of reciprocity, in the sense of 'getting something back for something that is given'.[152] In this light, the classical approach to contract interpretation with its superficial consideration of the contract and axiomatic dismissal of factors not expressly included in the contract itself, will arguably only lead to anomalous outcomes, despite classical contract theory's claim that its ultimate purpose is to safeguard commercial certainty and market stability by upholding the parties' express intentions.

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[150] M.E. Eisenberg, 'Why There is no Law of Relational Contracts' (2000) 94 *N.W.U.L.R.* 805, 814.

[151] *Ibid*, 813-817.

[152] Macneil (1983), n.142, 347. Similarly, Campbell identifies as distinctly relational the obligation on a claimant in a contract dispute to mitigate the loss suffered as a result of the defendant's breach. He argues that this obligation reflects a regime where 'parties are encouraged to cooperate to deal with the consequences of breach'; D. Campbell, 'A Relational Critique of the Third Restatement of Restitution §39' (2011) 68 *Wash.& Lee L.Rev.* 1063, 1067.

Campbell uses *Arcos v Ronaasen*[153] to demonstrate this point.[154] It will be remembered that the House of Lords in *Arcos* ruled that goods sold under a contractual specification must correspond to that specification absolutely, which was itself a condition implied into the contract by s.13 of the Sale of Goods Act 1893 (hereafter, SGA1893), then in force. Campbell argues that by expressly dismissing the relevance of industry standards (as evident in the findings of an industry umpire, on two occasions) in the dispute before them, the judges effectively reversed the *default* standard in sale of goods from that of goods having to be of merchantable quality or fit for the purpose for which they were sold, which was guaranteed by s.14 SGA1893, to that of goods having to *absolutely* correspond to their description in the contract (s.13). To be sure, Campbell does not disagree with a buyer being guaranteed absolute correspondence with the goods' contractual description, and therefore having the automatic right to reject them if that guarantee is breached, *so long as* the buyer has paid for such privilege.[155] Therein lies the anomaly. A legal regime which claims to track market norms and values cannot expect sellers to guarantee *absolute* correspondence with the goods' description as a *default* without contradicting its own terms. This is because such expectation would lead to higher manufacturing costs, as suppliers would scramble to comply with the high standard of contractual performance, leading to higher prices, which in turn would be unacceptable to classically defined rational buyers. If given the choice, the latter would reasonably be expected to opt to pay less for goods that on the one hand do not correspond with their description absolutely, but, on the other, are guaranteed to be fit for the purpose they were bought, or, at the very least, to be of merchantable quality. Campbell's ultimate point is that if the judges in *Arcos* had properly considered the dispute in light of the relational norms that made the exchange possible in the first place, they would have concluded that the buyer did not in fact have the right to reject the goods outright, because the goods substantially corresponded to their description as per the *default standard* as to correspondence set by s.14. Making s.13 SGA1893 the default would be contradicting the purposes of the legal regime itself.

Against this background it is important to emphasise that I do not disagree with the main tenets of relationalism, for Gauthier's own theory of constrained utility

[153] n.9; see 4.2.1.

[154] D. Campbell, '*Arcos v Ronaasen* as a Relational Contract' in Campbell et al., n.137, 138 [hereafter, Campbell (*Arcos*)].

[155] *Ibid*, at 162.

maximisation is fundamentally relational *in its application*.[156] Nevertheless, on a practical level, I contend that if a relational treatment of contracts is to be institutionalised, then it must operate at the level of abstraction also envisaged in Campbell's argument above; namely, as an interpretative tool[157] by which to set defaults whose purpose is to acknowledge and give effect to the objective intentions of rational agents, who, as a given, must adhere to the barest of relational norms, such as an expectation of reciprocity,[158] if market exchange is ever to be possible. Gauthier's constrained utility maximisation principle is fundamentally relational in its effect, because its very purpose is the *validation* of cooperation in economic activity between what he presumes to be rational (i.e. self-interested) agents. In the context of contractual joint ventures, the required level of abstraction is achieved through attributing rational intentions onto the co-venturers *a priori*, to the effect that the interpretation of their contract ultimately comes down to what they would have agreed to, if they had properly reflected on what their self-interest required.[159] This approach can then justify a default

[156] My understanding of the dichotomy is that what distinguishes Gauthier's contractarian morality from the relational theory of contract is their respective epistemologies. Gauthier sought to establish *ex ante* an objective account of what motivates fundamentally self-interested agents to cooperate (and thus allow for market and social exchange as we know it). In contrast, relational theory starts from the empirical premise that cooperation does take place (Macneil notably describes the question 'what came first: self-interest or solidarity' as a non-issue: Macneil (1980), n.1, 97) and relies *ex post* on the existence of both market and social exchange as evidence of this, its objective being to identify the norms that make exchange possible and interpret reality accordingly.

[157] After a long career of being subjected to many a diatribe on either the virtues of relational contract theory or its unmitigated flaws, an apparently exhausted Macneil argues along similar lines in 'Reflections on Relational Contract Theory after a New-classical Seminar' in D. Campbell et al., *Implicit Dimensions of Contract: Discrete, Network and Relational Contracts* (Hart, 2003) [hereafter, Macneil (2003)] but contends that the starting point of any enquiry should be *the context* in which the express terms of the contract at issue have been formulated and not the other way around. Interestingly, this approach is not unlike that applied in *Investors Compensation Scheme Ltd. v. West Bromwich Building Society*, where a majority of the House of Lords essentially interpreted a contract in accordance with its accompanying explanatory note rather than the meaning of the wording of the clause at issue. I do not entirely agree with this approach and discuss its limitations later in this chapter.

[158] Others include role integrity, implementation of planning and effectuation of consent – see Macneil (1980), n.1, 36-70 – which are especially relevant in more discrete contracts, as well as preservation of relation and harmonisation of relational conflict, which are most relevant to contracts on the more relational side of the spectrum; see Macneil (1983), n.142, 349-351. Wider (external) norms informing the parties' interaction also form part of the relevant normative context: e.g. the applicable law as well as industry customs; see Macneil (1980), n.1, 37-40 and Macneil (1983), n.142, 367-368.

[159] *Cf*: 'the way to criticize market-individualism is to show it cannot realize its own aspiration to institutionalize the values of freedom of contract expressed in contract's core doctrines. This can be done only by the relational theory, for those values express the objective relations which the parties to contracts must use to make their exchanges possible and they cannot be derived from the subjective intentions of the parties conceived of as atomistic individuals'; Campbell (*Arcos*), n.154, 163-164. My response to Campbell's last observation is that the values surrounding freedom of contract *can* be objectively (objectivity being determined by the – presumed – actions/desires of a rational agent) derived from the intentions of 'atomistic individuals', if those intentions are effectively *attributed* to these individuals *a priori*, based on what those individuals would have wanted if they had properly considered what their self-interest requires, *assuming* that rationality is defined as the pursuit of self-interest.

setting for a regime regulating the enforcement of mutual promises based on what the parties intended at the time the promises were made. The default informs the form and structure of the legal regime and allows for predictability and certainty in its implementation.

By contrast, relational contract theory's quest to identify and enforce the relational norms at play as evidenced *ex post* from the overall context of the parties' interaction allows for neither predictability nor certainty. For one thing, without an *a priori* understanding of *how* to identify the relevant norms and, once identified, *when* these norms become enforceable, the resultant regime ends up operating on a circular and, therefore impracticable, logic: the enforceability of promises is determined by the values underlying their exchange, and those values are enforceable because they made the exchange possible. So, an exchange of promises ends up being enforceable *because* it is an exchange of promises. This is not helpful. If anything, on a practical level, it is downright confusing: in our quest to identify the 'real deal', as Macaulay puts it,[160] between the parties which context is relevant in that it reveals the values that inform the parties' relationship and, in a dispute, where does the burden of proof really lie? What makes one party's case better than the other's?

The problem with implementing relational contract theory in its most contextualist form is evident in *Baird Textile Holdings v. Marks & Spencer.*[161] The case concerned Baird Textiles (Baird), a decades-long supplier of retailer Marks and Spencer (M&S). Baird had been supplying textiles to M&S for 30 years. Their arrangement was not based on an express long-term contract to that effect, but on M&S placing its orders with Baird in advance of every retail season every six months. After a total 60 orders, M&S notified Baird that it would place no more orders with them. Baird sued, claiming *inter alia* that there was an overarching implied contract between Baird and M&S, which required the latter to provide Baird with reasonable notice, before it ended their relationship, one so close that even the CEO of M&S had described as 'symbiotic'. Baird calculated the period of reasonable notice at 3 years and justified the amount of time on the basis that it was necessary to allow Baird to disentangle its affairs from those of M&S. Indeed, over the preceding three decades M&S had come to be involved

[160] S. Macaulay, 'The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules' in Campbell et al., n.157, 51.

[161] n.22.

intimately in, and on many occasions even determine, Baird's most crucial business decisions, e.g. with regard to plant expansion, investment in specialised machinery and even the identity of Baird's other clients. M&S's response was that in the absence of an express long-term contract, its legal relationship to Baird consisted of 60 separate, albeit consecutive, contracts and, therefore, any obligation to Baird begun with the placement of each order and ended with its completion. Affirming the High Court's decision at first instance, the Court of Appeal held that despite the ample evidence of co-dependency in the parties' relationship, the fact remained that, as with an implied contract term, an entire contract can only ever be implied as a matter of necessity and that, in this case, any such attempt would be impossible anyway for lack of certainty.[162]

How is the court to decide on the actual content of an agreement, with a view to *enforcing* it, when the parties themselves appear to have opposing impressions as to the very nature of their relationship? Campbell contends that this is possible by reference to the objective values, which informed the relationship and made it possible in the first place.[163] This is fair but let us consider the context in which those values operated. Baird was a well-established textile manufacturer, when M&S chose it to be one of its four major textile suppliers. All the same, the arrangement with M&S was especially lucrative for Baird because of M&S's own widely advertised policy with regard to its relationships with its suppliers, namely that the latter could rely on M&S's long-term custom and support in return for complying with M&S's own stringent manufacturing and marketing standards. However, throughout the 30-year relationship between the two, M&S resisted signing an express long-term contract with Baird in order to retain flexibility in that side of its business (see 2.5.2). For its part, Baird apparently accepted this risky state of affairs in the face of a lucrative arrangement that took over 40% of its output and more than doubled its turnover. What should also be relevant here is that the relationship was one of co-dependency; M&S had invested in the relationship at least as much as Baird had – if Baird suddenly decided to break from M&S, the latter would have found itself one major supplier short and, therefore, in dire straits when it came to satisfying its retail demands. Baird could have used this fact to leverage an agreement, which, if nothing else, at least provided for a period of notice. My point

[162] Baird's second ground, promissory estoppel arising from the long-standing and extremely close relationship with M&S, failed on the basis that an estoppel can only be the basis of a defence, rather than a cause of action in its own right.

[163] n.154.

here is that, Baird's understandable woes aside, M&S has an equally valid claim in terms of *context*.

Brownsword framed the fundamental problem posed by a purely contextualist interpretation of contract in terms of contract law's professed objective to give effect to the reasonable expectations of the parties.[164] Specifically, Brownsword asks 'relative to what precisely is a particular contractor's expectation "reasonable"?'[165] In response, he identifies two diametrically opposite standards of reasonableness. The first of these is established through practice to the effect that an expectation is reasonable only because it is accepted through practice as being reasonable. These are 'practice-based expectations'. The second standard designates an expectation as reasonable irrespective of whether the parties accept it as such, namely an expectation is reasonable because we ought to accept it as reasonable. These are 'entitlement-based expectations'.[166] Clearly, practice-based expectations are identified through a contextualist analysis, an approach already familiar in English contract law.[167] However, when a practice-based paradigm of reasonableness becomes the sole compass for determining whether an expectation may be enforced, then the problem becomes one of how the practice-established norms are to be identified and related to the contract at hand, a task easier said than done. Brownsword demonstrates this through his analysis of the House of Lords' decisions in *Investors Compensation Scheme v. West Bromwich Building Society*[168] and *Mannai Investments Co v. Eagle Star Life Assurance Co*.[169]

In *Investors Compensation* the appellant handled claims by investors who, following the advice of independent financial advisers, had mortgaged their homes with certain building societies and used the advances to invest in equity-linked bonds. Due to falling equities and escalating interest rates, the investors suffered heavy losses and claimed compensation through the appellant, as their financial advisers had become insolvent. The appellant was a statutory body established pursuant to s.54 of the Financial

[164] See e.g. Steyn, n.43.

[165] R. Brownsword 'After *Investors*: Interpretation, Expectation and the Implicit Dimension of the 'New Contextualism' in Campbell et al., n.157, 103, 105.

[166] *Ibid*.

[167] Examination of the relevant 'factual matrix' having already been established as a major element in contract interpretation in *Reardon Smith Line Ltd v. Yngvar Hansen-Tangen*, n.11, 997, per Lord Wilberforce.

[168] [1998] 1 WLR 896.

[169] [1997] AC 749.

Services Act 1986 to provide a compensation fund for investors with unsatisfied claims against persons authorised under the Act to carry on investment business. Crucially, certain losses were excluded from the compensation scheme so that the investors were only partially compensated in every case. Here, having compensated the investors, the appellant sought to recover from the respondent building society in damages for breach of duty in common law and under the 1986 statute. The appellant could do this on the basis of a clause in its compensation claim form by which the investors assigned to the appellant all rights arising out of the transaction with the financial advisers and any third parties. The clause was, however, subject to an exception in s.3(b) of the appellant's form, whereby the investors retained absolutely the benefits of:

> 'Any claim (whether sounding in rescission for undue influence or otherwise) that you have or may have against the West Bromwich Building Society in which you claim an abatement of sums which you would otherwise have to repay to that society in respect of sums borrowed by you from that society in connection with the transaction and dealings giving rise to the claim (including interest on any such sums).'

Based on this exception, some investors commenced separate proceedings against the respondent building society for rescission of their mortgages and damages. Consequently, the issue arose as to whether the exception in s.3(b) was restricted to claims in rescission or covered any claim the investors may have against the building society seeking to reduce the amount repayable to the latter in respect of the mortgage loans, thus rendering the assignment clause void, at least with respect to claims against the building society. Being sued by both the investors and the appellant, the building society argued that on a simple reading of its wording, s.3(b) had to be interpreted in the broader sense, thus rendering the assignment clause void and the appellant's claim groundless. The alternative would be contrary to public policy, for it would mean the respondent would end up being sued for the same damages twice.

A majority of the House of Lords held that, taking account of the context and what a reasonable person with knowledge of the context would have understood from the wording of s.3(b),[170] the latter had to be interpreted as being restricted to claims in rescission. Lord Hoffmann argued that, along with the claim form itself, s.3(b) was obviously only meant to be read by lawyers.[171] As laymen, investors were expected to

[170] n.168, 912H-E, per Lord Hoffmann.

[171] *Ibid*, 913H.

rely on the explanatory note accompanying the claim form, paragraph 4 of which made unequivocally clear that the investor was giving up all rights against anyone else and transferred them to the appellant. Thus, while it was clearly the only document to legally govern the relationship between the investors and the appellant, the claim form had to be interpreted in light of the explanatory note.[172] Dissenting, Lord Lloyd argued that s.3(b) had to be interpreted in the broader sense and that the explanatory note merely added to what a reasonable person would already have understood from the claim form itself; namely that they were expected to assign all claims *but* the right to sue *the building society* in order to reduce any outstanding debt on the mortgage.[173] Lord Lloyd contended that such a conclusion must be obvious in light of the fact that the appellant expressly excluded certain types of claims from its compensation scheme, to the effect that it covered only between half and three quarters of the amounts claimed by the aggrieved investors.[174] In other words, a broader interpretation of s.3(b) must have been what a reasonable investor would have understood and intended when they signed the appellant's claim form, for it would allow them to pursue additional compensation, at the very least to cover some of the losses which the appellant would not. Furthermore, addressing the respondent's argument that the commercial consequences of such interpretation would be 'ridiculous' (i.e. that in seeking to recover from the respondent – and other financial institutions and advisers in similar legal actions – the appellant would essentially be competing against the investors), Lord Lloyd observed that while the appellant was not a charity, it was also not a commercial organisation; as a statutory body its very essence was the compensation of aggrieved investors. In this light, there was nothing commercially unreasonable about an agreement providing that investors retain *the whole* of their rights against the respondent building society, while the appellant could recover from virtually everyone else involved.[175] Therefore, the specific reference to rescission in s.3(b) had to be

[172] Addressing the claim form's specific reference to the right to rescission, Lord Hoffman explained that this was necessary, for an investor who was entitled to rescission of the mortgage (e.g. if the building society had constructive knowledge of undue influence exercised by the financial adviser) or to an abatement of the debt by way of rescission, could not assign this right to someone else, in any event: a claim in rescission could only be made by the owner of the mortgaged property; *ibid*, at 916A-F.

[173] *Ibid*, 903B-C.

[174] *Ibid*, 905C.

[175] *Ibid*, 905E-F.

interpreted as merely an example of the options that might be open to individual investors against the building societies who provided the mortgages.[176]

Ultimately, the debate in *Investors Compensation* boiled down to the question 'what context is relevant to the task of determining the reasonable expectations of the parties to the specific contract at issue'. More importantly, the debate did not revolve around the interpretation of the wording in s.3(b) *qua* wording, but rather of the section's wording *in light of* the case's 'factual matrix'. For the majority, led by Lord Hoffmann, the relevant context began and ended with the explanatory note accompanying the appellant's claim form. A reasonable investor would have read it and understood that they were expected to relinquish all rights to claim (apart from those arising from rescission). For Lord Lloyd, however, it was also necessary to consider the fact that the appellant had expressly excluded certain claims from its remit and that investors would only ever be partially compensated as a result. A reasonable investor would have understood that they could keep the right to claim at least against the building society, whether in rescission *or* damages. In other words, both sides to the debate were devoted to identifying the context that shaped the expectations of the investors. However, despite its taking place at the highest level of adjudication, the debate in *Investors Compensation* still does not provide any guidance as to what made the majority's *selection* of facts from the case's 'factual matrix' more relevant to the dispute, than that of Lord Lloyd's. If anything, I contend that the Supreme Court in *Rainy Sky SA v. Kookmin Bank*[177] over a decade later supported Lord Lloyd's reasoning, for it held that where language can be interpreted in more than one way the court is entitled to choose the meaning consistent with business common sense and exclude all other meaning. My argument here is that business sense should be understood from the point of view of the reasonable investor, signing the appellant's claim form and having knowledge of the relevant background, which includes the explanatory note as well as the appellant's restrictions in its compensation policy. If this is the case, then Lord Lloyd's reasoning reflects the thought process of the reasonable investor more closely than the alternative presented by the majority, because the latter expects the reasonable investor to act in accordance with what made business sense for the *appellant*, which is improbable and

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[176] *Ibid*, 902H-903A.

[177] n.110.

self-contradictory, given the legal system's understanding of contractual parties as rational (i.e. *self*-interested) agents (see Ch.1).

To summarise, relational contract theory advocates contextualism, which on a practical level, involves cherry-picking the facts relevant to the dispute, from the tapestry of events and inter-party interactions that make up the relationship.[178] *Investors Compensation* demonstrates that there is an alarming element of arbitrariness in determining what context is relevant in the task of ascertaining the reasonable intentions of parties to a contract, particularly where the language of the document actually governing the dispute is vaguely drafted. Do things improve where the court is afforded a slightly more reliable compass, along the lines of, say, 'business common sense'? Brownsword argues that they do not,[179] as demonstrated in *Mannai Investments*, where the House of Lords sought to determine the reasonable expectations of a commercial person by taking into account standard commercial practice. In particular, the House of Lords in *Mannai Investments* had to consider the validity of a notice to terminate two identical 10-year commercial leases, which bore the wrong date for termination. In particular, the tenants sought to terminate in accordance with a break clause in the leases, which provided them with a *single* opportunity to terminate the leases prior to the expiry of their fixed 10-year term. The break clause required the tenants to serve the landlord written notice of no less than six months determining each lease 'on the third anniversary of the term commencement date', which in this case was 13 January 1995 for both (the leases having been signed on 13 January 1992). Unfortunately, in their identical written notices the tenants indicated that the date of termination was 12 January 1995. A majority of the House of Lords held that the issue was how a reasonable recipient, rather than the landlord in this particular case, would have understood the notices, which had to 'be construed taking into account the relevant objective contextual scene'.[180] Applying this test, Lord Steyn held that:

> 'a reasonable recipient with knowledge of the terms of the lease and third anniversary date (13 January), … would have appreciated that the tenant wished to determine the leases on the third anniversary date of the lease but wrongly described it as the 12th instead of the 13th. The reasonable recipient would not

[178] Macneil insists that not only is this not problematic, but rather expected in the adjudication of ultimately all contracts: Macneil (2003), n.157, 210-212.

[179] Brownsword, n.165, 113.

[180] *Mannai Investments*, n.169, 767G-H, per Lord Steyn.

> have been perplexed in any way by the minor error in the notices. The notices would have achieved their intended purpose.'[181]

Lord Steyn then went on to address the long-established argument put forward by Lord Greene MR in *Hankey v. Clavering*[182] that:

> 'Notices of this kind are documents of a technical nature, technical because they are not consensual documents, but, if they are in proper form, they have of their own force without any assent by the recipient the effect of bringing the demise to an end.'

As such, Lord Greene continued, where they are clear and specific but inaccurate as to a detail, such as the date of termination, the court cannot ignore the inaccuracy and substitute the correct detail 'because it appears that the error was inserted by a slip'.[183] This is because 'that would not cure the defect because the document was never capable on its face of producing the necessary legal consequence'.[184] In response, Lord Steyn pointed out that documents of this type (commercial contracts and unilateral contractual notices) tend to be construed in a commercially sensible way, or how a reasonable commercial person would interpret them, the reason for this approach being 'that it is more likely to give effect to the intention of the parties'.[185] In other words, the court should reason based on what a person with knowledge of commercial practice would have considered reasonable in the circumstances, i.e. that, here, the tenant clearly wished to terminate the leases in accordance with their break clause.

This is fair, but one must take into account all aspects of commercial practice, lest some relevant context is overlooked. So, as Brownsword observes[186] and a dissenting Lord Goff alludes to,[187] it should be relevant to this process that termination clauses in commercial leases are often worded in such a convoluted way, precisely so as to make it difficult for the tenant to comply. In other words, a commercial person with

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[181] *Ibid*, 768H – 769A.

[182] [1942] 2 KB 326, 329-330.

[183] *Ibid*.

[184] *Ibid*.

[185] *Mannai Investments*, n.169, 771A-B, quoting Lord Diplock's speech in *Antaios Compania Naviera SA v. Salen Rederierna AB* [1985] AC 191, 201: 'if detailed semantic and syntactical analysis of a word in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense.'

[186] Brownsword, n.165, 114.

[187] *Mannai Investments*, n.169, 759E-G.

knowledge of relevant practice would recognise such technical documents for the 'traps' that they are. Indeed, Lord Goff pointed out that all the tenant had to do in order to comply with the break clause was to simply reproduce the wording in the clause itself thus avoiding the 'trap' altogether.[188] Instead, the tenant made a reference to a specific date – which turned out to be wrong, for the wording of the break clause appeared intentionally vague in that regard. Thus, if the objective relevant context was determined by what a commercial person with knowledge of the background would consider reasonable, then on Lord Steyn's reasoning, the notices should have been deemed ineffectual.

Ultimately, as with *Investors Compensation*, the adjudication process in *Mannai Investment*s boiled down to the task of choosing one set of facts ostensibly relevant to the dispute over another set of facts, arguably, just as relevant to the dispute. There was no clear justification as to why Lord Goff's reasoning failed to satisfy the majority, despite the fact that it was consistent with established judicial precedent and, more importantly from a contextualist point of view, took account of actual commercial practice, which both sides to the debate accepted from the beginning was relevant to the case's factual matrix. To be sure, Brownsword observes that both *Mannai Investments* and *Investors Compensation* are hard cases for contextualism and that a contextual methodology does not always lead to the problems discussed here. Indeed, where the language in the contract is deemed clear then context can be a valuable tool in its interpretation.

This was the case in *Amlin Corporate Member v. Oriental Assurance Corporation*[189] which concerned the interpretation of a typhoon warranty clause in a charterparty prohibiting the vessel from sailing in the event that a storm warning was raised either at the vessel's port of origin or port of destination. When the vessel did sail amidst warnings raised in the wake of typhoon Frank, consequently suffering catastrophic losses of life and cargo, the issue was whether the warranty was breached, if a circular from the coast guard at the port of origin did not expressly prohibit the vessel from sailing, given the relatively low level of the storm warning raised at the time of the vessel's departure. Affirming Field J's ruling at first instance, the Court of Appeal held that the wording of the typhoon warranty was clear: the vessel was not to sail if any

[188] *Ibid*, 757E-F.

[189] [2014] EWCA Civ 1135.

type of severe weather warning was raised, the wording of the circular itself bearing little significance in its construction. The Court of Appeal applied *Investors Compensation* to the letter: 'the typhoon warranty should be construed having regard to the language actually chosen by the parties and giving those words their ordinary natural meaning, unless the background indicates that such meaning was not the intended meaning'.[190] The relevant background knowledge in light of which the typhoon warning (and the policy behind it) was to be interpreted consisted in:

> 'a) the prevalence of typhoons in the Philippines from the end of May to October [i.e. the time of the vessel's sailing];
>
> b) the grave danger that typhoons pose to shipping;
>
> c) the routine issuance by [the relevant authorities] of [storm warnings and severe weather bulletins]; and
>
> d) guidelines issued by [the coast guard] from time to time on movements of vessels when there are warnings of storms and typhoons.

Accordingly, the Court of Appeal held that the policy underlying the typhoon warranty was clearly one of 'safety first', and therefore sailing in the face of a warning (however low) rendered it breached.

To my mind, and in stark contrast to both *Mannai Investments* and *Investors Compensation*, *Amlin* demonstrates that identifying the relevant context serves as mere *ex ante* confirmation of the court's understanding of the wording in the warranty clause, for no other reason than the clause was fairly clear. Its purpose was clearly to prevent the unnecessary risk of sailing in severe weather and, in turn, informed the task of identifying the relevant context. On that basis, whatever guideline was provided in the coast guard's circular had to be deemed irrelevant; the vessel was not to sail in any event, if a severe weather warning had been issued. At the same time, the relative straightforwardness of *Amlin* also serves to show that in the absence of clear principle as to what makes certain pieces of the factual matrix relevant to the dispute *a priori*, it is impossible to instil any certainty in a contextualist adjudication process *ex post*: the outcome will most likely depend on judicial intuition, which is the only way, in my

[190] *Ibid*, [44], per Gloster LJ.

opinion, to explain the selection of relevant facts by the majority in both *Investors Compensation* and *Mannai Investments*.

In short, *Investors Compensation* and *Mannai Investments* demonstrate the difficulty in authoritatively identifying the relevant context, even where all parties involved in the adjudication process are clearly inclined to follow a contextualist – rather than literal – approach to the contractual dispute at hand. The difficulty stems from the fact that without an objective guiding principle informing the task of interpretation, such as an objective standard of reasonableness where we seek to ascertain a party's reasonable intentions,[191] what determines which context is relevant and how it is to be related to the issue at hand ultimately depends on the adjudicator's intuition, which is patently subjective.[192] This is not to say that contextualism can never be a successful paradigm for the resolution of contractual disputes. It must, however, operate abstractly. For instance, in the context of the research and development economy, which features primarily collaboration through joint ventures, Jennejohn, dismisses contextualism at the outset, because, on a practical level, it tends to focus on trade norms and the course of past dealings between the parties to determine their disputes.[193] He argues that (a), by definition, the innovation economy does not have established trade norms to be used as an interpretation tool, because the innovation economy consists in economic agents coming together to create entirely new products, for which no market yet exists; and (b) that in a joint venture formed in a market vacuum between two parties who have not collaborated before, reliance on the course of their past dealings is meaningless, for they tend to deal with issues as they arise. Yet, Jennejohn proposes a novel adjudication model for the innovation economy, which is not only fundamentally relational but also contextualist. Briefly, this model, which Jennejohn calls 'experimentalist', holds that once a third-party adjudicator becomes involved (the parties having exhausted all other dispute resolution processes set out in their contract), instead of producing a judgment awarding a one-off remedy to the aggrieved party, the adjudicator establishes an

[191] Brownsword, n.165, 137.

[192] Note, for instance, Lord Hoffmann's discussion of the paradox posed by the 'reasonable man' as the objective standard in law, where he points out the (arbitrary) fluidity of the meaning of 'reasonable person' or reasonable behaviour (the latter examined in terms of what is 'unreasonably'-held consent) and its dependency on what outcome the court wishes to prioritise in every case: the redistribution of loss or the attribution of liability based on some ill-defined moral responsibility; Lord Hoffmann, 'Anthropomorphic Justice: The Reasonable Man and his Friends' (1995) 29(2) *The Law Teacher* 127.

[193] M.C. Jennejohn 'Contract Adjudication in a Collaborative Economy' (2010) 5(2) *Va.L.& Bus.Rev.* 173.

enforcement programme with milestones that parties will each be required to meet as appropriate. This is profoundly relational because it seeks to preserve the relationship, which through a one-off judgement would likely collapse following its enforcement, as it expects the parties to continue addressing their issues, albeit with official direction and supervision. Jennejohn's model is also distinctly contextualist, albeit on an abstract level, for it takes into account and addresses the unique properties of the innovation economy.

Indeed, when applied on a more abstract level, contextualism can prove indispensable as an adjudication tool, which is amply demonstrated by such areas as insurance, construction and product liability law, all of which are fields of contract (and tort) law that have been informed by the factual similarities of the cases arising in their respective contexts and were developed accordingly.[194] The legal framework governing contractual joint ventures, which I propose in this thesis, is meant to operate at a similar level of abstraction, namely as a default legal structure informed by what the parties would have intended if they purported to act rationally, i.e. if they had properly reflected on what their self-interest requires. It is the latter proposition that determines the relevant context in the exercise of structuring the default legal relationship: contractual co-venturers would submit to extra-contractual duties being implied into the relationship by default, so as to avoid the risk of freeloading behaviour by their peers. Thus, in that regard, my thesis may well be said to have a relational or contextualist basis, albeit qualified.

4.5 Summary

This chapter sought to address what I consider to be the three main arguments in English contract law opposing a thesis, which proposes the implication of extra-contractual duties into the contractual joint venture as a default. The first of these arguments stems from the notion that the type of parties most commonly forming contractual joint ventures are commercial and therefore sophisticated enough to at least take account of and appreciate the risks involved in the venture before they agree to any bargain. The law should therefore treat them as if they are dealing carefully at arm's length and resist intervening into their relationship, for this would undoubtedly contravene the parties' reasonable expectations as evident from their contract. My response to this is that blind

[194] J.M. Feinman 'Relational Theory in Context' (2000) 94 *N.W.U.L.R* 737, 744ff.

adherence to the arm's length principle risks oversimplifying the parties' commercial and contractual relationship and can produce injustice and even considerable uncertainty in the law, where, seeking to avoid apparent injustice, the courts end up inventing ways to circumvent the arm's length approach altogether.

The second argument opposing my thesis holds that contract law already allows for parties to deal with changes in their relationship dynamic through clauses designed to adjust their respective obligations in response to specified events. Therefore, to introduce a new legal framework for contractual joint ventures alone would be unnecessarily interventionist and cumbersome for co-venturers. Here, I contend that, though prudent, adjustment clauses cannot ultimately overcome the problem of incomplete presentiation, which exposes the parties to opportunistic behaviour in the event of a tension-point, which has not been adequately addressed in the contract.

The third argument holds that the context shaping the relationship between the parties is just as important when adjudicating disputes between them as the express terms of their contract, which should be treated merely as a starting point of our enquiry. To this, I respond that this fundamentally contextualist approach to contract adjudication must be qualified heavily so as to conform to a web of *a priori* assumptions, if the logical and practical problems it raises are to be overcome. Viewed in this light, my thesis adopts, rather than opposes, contextualism but on a procedural rather than a substantive level.

The next chapter discusses the substance of default, extra-contractual duties to be implied into the contractual joint venture. Specifically, it examines the meaning of other-regarding duties in the context of constrained maximisation, arguing that utility maximisation is ultimately to be determined by the procedural mechanism through which it is implemented.

5 THE INADEQUACY OF CONTRACTUAL DEFAULTS

5.1 Introduction

5.1.1 Institutionalising Gauthier's 'constrained maximiser' in the English law of joint ventures

In the previous chapters I have demonstrated that the legal regime currently applying to the contractual joint venture in the UK does not capture the aims of the joint venture as a vehicle for growth nor does it accurately reflect the co-venturers' (presumed) contractual intentions (see Ch.2 and Ch.3). These, I contended, would be best addressed through the instrumental use of Gauthier's approach to rational bargaining in the context of cooperation (see Ch.1), which legally would translate into a set of default other-regarding duties to be implied extra-contractually into the joint venture (see Ch.4), on the basis that this is what the co-venturers would have desired had they properly reflected on what their self-interest requires (namely, having duly calculated their respective minimax relative concessions). My task over the next two chapters is to answer the question: what kind of default rules would best reflect Gauthier's rational bargaining principle for the purpose of a new legal framework specific to contractual joint ventures? In other words, what type of rules should the law presume that rational co-venturers would *choose* to submit to, on the basis that they maximise the co-venturers' self-interest in the long run?

To answer, we must examine the different jurisprudential avenues supporting the implication of default rules in English law specifically in the context of restraining the freedom of an agent to act with respect to a bargain. In this chapter, I identify three such avenues: the doctrine of unconscionability, the doctrine of good faith in contract and the doctrine of fiduciary obligation. For the reasons set out in the next section, I will focus on the last two. The second part of this chapter then goes on to examine the substantive content of a conduct-constraining default implied into the joint venture, observing that its moral essence is common to defaults implied either through the contract mechanism or the mechanism of fiduciary obligation. The third part examines the procedural aspects of conduct-constraining defaults, specifically examining the contract law procedure of implying such defaults into the joint venture. Having

established the limitations of the contract law mechanism in this regard, this chapter then assesses the level of utility, which a constrained maximiser (whom the law must presume has chosen to submit to conduct-constraining defaults having reflected on what their long-term self-interest requires) can expect to derive from such a default.

5.1.2 Jurisprudential avenues for implying conduct-constraining defaults

There are three jurisprudential avenues for implying default duties in the context of a contract. The first lies in the concept of 'unconscionability', namely an expectation that the law is to intervene, if allowing one of the parties to rely on its strict legal rights would yield unreasonable or patently unjust results. Thus, in this context the court has intervened to set aside an overly broad restraint of trade clause in an agreement regarding song-publishing rights,[1] while a contract whereby the defendant agreed to transfer her house to the plaintiff was set aside on the ground that, in the circumstances, such transfer would cause undue hardship to the defendant.[2] The court has also reversed transfers of property interests either by individuals who lack understanding of the transaction,[3] or by those whom the law presumes[4] have been taken advantage of as a result of undue influence exerted by a family member or someone equally close to them.[5] Considered specifically in a commercial context, the basis for court intervention into a contract by reason of unconscionability is similar to that for intervention by reason of common mistake or misrepresentation, namely that in the last two cases there is no 'meeting of the minds' on the subject matter of the bargain and therefore the bargain cannot be enforced. There is, in other words, an unmitigated defect with regard to the very foundation of the bargain itself. This means that, when challenged, the bargain is treated either as not having existed in the first place (in the case of mistake

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[1] *A. Schroeder Music Publishing Co. v. Macaulay* [1974] 1 WLR 1308.

[2] *Patel v. Ali* [1984] 1 All ER 978 (the defendant had lost a leg to bone cancer, which developed after the contract was made. The plaintiff was awarded damages only, rather than specific performance). *Cf. Scandinavian Trading Tanker Co AB v. Flota Petroleva Ecuatoriana* [1983] QB 529 (parties dealing at arm's length could not argue unconscionable enforcement of a forfeiture clause).

[3] *Fry v. Lane* (1888) 40 ChD 312 (transaction whereby property sold at gross undervalue by poor and ignorant vendor without independent advice was void).

[4] *National Westminster Bank v. Morgan* [1985] 1 AC 686, (avoiding a transaction on grounds of undue influence requires evidence that the transaction itself was wrongful in the sense that it constituted an advantage taken of the plaintiff, in addition to evidence of the plaintiff's close relationship with the defendant).

[5] *Cresswell v. Potter* [1978] 1 WLR 255; *Backhouse v. Backhouse* [1978] 1 WLR 243 (in both cases absence of legal advice rendered the transfer of a wife's property interest to husband unconscionable); *Cf. Butlin-Sanders v. Butlin* [1985] Fam Law 126 (wife acted despite legal advice and therefore transaction was valid).

and misrepresentation) or as contravening natural justice to the point that it *cannot* be allowed to stand (in the case of unconscionability). Having said that, it would be rather ambitious to claim that there is a separate doctrine of unconscionability in English law,[6] for much of the courts' equitable jurisdiction tends to be invoked on similar grounds.[7]

The second jurisprudential avenue to conduct-restraining defaults lies in the concept of good faith, namely an expectation that parties to a bargain are to treat each other fairly, for instance by sufficiently bringing onerous terms to the affected party's attention.[8] Again, in English contract law there is no doctrine of good faith subjecting contractual parties to an overarching duty to deal in good faith.[9] This is so emphatically the case that Powell[10] argued that, as a result, judges have had to resort to bending the legal rules by, say, implying terms in a contract [11] or twisting the application of the misrepresentation doctrines[12] in order to provide a just result in the circumstances.

Finally, the third avenue to conduct-constraining defaults lies in the concept of fiduciary obligation, namely the understanding that individuals in positions of trust

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[6] For example note the discussion in G. Muir 'Contract and Equity: Striking a Balance' (1986) 10 *Adelaide Law Review* 153, arguing that a doctrine of unconscionability would undermine the courts' equitable jurisdiction and would cause significant uncertainty in the market place. See also P.D. Finn 'Equity and Contract' in P.D. Finn (ed) *Essays on Contract* (New South Wales: The Law Book Company, 1987).

[7] E.g. proprietary estoppel – see *4.2.2.2*. Indicatively: *Taylor Fashions Ltd v. Liverpool Victoria Trustees Co Ltd* [1982] 1 QB 133; *Crabb v. Arun DC* [1976] Ch 179; *Dillwyn v. Llewelyn* (1862) 45 ER 1285; *Inwards v. Baker* [1965] 2 QB 29; *Plimmer v. Wellington Corporation* (1884) 9 App Cas 699; *ER Ives Investments Ltd v. High* [1967] 2 QB 379; *Pascoe v. Turner* [1979] 1 WLR 431.

[8] *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.* [1987] 1 QB 433 (a particularly onerous condition in the plaintiff's standard terms of trade was only brought to the attention of the defendant *after* the goods were delivered –the condition was on the accompanying delivery note– and was therefore not part of the contract).

[9] *L'Estrange v. F. Craubcob Ltd* [1934] 2 KB 394; *Walford v. Miles* [1922] 2 AC 128, esp. 138D-G, per Lord Ackner.

[10] R. Powell 'Good Faith in Contracts' (1956) *CLP* 16.

[11] *Ingham v. Emes* [1955] 2 All ER 740 (the plaintiff breached an implied obligation to notify her hairdresser of skin sensitivity to certain hair dye, despite the hair dye itself being subject to an implied condition of fitness for purpose); note also Lord Denning MR's famously dissenting opinion in *Liverpool City Council v. Irwin* [1976] QB 319, 329-331, where he sought to relax the rule on contract term implication from 'only when necessary' (as per *The Moorcock* (1889) 14 PD 64, 68) to 'when reasonable', so as to hold the city council accountable for repairs of the common areas of a council housing estate; for further comment, see M. Bridge 'Good Faith in Commercial Contracts' in R. Brownsword et al. (eds), *Good Faith in Contract: Concept and Context* (Ashgate, 1999) 140, 146-147. *Cf.* B.J. Reiter 'The Control of Contract Power' (1981) 1 *OJLS* 347, supporting strong judicial intervention into contracts, particularly where social and economic pressures do not operate adequately to curb contract power and legislation has not been introduced, essentially along the lines of Lord Denning's reasoning in *Irwin*.

[12] *Curtis v. Chemical Cleaning and Dyeing Co* [1951] 1 KB 805.

(fiduciaries) are under a duty to conduct themselves with 'utmost good faith' and *only* in the best interests of those, who, society presumes, have placed their trust in them (beneficiaries). The concept of fiduciary obligation, as will become apparent in later sections, is underpinned by the same ideal as a contractually mandated legal duty of good faith, namely the social expectation that interaction between agents takes place on a basis of fairness and mutual respect for each other's right and ability to pursue their own interests. However, unlike a *contractual* duty of good faith, the duties on those who have been designated as fiduciaries, either because of their formal status being recognised as such in law (e.g. trustees, partners, solicitors, company directors) or because the circumstances of their relationship with the other party in the transaction put them into the position of a *de facto* fiduciary, have a long history in English law and are grounded firmly in the court's equitable jurisdiction. Nevertheless, the circumstances giving rise to fiduciary obligations in a commercial context are far from clear-cut (see 4.2.2.2 and Ch.6).

In practice, these three jurisprudential avenues to conduct-constraining defaults give rise to three separate standards of conduct, whose effect is to restrict the freedom of the parties to commercial bargains to different extents. First, the standard of conduct arising from the law's apparent aversion to unconscionable bargains would require the parties to refrain from actions, which affect the soundness of the bargain itself, for instance, by creating a defect in the other party's consent. This quality, however, makes default rules reflecting this standard of conduct irrelevant to my thesis. This is because the commercial relationships I envisage here are not burdened by such defects, for all parties are presumed to have the necessary transactional experience and possess all necessary resources to both thoroughly vet the bargain and mitigate any foreseen risks. Therefore, a claim of unconscionability, in the sense that the bargain when struck was unconscionable, could not successfully stand in the envisaged circumstances. Instead, I will focus on default rules, which reflect standards of conduct arising from either the ideal of good faith in contract or from the better-established (in English law) concept of fiduciary obligation. My task in the following sections will be to identify which one of these two legal standards of conduct, *procedurally*, maximises in the long run the utility of co-venturers, who (the law must presume) have chosen to become constrained maximisers in accordance with Gauthier's approach to rational bargaining.

5.2 The substantive content of constraints to contractual conduct

Whereas, as a matter of procedure (and because of the current state of the law), the default rules I advocate in this thesis can only be built on distinct jurisprudential grounds, i.e. either upon contract law or the fiduciary doctrine, as a matter of *substance* they share a common moral basis. This is the principle that one has a duty to carry out the obligations they have freely taken on (whether expressly or impliedly) as part of an agreement, which they have struck with similarly consenting agents. It is the purpose of this section to explore the substantive content of such an obligation, before I go on to examine the procedural vehicle that best implements it, in the sense that, *in the long run*, it maximises the utility of the parties involved.

To begin with, it bears repeating that the existence of the 'bargain' is instrumental in this discussion, for Gauthier's contractarian morality operates on the assumption that agents cooperate on the basis of a prior agreement to pursue a joint strategy for mutual gain. At the outset, therefore, the answer to the question 'what does constrained utility maximisation entail in actual practice?' should be simple, i.e. it entails compliance with the *content* of the agreement setting out the joint strategy. However, this cannot be where the buck stops. Indeed, as demonstrated in the previous chapter, all agreements suffer from the problem of presentiation, namely the inability of the bargaining parties to fully predict whatever befalls their relationship in the future and thus effectively address the foreseeable consequences in the present. If the meaning of constrained utility maximisation were limited to the letter of the agreement itself, it would render Gauthier's entire thesis meaningless. Specifically, if the joint strategy were only determined by the letter of the agreement between them, it would be possible, and indeed rational, of the parties to opportunistically take advantage of the agreement's incompleteness, whether or not at the other party's expense,[13] without *technically* having defected from the joint strategy at all. Gauthier's response to this problem is that constrained maximisation is more than one of many strategies towards utility maximisation. In his words: 'constrained maximisation is not parallel to such strategies as tit-for-tat, for constrained maximisers may co-operate even if neither expects her

[13] This is similar to Hume's 'sensible knave' problem: 'That honesty is the best policy, may be a good general rule; but is liable to many exceptions: and he … conducts himself with most wisdom, who observes the general rule, and takes advantage of all the exceptions.'; *An Enquiry Concerning the Principles of Morals* (A. Millar, 1751), 193.

choice to affect future situations.'[14] Rather, constrained maximisation is a *disposition*. More specifically, the choice to be a constrained maximiser is a choice among *dispositions to choose*, i.e. a choice between the disposition either towards constrained maximisation or straightforward maximisation.[15] In this regard, it is one's choice of disposition that determines whether a chosen strategy is choice worthy. Therefore, an agent who chooses to be a constrained maximiser will by definition make constrained choices in strategic contexts.

However, a disposition towards constrained maximisation does not change the fact that the constrained maximiser is first and foremost a rational (i.e. utility maximising) agent. This means that constrained maximisation is still a disposition whose purpose is to maximise the agent's expected utility in the long run. In this light, a disposition toward constrained maximisation will only make rational sense, if it is employed in bargains with like-minded agents. In other words, a constrained maximiser will only achieve the benefits of constrained maximisation if they can be reasonably certain that they are bargaining with another constrained maximiser. To do this they must be reasonably adept at detecting the other party's disposition. In turn, such disposition will be reasonably evident by the prospective collaborators' conduct during the bargaining process and the extent to which they display compliance with norms that society tends to associate with collaboration, such as honesty (in the sense of the parties' being truthful as to what they have, and are willing to, offer in return for the other party's compliance) and fairness (at least in the sense of expected reciprocity, i.e. an acknowledgment that all parties involved in the bargain are entitled to the outputs of a successful collaboration). Fundamentally, however, it is an assumption of at least rudimentary honesty attributed to all involved that makes the bargaining process possible in the first place. Compliance with the expectations of honesty and fairness during the bargaining process, will in turn signal the parties' disposition toward voluntary compliance with the joint strategy agreed through the bargain, which in turn should signal the party's overall disposition toward constrained maximisation.[16] In other words, for Gauthier's approach to rational bargaining to work, the bargaining

[14] Gauthier, *Morals by Agreement*, 169-170.

[15] *Ibid*, 183.

[16] *Ibid*, 182-183.

parties must comply with *a priori* expectations of honesty and fairness, which form the necessary preconditions for a bargaining process toward *collaboration* to even begin.

Against this background, I contend that it is these preconditions for rational collaborative bargaining among parties we assume have chosen to become constrained maximisers, that inform the content of duties to be implied by law into the ensuing contractual relationship, alongside the terms of the agreement the parties reached as the result of the bargaining process. To be sure, the purpose of subjecting one's pursuit of their self-interest to constraints imposed by norms such as honesty and fairness (in the sense of expected reciprocity) is not to ensure that the constrained maximiser sacrifices their self-interest for that of the other parties in the bargain. Their purpose is, however, to ensure that the bargaining playing field is level on the one hand and, on the other, that the parties comply with the joint strategy once the bargaining is complete. From this point on, I will refer to conduct so constrained as 'conduct in good faith'. In the following sections, I will examine the jurisprudential avenues that best implement a duty to act as a constrained maximiser, i.e. in good faith, in the sense that it maximises the parties' expected utility in the long run.

5.3 Good Faith based in contract: a background

A legal duty to act in good faith with respect to contracts is a well-established concept outside of England and Wales. For instance, it features heavily in the Principles of European Contract Law,[17] a set of model rules first drafted in 1998 for use by EU member states or parties doing business in the EU who wish to use it as applicable law for their contracts,[18] and is a fundamental element of contract law in many civil law jurisdictions, notably Germany, France and Italy. The duty is no stranger to common law either, with the USA having institutionalised it in the form of s.2-205 Uniform Commercial Code (UCC), a model law which provides that parties to commercial contracts are subject to a duty of good faith and fair dealing both with regard to contract performance and enforcement. In contrast – it bears repeating – no such duty exists in English contract law, while the possibility, or indeed desirability, of introducing a good

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[17] http://www.jus.uio.no/lm/eu.contract.principles.parts.1.to.3.2002/, accessed 14.8.18. Article 1:201 imposes a duty of good faith and fair dealing on contractual parties and explicitly prohibits exclusion or limitation of the duty in the contract.

[18] *Ibid*, article 1:101.

faith standard of conduct into it has spawned fierce debate.[19] This debate consists in three main arguments, which Brownsword has classified as neutral, negative and positive.[20] The first holds that there is no need for an overarching good faith requirement, for English law is able to deal with good faith issues as and when they arise and to achieve similar results with the tools already available to it. The second argument altogether rejects the concept of good faith in contract and is most succinctly expressed in Lord Ackner's dicta in *Walford v. Miles*,[21] a case concerning the enforceability of an agreement to negotiate:

> 'The concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations… A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party. … In my judgment, while negotiations are in existence either party is entitled to withdraw from those negotiations, at any time and for any reason. There can be thus no obligation to continue to negotiate until there is a "proper reason" to withdraw.'

Finally, the third argument in the debate, which Brownsword himself espouses, calls for an overarching duty of good faith in English contract law. Brownsword's position is that English law must adopt a principle of good faith so as to be rational (and therefore legitimate), in the sense that it is *free from contradiction* in the promulgation of its legal doctrine and how this doctrine is applied in practice, the ideal being that 'the game should be played according to the declared rules'.[22] He points to inconsistent judicial attitudes to the exercise of the right to withdraw from a contract for breach of condition, as one of numerous examples of the judiciary's reactionary approach to having their ideals of fair dealing offended by opportunistic behaviour, which classical contract law is otherwise indifferent to.[23] In such cases, Brownsword observes,[24] what is technically a breach of condition, has been considered either as a non-breach[25] or as merely a

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[19] Seminally, see R. Powell, n.10; J.F. O'Connor, *Good Faith in English Law* (Dartmouth, 1990).

[20] R. Brownsword, 'Positive, Negative, Neutral: The Reception of Good Faith in English Contract Law' in R. Brownsword et al. (eds.), *Good Faith in Contract: Concept and Context* (Dartmouth, 1999) [hereafter, Brownsword (Reception)].

[21] n.9, 138D-G.

[22] R. Brownsword 'Two Concepts of Good Faith' (1994) 7 *JCL* 197, at 203 [hereafter, Brownsword (Two Concepts)].

[23] *Ibid*, 203-204.

[24] *Ibid*, 204.

[25] *Cehave NV. v. Bremer Handelsgesellshaft mbH (The Hansa Nord)* [1976] QB 44.

breach of warranty.[26] This fluidity is all but facilitated by the 'innominate terms' doctrine established in *Hong Kong Fir Shipping Co v. Kawasaki Kisen Kaisha*.[27] A principle of good faith unequivocally espoused in contract law would have rationalised such fluidity on the basis that withdrawal from the contract was done in bad faith and therefore could not be enforced in law. The outcome, Brownsword continues, would not necessarily be more just than the law's current state, but it would mean that English law can avoid the 'rationality-deficit' which currently burdens it.[28]

This observation is further bolstered by the fact that judges, despite acknowledging in every case that English contract law accepts no overarching duty of good faith, have on occasion explicitly used good faith as a justifying first principle for such landmark decisions as *Interfoto Picture Library v. Stiletto*.[29] Here, a particularly onerous standard term of trade was held to be unenforceable for it had not been properly brought to the attention of the affected party before the contract was made. Even more recently, Leggatt J in *Yam Seng Pte Ltd. v. International Trade Corp*[30] unequivocally linked an expectation of good faith with conventionally conceived relational contracts, when he emphasised the importance of recognising, and acting on, an ideal of good faith and fair dealing in all contractual relationships and especially those which involve long-term collaborations such as joint venture agreements, franchise agreements and long-term distributorship agreements.[31] Building on this rationale, the High Court in *Bristol Groundschool v. Intelligent Data Capture*[32] held that not only was an implied duty of good faith a given in relational contracts, but that it went beyond a mere requirement of honesty. The relevant test was that of conduct, which reasonable and honest people would regard as 'commercially unacceptable' in the case's particular context.[33]

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[26] *Ibid*, in response to the claim that the goods had not been shipped in a good condition.

[27] [1962] 2 QB 26; the doctrine holds that for contract terms, which it is unclear from the outset whether they are conditions or warranties, their nature will be determined by the seriousness of the consequences of their breach.

[28] Brownsword (Two Concepts), n.22, 204.

[29] n.8, per Bingham LJ.

[30] [2013] EWHC 111.

[31] In this context, see Brownsword's take on *Philips Electronique Grand Public SA v. British Sky Broadcasting Limited* [1995] EMLR 472 in Brownsword (Reception), n.20, 28-29.

[32] [2014] EWHC 2145.

[33] Here the judge applied the test for dishonesty as set out in *Royal Brunei Airlines v. Tan* [1995] 2 AC 378 and adapted by Beatson LJ in the context of an express contractual term requiring good faith in

Yet, it appears that not all 'relational' contracts are subject to a good faith requirement. A case in point is *Property Alliance Group v. Royal Bank of Scotland*,[34] where, distinguishing *Yam Seng* on the facts, Asplin J refused to imply a term imposing good faith conduct on the part of a bank in two – long-standing – agreements for banking services with a property investment and development company, on the ground that, on the one hand, the agreement explicitly excluded equitable duties[35] thus indicating that the parties did not intend to be bound by duties outside of those prescribed in the contract and, on the other, that such duties were unlikely to arise in any case, given that the agreements were negotiated at arm's length between two sophisticated commercial parties. Regardless of the soundness of this rationale (see 4.2.2.3), it is not the purpose of this section to add to the debate on the desirability of an overarching duty of good faith being introduced into English contract law. Rather, in this section I will consider what a duty of good faith would entail in current contract law practice, with respect to an agreement made by rational commercial parties who have chosen to become constrained maximisers having reflected on what their self-interest requires. Therefore, given its set parameters, my thesis overcomes the hurdle of determining the parties' intentions from the express terms of their agreement, by attributing to them – from the outset – an intention to submit to voluntary constrains on their behaviour, so as to achieve the mutual benefits of cooperation.

Nonetheless, where it is open to interpretation whether the duty to be implied into the relationship directly contradicts an express term of the contract, as, in my view, was the case with Asplin J's argument in *Property Alliance Group*, I contend that the contract should be interpreted in favour of the duty's implication. This is because – on its own – the agreement as set out in the express contract does not necessarily reflect the reality of the parties' relationship (see 4.2.2 - 4.2.3). Thus, unless the contract *specifically* denounces a general duty on the parties to act in good faith, no such disclaimer should be inferred from a term, which denounces other types of similar, related, or derivative duties, such as equitable or fiduciary duties,[36] as was the case in *Property Alliance*

Compass Group UK and Ireland Ltd v. Mid Essex Hospital Services NHS Trust [2013] EWCA Civ 200, [150].

[34] [2016] EWHC 3342.

[35] *Ibid,* [275]-[276], and see [250], regarding the conflict with express terms disclaiming the existence equitable duties.

[36] Although, it will be remembered, the effectiveness of such disclaimers is moot where the reality of the case contradicts the express agreement – see *3.3.3*.

Group.[37] For one, equitable or fiduciary duties trigger a score of equitable remedies, which are not normally available with respect to conventional contractual duties (see Ch.6) and this, rather than the duties' substantive content, may well be the reason for the parties' attempt to disclaim them. In other words, I do not necessarily regard an express provision denouncing the operation of good faith-*like* duties as an obstacle to the implication of a *general* good faith requirement into the contractual relationship, unless such disclaimer is clear and unequivocally against such implication.[38] Finally, I will limit my discussion of the operation of good faith to contract performance and enforcement. This is because I do not regard a requirement of good faith at the negotiation stage as relevant to the scope of this thesis, which presumes that the bargain is free from procedural defects and that the parties are reasonably adept at discerning each other's dispositions as constrained maximisers, at least with respect to the early stages of the relationship, given their resources and transactional sophistication.

Thus, in the next section I will examine the practical implications of good faith (in the sense of adherence to mutual pre-contractual expectations of honesty and compliance with the joint strategy) mandated through the mechanism of contract law, in order to determine the extent to which such a duty would maximise the utility of co-venturers, who – the law must presume – have chosen to become constrained maximisers having properly reflected on what their self-interest requires.

5.4 Good faith mandated through the contract mechanism

5.4.1 The duty's content in the context of constrained maximisation

A natural starting point in determining what it means to perform one's contractual obligations in good faith are the basic social norms which make bargaining possible in the first place. These are an expectation of honesty (at least as to what each party has and is willing to offer in the bargain) and of fairness (in the sense of an expectation of basic reciprocity).[39] Indeed, in the USA, the UCC, which subjects all contracts in its

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[37] *Cf. Compass Group v. Mid Essex Hospital Services*, n.33 (an express obligation on the parties 'to co-operate in good faith' was interpreted restrictively, so that the obligation applied only to the context of the clause in question and not to the entirety of the contract).

[38] E.g. along the lines of Lord Wilberforce's reasoning in *Liverpool City Council v. Irwin* [1977] AC 239, 256E-F; and *Greys v. Societe Generale* [2012] UKSC 63, [55]-[56], per Lord Hope.

[39] While good faith has been a contract law staple of several civil, and some major common law, jurisdictions its content has not been definitively ascertained, although aspects of fair dealing and honesty (which form what is generally understood to be the normative basis of good faith – e.g. see B.J. Reiter

purview to a duty of good faith in both performance and enforcement,[40] defines 'good faith' as 'honesty in fact and the observance of reasonable commercial standards of fair dealing'.[41] For the purposes of this sub-section I will discuss the meaning of post-contractual honesty and fair dealing separately.

5.4.1.1 Fairness/ Fair Dealing

Having identified 'fairness' (or 'fair dealing') with an expectation of reciprocity at the contract's bargaining stage, we must now consider what happens to this expectation at performance stage. It will be remembered that once the contract has been completed, bar any defects of substantive procedure, the law assumes that the bargain is fair in the sense that all involved have sacrificed something and gained something else in return. If the agreement is by definition 'fair', then all the obligations it imposes should be fair as well, otherwise, the law assumes, rational parties would not have accepted them.[42] Therefore, assuming that the agreement is by definition fair, one could argue that it would be superfluous for the law to demand that the parties treat each other fairly as part of a general obligation to perform their contractual obligations in good faith. This is not so. If the definition of 'fairness' lies in an expectation of reciprocity, then the operation of the expectation cannot end with the successful negotiation of the contract, for the parties cannot obtain the benefit of the contract without it being performed. Therefore, the meaning of 'fairness' here must be adapted so as to specifically accommodate the context of contractual performance, whose declared purpose at negotiation stage was to generate mutual benefit.

Then, what does fairness in contract performance entail? Given the purpose of the contract is to generate mutual benefit, an expectation of fairness or fair dealing in this context should translate into an expectation that, at the very least, the parties avoid

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'Good Faith in Contracts' (1983) 17 *Val.U.L.Rev.* 705) can be identified in several contractual doctrines, such as those dealing with fraudulent or negligent misrepresentation. Arguably, the most extreme manifestation of a practical good faith obligation manifests in the German '*culpa in contrahendo*' or 'fault in negotiating' doctrine, which carries severe penalties for those who knowingly or negligently create in the other a false expectation of a forthcoming bargain; seminally see F. Kessler & E. Fine, 'Culpa in Contrahendo, Bargaining in Good Faith and Freedom of Contract: a Comparative Study' (1964) 77(3) *Harv.L.Rev.* 401.

[40] UCC, art.1-304.

[41] UCC, art.1-201(20).

[42] E.g. P.S. Atiya 'Contract and Fair Exchange' (1985) 35(1) *U.T.L.J.* 1.

conduct, which would deprive the other of its expected benefit under the contract.[43] Indeed, the US Restatement (Second) of Contracts explains that:

> 'Good faith performance or enforcement of a contract emphasises faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving "bad faith" because they violate community standards of decency, fairness or reasonableness.'[44]

In the case of a joint venture where by definition the parties' respective benefit is presumed to derive from the joint strategy, parties must avoid conduct, which ultimately harms the joint strategy. In other words, a fairness component of the post-contractual duty of good faith, to my mind, should be framed in terms of a negative duty.[45]

5.4.1.2 Honesty

Matters are different for a requirement of post-contractual honesty adapting the pre-contractual expectation of honesty (regarding the parties' initial factor endowment and what they are willing to sacrifice for the purposes of the bargain) to the context of contractual performance. Indeed, in contrast to the negative duty implicit in the expectation of post-contractual fairness articulated above, a separate duty of post-contractual honesty must be a positive one. This is because a fairness-based obligation to avoid conduct, which would deprive the other party of the benefit of the contract, arguably includes a duty to avoid being actively dishonest, such as a seller concealing a defect in a product they are selling. If this is the case, then – to avoid duplication – a *separate* duty of honesty must be a *positive* one,[46] in the sense that the parties are expected to volunteer information, which is pertinent to the furtherance of the joint strategy.[47] This interpretation is necessary in order to avoid a divergence of duties, because unless the duties of good faith-as-fairness and good faith-as-honesty run in

[43] This is consistent with the interpretation of contract terms that expressly impose a duty of good faith in the performance of the parties' obligations – see, e.g., *CPC Group Ltd v. Qatari Diar Real Estate Investment Co.* [2010] EWHC 1535, [246], per Vos J.

[44] Restatement (Second) of Contracts, [205].

[45] This is arguably consistent with Summers' understanding of good faith as an 'excluder', i.e. the content of the duty being determined by what good faith is *not*; R.S. Summers, '"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code' (1968) 54(2) *Va.L.Rev.* 195.

[46] *Cf.* Summers, *ibid*, 204, arguing that a definition of good faith which relies on honesty merely excludes dishonesty, which is hardly the only type of bad faith conduct one encounters in contracts.

[47] Similarly see Brownsword's conception of good faith-as-a-rule in contract negotiation: Brownsword (Two Concepts), n.22, 228-230.

complete synchronicity, they could end up requiring conflicting things.[48] In this sense, then, a duty of good faith-as-honesty should entail a positive duty to disclose. In the case of a seller with a defective product to sell, such duty entails actively pointing out the defect, which would inevitably have a knockdown effect on the price of the product itself.[49]

Therein lies the problem raised by a duty of good faith-as-honesty understood as a *positive* duty of disclosure (outside of contexts where it is specifically imposed, such as insurance, where the insured is subject to strict duties of disclosure and 'utmost good faith') – to what extent is the self-interested economic agent underpinning Gauthier's contractarian morality compelled to disclose facts, which can be detrimental to their economic interest? Where the impact of the disclosure on the agent's long-term self-interest is *positive or neutral*, Gauthier's constrained maximiser will naturally comply with the requirements of the duty and disclose all facts that are reasonably expected to further the joint strategy. This is because complying with the duty signals the agent's disposition as a reliable constrained maximiser to other prospective collaborators, thus contributing to the maximisation of the agent's self-interest *overall*. However, where the disclosure is likely to be detrimental to the agent's self-interest *beyond* the scope of the joint strategy or the agent's self-interest *overall*, then compliance with a positive duty to disclose would be outright irrational. In other words, if constrained maximisation as expressed through compliance with a conduct-restricting rule, such as a duty of good faith, were to conflict with an agent's long-term interest, then a duty defined in terms of what would be prudent for a rational agent to conform to would be self-contradictory and therefore unenforceable.

5.4.1.3 Example

Let us consider a hypothetical joint venture between Acorn and BrazilNut. Acorn is wholly owned and managed by an inventor and through her it has an exclusive licence to an ultrasound technology, which can be applied in petroleum development to stimulate oil and gas production. BrazilNut is long-established in petroleum exploration

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[48] See Z.X. Tan 'Keeping Faith with Good Faith? The Evolving Trajectory post-*Yam Seng* and *Bhasin'* (2016) *JBL* 420, 441ff, who points out the confusion, which can be generated by conflating honesty with fair conduct.

[49] This is assuming that the defect is not one, which renders the product unsafe or otherwise illegal to sell.

and development. The two companies have signed an agreement establishing a joint venture for the acquisition of underperforming or late-life oil wells and their exploitation through the application of Acorn's technology. Under the agreement, BrazilNut is responsible for identifying, securing the finance for, acquiring and developing the wells for the benefit of both parties. Acorn is solely responsible for the presentation of its technology to investors at the project-financing stage and its operation at development stage, through its own specially retained and trained engineers. In keeping with their agreement, BrazilNut acquired a severely underperforming well, where, with the application of Acorn's technology, oil production increased to almost double. Using this outcome as proof of concept, BrazilNut secured a confidential, multi-billion, long-term financing offer from Coconut Bank plc. The offer, however, is contingent upon Acorn licensing its technology to BrazilNut for mass application to a large number of wells, which are to be simultaneously acquired before their price hikes up once news of the technology's effect becomes widely public. The licensing process requires Acorn to disclose the algorithm and map out the computer code at the core of its technology. Acorn knows that by disclosing the technology's operating system, it will lose its exclusive control over the technology and risk it being reverse engineered by Acorn's competitors or even by BrazilNut itself (in breach of their agreement). This could effectively push Acorn out of the petroleum development market entirely. Nonetheless, wishing to avoid a breakdown in the joint venture relationship, Acorn goes ahead with the licensing process with an important addendum, which goes unnoticed by both BrazilNut and Coconut: Acorn's owner (and inventor of the technology) is solely responsible for emergency technical support. Thus, when BrazilNut proceeds with the mass acquisition of several wells with Coconut's financing and applies the technology successfully over several weeks based on Acorn's instructions, Acorn is the only one who can correctly calibrate the equipment following an emergency reboot. Such reboots are necessary when the equipment presents a small but significant glitch, which distorts the feedback it receives from the field it operates in and renders the technology ineffective. The glitch does not happen often, but it cripples BrazilNut's field operations when it does. Thus, after a few times of having to fly Acorn's owner to the middle of nowhere in order to calibrate equipment which, by all accounts, should work perfectly on the instructions they were given, BrazilNut caught on to the fact that Acorn not only had known of the glitch's existence, but that it had actively ensured that it would be the only party capable of dealing with it when it arose. Being responsible for the finances of the venture,

BrazilNut now wants to recoup the costs it incurred from its stalled operations as a result of the glitch. Acorn, however, is not in breach of its express obligations under the joint venture agreement. If a duty of good faith were to be implied into the contract on the basis that this is what the parties, as constrained maximisers, would have wanted, then BrazilNut could argue that Acorn breached this duty by failing to disclose material facts regarding the operation of its technology.

First, let us consider this claim in light of good-faith-as-fairness, i.e. a negative duty to avoid doing anything, which would jeopardise the common strategy. On the facts, Acorn's withholding information on the glitch does not necessarily harm the common strategy in the long-term.[50] If anything, Acorn ensured that the joint venture secured the necessary financing by capitulating to Coconut's terms, thus ultimately securing the future of the joint strategy itself. However, BrazilNut's claim might have merit if considered in light of good-faith-as-honesty, in the sense of a *positive* duty to disclose facts material to the success of the joint venture. Withholding knowledge of both the glitch and its solution would arguably qualify in this regard, given the costs arising from freezing operations and the potential repercussions of this on the joint venture's relationship with third parties, like Coconut, at least in the short-term.

Whether BrazilNut's claim is successful will depend on how broad Acorn's duty to disclose is. This is the difficulty arising from the operation of positive duties. Whereas the content and extent of a negative duty is determined by its very definition and the effect of a failure to comply, the content of a positive duty could literally encompass all action and therefore compliance is equally indeterminable. Nonetheless, for the purposes of this thesis, an overarching duty of good faith is capable of being implied into the joint venture agreement from the outset, only because it is a conduct-constraining rule that rational agents contemplating cooperation would have agreed to, if they had properly reflected on what their self-interest requires. Therefore, here, a positive duty to disclose must be limited by Gauthier's minimax relative concession, namely the maximum amount of information that a rational agent can disclose without damaging its self-interest in the long-term. On the facts, if Acorn had not withheld the information on the glitch and, more importantly, its solution, it faced the distinct

[50] E.g. if the possibility of difficulties in securing future finance is raised then the costs caused by stalled operations due to the glitch could be factored into the joint venture's budget.

possibility of being pushed out of the market entirely and becoming defunct.[51] Indeed, when a similar point was raised in *BP Gas Marketing v. LA Societe Sonatrach*,[52] the High Court held that an express obligation of good faith in the contract did not require a party to relinquish a contractual right to its own financial detriment and to the benefit of the other party.[53] Therefore, it would be irrational to seek to enforce a good faith obligation understood as a positive duty to disclose against Acorn, given that as a rational agent it would never have accepted the duty in the first place, since it would jeopardise its self-interest *overall*.[54]

5.4.2 Procedure

Having broadly determined the content of a duty of good faith implied into a joint venture, I will now examine the level of utility that a rational agent contemplating collaboration can expect to achieve through a duty of good faith based in current English contract law. In the absence of an overarching duty of good faith governing all contracts as a rule, a duty on the co-venturers to perform and enforce the contract in good faith can only be imposed as an implied contract term. However, this is no simple task. A term will not be implied into a contract with the intention of improving upon the bargain between the parties,[55] nor will it be implied because it would be fair or equitable to do so.[56] Rather, the purpose of the exercise is merely to assist in the interpretation of the contract, when the parties have made no provision as to what is to happen when a specific event occurs.[57] In that case, a term will be implied based on the

[51] Notably, similar conduct in *Bristol Groundschool Ltd v. Intelligent Data Capture Ltd*, n.32, was not deemed to be in bad faith, but essentially precautionary in the face of genuine concerns for the claimant (and defendant in counter-claim) company's legitimate interests; *ibid*, [196], per Richard Spearman QC.

[52] [2016] EWHC 2461; see also *Hamsard 3147 Ltd (t/a Mini Mode Childwear) v. Boots UK Ltd* [2013] EWHC 3251, [82]-[93]; *Gold Group Properties Ltd v. BDW Trading Ltd* [2010] EWHC 1632, [91].

[53] *Ibid*, [400]-[402].

[54] In this sense, therefore, the Court of Appeal in *Philips Electronique v. British Sky Broadcasting*, n.31, was correct to reject the claim that the defendant had breached several implied good faith-related duties to avoid doing anything which frustrated the commercial purposes of its joint venture agreement with the claimant, by the defendant's merging with its competitor and thus rendering the joint venture with the claimant obsolete. *Cf.* Brownsword (Reception), n.20, 28-29.

[55] The court does not have the power to improve upon an instrument; it is only concerned to discover what the instrument means. This is determined by what a reasonable person having 'all the background knowledge, which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant': *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50, [21], per Lord Clarke JSC.

[56] *Philips Electronique v. British Sky Broadcasting*, n.31, 482, per Bingham MR.

[57] *Attorney General of Belize v. Belize Telecom Ltd* [2009] WLR 1988, 1993, per Lord Hoffmann.

presumed intention of the parties 'with the object of giving the transaction such efficacy as both parties must have intended that at all events it should have'.[58] Thus, the term to be implied must either be one which makes commercial common sense, in the sense that the term is *necessary* to ensure the contract's 'business efficacy',[59] *or* it must be a term that would have been so *obvious* at the time of contracting that it went without saying.[60] Only one of these two conditions need be satisfied and the test for each is an objective one. Therefore, the court needs no evidence of the parties' actual intention when negotiating the contract.[61] Rather, the question is what would notional reasonable people in the position of the parties, at the time at which they were contracting, have agreed.[62]

This formulation of the doctrine maps on to Gauthier's methodology for ascertaining the type of duties, which presumed constrained maximisers in a joint venture would agree to undertake in order to further the joint strategy. The reasoning here is that implying into a joint venture agreement a term imposing a duty to perform *all obligations* in the contract in good faith [63] is necessary to ensure the business efficacy of the joint venture agreement, namely, the furtherance of the joint strategy. Adopting a markedly contextualist approach,[64] Leggatt J in *Yam Seng Pte Ltd. v. International Trade Corp.* [65] arrived at a similar conclusion. The case concerned a 30-month distributorship agreement, for fragrances to be sold duty-free by the claimant in various

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[58] *The Moorcock*, n.11, 68, per Bowen LJ.

[59] *Marks and Spencer plc v. BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2016] AC 742, 754, per Lord Neuberger JSC; *Arnold v. Britton* [2015] UKSC 36 , [112], per Lord Carnwath JSC; *Greys v. Societe Generale*, n.38, [55], per Baroness Hale JSC; *Liverpool City Council v. Irwin*, n.38, 254, per Lord Wilberforce. *Cf. Attorney General of Belize v. Belize Telecom Ltd*, n.57, where Lord Hoffmann suggested that a term could be implied into an agreement where the context of the dispute so required, so as to address a gap caused by the inability of the parties to address all contingencies at the time the contract was made. In *Marks and Spencer*, the Supreme Court roundly rejected this interpretation and re-asserted that a term may only be implied when strictly necessary and only to aid in the interpretation of the contract: *Marks and Spencer*, *ibid*, 755-756 per Lord Neuberger JSC.

[60] See *Reigate v. Union Manufacturing Co (Ramsbottom) Ltd* [1918] 1 KB 592, 605, per Scrutton LJ and *Shirlaw v. Southern Foundries (1926) Ltd* [1939] 2 KB 206, 227, per McKinnon LJ.

[61] *Equitable Life Assurance Society v. Hyman* [2002] 1 AC 408, 459, per Lord Steyn.

[62] *Marks and Spencer*, n.59, 754, per Lord Neuberger JSC.

[63] Interestingly, in many recent cases where the court has encountered an express term requiring the performance of a specific contractual obligation to be performed in good faith, the court has been reluctant to extend the duty beyond the narrow confines of the obligation at issue: see *Compass Group v. Mid Essex Hospital Services*, n.33, [106]-[107], per Jackson LJ, and *Ilkerler Otomotiv Sanayai Ve Ticaret v. Perkins Engines* [2017] EWCA Civ 183, [29], per Longmore LJ.

[64] n.30, [160]-[164].

[65] n.30.

specified territories in South East Asia bearing the 'Manchester United' brand name which the defendant was to supply. The claimant argued, *inter alia*, that the defendant had breached an implied duty of good faith by providing the claimant with false information (as to the products' retail price and their availability altogether) and outright undercutting the claimant's duty-free prices by allowing the products to be sold more cheaply by the defendant's retail distributors. Leggatt J explained that at its core the duty of good faith was based, and certainly went beyond, a duty of honesty, which the defendant had breached by being actively dishonest with regard to the products' retail prices. More importantly, the defendant's conduct in this regard also amounted to a repudiatory breach, making the implied term of good faith performance one that went to the core of the contract.[66] Consequently, the claimant was entitled to terminate the contract on this ground and was awarded damages to recoup the net expenditure it incurred throughout its contractual relationship with the defendant.

5.5 Level of utility achieved from basing good faith in contract

Having demonstrated how a good faith duty may be implied into contractual joint ventures following Gauthier's approach to rational bargaining, this section will examine the level of utility, which a constrained maximiser would achieve, if it had agreed to a duty of good faith implemented through the contract mechanism. A duty of good faith in the context of cooperation includes both a negative and a positive component. It is the positive component that would cause a constrained maximiser to pause before accepting the duty, given that it is by definition nebulous and therefore difficult to implement in practice. One could argue that this difficulty would adversely affect the level of utility a co-venturer could expect to achieve through a contractually mandated duty of good faith. This is not necessarily so. As noted earlier, the too-broad aspects of the duty can be bounded based on Gauthier's minimax relative concession, to the effect that the law would presume that a constrained maximiser would have agreed to an extra-contractual other-regarding duty of this type, only to the extent that the duty did not cause it to lose out in the long-term. This will be a question of fact and

[66] As per the tenets described in *Heyman v. Darwins* [1942] AC 356, 397, per Lord Porter. *Cf. MSC Mediterranean Shipping Company S.A. v. Cottonex Anstalt* [2016] EWCA Civ 789, [45], per Moore-Bick LJ (who cautioned against Leggatt J's approach entirely).

relevant context. Therefore, the substantive content of a duty of good faith based in contract will not necessarily be the limitation on the level of utility it yields.

Rather, I submit that this limitation is purely procedural and lies in the remedy available to the innocent party as a rule in the event of its collaborator's breach of the joint venture agreement, namely damages. Indeed, it is a cornerstone of English contract law that breach of a contract term automatically entitles the innocent party to damages. Briefly, 'damages' refers to a monetary value, which aims to reflect the value that the innocent party would have obtained if the contract had been performed. This value is assessed based on the principle that 'the victim of the breach should be placed, so far as damages can do it, in the position he would have been in had the contract been performed.'[67] In one-off transactions, this task should be fairly straightforward, in the sense that the parties' respective expectations from the contract are generally evident from the basic content of the transaction itself, namely what they each have agreed to sacrifice and gain in return. The relative simplicity of this interaction makes the loss – which the innocent party has suffered as a result of the other's breach – and the innocent party's ultimate objective under the contract more easily quantifiable and the award of a remedy based on that value relatively straightforward.

In contrast, this process is less straightforward in the context of a contractual joint venture. Here, the parties' interaction is constant and informed by an agreed strategy to achieve agreed objectives. In terms of contract procedure, this relationship could be understood as several interlinked transactions, each representing a tension-point closer to the parties' agreed objectives. Before each tension-point is cleared, one party will be vulnerable to loss until the other has performed its part of the transaction, with the power pendulum swinging back and forth until the joint project is deemed complete. Given the fluidity of such relationship, what does it mean to put the innocent party – through an award of damages – in the position he would have been in had the contract been performed? Bearing in mind that the purpose of this section is to assess the utility derived from the enforcement of a good faith obligation through the current contract mechanism, I submit that this question should be examined in terms of practicality. In this sense then, the question boils down to: what is the baseline for determining the

[67] *Robinson v. Harman* (1848) 154 ER 363, 365.

appropriate amount of damages in the event of default in a collaborative relationship? Is it:

a) the expectations of the innocent party as shaped by the joint venture's ultimate objective;

b) the value (including any expected value) attributed to the specific task which the breaching party has failed to perform; or

c) the loss the innocent party has suffered as a result of that failure?

Of the three options, I submit that (a) presents the highest utility, because it puts the injured party in the position it would have been in had the joint venture, *as a whole*, been successful, in the sense that it bore fruit from which the injured party can expect a share. Option (c) presents the least utility given that the injured party may not suffer any actual or, at least, quantifiable loss from its collaborator's failure to perform under the contract. Regardless, of these options English contract law focuses on the third, aiming to compensate the innocent party only for the loss it has suffered as a result of the other's breach. In a nutshell, this is the compensatory principle, which determines the calculation of an award of damages following a breach of contract. The following sections will discuss how the compensatory principle operates and how it can become an obstacle in maximising the utility a constrained maximiser may derive from enforcing good faith obligations through the contract mechanism.

5.5.1 The supremacy of the compensatory principle and its application

Following recent Supreme Court rhetoric, it is now undisputed that the purpose of contractual damages is to make good the loss suffered by the innocent party and nothing more.[68] The award itself is to be calculated in the strictest terms with the declared objective to avoid over-compensation, the interests of 'justice', in this sense, outplaying those of commercial certainty (or, indeed, rational reasoning). The supremacy of this principle is nowhere more evident than in the area of 'anticipatory breach', where a contractual party repudiates, i.e. renounces, its contract with another in anticipation of the latter's failure to perform its obligations under the agreement. A seminal case in

[68] *Bunge SA v. Nidera BV* [2015] UKSC 43.

point is *Golden Strait Corpn v. Nippon Yusen Kubishika Kaisha (The Golden Victory)*,[69] where, by a bare majority, the House of Lords held that post-repudiation events that the court, in hindsight, knows would have limited the contractual rights of the appellant had the contract not been repudiated, were a significant factor in assessing the damages available to the appellant. Accordingly, the Lords limited the damages awarded in respect of a repudiatory breach in 2001 of a seven-year charterparty with about four years left to run, to the amount that the appellant would have received had the charterparty been instead terminated in accordance with the war clause therein, following the outbreak of the second Gulf War in 2003. Dissenting, Lord Bingham was of the view that the damages should have been assessed at the point of repudiation and that hindsight should not have been relevant to the court's calculation of the award. The respondent charterers' core argument was that the appellant would have been overcompensated had it been awarded damages reflecting the contract's would-be performance to its original term. In response, Lord Bingham accepted that the value of a contract in the market may well be reduced, if the contract is terminable by an event which the market perceives as likely, but not necessarily certain, to take place.[70] If a contract were repudiated during such circumstances, then the appellant receiving an award reflecting the consequent reduction in the contract's market value would be a fair outcome. However, this was not the case in *The Golden Victory*. Lord Bingham stressed that, at the time the contract was repudiated, the prospect of war had been described as a 'mere possibility', which suggested strongly that it did not in fact affect the contract's marketable value at the time of repudiation.[71] Lord Bingham's emphasis here is significant, because it suggests that the time of repudiation was the latest point in time, when the court could be certain that it was reasoning on the basis of verifiable facts rather than conjecture.

Unsurprisingly, the majority's opinion in *The Golden Victory* drew heated criticism.[72] For instance, commenting on the Court of Appeal's ruling in *The Golden Victory*, which the majority in the House of Lords accepted on appeal, Treitel pointed out that the

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[69] [2007] UKHL 12, [29]ff, per Lord Scott.

[70] *Ibid*, [22].

[71] *Ibid*.

[72] See for example J. Morgan, 'A Victory for 'Justice' over Commercial Certainty' (2007) 66 *CLJ* 263, 264; M. Mustill, '*The Golden Victory* – Some Reflection' (2008) 124 *LQR* 569, 585; E. Peel 'Desideratum or Principle: The Compensatory Principle Revisited' (2015) 131 *LQR* 29, 33, commenting on *Flame SA v. Glory Wealth Shipping Pte Ltd* [2013] EWHC 3153.

compensatory principle as applied therein presented several problems, not least because of its sweeping treatment of post-repudiation events which are likely to affect the measure of damages available to the injured party and may go well beyond the historic, far-reaching type giving rise to the problem in *The Golden Victory*. What if the injured party were to suffer an unforeseen setback *post-repudiation* rendering it unable to perform its original obligations under the contract?[73] Could the repudiating party use this as a basis to (a) justify its repudiation of the contract retrospectively and (b) limit the damages available to the injured party?[74] I submit that, the pointless opening for opportunistic breaches of contract aside, this also does not explain how the interests of justice are served by safeguarding the financial interests of the repudiator rather than those of the injured party. Avoiding the award of excessive compensation is one thing,[75] but doing so by stretching the limits of rational reasoning is another. If anything, and on policy grounds alone, it sends a rather problematic message, one where opportunism is rewarded rather than actively discouraged.

Building onto Treitel's observation regarding the sweeping nature of the majority's argument in *The Golden Victory*, what would the case be if the court had been faced with a sequence of post-repudiation events every one of which had been capable of affecting the value of the contract, whether positively or negatively? Say, for example, that following the post-repudiation onset of war, the now injured party in *The Golden*

[73] Not to be confused with an undiscovered absolute inability to perform on the part of the innocent party prior to the contract being made, along the lines of *Universal Cargo Carriers v. Citati (No2)* [1958] 2 QB 254, where *unbeknownst* to the respondent charterer no cargo was ever going to be available for freight under a charterparty for the carriage of scrap iron from Basra, which the ship owners cancelled before this issue became known to the respondent.

[74] G.H. Treitel 'Assessment of Damages for Wrongful Repudiation' (2007) 123 *LQR* 9, 15. *Cf. Gill & Duffus SA v Berger & Co Inc.* [1984] AC 382 and *Fercometal SARL v. MSC Mediterranean Shipping Co SA (The Simona)* [1988] AC 788, the House of Lords established that post-repudiation failure to perform on the part of the innocent party was not to be taken into account in the calculation of damages in a claim arising from the repudiation. Addressing these points, Lord Toulson in *Bunge SA v. Nidera BV*, n.68, [88], distinguished the principle in *Gill & Duffus*, and *The Simona* on the basis that they did not concern events which may lead to the cancellation of the contract, as per *The Golden Victory*. Specifically, they concerned circumstances pertaining to the subjective ability of the parties to perform the contract, rather than extra contractual events, which would more likely than not lead to cancellation of the contract as a whole, presumably because the environment in which performance was to take place would be altered radically by the event originally contemplated in the contract itself. On this reasoning, 'anticipatory repudiation' appears to operate as 'repudiation in anticipation of frustration', which triggers another set of problems if one considers the sheer rigidity by which the regime on contractual frustration operates – see 4.3.2.

[75] E.g. Lord Diplock in *Gill & Duffus*, *ibid*, 390, made certain of this by taking into account that in the calculation of an award following a claim for repudiation, the repudiator was entitled to offset the damages due by the value of the innocent party's performance of its own obligations, which would have been contractually due, but were extinguished at the point when the repudiation was accepted or could be deemed as such.

Victory could have availed itself of a number of exclusive trade incentives put in place by the allies of one of the warring parties in order to assist the latter in its war effort. To be sure, cancellation of the contract on the basis of the 'war clause' would still be possible, but for the purposes of the calculation of the award of damages such events could be significant. In particular, the opportunities in question would arguably not only restore the value of the now-defunct charterparty but could even increase it. What if the governments of the allied states faced considerable political opposition in their own territories on account of their pledge to support their ally's war effort with lucrative trade incentives? Would the resulting political turmoil, whether small or significant, have a bearing on the perceived would-be value of the now-defunct charterparty? At which point in this sequence of events is the court expected to stop its speculation as to the value of the repudiating party's performance, if at all? To my mind, allowing hindsight to affect the assessment of damages in *The Golden Victory* was irreparably harmful not only to commercial certainty but also to legal principle. This is because, apart from the relevance of certain events affecting retrospectively the perceived market value of a contractual promise, the House of Lords offered no guidance as to which factors made such events relevant or, indeed, when the court's inquiry into extraneous events and its speculation as to their retrospective effect should end. Indeed, when attempting to rationalise the law on 'anticipatory repudiation', Lord Mustill concluded that:

> 'the concept of anticipatory breach cannot be rationalised, but must be seen as a piece of positive law, firmly established but not anchored in or deducible from the ordinary course of the law of contract. The act can be called a breach, if one wishes, but it must always be kept in mind that this is not what it really is, and it follows to my mind that applying mainstream damages law to this arbitrary concept will not yield reliable results.'[76]

Regardless, some years later in *Bunge SA v. Nidera BV*,[77] the Supreme Court unanimously applied the compensatory principle as expressed by the majority in *The Golden Victory*, and stressed that it applies as much to one-off transactions as to instalment or period contracts.[78] It follows, then, that for the purposes of this thesis the current view of the compensatory function of damages applies squarely to joint venture relationships and that freeloading, in the sense of opportunistic breaches of the joint

[76] Mustill, n.72, 584.

[77] n.68.

[78] *Ibid*, [22], per Lord Sumption, and [87] per Lord Toulson.

venture contract (whether pursuant to an 'efficient breach' strategy or not) will do little to affect its operation.

5.5.2 The supremacy of the compensatory function of damages and good faith

Having demonstrated the fervour with which current judicial thinking seeks to uphold the compensatory function of damages, I will now examine the level of utility that this mechanism affords a co-venturer, who, as a constrained maximiser, has decided to submit to an overarching good faith requirement having properly reflected on what its self-interest requires. It will be remembered that, however nebulous as a concept, the substantive content of a good faith requirement may be determined on a case-by-case basis by applying Gauthier's adaptation of the Lockean proviso, namely the minimax relative concession.[79] But, even if we manage to get over the hurdle of a 'good faith' definition, we must still address the hurdles raised by the contradictions inherent in the contract mechanism itself. Indeed, on the one hand the contract mechanism operates on a strict liability basis, which by definition entails the examination of tangible facts. On the other hand, the contract mechanism may allow for unbridled speculation to substitute for judicial reasoning where the interests of justice so require, as the whole area of 'anticipatory breach' demonstrates. But the difficulties inherent in the contract mechanism do not stop there. In the context of a contractually implied duty of good faith in a joint venture, the most significant difficulty probably lies with assigning a concrete value to the injured party's loss as a consequence of the other's bad faith. All the while we must bear in mind that Gauthier's minimax relative concession requires constrained maximisers to only concede their short-term self-interest up to the point when their long-term self-interest is jeopardised.

So, what happens when, as is commonly the case with this type of relationship (see Ch.2), the joint venture is both risky and entirely speculative, much like the 'novel' set of circumstances in *Philips Electronique v. British Sky Broadcasting*?[80] In *Philips Electronique*, the plaintiff had agreed to produce receiving equipment for use with the defendant's soon-to-be-launched satellite broadcasting service. Under the agreement, Philips was responsible for a) manufacturing a large number of units to be sold to subscribers of the defendant's service, and b) ensuring that it had the manufacturing

[79] See *1.3*.

[80] n.31.

capacity to produce a minimum number of units in set periods. Philips both manufactured the prescribed number of units and expanded its operations to accommodate an increase in production requirements at a large cost. On the other hand, BSB was responsible for launching the satellite service and marketing it. However, having spent around £70 million in marketing the service, BSB had only succeeded in attracting 120,000 subscribers – some 280,000 fewer than initially projected. At the same time, and mere months before BSB launched its service, its competitor, Sky, launched a rival satellite, which transmitted to a lower quality but much cheaper standard, with which the equipment manufactured by Philips was incompatible. When Sky proposed a merger with BSB, the latter accepted and promptly terminated its agreement with Philips. Philips then sued claiming that BSB had breached several *implied* obligations to perform its duties in good faith, which included not doing anything that would frustrate the purposes of the agreement.

Delivering the judgment of the Court of Appeal, Sir Thomas Bingham MR observed that 'the agreement related to an operation which was known to be novel, to involve more than ordinary risk and to be more than ordinarily uncertain in its outcome.'[81] The venture's novelty lay in the fact that it was premised on an agreement, which was itself highly unusual. As Sir Thomas pointed out, under the agreement 'Philips undertook to manufacture receivers, but BSB did not agree to buy them or to ensure that they were paid for. Philips agreed to maintain manufacturing capacity, but BSB did not undertake to place orders or warrant that there would be a market.'[82] Would even an established duty of good faith have afforded Philips a remedy in this case? Sir Thomas doubted that it would. On the one hand, the parties gave no indication as to how they planned to apportion risk in the event that the venture turned out to be a major commercial flop, which it ultimately was, rendering the calculation of damages essentially impossible. On the other hand, Philips did not really suffer its loss by BSB's termination of their agreement, but by the fact that, despite its efforts, BSB failed to create a market for its broadcast service, and therefore for Philips' product, having itself suffered significant losses in promoting both. In other words, even if BSB persisted with the project as per the core agreement, Philips was in no way guaranteed a profit or even a smaller loss.

[81] *Ibid*, 483.

[82] *Ibid*.

To be sure, according to Gauthier's approach to rational bargaining, it would not have been prudent for BSB to persist with the joint venture with Philips because it was clearly not in its own long-term interest to do so. Therefore, BSB would not have breached a good faith duty determined by what a constrained maximiser would have chosen to do in the circumstances. This is also consistent with current judicial thinking on the nature of good faith, which does not require a party to actively sacrifice its own self-interest.[83] However, even if it could be established that BSB had acted in bad faith in a framework where implied good faith obligations were readily enforceable, *Philips Electronique* should still illustrate that a duty of good faith being enforced through the mechanism of contract law would not necessarily provide the innocent party with a meaningful remedy. Given that here we are concerned with the level of utility, which a constrained maximiser can expect to achieve through conduct-constraining rules mandated through the contract mechanism, this limitation is rather significant. Thus, it could be argued that if BSB had been held to be in breach of a good faith obligation by ending the contract with Philips so as to establish a competing business with a third party, Philips would still be entitled to at least nominal damages, since, as per *The Mihalis Angelos*,[84] the right to damages arises automatically from breach even where the innocent party suffered no actual loss. But an award along those lines would be of little use to Philips.

It will be remembered that in the absence of an express relevant obligation on BSB, there was nothing to connect Philips's expenditure and subsequent loss to BSB's failure to comply with that obligation. Therefore, Philips' loss in the event of BSB's bad faith would consist in being deprived of the benefit of the contract with BSB, essentially by BSB doing the very thing that it had contracted not to do,[85] i.e. pursuing an opportunity with its competitor. The court's strict adherence to the compensatory principle, however, would do little to remedy this issue. A case in point is, *Surrey County Council v. Bredero Homes*, [86] where the claimant had offered some 12 acres of its land for housing development with the defendant agreeing to build no more than 72 homes. In breach of its promise, the defendant built 77 homes. The Court of Appeal held that as it suffered no direct loss from the defendant's breach, the claimant was only entitled to

[83] n.51 and accompanying text.

[84] [1971] 1 QB 164.

[85] On this issue see also the examples in P. Birks 'Profits of Breach of Contract' (1993) *LQR* 518.

[86] [1993] 1 WLR 1361.

nominal damages. But the claimant did suffer loss. The Court's strict adherence to the 'purely' compensatory function of damages discounted the very reason behind the claimant's restriction on the number of homes to be built on its land; namely the prospect of opening up more of its land for development in the future and thus creating an additional source of income. In other words, the claimant's actual loss consisted in the income it could reasonably expect to generate had it offered up licences for the development of an additional 5 homes.

5.5.3 Exceptions to the compensatory function of damages: restitutionary damages, their scope and their relationship to good faith

Had an implied duty of good faith been upheld in *Philips Electronique*, the claimant might have been able to argue exceptionally that in having been deprived of the benefit of the contract due to the defendant's bad faith, it was entitled to restitutionary damages instead. The purpose of such damages, whose award in a contractual context is very much the exception rather than the rule, is to deprive the defendant of the gain it generated from its behaviour, rather than to compensate the claimant for the loss it suffered as a result of this behaviour. At first glance, such proposition would go a long way to remedy the problems highlighted in the previous section. Thus, two decades before *Bredero*, the Court had tackled similar circumstances in *Wrotham Park Estate Co. v. Parkside Homes*,[87] where the defendant constructed a road and built 14 homes in breach of a covenant, whereby no construction on the allotted land could take place without the claimant's consent. The claimant sought an injunction to restrain the defendant from going ahead with the development, as well as a mandatory injunction to demolish any buildings constructed in breach of the covenant. However, the claimant did not seek an interlocutory injunction and in the meantime the defendants not only received deposits for the houses under construction but by the time of the trial the purchasers had taken possession and moved in. Brightman J held that in the circumstances it would have been inequitable to grant a mandatory injunction for the demolition of the houses and awarded damages in lieu of an injunction, pursuant to the power granted the court under the Chancery Amendment Act 1858. The defendant argued that the compensation the claimant would have been entitled to for breach of covenant would have been nil or, at most, nominal damages, because the value of the claimant's land was not in any way affected by the construction of a road and 14 homes.

[87] [1974] 1 WLR 798.

Regardless, Brightman J calculated the claimant's damages at 5 per cent of the defendant's anticipated profits from the sale of the homes, reasoning that this sum represented what the claimant would have reasonably required in return for relaxing the covenant.

O'Sullivan described the reasoning in *Wrotham* as 'somewhat fictitious' for there was no indication that the claimant was ever willing to relax the covenant at any price.[88] Indeed, while the claimant did not suffer loss, the defendant did gain something at the claimant's expense by breaching a covenant benefiting the claimant's land. Thus, Brightman J's insistence on regarding the award of damages as compensation (the purpose being to make good the claimant's loss), rather than restitution (the purpose being to ensure that the defendant does not retain a benefit from a wrong it committed) gives rise to an irreconcilable fault in his reasoning. Awarding compensation implies that the claimant has suffered loss, when, on the facts, it has not. And if this is the case, providing any measure of damages *in lieu* of the remedy the claimant is actually seeking is simply illogical.[89] And while the strain in the *Wrotham ratio* would have been avoided had the awarded damages been simply regarded as restitutionary,[90] later courts have doubled down on the compensatory nature of the *Wrotham* award.

Thus, in *Experience Hendrix v. PPX Enterprises*[91] the Court of Appeal held that where in a clear and deliberate breach of contract the claimant cannot show financial loss resulting from the breach, the award of damages may be calculated by reference to the profits generated by the defendant as a result of the breach. In this case, in breach of a settlement agreement with Jimi Hendrix's estate, the defendant record company

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[88] J. O'Sullivan, 'Reflections on the Role of Restitutionary Damages to protect contractual Expectations' in D. Johnston et al. (eds), *Unjustified Enrichment: Key Issues in Comparative Perspective* (CUP, 2002), 329.

[89] For a discussion on the importance of correctly and clearly distinguishing between the concepts of compensation (making good a loss) and restitution (taking away a gain) see P. Birks, 'Misnomer' in W. Cornish et al. (eds), *Restitution: Past, Present and Future* (Hart, 1998), emphasizing restitution as a direct effect of the concept of unjust enrichment and not the other way around, unjust enrichment itself being capable of giving rise to a number of actions, restitution being one of them; see also D. Friedman, 'Restitution for Wrongs: The Basis for Liability' *in* Cornish et al., *ibid*, for an examination of restitution and its operation as an autonomous remedy in an action for unjust enrichment, where the author argues that an action in restitution should not require the existence of a wrong in contract or tort for it to subsist, essentially, parasitically – all that should be required is 'the invasion or appropriation of another's protected interest'; *ibid*, 136ff.

[90] See for instance C. Rotherham, '"Wrotham Park Damages" and Accounts of Profits: Compensation or Restitution?' (2008) 1 *LMCLQ* 25; *Cf.* F. Giglio, *The Foundations of Restitution for Wrongs* (Hart, 2007).

[91] [2003] EWCA Civ 323.

licenced to third parties a number of Hendrix's recordings without the consent of the estate. The estate then sued for an account of profits based on the House of Lords' ruling in *Attorney General v. Blake*.[92] In *Blake* the Crown sued a former British Intelligence agent who defected to Russia, where he published a book disclosing state secrets and detailing covert missions he carried out while in the service of the British Government. The House of Lords held that despite the fact that the Official Secrets Act no longer applied to the information disclosed in the book, Blake had committed an egregious breach of confidence by breaching the non-disclosure agreement he signed when he joined British Intelligence. Furthermore, having had access to such information by virtue of his unique position alone, his relationship to the Crown was not unlike that of a fiduciary, particularly given the national security risk that disclosure of this information represented for the country. Consequently, Blake was compelled to account to the Crown for the profits he generated as a result of his breach, including a book advance and a substantial sum in royalties due. Mance LJ in *Hendrix* observed that while the case did not arise from the exceptional circumstances the House of Lords tackled in *Blake*, there were still significant similarities, given that in both cases the defendant had done the very thing that he contracted not to do,[93] while the claimant had a 'legitimate interest in preventing the defendant's profit-making activity and, hence, in depriving him of his profit.'[94] Mance LJ then considered the possibility of a restitutionary remedy along similar lines, but in a purely commercial context, as in *Esso Petroleum v. Niad*.[95] Here, the claimant was entitled to an account of profits representing the amount by which the fuel prices charged by the defendant to the claimant's customers exceeded the prices recommended by the claimant. Exceptionally, as in *Hendrix*, the claimant in *Esso* found it impossible to calculate the loss it suffered as a result of the defendant's actions, but unlike *Hendrix*, the case featured a fiduciary-like element, which justified a full account of profits on the ground that the defendant had received financial assistance from the claimant so as to be able to afford charging the claimant's recommended prices. Because of the unique context of both *Blake* and *Esso*, which featured elements resembling those of a fiduciary relationship, Mance LJ distinguished both cases and held than an account of profits

[92] [2001] 1 AC 263.

[93] *Hendrix*, n.91, [30].

[94] *Ibid*, [27].

[95] [2001] All ER 324.

could not be ordered in the circumstances before him. However, he supported the concept of ensuring that the defendant is deprived of the benefit he received as a result of his wrongdoing and turned to *Wrotham Park*, observing that Brightman's J reasoning:

> 'has the merit of directing the court's attention to the commercial value of the right infringed and of enabling it to assess the sum payable by reference to the fees that might in other contexts be demanded and paid between willing parties.'[96]

Accordingly, he held that the claimant was entitled to an award of damages, which represented the sum which the defendant would reasonably have been required to pay as a quid pro quo for the benefit he acquired as a result of his conduct.[97] This line of reasoning was adopted by the Court of Appeal in *One-Step (Support) v. Morris-Garner*,[98] which for a time pointed to the development of an exceptional type of *compensatory* award, or 'buy-out damages', assessed on what the defendant might reasonably have expected to pay the claimant for the right to act as he did.[99] However, when the question of 'buy-out' damages reached the Supreme Court,[100] the result was to materially restrict the circumstances in which an award of this type may be made; specifically where the loss of a tangible or quantifiable asset is concerned.

In any event, it could be argued that the existence of 'buy-out' damages could, theoretically, address the problem of damages awards being too rigid in their application for the purposes of a constrained maximiser seeking to enforce a standard of conduct mandated through the contract mechanism. However, 'buy-out' damages are an exceptional award. They arise where the circumstances and the interests of justice make it imperative for the court to deprive the defendant of the gain resulting from their wrongdoing. The power to award 'buy-out damages' is, in other words,

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[96] *Hendrix*, n.91, [45].

[97] In the vein of *Wrotham Park*, see also *Jaggard v. Sawyer* [1995] 2 All ER189 (damages awarded in lieu of injunction for breach of restrictive covenant); *Bracewell v. Appleby* [1975] Ch 408 (damages awarded in compensation for a right of way over a private road, which the defendant's predecessor in title wrongfully extended to benefit adjoining land).

[98] [2016] EWCA 180.

[99] See *Pell Frischmann Engineering Ltd. v. Bow Valley Iran Ltd.* [2009] UKPC 45, where a purported joint venture for the development of several oil fields in Iran failed when two members excluded the third in negotiating with the Iranian incumbent, in breach of a confidentiality agreement.

[100] *Morris-Garner v. One Step (Support)* [2018] UKSC 20.

entirely discretionary and very much outside of normal contract procedure.[101] For this reason, I submit that conduct-constraining rules mandated and enforced through current contract procedure would not be a utility maximising option for the purposes of a constrained maximiser, whom the law must presume has accepted extra-contractual duties in the context of rational collaborative bargaining. Even if such duties were to be implied into the joint venture contract as a default, for instance along the lines of Leggatt J's reasoning in *Yam Seng*, the *standard* remedies available for breaching the duty would hardly be a disincentive to freeloading. If anything, the freeloader could just budget for a damages award, along the lines of an 'efficient breach' strategy.

To be sure, in addition to damages, remedies for breach of contract include specific performance and injunction, but these are also discretionary and, therefore, far from standard. I submit that constrained maximisers would derive far greater utility from conduct-constraining duties, which are enforced through restitutionary remedies as a matter of course,[102] rather than on the exceptional circumstances envisaged in *Blake* (account of profits) or *Wrotham* and *Hendrix* ('buy-out damages'). Therefore, for the purposes of this thesis, which at this stage seeks to establish the highest-utility method of implying extra-contractual conduct-constraining duties into the joint venture, contract procedure presents the lowest utility of the two options identified. In response to the hurdles raised by contractual procedure, the next chapter will discuss, and assess the level of utility achieved through, the implication of default conduct-constraining rules into the joint venture based on the jurisprudence and process of fiduciary law.

[101] See, e.g., *Blake*, n.92, 285, per Lord Nicholls.

[102] These are considerably more flexible and may be awarded even in circumstances where the restitution is of money which has been paid to the defendant for an illegal purpose: *Patel v. Mirza* [2016] UKSC 42 (the Supreme Court expressly overruling the 'reliance test' (i.e. a claim must be barred if it relies on illegality) established in *Tinsley v. Milliga*n [1994] 1 AC 340).

6 GOING BEYOND CONTRACTUAL DEFAULTS: FIDUCIARY DUTIES

6.1 Good faith mandated through fiduciary law

The standard of conduct mandated through fiduciary law is by far the most stringent in civil law. The expectation is that those who are identified as fiduciaries in relation to others, owe the latter a duty of utmost loyalty. From this core duty flow a number of related duties, which range from the well-defined, such as the duty to avoid conflicts of the fiduciary's own interests with those of the individuals whose interests they are expected to serve, to the nebulous, such as the duty to act with utmost good faith and always in the latter's best interests. The purpose of this chapter is to establish that a fiduciary good faith standard implied by default into the relationship represents the highest utility strategy for constrained maximisers, who choose to cooperate through a contractual joint venture.

Thus, in the first section I will establish the necessity of fiduciary duties being implied into contractual joint ventures by default, rather than on a case-by-case basis, which is the preferred approach when it comes to dealing with sophisticated commercial transactions (see Ch.4). Specifically, I will discuss the nature, role and operation of fiduciary law with reference to commercial transactions and sophisticated commercial parties. I will then demonstrate that the development of fiduciary law in the context of commercial transactions is problematic, particularly since the circumstances which trigger the fiduciary obligation remain nebulous, rendering the *ad hoc* imposition of fiduciary duties impractical.

Penultimately, I will examine the extent and content of the fiduciary duties to be implied into the joint venture by default, in keeping with Gauthier's approach to rational bargaining in the context of cooperation. In the final section I will demonstrate that a fiduciary standard of good faith, whose operational parameters are defined *a priori*, represents the highest utility option in constrained maximisation. By examining the remedies available to a claimant following a breach of fiduciary duty, I will establish that, in the current state of the law, good faith mandated through the fiduciary standard of conduct will most effectively address the practical limitations of Gauthier's contractarian morality – namely the problem of the powerful freeloader.

6.2 The necessity of a default fiduciary standard in contractual joint ventures

Fiduciary obligation is a peculiar concept in that there is considerable resistance from academics and judges alike to coming up with anything approaching a concrete definition for it. The very act of attempting to define the fiduciary concept is controversial. This attitude stems from the origins of the fiduciary concept as a cornerstone of the equitable jurisdiction, whose *raison d'etre* was to rectify the social injustice caused by an overly technical and rigid common law. The argument here is that, given the equitable jurisdiction developed as a response to common law's inflexibility, an attempt to force the fiduciary obligation into a concrete mould would be to defeat the doctrine's very purpose.[1] Thus, while we understand that the fiduciary obligation comprises a duty of utmost loyalty, it still remains rather nebulous, defined more by the circumstances where it appears to arise and less by any *a priori* judicial definition or expectation.

Against this background, Finn argued that what determines the existence of a fiduciary obligation is an *expectation* somehow created in one of the parties to the relationship that the other is going to act in the first party's interests to the *exclusion* of its own individual interest. He thus provided the following definition:

> 'A person will be a fiduciary in his relationship with another when and in so far as that other is entitled to expect that he will act in that other's interests or (as in partnership) in their joint interests, to the exclusion of his own several interests.'[2]

He went on to clarify that 'this entitlement may arise from what one party undertakes or appears to undertake for the other, from what actually is agreed between the parties, or, for reasons of public policy, from legal prescription'.[3]

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[1] For example, see *Midcon Oil & Gas Ltd v. New British Dominion Oil Co Ltd* (1958) SCR 314, where the Supreme Court of Canada rejected the argument that the parties to a joint venture were in fact in a fiduciary relationship, because their relationship did not fall into any *established* category which created a fiduciary obligation (and they had expressly excluded the characterisation of agency in the joint venture agreement).

[2] P. Finn, 'Fiduciary Law and the Modern Commercial World' in E. McKendrick (ed.), *Commercial Aspects of Trusts and Fiduciary Obligations* (Clarendon Press, 1992) 7, 9.

[3] *Ibid*.

The essence therefore of the fiduciary obligation lies in an *undertaking* by one party and a corresponding *entitlement* on the other party that the former will act in the latter's best interests to the exclusion of his own. The law recognises a number of circumstances, where the undertaking/corresponding entitlement pair arises by default. These are the circumstances surrounding specific professional relationships, such as those of business partners *inter se*, company directors in relation to their company, commercial agents in relation to their principals, solicitors in relation to their clients, and, quintessentially, trustees in relation to the *cestui que trust*, which the law identifies as fiduciary by default. The underlying policy here appears to be an institutional desire to maintain the public's confidence in certain professional relationships, which are generally perceived as socially valuable.[4]

Where the parties do not fall in a recognised fiduciary relationship, however, identifying the circumstances which give rise to the fiduciary obligation becomes a much more complex task. This is because the circumstances in which a person can be deemed *entitled* to expect that the other will act in that person's best interests to the exclusion of his own are not defined in any meaningful way, nor are the principles arising from the case law consistently applied.[5] This is especially true of commercial relationships, where the proposition that an economic agent is *entitled* to such expectation directly contradicts the law's operative presumption that the primary driver of economic activity is an economic agent's pursuit of their *own* self-interest. From an economics standpoint, the 'common knowledge of rationality', which is presumed to underpin all interaction between economic agents, by definition precludes the possibility for such an entitlement to arise. I contend that the courts' understanding and application of this fundamental presumption is too simplistic and does not properly take into account the drivers behind collaborative economic activity (see Ch.2 and Ch.3), where, incidentally, the fiduciary obligation may *de facto* arise.

Because of this ostensible contradiction, English law tends to presume that, outside of the prescribed status-based fiduciary categories, the fiduciary obligation rarely, if at all,

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[4] Peculiarly, in the UK, this does not include the relationship between doctor and patient – see below.

[5] E.g. see the marked discrepancy between *Hospital Products Ltd v. United States Surgical Corporation* [1984] HCA 64 and *United Dominions Corporation Ltd v. Brian Pty Ltd* [1985] HCA 49, in both of which the High Court of Australia dealt with joint ventures between sophisticated commercial parties at different stages of development – notably, it found a fiduciary relationship only with respect to the venture which was still at negotiation stage, albeit advanced (*Brian*).

arises in a commercial context. This does not mean, however, that *de facto* fiduciary loyalty and the commercial world are mutually exclusive. Thus, the next two sections will illustrate the mystifying state of the law on the commercial fiduciary obligation, first with respect to its operation, and, secondly, with respect to its content. The purpose of this exercise is to demonstrate the necessity of implying fiduciary duties into contractual joint ventures by default.

6.2.1 Problem 1: Identifying the circumstances giving rise to the fiduciary obligation in commerce

Because of its origins in the court's equitable jurisdiction, whose very purpose was remedial to begin with, the fiduciary obligation is a fundamentally unpredictable animal. Not only does it impose a very high standard of conduct on those identified as fiduciaries, but also it opens up a slew of potent equitable remedies, which are not normally available to a claimant at common law. In practical terms, then, the fiduciary obligation gives rise to a paradox. This is because it is simultaneously a formidable constraint on the parties' conduct – making it repugnant to the classically conceived utility-maximising economic agent; and the route to arguably the furthest-reaching remedies available in private law – making it the basis of a particularly attractive strategy in the event of a dispute. Thus, it should come as no surprise that commercial parties routinely attempt to avoid being identified as fiduciaries by explicitly describing their relationship as non-fiduciary through the use of 'status clauses', despite the fact that the effect of such clauses is dubious at best.[6] Yet, when a dispute arises, the same parties will often claim that the relationship was in fact fiduciary, so as to access the equitable remedies this would trigger if successful.

It is then for the court to answer the fiduciary question. However, given the lack of a concrete legal definition of the term itself, the answer to the fiduciary question may well be determined by the outcome the court deems just in the circumstances. The

[6] See *3.3.3*; This is because a *de facto* fiduciary finding does not depend on the parties' own description of their relationship, but rather on the mantle that the Court deems the relationship to have taken once the reality of it has come into effect; see e.g. *Reid v. Hollinshead* (1825) 4 B&C 867, 107 ER 1281 and *Adam v. Newbigging* [1888] 13 AC 308, which established that whether a partnership exists is a matter of substance and not form; *Cf. Printing and Numerical Registering Co. v. Sampson* (1875) LR 19 Eq. 462, where Jessel MR articulated the freedom of contract principle as the established orthodoxy.

circular logic of this is illustrated in Fry J's dicta in *Re West of England and South Wales District Bank, ex parte Dale*[7] where he described a fiduciary relationship as:

> 'one in respect of which if a wrong arises, the same remedy exists against the wrongdoer on behalf of the principal as would exist against a trustee on behalf of the *cestui que trust*.'

Later definitions of the concept do not shed more light as to the circumstances which would definitely give rise to a fiduciary relationship. Let us consider, for instance, Millet LJ's influential account of the fiduciary obligation in *Bristol and West Building Society v. Mothew*:[8]

> 'A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary.'

The learned judge did not elaborate on the circumstances giving rise to the fiduciary obligation, beyond what appears to be the established consensus at least with respect to the starting point of the enquiry, namely that the obligation arises from an individual's *own* undertaking to act in the best interests of another.

Nevertheless, the natural next step in the enquiry is to examine the effect of this undertaking. Thus, what appears to be of major significance in the authorities is that the effect of this undertaking is to simultaneously create an ascendancy on the part of the fiduciary and a dependency on the part of the beneficiary of the fiduciary's actions. In fact, some Commonwealth authorities focused on the incidence of an ascendancy and a corresponding dependency as a determining criterion of circumstances giving rise to a fiduciary relationship. Thus, in *International Corona Resources v Lac Minerals*,[9] the Supreme Court of Canada ruled that the defendant was in breach of its fiduciary duty to the plaintiff, when it took advantage of confidential information about a mining

[7] (1879) 11 ChD 772, 778.

[8] [1998] Ch 1, 18.

[9] [1990] FSR 441.

prospect, which the plaintiff divulged in the process of negotiations for a joint venture with the defendant, so as to enable the latter to make an informed decision as to the viability of the prospect. The court's decision was especially influenced by the fact that according to industry custom parties in such circumstances would not be acting to the detriment of each other.[10] Flannigan argues that the court here should have reasoned along the lines of – what he dubs– 'vigilant trust relationship'[11] rather than rely on industry custom, which had been deemed irrelevant in the past.[12] I contend that this would not have been correct on the facts of the case. All Flannigan's references to 'vigilant trust relationships' derive from a sort of agency, in the sense that one party undertakes with the other's consent and expectation to represent the other to the world.[13] The facts of the case simply did not support an agency, however loosely interpreted.[14] To my mind, the significance of the industry custom lies in the fact that the practice effectively took over the parties' imputed adherence to the 'common knowledge of rationality', causing the plaintiff to suspend the vigilance arising from this default position (see 1.3.1). In turn this rendered the plaintiff particularly vulnerable to the defendant's defection from the implied agreement, given that compliance was clearly not an equilibrium strategy, but merely an optimum one along the lines of Gauthier's reasoning. In effect, therefore, the court in *Lac Minerals* simply enforced a constrained maximisation strategy, which had established itself organically within that particular industry, and serves as a prime example of the courts' key role in tackling freeloading.

The High Court of Australia adopted a similar approach in *United Dominions Corporation v. Brian*,[15] only the vulnerability argument was framed in terms of 'trust and confidence'.[16] Here, the parties were commercial, sophisticated and dealing at arm's length, in the sense that they had no other relationship outside of the joint venture

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[10] *Ibid*, 460, per La Forest J.

[11] I.e. a fiduciary relationship arising as a result of socio-legal policy whose purpose is to reduce the costs of mischief by intermediaries who have control of another's property or affairs for a limited purpose, e.g. solicitor-client, employer-employee, partners *inter se*, director-company; R. Flannigan, 'The Fiduciary Obligation' (1989) 9 *OJLS* 285, 286.

[12] Specifically, in the seminal north-American authority *Meinhard v. Salmon* 249 NY 458 (1928).

[13] Flannigan, n.11, 289-295 and 309, with respect to the *Lac Minerals* judgment.

[14] Representation and its role in the definition of the fiduciary position is further discussed below.

[15] n.5; see 3.4.3.

[16] *Ibid*, [6], per Gibbs CJ,.

negotiations for the development of certain properties. Regardless, the court held that the parties were in a fiduciary relationship. The deciding factor was the trust and confidence which the parties had reposed in each other given the advanced stage of negotiations between them. This allowed the court to imply a partnership.[17] In particular, Gibbs CJ drew an analogy between the vulnerability of persons invited to purchase shares in a company by its promoters and that of persons invited to join a partnership: the vulnerability arises from the *information disparity* inherent in both interactions, for the invitee's decision to participate will be to some extent influenced by the information provided by those who invite their participation.[18]

Nevertheless, vulnerability of itself is not the determining factor of a fiduciary relationship. For instance, an archetypal relationship which should give rise to fiduciary duties given one individual's voluntary undertaking and the dependency/vulnerability this creates in another, is that of a doctor and her patient. However, when this point was put to the House of Lords in the context of a surgeon's *deliberate failure* to inform his patient of the risks inherent in a recommended treatment, their Lordships roundly rejected the argument, with Lord Scarman observing in *Sidaway v. The Board of Governors of the Bethlem Hospital and the Maudsley Hospital* that:

> 'there is no comparison to be made between the relationship of doctor and patient with that of a solicitor and client … or the other relationships treated in equity as of a fiduciary character'.[19]

Parenthetically, Sidaway's argument here was based on the idiosyncratic decision of the House of Lords in *Nocton v. Lord Ashburton*[20] (discussed below). The case has muddled in some respects the conceptual foundation of the fiduciary obligation, which normally rests solely on the duty of loyalty. Specifically, *Nocton* suggested that the

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[17] *Ibid*, [6], per Mason, Brennan and Deane JJ.

[18] *Ibid*, per Gibbs CJ, [4], citing the principle in *Venezuela Central Railway v. Kisch* (1867) LR 2 HL 99, 113, per Lord Chelmsford. *Cf.* Lord Romilly's opinion urging the court to treat the relationship between the company and the public as a contract between any two individuals, with the false representations addressed on the basis of fraudulent misrepresentation principles, rather than a contrived fiduciary relationship; *Venezuela Central Railway*, *ibid*, 125.

[19] [1985] AC 871; their Lordships' deferred to the expertise of the surgeon, who – as per the specialised test for negligence previously established in *Bolam v. Friern Hospital Management Committee* [1957] 1 WLR 582– was best placed to determine whether such information was necessary given that its very purpose was to deter the patient from consenting to what the surgeon, in his expertise, regarded as lifesaving treatment; *Sidaway* was mercifully overruled by the Supreme Court in *Montgomery v. Lanarkshire Health Board* [2015] AC 1430.

[20] [1914] AC 932.

duties arising in the context of a fiduciary relationship may go well beyond those identified by Milett LJ above, which conceptually arise from the duty of loyalty alone.[21] In any event, what is striking here is that the ascendancy/dependency argument alone, even in a context as profoundly evocative of vulnerability as that of a doctor being in *de facto* control of another's wellbeing, was an insufficient ground for finding a fiduciary relationship.[22]

To my mind, this affirms Finn's opinion that although vulnerability may feature heavily in ordinary contractual or social interactions, frequently, it will not attract fiduciary status because those relationships are nevertheless regulated through 'a significant array of doctrines (tortious, contractual and equitable), which serve to ensure that neither party takes the pursuit of his own interests beyond acceptable bounds or unduly prejudices the interests of the other'.[23] What appears to be entirely uncontroversial, however, is that where the ascendancy/corresponding dependency pair arises from a person's voluntary undertaking to act in the interests of another, having been previously *granted a power to exercise discretion* in the conduct of that other person's affairs, then a fiduciary relationship unquestionably will be made out. This proposition is founded on the fiduciary's core function as a representative, whose actions can have a legal or practical effect on the person for whom the fiduciary is acting. Thus, in *Guerin v. The Queen*[24] Dickson J observed:

> 'Where by statute, agreement or perhaps by unilateral undertaking, one party has an obligation to act for the benefit of another and that obligation carries with it a discretionary power, the party thus empowered becomes a fiduciary. Equity will then supervise the relationship by holding him to the fiduciary's strict standard of conduct.'[25]

What is important to note here is that the alleged fiduciary has not merely *assumed* a power to exercise discretion in the conduct of another's affairs. Rather they have been

[21] *Bristol and WBS*, n.8.

[22] *Cf. Slater v. Bisett* (1986) 69 ACTR 25 (Supreme Court of Australian Capital Territory), in the context of doctor-patient confidentiality, which should have been tackled through the law on breach of confidence rather than as a breach of fiduciary duty.

[23] P.D. Finn, 'The Fiduciary Principle' in T.G. Youdan (ed.), *Equity, Fiduciaries and Trusts* (Carswell, 1989), 1, 35 (hereafter, 'Finn (1989)').

[24] (1984) 2 SCR 335.

[25] *Ibid*, 384.

empowered to do so by the latter, whether consciously or unconsciously.[26] Relying on the existence of this power to exercise discretion in the conduct of another's affairs as the catalyst for the incidence of a fiduciary relation conceptually accommodates both the proposition that the core of the fiduciary's function is that of a *representative* and the consequent expectation that the purported beneficiary of the fiduciary's actions is *entitled* to the latter's absolute loyalty.[27] I will demonstrate the connections between these propositions on the basis of an implied agreement between fiduciary and beneficiary. In any event, the proposition that the defining criterion of the fiduciary position is the fiduciary's role as a representative, who has been given discretion over another's affairs, is strongly supported in the law.[28]

This is illustrated through such seminal English authorities as *Boardman v. Phipps*[29] and *Regal (Hastings) v. Gulliver*,[30] which, incidentally, reinforced the strict liability associated with a party identified as a fiduciary. In *Boardman*, the later of the two decisions, the appellant was solicitor to a family trust, whose assets included a significant minority shareholding into a struggling textile company with operations in England and Australia. Boardman realised early that the company could be turned around (through consolidating its operations and capital), thus improving the value of the trust's asset, but only if the trust were duly represented on the company's board, which in turn could be achieved through a majority shareholding. On this basis,

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[26] See the examples in L.S. Sealy, 'Fiduciary Relationships' (1962) *CLJ* 69, esp. 78ff, with respect to relationships giving rise to the presumption of undue influence; F. Dowrick, 'The Relationship of Principal and Agent' (1954) 17 *MLR* 24, 36; see also the 'vigilant trust' and 'deferential trust' dichotomy articulated in Flannigan, n.12. *Cf. English v. Dedham Vale Properties*, considered later.

[27]E.g. see the analysis of authorities on conflicts of interest in E.J. Weinrib, 'The Fiduciary Obligation' (1975) 25 *U.T.L.J.* 1 and in J. Gummow, 'Compensation for Breach of Fiduciary Duty' in T.G. Youdan (ed.), *Equity, Fiduciaries and Trusts* (Carswell, 1989), 57.

[28] Examples of some early influential authorities are *Keech v. Sandford* (1726) 25 ER 223 (trustee in control of the minor beneficiary's interest with respect to a lease), *Hichens v. Congreve* (1828) 38 ER 917 (directors in control of company's interests); *Fawcett v. Whitehouse* (1829) 39 ER 51 (partners representing and being in control of each other's interests within the context of the partnership); *Aberdeen Railways v. Blaikie Bros* (1854) 1 Macq 461 (director was conflicted out having allowed the company to contract with a business of which he was managing partner); *Lister v. Stubbs* (1890) 45 ChD 1, (employee in charge of purchasing for claimant firm was conflicted out having received bribes from suppliers); *Aas v. Bowen* [1891] 2 Ch 244 (partner acting on information acquired during partnership business was not in breach of fiduciary duty having used that information to his own profit in the course of a transaction which was unrelated to his firm's business); *Dean v. MacDowell* [1878] 8 Ch 345 (retired partner prohibited from competing with his previous firm); and recently: *FHR European Ventures LLP v. Cedar Capital Partners LLC* [2014] UKSC 45(brokerage firm had to disgorge unauthorised commission paid by the party with whom it brokered a deal for the appellants).

[29] [1967] 2 AC 46.

[30] [1967] 2 AC 134.

Boardman urged the trustees to purchase more shares in the company so as to build up to a majority shareholding. However, it transpired that this would have been *ultra vires* their authority and the trustees were therefore unable to act. Boardman then procured financing along with one of the trustees to purchase more shares personally and to combine that shareholding with that of the trust. Boardman's scheme did go through with the knowledge and consent of the trustees and most, but crucially not all, of the trust's beneficiaries. This triggered a shift in the company's management strategy, which significantly increased the value of the trust-fund, with Boardman and the trustee with whom he had partnered up making a very sizeable profit. The one beneficiary who had been kept out of the loop sued to recover the profit that Boardman had made as a result of the transaction. The House of Lords upheld the decisions of both the courts below that Boardman was compelled to account to the respondent for his share of the profits he had obtained as a result of the scheme.

Crucially, it was not relevant that the trust, and therefore its beneficiaries, could not of itself have benefitted from the opportunity in question. It was also irrelevant that Boardman's actions caused the trust-fund to be significantly increased and that he had clearly acted with both integrity and business acumen.[31] The fact was that, in representing the trust in the negotiations with the company,[32] Boardman had been a fiduciary in relation to the trust and, as such, he had been outright forbidden from obtaining any personal benefit in the course of the conduct of his duties as a fiduciary. Lord Cohen stressed that this was directly correlated to the duty of loyalty and specifically to the duty of a fiduciary to avoid putting themselves in situations, where their own interest conflicts with that of their beneficiary.[33] Lord Cohen observed that given Boardman's capacity as the trust's solicitor, the trustees would be accustomed to relying on his advice. It was difficult to see how that advice would be prioritising the

[31] Dissenting, Viscount Dilhorne in *Boardman*, n.29, 90-91, argued along these lines citing dicta by Bowen LJ in *Aas v. Bowen*, n.28, 257-258, and Cotton LJ in *Dean v. MacDowell*, n.28, 354 to the effect that a partner, who benefits from information which came into his knowledge in his capacity as a partner, should not be liable to account for such benefit, if it came from a transaction which, as in *Boardman*, had been outside the scope of the partnership.

[32] Lord Cohen emphasised that the information with respect to the opportunity to purchase the shares only came to Boardman in his capacity as the trust's representative to the company's board, as the company was private and such information was not publicly available: *Boardman*, n.29, 100-101 and 102-103.

[33] *Ibid*, 103; The no-conflict rule had been first articulated in *Hamilton .v Wright* (1842) 8 ER 357 and later established in *Aberdeen Railway*, n.28, 471, per Lord Cranworth LC.

interests of the trust, when the advisor himself had an interest in the business opportunity he was advising on.[34]

Their Lordships, thus, reiterated the principle they had articulated earlier in *Regal (Hastings) v. Gulliver*, where, similarly to *Boardman*, the four company directors of the appellant company made a profit by purchasing shares, which had originally been intended for Regal. However, the company had no funds and so could not avail itself of the opportunity. As the directors had become aware of the opportunity in their capacity as Regal's directors, the opportunity and any proceeds from it duly belonged to Regal. Accordingly, the directors were held liable for breaching the no-conflict rule. Rejecting Lord Greene MR's argument in the Court of Appeal, their Lordships were keen to emphasise that the directors' honest state of mind was entirely irrelevant and that their liability was established by the mere breach of their no-conflict duty as fiduciaries.[35]

In both of the cases above, the liability arose from the power of discretion inherent in the fiduciaries' function in representing the interests of their respective beneficiaries. Loke argues that reliance on the triptych of power-discretion-vulnerability to determine the existence of a fiduciary relationship is question-begging. He contends that while vulnerability explains the policy motivation behind fiduciary law, it is merely a consequence of exposure to the relationship and it does not help in identifying the interest to be protected or explain why the relationship is fiduciary in the first place.[36] My contention, however, is that, as a starting point, the focus of the enquiry must be on the discretion which may be inherent in the alleged fiduciary's position as a representative. Thus, it is important to distinguish this position from the case where the representative has no discretion over the conduct of their duties, as is the case with many types of employee in relation to the affairs of their employer, such as manual

[34] *Boardman*, *ibid*.

[35] *Regal (Hastings)*, n.30, 154, per Lord Wright, and 158, per Lord Porter.

[36] A.F.H. Loke 'Fiduciary Duties and Implied Duties of Good Faith in Contractual Joint Ventures' (1999) *JBL* 538, 554. See also L.I. Rotman, 'Fiduciary Doctrine: A Concept in Need of Understanding' (1995-1996) *Alta.L.Rev.* 821, 850, who points out that not all positions of power attract fiduciary duties in the sense of acting in another's best interest, a case in point being members of the judiciary. My response to this is that (as demonstrated in 6.3), the scope of fiduciary duties is to be determined by the circumstances in which they arise. Therefore, while a judge may not be expected to act in the best interests of the accused to the same extent as the accused's legal representative, the judge is still expected to safeguard the accused's interests by ensuring that they are subject to due process, which begins with the judge ensuring that they are not conflicted out when hearing the case.

workers or those low in the hierarchy of their employer's organisation.[37] Their function as a representative in that case is limited to the extent that the employee does something within the scope of their job description for which the employer is then vicariously liable in tort.[38] Thus, with the existence of discretion taken as the starting point of the fiduciary enquiry, the vulnerability associated with the legal and practical effect on the beneficiary's interests is to be recognised as the logical consequence of the fiduciary's exercise of this discretion, rather than the source of the fiduciary obligation itself.

The benefit of focusing our enquiry on one person's power to exercise discretion over another's affairs is twofold. First, it provides us with a well-defined criterion through which to conceptualise fiduciary law as the means of regulating the exercise of the fiduciary's discretion, however it arises, or even fettering its scope. Secondly, it enables a clear jurisprudential distinction between fiduciary law and the realms of contract or tort law, which have been significantly interfered with through the courts' rather capricious application of the fiduciary doctrine. The following section will briefly explore this tendency in order to demonstrate that reliance on the court to determine whether a contractual joint venture has either created a fiduciary relationship or has elements thereof, would be neither useful nor conducive to commercial certainty.

6.2.2 Problem 2: pinning down the content of the commercial fiduciary obligation

It will be remembered that the paradox of the commercial fiduciary obligation does not lie in the law's misguided view of what constitutes a vulnerable party (which, as demonstrated earlier, is merely a consequence of the fiduciary relation – not its source) but in the push-pull relationship it has with commercial parties themselves, who will often seek to exclude the obligation altogether only to plead it where they want to access the formidable remedies it unlocks. In this light, answering the fiduciary question accurately is of profound importance, because, if successfully invoked, the doctrine will take over entirely from other relevant doctrines, be they contractual or tortious.[39] This

[37] *Cf. Reading v. Attorney-General* [1951] AC 507.

[38] *Cf.* the case where an employer ends up bound to a third party by the acts of an employee acting with ostensible authority to represent their employer's will, although the enquiry then will include the question of whether, in the circumstances, it was reasonable for the third party to infer authority on the part of the rogue employee.

[39] E.g. see Finn(1989), n.23, 2; and 24ff.

in turn impacts on the type of remedies available to the successful claimant, as well as the evidential process in establishing and recouping loss.

This is because liability for breach of fiduciary duty is strict, namely it arises *automatically* where the fiduciary has breached his obligation of loyalty, their state of mind being entirely irrelevant to the enquiry, which is purely one of fact. Because the wrong lies in the fiduciary's gaining from their position, rather than in actively causing the claimant-beneficiary loss, the remedies available to the successful claimant-beneficiary are restitutionary. This means that the errant fiduciary is expected to disgorge the gain from his actions rather than to make good the claimant's loss (see 5.5.3). Thus, unlike actions in contract and tort, the claimant-beneficiary need not show loss or injury respectively, nor are they burdened with demonstrating mitigation of loss (contract) or absence of contributory negligence (tort) on their part, which would normally impact the size of a (compensatory) award. Consequently, the evidential process and remedial regime associated with actions for breach of fiduciary duty are extremely favourable to the claimant – making actions based on the fiduciary doctrine a prudent litigation strategy in commercial disputes.

In this sense, the fiduciary doctrine is prone to abuse by strategic claimants. Consequently, courts are generally wary of such claims arising in a commercial context and they are notoriously reluctant to identify commercial parties as fiduciaries.[40] Nevertheless, the fiduciary doctrine has been consistently abused in the courts' own attempts to provide sympathetic claimants with remedies, despite relationships between the parties featuring few, or even none, of the characteristics of the fiduciary relation. Worse still, in doing so, they muddle fiduciary law jurisprudence by conflating the fiduciary doctrine with contractual and tortious principles, thus throwing off our understanding of an already nebulous concept. The purpose of the following sections is to demonstrate this problem by examining a series of cases, which illustrate the courts' remedy-driven application of the fiduciary doctrine in individual cases and the wider implications for legal principle and certainty.

[40] Unless there is a straightforward trust involved: *Barclays Bank Ltd. v. Quistclose Investments Ltd.* [1968] UKHL 4; *Cf. Noranda Australia Ltd. v. Lachlan Resources*, 1988 WL 859786 (Westlaw): the parties expressly identified their relationship as fiduciary, but the court significantly limited the scope of the duty to reflect their agreement as a whole; 17, per Bryson J.

6.2.2.1 English v. Dedham Vale Properties

In *English v. Dedham Vale Properties*,[41] the claimant sued the purchaser of a piece of land she sold him seeking, *inter alia*, an account of profits, on the basis that prior to the contract being completed the defendant had, unbeknownst to the claimant, applied for and acquired planning permission in the claimant's name for the development of the land. Here, Slade J relied on dicta by Lord Denning MR in *Phipps v. Boardman*,[42] where he introduced the concept of a 'self-appointed agent' to describe Boardman's actions with respect to the family trust and relied on this description to rule against him for breach of fiduciary duty (as opposed to Boardman's actual role as a solicitor for the trust, who acted for personal profit on information he received in this capacity). Slade J was not convinced by counsel's argument that the mere application for planning permission being made in the plaintiff's name could not give rise to a fiduciary relationship. Thus, he held that the fiduciary relationship arose from the defendant having taken an action with respect to the vendor's property, without the vendor's authority or consent, 'which, if disclosed to the vendor, might reasonably be supposed to be likely to influence him in deciding whether or not to conclude the contract'.[43] By failing to disclose the application for, and grant of, planning permission the defendant was accordingly in breach of fiduciary duty and was therefore liable to account to the plaintiff for any profits he had made as a result.

English, which remains good law, stretches the limits of the fiduciary doctrine in that it completely disregards the fact that for an agency to subsist the person represented must have at least consented to being represented or have positively empowered the representor to act on their behalf.[44] Even Lord Denning's highly controversial 'self-appointed agents' in *Phipps v. Boardman* were, on the facts, acting with the knowledge and, arguably, implied consent of the majority of the trustees and beneficiaries, given the defendants' pre-existing *fiduciary* relationship with the family trust.[45] Thus, an

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[41] [1978] 1 WLR 93.

[42] [1965] Ch 992, CA, 1017.

[43] [1978] 1 WLR 93, 111.

[44] McMeel refers to these views of agency as the 'consensual' and 'power-liability models' respectively: G. McMeel, 'The Philosophical Foundations of law of Agency (2000) 116 *LQR* 387, arguing that the ostensibly competing models of agency are in fact complementary.

[45] Which is why Lord Denning's argument should have been heavily qualified and expressed along the lines of an unauthorised exercise of power rather than an entirely new type of agency.

agency does not arise when someone claims they are acting on behalf of an alleged principal,[46] but rather when the alleged principal has held this person out to be acting as their representative.[47] On this basis, where a principal has expressly granted another the power to represent the principal's interests to the world, it is trite that the principal will be bound in contract, or in tort,[48] to honour dealings with third parties which the agent has concluded on the principal's behalf. However, the pivotal role of the purported principal's actions on the operation and effect of an agency relationship is further emphasised where the enquiry into the principal's liability for the agent's actions requires us to consider the extent of the agent's authority, whether the latter's actions have in any way exceeded it and, perhaps more importantly, how the agent's authority appears to the world. It is the principal's, rather than the agent's, actions that determine the answer to all three questions and will ultimately determine whether the principal is in fact legally bound by the agent's conduct. A principal's liability for actions, which an agent has committed outside of the authority conferred by the principal, will flow from an estoppel, namely:

> 'where a principal, by words or conduct, has represented that the agent has the requisite actual authority, and the party dealing with the agent has entered into a contract with him in reliance on the representation. The principal in these circumstances is estopped from denying that actual authority existed.'[49]

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[46] *Freeman & Lockyer v. Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, esp. 505, per Diplock LJ; Note also *Hely-Hutchinson v. Brayhead Ltd* [1968] 1 QB 549, 583, per Lord Denning MR, who pointed out that the agent 'himself may do "the holding-out"' as to the extent of his authority. However, I submit that this must be read in context of the rest of the judgment, to the effect that for the agent's own holding-out to be binding on the principal, the latter must have held the agent out as being in a position, which is generally understood to carry the relevant authority (e.g. managing director of a company). This interpretation is in line with the Court of Appeal's approach later in *First Energy (UK) Ltd. v. Hungarian International Bank Ltd* [1993] BCC 533; *Cf.* McMeel, n.44, 403.

[47] Indicatively, see: *Farquharson Brothers & Co v. C. King & Co* [1902] AC 325; *Freeman & Lockyer*, *ibid*; *Armagas Ltd v. Mundogas SA (The Ocean Frost)* [1986] AC 717; *First Energy (UK) Ltd. v. Hungarian International Bank Ltd*, *ibid*; *Kelly v. Fraser* [2013] 1 AC 450.

[48] By operation of the vicarious liability doctrine, where the agent has acted within the scope of his authority: *Lloyd (Pauper) v. Grace, Smith & Co.* [1912] AC 716 (firm vicariously liable for their agent's fraud committed in the course of his employment); *Kooragang Investments Pty v. Richardson & Wrench* [1982] AC 462 (the defendant estate agents were not liable for their employee's negligence, when preparing valuations of properties, which he had been expressly forbidden from doing and was therefore acting outside the course of his employment); *Various Claimants v. Institute of the Brothers of the Christian Schools* [2012] UKSC 56 (the defendant religious order were vicariously liable for the sexual abuse by brother teachers at a residential school for boys, even though the school was not managed by the defendants); *Cox v. Ministry of Justice* [2016] UKSC 10 (vicarious liability may also arise, where the tortfeasor's actions are in furtherance of the defendant's interests – an employment relationship is not essential).

[49] *The Ocean Frost*, n.47, 777, per Lord Keith of Kinkel.

To be sure, the estoppel's operation here is heavily qualified. Thus, as per Lord Keith's dicta above, the party claiming against the principal must have both relied on the principal's representation and acted to their detriment as a result.[50] Furthermore, where it is known to the claimant that the agent they are dealing with has limited authority in certain respects, the claimant will not be able to rely on the principal's representations to the contrary.[51] Similarly, the agent's actions must have been within the ambit of the general authority conferred to an agent in a similar position.[52] Thus, a particularly unusual transaction will be unlikely to fall within an agent's apparent authority and the claimant will be expected to have made enquiries as to the extent of the agent's actual authority.[53]

It is clear therefore that the driving force behind the agency relationship flows from the principal's actions. In *English*, there was simply no such initiative on the part of the plaintiff, who knew nothing of the defendant's actions aside from his part in the sale negotiations with regard to her property. Therefore, there was no agency in *English* because there was no indication that the plaintiff ever intended for there to be one. In effect, Slade J cherry-picked the parts of the fiduciary doctrine which most favoured the claimant, ignoring its operative elements, at the expense of legal principle and certainty.

6.2.2.2 Nocton v. Lord Ashburton

In *Nocton v. Lord Ashburton*[54] the appellant solicitor had advised the respondent client to lend a large sum to a property venture, in which the solicitor had a personal interest (with his client's knowledge), on the security of the property in question. Thus, the respondent was to take on a loan at a preferential interest rate and, in turn, loan the advance to the venture, but at a higher interest rate. The interest from the mortgage

[50] See e.g. *Rama Corp Ltd. v. Proved Tin & General Investments Ltd* [1952] 2 QB 147, where Slade J held that the claimant could not rely on *ex post* knowledge of the defendant's power to confer authority on its agent (arguing along the lines of constructive notice) in order to establish *ex ante* apparent authority for the purposes of its claim.

[51] *Russo-Chinese Bank v. Li Yau Sam* [1910] AC 174.

[52] See, e.g. *Freeman & Lockyer*, n.47, 494, per Wilmer LJ.

[53] E.g. *Houghton v. Nothard, Lowe and Wills Limited* [1927] 1 KB 246, (the managing director of two separate companies pledged the revenues of both as security for a loan advanced to only one of them); *Frederick v. Positive Solutions (Financial Services) Ltd* [2018] EWCA Civ. 431 (respondent was not liable for their agent's fraud, committed while 'moonlighting' through an online portal which was unrelated to the respondent's business).

[54] [1914] AC 932.

payments would then serve to offset the payment on the original loan. Some years later the appellant advised his client to release part of the security on the mortgage, so that the solicitor could raise funds on the property as a first charge (again, with the respondent's knowledge). The result was to significantly reduce the amount the respondent held as security against the original mortgage. When the first expected mortgage payments from the venture fell into arrears, the respondent suffered significant losses, as he was liable to keep up interest payments on the original loan. Thus, the respondent sued on the ground that the appellant had acted fraudulently and to his own interest when he advised the respondent. At first instance, and treating the action as one of deceit, Neville J applied the rule in *Derry v. Peek*,[55] which requires proof of fraudulent intention, ruling that while the solicitor fell short of the standard of care required of a person in his position, there had been no evidence that he had in fact acted fraudulently. Overturning the decision of the Court of Appeal, the House of Lords agreed with Neville J's judgment on the issue of fraud, but went further to establish that, while it was not possible to substitute an action based on deceit with one based on negligence, the judge still should have recognised that the appellant was in a special relationship to the respondent, a fiduciary one, which gave rise to a duty to exercise care in giving information or advice. Viscount Haldane went on to say that the case before the court:

> 'was really an action based on the executive jurisdiction of a Court of Equity over a defendant in a fiduciary position in respect of matters which at law would also have given a right to damages for negligence'.[56]

In other words, the House of Lords in *Nocton* ruled against the appellant on the basis that he had been rash and negligent in his conduct of his duty as a *fiduciary*, which required that he exercised care and skill in the provision of his professional advice.[57] Thus, their Lordships treated the cause of action in *Nocton* as a straightforward action in negligence which arose incidentally from the appellant's fiduciary capacity as a solicitor. Accordingly, they went on to make the first ever award of equitable damages, requiring the appellant to restore to the mortgage security the amount the respondent

[55] (1889) 14 App Cas 337.

[56] *Nocton*, n.54, 957.

[57] *Ibid*, 958.

lost, as well as make good the corresponding amount of interest lost, due to the appellant's actions.

The House of Lords in *Nocton* used the appellant's fiduciary capacity as a springboard for the court's equitable intervention in a case where the respondent would otherwise obtain no remedy, given that negligence had not been pleaded on his behalf and fraud could not be made out on the facts. However, their Lordships' fast and loose treatment of the content of the fiduciary obligation has far-reaching consequences for our understanding and application of the fiduciary concept.

Following *Nocton*, the breach of a *professional* duty of care and skill by a person in a fiduciary role may well be treated as a breach of *fiduciary* duty, as Lord Browne-Wilkinson indicated in *White v. Jones.*[58] Here, a solicitor who had negligently failed to execute a will in time for his client's death owed a duty of care to the intended beneficiaries of the will, who had been disinherited by the deceased in a prior will. His Lordship relied squarely on *Nocton* declaring that:

> 'there can be special relationships between the parties which give rise to the law treating the defendant as having assumed a duty to be careful in circumstances where, apart from such relationship, no duty of care would exist … a fiduciary relationship is one of those special relationships.'[59]

To be sure, both *Nocton* and *Jones* can and should, in my opinion, be interpreted as merely using the defendant's fiduciary status as the source of a duty of care, which is necessary to found a claim in negligence.[60] However, as there is no relevant qualification in either judgment, both cases could be treated as an indication that an action for professional negligence in tort may well be substituted with an action for breach of fiduciary duty, simply because the associated evidential process and remedies are more favourable to the claimant.

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[58] [1995] 2 AC 207.

[59] *Ibid*, 271.

[60] E.g. along the lines of a trustee managing investments of the beneficiaries' trust-fund, who has been held to be subject to a duty of reasonable care, namely the care expected of an ordinary prudent man of business with respect to his own affairs: *Bartlett v. Barclays Bank Trust Co.* [1980] Ch 515, 531-532, per Brightman J.

If cases like *Mahoney v. Purnell*[61] are any indication, this is more than just an unfounded fear. Here, the plaintiff had been pressured by his defendant son-in-law to sell his shares in the family company, which ran a hotel business. The defendant later sold the hotel for a considerably higher price than that reflected in the amount the plaintiff sold his shares for. The plaintiff sued for rescission of the share sale agreement claiming that he had been unduly influenced by the defendant, but, before trial, the company went into liquidation. The court held that the relationship between the parties, was based on trust and therefore could be described as fiduciary. Accordingly, because the company was in liquidation and the defendant had not personally profited from the sale of the plaintiff's shares, the plaintiff had no remedy other than equitable compensation to which he was entitled as a consequence of his alleged fiduciary relationship with the defendant. Thus, along the lines of *Nocton*, he was awarded an amount equal to the true value of the shares at the time of their sale.

I contend that the court here was rather flippant with its use of the fiduciary label, given that there was no indication that the defendant had in fact any control or discretion in the conduct of the plaintiff's affairs beyond the fact that the plaintiff tended to defer to the defendant's judgment with respect to the operation of the business (e.g. regarding its incorporation from a partnership some years before). Furthermore, with regard to the sale of his shares, it was the plaintiff who, needing cash, initiated the transaction with the defendant and negotiated the price with him and the company's accountant based on what the company could afford at the time. On May J's analysis, the case was in fact one which fell squarely into the realm of undue influence, the relevant presumption arising from the fact that the relationship between plaintiff and defendant had been one of trust and confidence and the impugned transaction had been particularly onerous for the plaintiff.[62] Nevertheless, May J acknowledged that the normal remedies for undue influence (namely setting the impugned transaction aside and ordering an account of the profits gained from it) would not bring about 'practical justice' given that in the circumstances it was impossible to place the parties into their original position. Consequently, he established a basis for an award of equitable

[61] [1997] 1 FLR 612.

[62] Note the criteria giving rise to the presumption of undue influence in *Barclays Bank v. O'Brien* [1994] 1 AC 180 (referred to in May J's judgment) and, later, in *Royal Bank of Scotland v. Etridge* [2001] UKHL 44, which established that along with the trust and confidence, the impugned transaction must not be readily explicable on the relationship of the parties.

compensation by shrewdly identifying the defendant as fiduciary,[63] even though there was little in the facts to justify this.

6.2.2.3 Chase Manhattan Bank v. Israel-British Bank

The previous sections demonstrated that the remedies available to a successful claimant-beneficiary following an action for breach of fiduciary duty are considerably more expansive than those available pursuant to other (legal) doctrines. This is because the remedies arising from breach of the fiduciary obligation, an archetypical equitable doctrine, are by necessity equitable. It will be remembered that the equitable jurisdiction evolved in its flexibility as a response to the common law's rigidity, so that the resulting evidential and remedial regime was far more permissive than its legal counterparts. It should be no surprise then that equity's approach is equally flexible with respect to the tracing of assets for the purpose of their recovery. Incidentally, tracing is not itself a remedy or a claim, a point that the House of Lords drove home in *Foskett v. McKeown*.[64] Instead, tracing is:

> 'merely the process by which a claimant demonstrates what has happened to his property, identifies its proceeds and the persons who have handled or received them and justifies his claim that the proceeds can properly be regarded as representing his property'.[65]

Crucially, the rules of tracing are understood to be different in equity and common law, equity providing the more permissive regime.[66] Specifically, under the common law rules a claimant may trace their asset into the hands of another or into the proceeds of its sale. However, the buck stops once the asset has been mixed with something else so that it is no longer identifiable as the original asset, e.g. wood chips being mixed with resin to make chipboard.[67] The same reasoning applies where the proceeds of its sale

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[63] [1997] 1 FLR 612, 642.

[64] [2001] 1 AC 102; I use the term 'tracing' to encompass both 'tracing' (tracking an asset into a substitute asset or the proceeds of its sale) and 'following' (tracking the same asset as it changes hands); the two terms were defined *ibid*, 119, per Lord Millet.

[65] *Ibid,*120, per Lord Millet.

[66] Their Lordships in *Foskett v. McKeown* were very dismissive of this distinction, though their comments were obiter; *ibid*, 128, per Lord Millet and 113, per Lord Steyn.

[67] *Borden (UK) Limited v Scottish Timber Products Limited* [1981] Ch 25; The claimant's ability to identify their asset is key in its retrieval: see *Clough Mill Limited v. Martin* [1984] 2 All ER 152, (Yarn sold to insolvent buyer could be identified as the original asset and retrieved on the basis of a retention of title clause); *Re Peachdart Limited* [1984] Ch 131, (leather used in the manufacture of various leather goods could in theory be traced into the substitute goods or the proceeds of their sale); *Hendy Lennox (Industrial Engines) Limited v. Grahame Puttick Limited* [1984] 1 WLR 485, (diesel engines which could

have been mixed with other funds, so that it is not possible to make the connection between those proceeds and the original asset.[68] If the claimant cannot identify the asset they want to recover or its substitute, then they cannot assert a claim against it, which, if successful, would give the claimant a proprietary right over the asset in question. In the absence of a claim against specific property (e.g. through an action in money had and received or for tortious interference with goods, when the action is for recovery of a specific chattel), the claimant is only left with a debt to enforce against the defendant. This, however, is of little use where the defendant is insolvent, as the claimant is then an unsecured creditor entitled to share *pari passu* with other unsecured creditors[69] in whatever is left of the defendant's assets once the secured creditors (i.e. fixed charge holders), the expenses of liquidation and various preferential creditors[70] have been paid. In contrast, where a claimant can demonstrate a fiduciary relationship with the defendant,[71] equity allows the claimant to trace their asset into its substitute, as well as through mixed funds, thus establishing a beneficial interest in the asset or its substitute, which is then kept separately from the assets available to a liquidator to discharge the defendant's liabilities to its creditors.[72]

It is unsurprising, therefore, that claimants attempt frequently, and with various degrees of success, to apply the fiduciary label onto otherwise arm's length relationships in

be identified by their serial numbers could be retrieved by the plaintiff and did not form part of the assets available to the liquidator); *Cf. Indian Oil Corpn Ltd v Greenstone Shipping SA* [1988] QB 345 (oil wrongfully mixed with existing oil in a tanker by the ship's master was held on trust for the plaintiff) and *Re Oatway* [1903] 2 Ch 356 (where a trustee mixes trust-funds with his own, the beneficiaries are entitled to the whole).

[68] *Banque Belge Pour L'Etranger v. Hambrouck* [1921] 1 KB 321 (tracing of embezzled funds was possible through substantially empty bank accounts); Cf. *Agip (Africa) Ltd v Jackson* [1991] Ch 547 (funds cannot be traced in common law if mixed with other funds or where they have been through the banking clearing system: *ibid*, 566, per Fox LJ).

[69] The *pari passu* principle is reflected in s.107 Insolvency Act 1986 (voluntary liquidation), r.14.12 Insolvency (England and Wales) Rules 2016/1024 (compulsory liquidation) and s.328 Insolvency Act 1986 (bankruptcy); see also *British Eagle International Airlines Ltd. v. Compagnie Nationale Air France* [1975] 1 WLR 758, where the House of Lords rejected a contractual arrangement whose effect was to defeat the statutory *pari passu* requirement; see also the discussion of the law in *Perpetual Trustee Co Ltd. v. BNY Corporate Trustee Services Ltd* [2009] EWCA Civ 1160.

[70] Set out in ss.175, 176A, s.176(3) Insolvency Act 1986 and defined in s.386.

[71] *Re Hallett's Estate* (1879) 13 ChD 696; *Sinclair v Brougham* [1914] AC 398; *In Re Diplock a.k.a. Ministry of Health v. Simpson* [1951] AC 251.

[72] See *Re Hallett's Estate*, *ibid*, which originally established that the claimant's remedy in such circumstances was equitable lien. The principle was later extended in *Foskett v. McKeown*, n.64, to the effect that a claimant may choose to assert either an equitable lien or a constructive trust over the mixed fund, thus founding a claim over any new asset acquired through the mixed fund to the proportion of the claimant's own contribution to the acquisition.

order to trigger the equitable rules of tracing.[73] A case in point is *Chase Manhattan Bank v. Israel–British Bank*.[74] Here, the plaintiff bank made a payment into a bank account held at the defendant bank and due to a clerical error made a second payment into the same bank account. Shortly after that, the defendant bank became insolvent and went into liquidation. Goulding J relied on the House of Lords decisions in *Sinclair v. Brougham*[75] and *In Re Diplock*[76] to hold that the defendant had been in a fiduciary position in relation to the plaintiff and therefore held the mistaken payment on trust. Specifically, on the basis of *Sinclair*, he argued that the fiduciary relationship was a result of the defendant's mere receipt of the mistaken payment, the defendant becoming a trustee of the funds for the plaintiff from the moment of receipt.[77] Accordingly, the plaintiff was entitled to trace the mistaken payment into mixed funds held by the defendant and the assets acquired through them so as to support a claim in restitution.

At this point, it is worth considering the circumstances in *Sinclair* that appear to give support to Goulding J's reasoning. Briefly, the case concerned a building society, which had operated a banking business for a number of years and which, it later transpired, had been *ultra vires* its objects. Regardless, in that time it had amassed deposits of some £10 million. The deposits had been wrongfully mixed with the building society's general assets. The building society later became insolvent and was wound up, raising the question of where the depositors ranked in relation to the society's shareholders, given that after settlements paid to certain priority creditors, the assets available were insufficient to cover the society's liabilities to both the depositors and its shareholders. The House of Lords held that a common law claim for money had and received could not stand, as the shareholders' and depositors' funds had been mixed and could not

[73] This tendency is particularly prominent in the context of retention of title clauses: e.g. see *Aluminium Industrie Vaassen BV v. Romalpa Aluminium Ltd* [1976] 1 WLR 676 (bailment effectively identified as agency); *Borden (UK) v. Scottish Timber Products* [1979] 2 Lloyd's Rep. 168 (bailment identified as a fiduciary relationship – reversed on appeal: [1981] Ch 25), *Re BA Peters Plc (In Administration)* [2008] EWHC 2205 (dealership agreement identified as an agency despite express provision to the contrary); *Cf. Re Andrabell* [1984] 3 All E.R. 407 (no fiduciary relationship arose in the absence of a duty on the subsequently insolvent buyer to account to the seller for any sale proceeds on goods which were the subject of a retention of title clause), *Re Goldcorp Exchange* [1995] 1 AC 74 (the customers of an insolvent gold trader, from whom they had purchased gold bullion and with whom the bullion was stored on the understanding that it could be claimed on demand, were not in a fiduciary relationship with the insolvent trader and therefore did not take priority over the holder of a fixed charge – a simple breach of contract did not give rise to a fiduciary relationship).

[74] [1981] 1 Ch 105.

[75] n.71.

[76] *Ibid*.

[77] n.74, 119.

therefore be identified or traced, so as to provide the evidential basis for their respective claims. Nonetheless, the majority went on to hold[78] that the shareholders and depositors were entitled in equity to share in the mixed fund on a *pari passu* basis. Thus, on the one hand, the shareholders were entitled to assert a claim against the fund on the basis of their fiduciary relationship with the building society's directors, who had misappropriated their assets in the ultra vires undertaking. But on the other hand, the depositors were entitled to trace their money into the mixed fund on the basis that it had been obtained by the building society illegally – no pre-existing fiduciary relationship was necessary.[79] Specifically, their Lordships reasoned along the lines of unjust enrichment, in the sense that, as Lord Mansfield put it in *Moses v. MacFerlan*,[80] 'the defendant, upon the circumstances of the case, [was] obliged by the ties of natural justice and equity to refund the money'.[81] On this basis, Viscount Haldane LC held that the depositors' funds had been the subject of an 'inactive' resulting trust, which was sufficient to support the court's exercise of its equitable jurisdiction to allow the depositors to trace their money into the mixed fund.[82] The practical consequence of this ratio, however, was to ostensibly do away with the requirement for a pre-existing fiduciary relationship, before a claimant could seek a proprietary remedy claim against the defendant for breach of fiduciary duty.[83]

When the House of Lords was faced again with the question of a mistaken payment in *Re Diplock*,[84] they did not directly contradict this reasoning, for the facts in this case did support a fiduciary finding. Here, the executors of a large estate were challenged by the testator's estranged next of kin, who emerged after the estate had mostly been distributed, albeit according to the wishes of the testator. Their Lordships held that the executors owed, and were in breach of, a fiduciary duty to both the estate and its

[78] Lord Dunedin dissenting on the manner of risk apportionment being of the view that the parties should share in proportion to their respective contributions to the fund; *Sinclair*, n.71, 438.

[79] *Ibid*, 420, per Viscount Haldane LC.

[80] (1760) 2 Burr. 1005.

[81] *Ibid*, 1012.

[82] *Sinclair*, n.71, 421.

[83] Millet J applied the same rationale in *El-Ajou v. Dollar Land Holdings Plc (No.1)* [1993] 3 All ER 717 (approved on this point by the Court of Appeal: [1994] 2 All E.R. 685) where the claimant could trace its funds into the hands of the defendant company, on the basis of a resulting trust which arose immediately when the claimant's fraudulent investment manager invested it into the defendant. The trust arose straightforwardly from the claimant's relationship with the fraudulent agent.

[84] *Re Diplock*, n.71.

beneficiaries, who were therefore entitled to trace the wrongly distributed funds into the hands of the recipient charities. The analysis in *Re Diplock* was approved later in *Westdeutsche Landesbank Girozentrale v. Islington LBC*,[85] where the House of Lords stoutly rejected the ratio in *Sinclair* to the extent that it supported a resulting trust arising automatically from a mistakenly or illegally obtained payment. Specifically, Lord Browne-Wilkinson stressed that while a trust may well arise where a third party innocently acquires property which is subject to a claimant's equitable interest, this will occur not at the time of the third party's receipt of the property but at the time when the latter has become aware of the claimant's interest. His Lordship emphasised that the key criterion giving rise to the trust, was the purported trustee's *knowledge* of the fact that they are in possession of what is in effect trust property.[86] This analysis, he argued, complied with the fundamental principle of trust law, namely that for the law to intervene

> 'the conscience of the trustee is affected. Unless and until the trustee is aware of the factors which give rise to the supposed trust, there is nothing which can affect his conscience'.[87]

The effect of *Westdeutsche Landesbank* was to rein in the circumstances in which claimants could be awarded restitutionary remedies with respect to funds which have been mixed with those of a third party by mistake or fraud. It is important for the claimant to demonstrate a fiduciary relationship with the defendant, which may have been pre-existing or the consequence of an implied trust, arising as soon as the defendant becomes aware that they are in possession of what is in effect trust property.[88]

The discussion of how the law on resulting trusts evolved to this point should illustrate the dangers inherent in the malleability of the fiduciary concept. Indeed, the state of the fiduciary doctrine perpetuates the paradox of courts both rejecting the doctrine, where the relationship is ostensibly an 'arm's length' one, and openly resorting to it, where

[85] [1996] AC 669, 707, per Lord Browne-Wilkinson.

[86] *Ibid*, 709.

[87] *Ibid*.

[88] Where the funds have been acquired through deceit, then the court will be more permissive in its application of the tracing rules, e.g. potentially even allowing 'backward tracing', including tracing into overdrawn accounts (see *Brazil v. Durant International Corp* [2016] AC 297), while the remedies available to the claimant can be far more stringent, such as including an award of compound interest: *Target Holdings Ltd. v. Redferns* [1996] AC 421; *AIB Group (UK) Plc. v. Mark Redler & Co Solicitors* [2015] AC 1503).

they simply wish for claimants to recover property from unscrupulous defendants, regardless of whether key features of the fiduciary relation are missing. Thus, cases as disparate as *English*, *Nocton* and *Chase Manhattan* are a reminder that courts may well abuse the fiduciary doctrine to ensure that swindled claimants get a meaningful remedy, usually by being able to trace their property into new assets, products or mixed funds in the hands of the defendant or third parties. In other words, the slippery nature of the fiduciary doctrine allows courts to apply it as a one-off band-aid, rather than a coherently applied preventative measure regulating the conduct of those who are empowered to exercise discretion in relation to the legal and/or financial affairs of another. In the following sections I will show that my methodology provides a principle whereupon many of the aberrations in the commercial application of the fiduciary doctrine can be explained rationally.

6.3 The fiduciary obligation as a response to the powerful freeloader: default duties, content, and extent.

The problems associated with the fluidity of the fiduciary doctrine, as developed briefly above, are even more pronounced when considered in light of the fact that the fiduciary obligation not only represents the most demanding standard of conduct in private law, but it operates on a strict liability basis and, for a successful claimant, unlocks the most permissive remedial regime possible in common law. Therefore, given the state of the fiduciary doctrine, why would rational parties, who choose to cooperate through a contractual joint venture, voluntarily submit to an extra-contractual duty of good faith that carries all the weight and unpredictability of the fiduciary doctrine, as is the crux of this thesis? Put differently, how does choosing conduct-constraining defaults in the form of fiduciary duties reflect the highest utility strategy for constrained maximisers who have chosen to cooperate? The purpose of this section is to discuss how the fiduciary doctrine maps onto Gauthier's conception of rational collaborative bargaining, as well as what this means in terms of the ensuing duties' operation and extent.

6.3.1 The fiduciary doctrine in light of rational bargaining

I contend that there are significant parallels between the fiduciary doctrine in a commercial context and Gauthier's contractarian morality. Identifying these parallels

will not only help rationalise the commercial fiduciary obligation,[89] but will also effectively address the gap in Gauthier's conception of rational bargaining, namely the problem of the powerful freeloader. Thus, the parallels between the two frameworks are twofold. First, on a practical level, they both concern – what is ultimately self-imposed – constraints on utility maximising conduct. Secondly, on a conceptual level, they are both the product of an overarching welfarist ideology, to the effect that the conduct constraints they articulate are fundamentally other-regarding, namely they consist of the duty to give effect to interests other than the rational agent's self-interest. I will discuss each of these propositions in turn.

As regards the first proposition, i.e. that both frameworks are concerned with self-imposed conduct constraints, I contend that this is directly so in the case of Gauthier's methodology, whereas it is indirect with respect to the commercial fiduciary obligation. Thus, according to Gauthier, classically defined utility maximisers who have chosen to collaborate, must necessarily choose to constrain the pursuit of their interest in the short-term, so as to preserve and maximise their self-interest overall. The extent to which Gauthier's constrained maximisers are to sacrifice their self-interest is then determined by the minimax relative concession. Correspondingly, the fiduciary doctrine is concerned with regulating the conduct of those, who have *chosen* to act in the interests of another and, in return, have been empowered by the latter to exercise discretion with respect to the conduct of the latter's affairs. The fiduciary obligation, then, at least in the commercial context, may well be described as an exchange of linked undertakings – not just on the part of the fiduciary (see 6.2) but also on the part of the beneficiary, who must first empower the fiduciary to act for them (see, e.g., 6.2.2.1).

In this light, I contend that it is imperative to imply an agreement into the exchange to the effect that the fiduciary will not act in a way that would adversely affect the interests of their charge. Why is this so? In the absence of the implied agreement, the beneficiary, presumed to be an agent equally rational to the fiduciary (and therefore presumed to

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[89] This qualification is important. Gauthier's theory of morals operates only in the context of bargaining. Bargaining is the quintessence of commercial/economic activity and therefore the mechanics of Gauthier's theory of bargaining are on all fours with standard commercial practice. However, Gauthier's morality on its own tenets cannot operate outside of the bargain (see *1.3.2*). Therefore, the justification of the fiduciary doctrine based on an implied agreement between fiduciary and beneficiary, which I develop below, cannot work with respect to individuals who do not have the capacity to bargain for themselves, e.g. minors or other legally incapacitated persons. In other words, outside of the commercial realm, the fiduciary doctrine's protection of those who cannot bargain cannot be justified through Gauthier's methodology.

operate on the common knowledge of rationality), would not have granted such power to the fiduciary in the first place. This is because the risk to the beneficiary's self-interest, whether short or long-term, would be too high if it were left in the hands of another maximiser, who is not so constrained. In response to this agreement, the fiduciary doctrine may then be described as the institutional framework fleshing out and giving legal effect to its terms. I submit that, in light of this implied agreement, the fiduciary doctrine fits in seamlessly with Gauthier's approach to rational bargaining.

At this point, I should clarify that I am not concerned here with the question of whether the fiduciary obligation is philosophically autonomous[90] or simply an alternative iteration of a classic contractual duty[91] or whether it is merely legal shorthand for a gap-filling exercise by the courts, as they address the high transaction costs associated with apportioning liability for economic activity which adversely impacts social welfare.[92] My focus here is that the fiduciary doctrine, at least in the *commercial* sense, is inherently driven by the autonomous, parallel actions of both fiduciary and beneficiary, who must be presumed to be rational. To be sure, this vaguely contractarian view[93] of the fiduciary doctrine is not supported in the case of a fiduciary identified as such in the wake of a resulting trust, as expressed in *Westdeutche Landesbank* (see *6.2.2.3*). This type of trust is institutional (i.e. triggered by the court rather than the parties'

[90] See, D.A. Demott 'Beyond Metaphor: An Analysis of Fiduciary Obligation' (1988) *Duke L.J.* 879.

[91] As advocated in F.H. Easterbrook and D. Fischel 'Contract and Fiduciary Duty' (1993) 36 *J. Law Econ* 425.

[92] A viewpoint first set out in R. Coase, 'The Problem of Social Cost' (1960) 3 *J. Law Econ* 1 and expanded upon in Easterbrook and Fischel, *ibid*, as well as R. Cooter and B.J. Freedman 'The Fiduciary Relationship: its Economic Character and Legal Consequences' (1991) 66 *N.Y.U.L.Rev.* 1045.

[93] Briefly, my contention is that a purely contractual analysis of the fiduciary doctrine, as per the economic analysis of the authors cited in n.92, is plainly inappropriate. The benefit of a contractual analysis lies in its appreciation of the parties as autonomous agents and their intentions in the exchange of implied promises. However, this is where the buck stops. There is no *quid pro quo* in the fiduciary relation, which is the very essence of a contract. To be sure, a fiduciary is more likely to be a professional (almost invariably, an agent of some description) acting for the beneficiary for a fee, and in that respect the fiduciary is *also* in a contractual relationship with the beneficiary. However, the fiduciary's capacity *qua* fiduciary lies in their power to exercise discretion over the affairs of the beneficiary, which automatically precludes the fiduciary relation from being a classically understood 'contract'. It will be remembered that in contract law, a contract is defined as a bargain among equals; an exchange of promises, with the agreed consideration reflecting the value the parties have attributed to these promises. If one of the parties empowers the other to exercise discretion in their conduct of the yielding party's affairs, the relationship by definition stops being equal – the power dynamic shifts automatically onto the party with power over the other – and no manner of consideration could reflect the value of the yielding party's very autonomy. Thus, contractual analysis offers a familiar and well-worn path toward understanding the mechanics of the fiduciary relation but in no way should it be the last word in shaping the doctrine itself, because the nature of the fiduciary relation is simply alien to classical contract's founding tenet: a rational agent will only ever yield part of their factor endowment in exchange for something (*the law presumes*) of equal value.

express or implied intentions)[94] and, following *Westdeutche Landesbank*, arises automatically once the person, who has received the claimant's asset in error, becomes aware of holding the claimant's property. Its purpose, in other words, is to correct a technicality, an error on the part of the claimant, where the circumstances so justify. This is not to say that the parties' intention, or – more aptly – absence thereof, with respect to the claimant's property is not conceptually relevant to the operation of the resulting trust and the fiduciary conception in that specific context. If anything, the resulting trust is conceptually the exact inverse of both express and constructive trusts, given that it operates on the *absence* of an intention for there to be a transfer of the legal title to (what is effectively) the trustee and in the *absence* of a relationship of any type (let alone the oft-cited 'trust and confidence') with the claimant. Therefore, putting the 'fiduciary' under a resulting trust on par with the fiduciary in an express or constructive trust, would be both inaccurate and damaging to our understanding of the fiduciary concept. To my mind, the resulting trust is an easily digestible and effective judicial manoeuvre, which borrows the mechanism of title separation from classic trust jurisprudence so as to justify the use of a restitutionary remedy in cases of unjust enrichment. In this light, the resulting trust should be regarded as a standalone route to a restitutionary remedy, separate from general trusts jurisprudence, so as to avoid further compromising the operational integrity of the fiduciary concept.

The second parallel between Gauthier's contractarian morality and the fiduciary doctrine lies in the underlying ideology driving the conduct constraints. Thus, according to Gauthier, a rational economic agent must accept that actively constraining their pursuit of their short-term self-interest, so as to allow a similarly disposed agent to achieve their own ends under the bargain, is a necessary requirement for successful collaboration, which in turn is the only effective response to market externalities. Externalities, it will be remembered, are the perceived cause of our failure to develop a reliable compass for human interaction based on the market mechanism, which operates on a classic model of supply and demand, free from extraneous influences. It should go without saying that, in addition to being self-imposed, Gauthier's conduct constraints are by definition other-regarding, and therefore they amount to moral duties. Thus, according to Gauthier, being moral is a rational agent's ultimate utility maximising

[94] *Cf*. W. Swadling 'The Fiction of the Constructive Trust' (2011) *C.L.P.* 399, who rejects any such distinction and argues that the constructive trust is merely a portmanteau for a certain type of money order.

response to an unpredictable world ruled by externalities, because it is conducive to creating a predilection for successful collaboration (most of the time).

The ideological underpinnings of the fiduciary doctrine are strikingly similar to those which Gauthier sought to instil in his constrained maximisers. The common ground among Gauthier's contractarian morality and the fiduciary doctrine is the realisation that maintaining the integrity of one's relationships (be they social or professional) contributes to the maximisation of universal utility in the long run. This is because, if being moral is the objectively rational (long-term) strategy, then it should be what classically understood rational agents would choose to implement in the majority of cases. As demonstrated in the previous section, the fiduciary doctrine has not been articulated in so many words (hence the widespread debate as to the extent and even nature of its coverage), as it developed and evolved through case law, which on the one hand keeps the doctrine flexible but, on the other, renders it frequently unpredictable. Having said that, at least in the commercial context, the doctrine can be usefully rationalised by tracking Gauthier's contractarian reasoning, given that the commercial fiduciary obligation itself can comfortably fit the contractarian mould. The exchange in both frameworks concludes with at least one party assuming other-regarding duties. I submit that the difference between the two frameworks is that under Gauthier's reasoning the other-regarding duties are self-imposed directly, whereas under the fiduciary doctrine the other-regarding duties are self-imposed *indirectly*. This means that, in the absence of an express prior understanding between the parties, it is the courts that impose the fiduciary obligation, in effect, enforcing an implied agreement between two rational agents, where one (the beneficiary) empowers the other (the fiduciary) to exercise discretion in their conduct of the beneficiary's affairs, in exchange for a promise to do so with utmost loyalty to and in the beneficiary's best interests.

This reasoning tracks the primary objective of English commercial law, which is to give effect to 'the reasonable expectations of honest persons', the idea being that in the absence of circumstances somehow negating the consent of those involved, the bargain among legally capable agents is sacrosanct. On this reasoning, the extraneous implication of other-regarding duties into such bargains would only be possible where it can be demonstrated that doing so gives effect to the reasonable expectations of the parties to the bargain. By applying Gauthier's approach to rational bargaining in the context of collaboration, this thesis sought to demonstrate just that; i.e. that given the

economic drivers behind commercial collaboration – a set of circumstances that must be taken into account as relevant context in order to determine the perceived expectations of the parties at the time of contracting – the rational economic agents involved in contractual joint ventures would voluntarily assume other-regarding duties in order to ensure successful collaboration and maximise their self-interest overall. Thus, I submit that considering the commercial application of the fiduciary doctrine through the lens of Gauthier's rational bargaining based on an implied agreement between the purported fiduciary and beneficiary, is a dependable means of effectively rationalising the law in this area, in the sense of rendering it consistent and replicable. This is because it reconciles the operation of the fiduciary doctrine, whose core tenet lies in the assumption of other-regarding duties, with the foremost consideration of English commercial law, namely the parties' intentions (in terms of their individual and collective objectives under the bargain, and the obligations they agree to in pursuit of those objectives).

6.3.2 Fiduciary defaults in contractual joint ventures: their extent

A contractarian analysis appears to also shape the commercial fiduciary obligation once the relationship is underway. Accordingly, the character and extent of the duties, which make up the obligation are determined by the circumstances of the case, including any relevant agreement between the parties. The Privy Council addressed this point directly in *Kelly v. Cooper*,[95] which concerned the extent of the obligation in the context of an estate agent hired by two competing principals to sell their respective houses, which were adjacent to each other. The plaintiff's house was eventually sold to the same buyer, who had first purchased the adjacent house. Following completion of the sale, the plaintiff refused to pay the defendant their agreed commission on the sale and sued on the ground that the defendant had been in breach of fiduciary duty, not having disclosed the fact that they had been acting for a competing home-owner and having allowed their own interests to compete with those of the plaintiff. The Privy Council held that since it was the business of estate agents to act for multiple principals, a term was to be implied into the agency contract that such an agent was not only entitled to act for other principals selling similar properties, but also to maintain the confidentiality of information obtained from each principal. This ratio was later approved by the House

[95] [1993] AC 205.

of Lords in *Henderson v. Merrett Syndicates*,[96] where Lord Browne-Wilkinson famously observed that:

> 'The phrase "fiduciary duties" is a dangerous one, giving rise to a mistaken assumption that all fiduciaries owe the same duties in all circumstances. That is not the case. Although, … every fiduciary is under a duty not to make a profit from his position (unless such profit is authorised), the fiduciary duties owed, for example, by an express trustee are not the same as those owed by an agent. Moreover, and more relevantly, the extent and nature of the fiduciary duties owed in any particular case fall to be determined by reference to any underlying contractual relationship between the parties.'[97]

In other words, the nature and extent of fiduciary duties being implied into the contractual joint venture by default must inevitably be subject to the joint venture agreement. Mason J expressed this point in *Hospital Products v. United States Surgical Corporation*[98] thus:

> 'That contractual and fiduciary relationships may co-exist between the same parties has never been doubted. Indeed, the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations, it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them. The fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation, which the contract was intended to have, according to its true construction.'[99]

This dictum has been applied rather enthusiastically by the Australian courts, with arguably unbalanced results. A case in point is *John Alexander's Club v. White City Tennis Club*[100] which concerned a joint venture between the appellant and respondent for the acquisition and development of land, on part of which the respondent conducted sports activities under a lease and licence. The legal issue arose from the discrepancy between a memorandum of understanding in which the terms of the joint venture were originally recorded and a subsequent agreement, which was to be read in conjunction with the memorandum but was to supersede the latter where the two conflicted. A number of obligations to be performed by the appellant (JAC) on behalf of the

[96] [1995] 2 AC 145.

[97] *Ibid*, 206.

[98] n.5.

[99] *Ibid*, [70].

[100] [2010] 241 CLR 1.

respondent (WCT) were included in the memorandum but not the subsequent agreement. Under the memorandum JAC was to acquire two options to purchase the land, one to be exercised by JAC and the other to be exercised by WCT, only in the event that JAC failed to exercise the first. With respect to the first option, JAC was to exercise it on behalf of a newly incorporated company, whose membership was to be offered to existing members of the respondent club. That company was then to offer a ninety-nine-year lease over the land to a second company, with whom JAC was to enter an operating agreement. However, under the subsequent agreement, JAC was under no obligation to exercise the option on behalf of another company, grant a lease or enter into an operating agreement. In fact, under this agreement JAC was free to acquire the land for itself or a nominee, which is what it did, once relations with WTC deteriorated. WTC sued claiming *inter alia* that by exercising the option, JAC breached its *Pallant v. Morgan*-like fiduciary duty (see *4.2.3.2*) so that JAC's nominee held the land on constructive trust *exclusively* for the respondent.

In a rather peculiar judgment,[101] the High Court openly disparaged WTC for taking an all-or-nothing approach to its claim, pursuing only the fiduciary relationship and constructive trust angle and not considering in its strategy the interests of third parties (such as those of the entity that financed JAC's acquisition of the land).[102] Never mind that the nature of litigation is by definition adversarial and the parties are entitled, expected even, to take an entirely self-interested approach to their claims. Never mind, also, that a strategy based in contract would have left WTC with no meaningful remedy, for JAC had no assets against which to enforce an award of damages, apart from the land acquired for its nominee, in which, had the memorandum and, later, its spirit been upheld, WTC would have a significant proprietary interest (through a corporation).[103] Instead, the court held unanimously that not only had there been no breach of fiduciary duty on JAC's part, but that there had been no fiduciary relationship between the parties at all. Applying Mason J's dicta in *Hospital Products*, the Court held that the

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[101] For comment see R. Flannigan 'Collateral Contracting Implicitly may vary Fiduciary Relationship' (2010) *LQR* 496; J. Knowler and C. Rickett 'The Fiduciary Duties of Joint Venture Parties – When do they arise and what do they comprise?' (2011) 41 *V.U.W.L.R* 117, 126ff.

[102] n.100, [75]-[76].

[103] The Court also referred, apparently with approval, to JAC's assertion that it did not act fraudulently, unconscionably or in breach of fiduciary duty, for its nominee offered a licence to WTC's membership to continue using the grounds for sporting activities following its acquisition of the disputed land (namely the clubhouse and grounds, on which WTC previously held a lease and licences); n.100, [40]. As Flannigan points out, *ibid*, 498, this *ex post* event was irrelevant to the legal issue of whether the appellant was in breach of fiduciary duty when it exercised the option for, effectively, its sole benefit.

subsequent agreement superseded any fiduciary relationship established by the memorandum of understanding.[104] The court rejected WTC's argument that their relationship with JAC, which started with the memorandum, had placed WTC in a vulnerable position for not only did it trust and rely on JAC to secure its future, it also gave up its valuable legal rights (namely its lease on the clubhouse, with 15 years remaining on it, and licences to use the grounds for sporting activities) to pursue the opportunity with JAC. On the facts, the court held, the only reliance was with respect to JAC's performance of its contractual obligations and any vulnerability arose from the risk of JAC's breach, which is the case with all contracts.[105] The court held that WTC did not rely on any representations by JAC, was on an equal bargaining position with it and did not depend on JAC to carry out any dealings of which WTC was ignorant.[106] Furthermore, WTC's argument based on the *Pallant v. Morgan* equity was not applicable on the facts, for there was no firm arrangement between the parties and JAC had not induced WTC not to seek the purchase options which JAC obtained and exercised.[107]

The effect of the High Court's judgment is to suggest that a fiduciary relationship may be entirely displaced by a subsequent agreement between the parties. I contend that, on a contractarian analysis of the fiduciary doctrine's commercial application, this is the correct conclusion, but only where the subsequent agreement actually reflects the relationship between the parties. It will be remembered that the commercial fiduciary obligation itself depends on the voluntary undertakings of both the fiduciary (to act in the beneficiary's or the joint interests to the exclusion of their own several interests) and the beneficiary (to relinquish control of their own affairs to the discretion of the fiduciary). In the present case, the court refused to acknowledge the relevant context which informed the relationship between the parties at both times of contracting, which was plainly the original memorandum of understanding.[108] Indeed, not only did the subsequent agreement not extinguish the memorandum but it expressly ensured that it remained relevant to the relationship, albeit with the agreement taking precedence in

[104] n.100, [91]-[95].

[105] *Ibid*, [81].

[106] *Ibid*, [81]-[83].

[107] *Ibid*, [68]-[69].

[108] This approach was unanimously taken by the Court of Appeal in *White City Tennis Club Ltd v. John Alexander's Clubs Pty Ltd* (2009) 261 ALR 86, [53] and [61]-[65].

the event of conflict. No doubt, both parties were represented by competent and experienced professionals. However, given the language of the two documents and the collaborative spirit in which the parties first approached the opportunity, it was also entirely reasonable for the respondent to read the subsequent agreement in light of the memorandum of understanding, so much so that it acted to its considerable detriment as a result.[109] I submit that the latter point contradicts directly the Court's reasoning with respect to the applicability of the *Pallant v Morgan* equity; there was a clear arrangement, which – on the facts – even went beyond the 'advanced negotiations' that gave rise to fiduciary obligations in *Brian*, according to which WTC acted to its detriment by both relinquishing its legal rights and refraining from pursuing the option to purchase the land (which would have put it in direct competition with JAC and would have defeated the point of the joint venture).

To my mind, JAC's conduct in *John Alexander's Clubs* is a classic example of a freeloader taking the competition out of the equation in order to develop an opportunity to its sole advantage. It is also an example of the type of conduct, which the *Pallant v. Morgan* equity was meant to address, if rationalised in light of an implied agreement among self-interested agents who have opted to become constrained maximisers in the context of collaboration. WTC in *John Alexander's Clubs* had not made a bad bargain, as the High Court appeared to suggest,[110] for the bargain made reasonable sense in light of the collaborative arrangement with JAC. It was JAC's reneging on the agreement in order to pursue the opportunity in its sole benefit that gave rise to the dispute and WTC's ambitious claims. As I understand it, the Court's uncharacteristically hostile attitude to WTC's case was due to WTC insisting on the imposition of a constructive trust and the Court being eager to reign in the circumstances where the remedial constructive trust is imposed, particularly where parties unconnected to the dispute could be affected by it. In its own words: 'A constructive trust ought not to be imposed if there are other orders capable of doing full justice',[111] such as equitable compensation

[109] On this the Court, peculiarly, observed that the pressure on WTC to relinquish its legal interests did not come from JAC, but from third-party purchasers of the land from whom JAC and WTC would subsequently acquire the options to purchase; n.109, [62]; this however is immaterial – the respondent offloaded its interest not because it was required to do so by the memorandum, but in the spirit of the arrangement with JAC, on whose undertaking in the memorandum WTC had relied.

[110] n.100, [56].

[111] *Ibid*, [128]. For a well-reasoned analysis of the circumstances where a proprietary remedy for breach of fiduciary duty is appropriate, see S. Worthington 'Fiduciary Duties and Proprietary Remedies: Addressing the Failure of Equitable Formulae' (2013) *CLJ* 720; on this analysis, the appropriate remedy

or an account of profits, neither of which WTC pursued. Having said that, I submit that the artifice of the High Court's reasoning could have been avoided had the joint venture been subject to default fiduciary obligations, thus eliminating the gap created by the memorandum and the subsequent agreement. The default duties would have been justified on the basis that this is what the parties would have wanted, had they properly considered what their self-interest requires. On the matter of the appropriate remedy, it would have been open to the equitable jurisdiction of the court to either substitute the award of a constructive trust in favour of WTC for an account of profits[112] or to declare a constructive trust for the *joint* benefit of both JAC's nominee and WTC. I submit that the latter option would have accurately upheld the intentions of the parties at the time of contracting, both originally and with respect to the subsequent agreement.

In summary, this section has demonstrated that the commercial application of the fiduciary doctrine is primarily informed by the contractual arrangements of the parties, whether implied or express. By the same token, a fiduciary relationship in the context of collaborative activity, such as the contractual joint venture, may well be terminated by contract. However, as the Australian High Court's decision in *John Alexander's Clubs* illustrates, the intention to terminate must be clear from the circumstances of the relationship and having regard to the conduct of all parties. Such assessment must include any circumstances on the basis of which the parties may become entitled to expect that the other party is to act in the joint interest to the exclusion of their several interest. Any ambiguity (as, I submit, was the issue in *John Alexander's Clubs*) should be interpreted in favour of mutual fiduciary duties on the basis that this is what rational agents, who the law must presume are constrained maximisers given their agreement to collaborate, would have wanted so as to optimise their self-interest in the context of the particular agreement and maximise their self-interest *overall*.

6.3.3 Fiduciary defaults in contractual joint ventures: their content

The effect of the analysis above is that the conduct of contractual co-venturers, who have been identified as fiduciaries following Gauthier's methodology of rational

against the appellant would have been personal, such as equitable compensation, rather than a constructive trust.

[112] The House of Lords did something similar in *Nocton* (*6.2.2.2*); See, also the discussion of the operation of equity in Australian courts in P. Finn 'Common Law Divergences' (2013) 37 *Melbourne University Law Review* 509.

bargaining, cannot be constrained *beyond* the scope of the joint venture agreement. At the same time, while the incidence and extent of the fiduciary obligation is determined by the parties' intentions as manifest from their relationship or agreement, its content is not. In terms of content the fiduciary obligation is almost entirely independent from the intentions of the parties[113] and comprises exclusively the duty of loyalty.[114] It will be remembered that the commercial fiduciary obligation refers to the duty to act in the beneficiary's and/or the joint interest to the exclusion of the fiduciary's several interest. According to English law, however, the duty does not extend further than this.[115] In other words, liability for breach of a fiduciary duty will arise only where the fiduciary has contravened their duty of loyalty – generally, by making an (unauthorised) personal gain, whether directly or indirectly, by virtue of their position as a fiduciary.

There are two consequences of this narrow conception of fiduciary loyalty. First, as Millet LJ pointed out, 'not every breach of duty by a fiduciary is a breach of fiduciary duty'.[116] Consequently, a fiduciary acting negligently or recklessly in the conduct of the joint venture business would not of itself be a breach of fiduciary duty. Where this conduct is actionable,[117] it will be the subject of an action in tort (e.g. negligence) or contract (e.g. for breach of a reasonable care and skill clause).[118] Similarly, where the fiduciary divulges sensitive confidential information, such as trade secrets pertinent to the joint venture, the offending conduct would be addressed through the law of confidence or contract. [119] The fiduciary in this case would not be in breach of their

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[113] While a fiduciary may breach the duty of loyalty, they may not be liable if the beneficiary has ratified the breach. In that sense, the parties' intentions may impact on the *effect* of the duty, but not its content.

[114] *Bristol and WBS*, n.8, 18, per Millet LJ.

[115] The same holds for the other major common law jurisdictions, namely Canada, Australia and New Zealand: see, generally, R. Flannigan 'The Boundaries of Fiduciary Accountability' (2004) 83 *Can.B.Rev.* 35. *Cf.* American jurisprudence; see below.

[116] *Bristol and WBS*, n.8, 16.

[117] Note the analysis of different types of opportunistic behaviour ('production opportunism', associated with the production process – contrasted with 'exchange opportunism', associated with the negotiation/bargaining process. The first is actionable while the latter is not, for it refers to what is essentially, competitive behaviour) in R. Flannigan 'The Economics of Fiduciary Accountability' (2007) 32 *Del.J.Corp.L.* 393, 396.

[118] E.g. *Bristol and WBS*, n.8 (solicitor acting for both borrower and lender negligently advising lender); *LAC Minerals,* n.9*;* and see *Chaudhry v. Prabhakar* [1989] 1 WLR 29, (a gratuitous agency was the basis for establishing the duty of care in a negligence claim); see further the discussion in M. Conaglen, *Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties* (Hart, 2010), who argues that the duty of loyalty is merely an amalgam of the various duties making up the fiduciary obligation (namely acting in good faith, avoiding conflicts of interest), its function being to ensure that the fiduciary will perform properly the non-fiduciary aspects of their undertaking.

[119] *Attorney General v. Guardian Newspapers* [1990] 1 AC 190 ('a duty of confidence arises when confidential information comes to the knowledge of a person (the confidant) in circumstances where he

duty of loyalty, unless they had made an unauthorised personal gain from their conduct, whether directly or indirectly.[120] To be sure, it could be argued that in a broad sense the duty of loyalty includes a duty to act to one's best abilities (that is, avoiding negligent or reckless acts with respect to the conduct of the beneficiary's or the joint venture's business), as well as a duty to adhere to the terms of the joint venture contract.[121] However, addressing conduct, which is actionable under other legal doctrines, as a breach of fiduciary duty would not only amount to abuse of the doctrine itself, but would also cause unnecessary and unwelcome duplication in both legal doctrine and practice. In turn, this would further cloud our understanding of the doctrine and its operation, while practically it would do away with important safeguards, such as the rules on loss mitigation or contributory negligence, which ensure a balanced adjudication process.

The second consequence of the narrow conception of fiduciary loyalty is that it is generally understood to be merely proscriptive of disloyal conduct. Thus, while the fiduciary is required from the outset to act in an entirely other-regarding manner, that obligation does not involve *actively* promoting their beneficiary's interests, nor does it prescribe the way the fiduciary exercises their discretion in connection with the beneficiary's affairs (though the fiduciary will be exposed to liability in negligence, if they fail to exercise care). Rather, the fiduciary is required to refrain from acting in a way which would cause their own interests to conflict with those of the beneficiary's. In Nolan's words 'fiduciary duties promote loyalty by prohibiting disloyalty, and activity which might lead to disloyalty'.[122]

How does the duty of loyalty then, fit in with the conception of constrained maximisation understood as 'good faith conduct' (see 5.3.2), when implied into the joint venture contract? In Chapter 5, I argued that a duty of good faith mandated through

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has notice, or is held to have agreed, that the information is confidential', *ibid*, 281, Per Lord Goff); in the commercial realm see: *Arklow Investments Ltd v. Maclean* [2000] 1 WLR 594 (bank was not liable for using for own purposes sensitive information it received when acting for a client in a property transaction); *Vercoe v. Rutland Fund Management Ltd* [2010] EWHC 424 (venture capital firm using confidential proposals to proceed with transaction excluding those who made the proposals was in breach of confidentiality agreement).

[120] E.g. *Campbell v. Frisbee* [2002] EWCA Civ. 1374 (duty of confidentiality was part of contract of former employee).

[121] This is the operative argument in American fiduciary jurisprudence. Indicatively, see R.R.W. Brooks 'Knowledge in Fiduciary Relations' in A.S. Gold and P.B. Miller (eds), *Philosophical Foundations of Fiduciary Law* (OUP, 2014).

[122] R. Nolan 'A Fiduciary Duty to Disclose?' (1997) *LQR* 220, at 222.

the contract mechanism must reflect the values of honesty and fairness, which the parties (whom the law must presume are constrained maximisers) must have exhibited in order to successfully bargain in the first place. I argued that the post-contractual aspect of the duty must take both a positive and a negative form. Specifically, post-contractual good-faith-as-fairness should comprise a duty to avoid conduct which would ultimately harm the joint strategy and good-faith-as-honesty should comprise a limited duty to disclose, its extent to be determined by the application of Gauthier's minimax relative concession (see *5.3.2.1*).

Against this background, I contend that in the context of contractual joint ventures, the duty of good faith, understood as honesty and fairness, is conceptually compatible with the general understanding of the duty of loyalty described above. This is because the duty of loyalty may be understood as a duty to, if not actively promote, at least preserve the interests of the beneficiary. In the context of the contractual joint venture, the duty of loyalty is presumed to be mutual by definition, for the law's presumption of rationality requires constrained maximisers to bargain only with similarly disposed agents. Therefore, all parties to the venture will be presumed to have submitted to the duty of loyalty. The mutual duty of loyalty must then be understood as an all-round obligation to refrain from harming the others' interests, which are in turn presumed to identify with the joint strategy. Fidelity to the joint strategy is also presumed to be the core of good-faith-as-fairness and good-faith-as-honesty, articulated through the contract mechanism, making the duty of loyalty under fiduciary law conceptually and practically identical to a contractually mandated good faith standard.

However, I submit that while the two duties (fiduciary loyalty and contractual good faith) have a common conceptual core, at least in the contractual joint venture context, it is their respective procedural mandates that set them apart, even where fiduciary loyalty is examined through a contractarian lens. Thus, I contend that Gauthier's method of rational bargaining (namely one that presumes voluntary conduct constraints in agreements between rational agents) would be severely handicapped, if implemented through the contract mechanism. This is evident from the hypothetical scenario contemplated in *5.3.2.1(c)*, where the implementation of conduct constraints through

the contract mechanism ultimately allows Acorn's freeloading to go unaddressed.[123] In response to this, I contend that good-faith-as-honesty, at the post-contractual stage, may take the form of an unbounded duty to disclose. In the next section I will argue that in certain circumstances and in order to prevent and even address freeloading in contractual joint ventures, the duty of loyalty may be interpreted as comprising a duty to disclose, where this falls within the scope of the joint venture and the information is vital for its continuing success. However, this is only prudent where the long-term interests of the disclosing party are secured through the proprietary remedies afforded through the fiduciary mechanism.

6.4 Level of utility achieved from basing good faith in fiduciary law: solving the freeloader problem

Let us consider the effect of implementing Gauthier's conduct constraints as a contractual duty of good faith in the hypothetical joint venture between Acorn and Brazilnut (see *5.3.2.1(c)*). Whether approached as a negative or positive duty, the purpose of the contractually implied good faith requirement is to safeguard the joint strategy. At the outset, this is entirely compatible with Gauthier's approach to rational bargaining in the context of cooperation. The difficulty arises with respect to how this requirement translates into action for both Acorn and Brazilnut when implementing the joint strategy. The technical calculation, it will be remembered, is determined by the parties' respective minimax relative concessions. Gauthier's methodology requires that every time the parties' respective long-term self-interest is likely to be affected by the joint strategy, the parties have to calculate their minimax relative concession. Gauthier holds that if the parties remain faithful to the joint strategy the calculation will eventually become unnecessary. However, as illustrated from Acorn's decision to withhold information on the effective solution to the glitch if and when it occurs, the minimax relative concession will not allow a rational agent to knowingly jeopardise their long-term interest for the benefit of the joint strategy. It goes without saying that Acorn's decision amounts to freeloading. Apart from the additional expense caused by field operations stalling following a glitch, Acorn's unique knowledge and understanding of the technology puts it in a position to theoretically hold the joint

[123] Perhaps along the lines of 'shirking', although, here, I submit that the conduct is fairly more egregious; see the analysis on this in R. Flannigan 'Fiduciary Obligation in the Supreme Court' (1990) 54 *Sask.L.Rev* 45, at 51.

venture hostage particularly at times when the reliability of the technology is under examination, for instance when the venture seeks additional financing. However, with Acorn not being technically in breach of its express obligations under the joint venture agreement, Brazilnut would have to rely on a default contractual duty of good faith, determined by what the parties (as constrained maximisers) would have agreed to had they properly reflected on what their self-interest requires. In the circumstances, the claim would fail. This is because its minimax relative concession would not allow Acorn to make further disclosures, thus becoming catastrophically exposed to the risk of Brazilnut's own freeloading, so Acorn could not be held to be in breach of the duty.

Furthermore, Acorn's size and resources relative to Brazilnut's will not exempt it from the freeloader label. It will be remembered that vulnerability in the context of an ongoing contractual relationship is not determined by the respective resources and clout of the parties (though these will certainly be relevant in the innocent party's ability to deal with the fallout from the freeloader's conduct) but is dynamic, as the power pendulum shifts back and forth depending on which party is relying on the other's performance of its obligations under the joint strategy. The constant calculation of the minimax relative concession ensures that, where adherence to the joint strategy is likely to cause a party to lose out in the long-term, at least some freeloading will remain an option.

Having said that, the outcome of the calculation would be different had there been a regulatory framework in place which would mitigate or even negate the risk to Acorn's long-term self-interest. However, the contract mechanism simply cannot provide the necessary framework to safeguard the calculating agent's long-term self-interest, *every time* (see *5.3.2.3*). The remedial system under English contract law, even in its most permissive form (i.e. the exceptional *Wrotham Park* damages) is not sufficiently robust to actively discourage freeloading. This is because the freeloader may calculate the damages payable upon defection from the joint strategy and bear them willingly as the cost of defection – it will matter little if the overall profit from defection is greater than this cost. Therefore, conduct-constraining rules in the form of a contractually implied duty of good faith are not capable of effectively addressing freeloading.

It is a different matter, however, where the duty of good faith is implied into the contractual joint venture as a fiduciary obligation compelling the parties to act with utmost loyalty toward each other and the joint strategy. The remedial framework in this

case is entirely gain-based, giving the innocent party access, both substantively and procedurally (in terms of asset tracing), to any benefit the freeloader has acquired in breach of their duty of loyalty. Indeed, in English law it is now established that where the fiduciary makes a gain either through the use of property or information acquired in their capacity as a fiduciary, they will be holding the benefit on constructive trust for the beneficiary.[124] In the context of a contractual joint venture, therefore, the freeloader would be holding the benefit from their conduct on constructive trust for the co-venturers.

How does the operation of this gain-based remedial regime impact the calculation of the parties' respective minimax relative concessions? I submit that the concession in each case would be far more extensive, given that the risk of loss to the innocent party would be significantly mitigated, if not negated outright. In Acorn and Brazilnut's case, Acorn could be compelled to disclose its knowledge of the glitch on the ground that it would otherwise be contravening its duty of loyalty to the joint venture, by jeopardising the joint strategy. At the same time, Brazilnut is prohibited from using this knowledge for its own purposes to the exclusion of Acorn[125] on pain of being compelled to hold whatever gain it has made for its collaborator, at least in part. Therefore, the operation of the gain-based remedies and the procedurally favourable tracing process, which go hand in hand with the enforcement of the fiduciary obligation, render straightforward the presumption that the parties – as constrained maximisers – have submitted to stricter other-regarding duties of mutual loyalty and good faith, having properly reflected on what their self-interest requires (i.e. having calculated their respective minimax relative concessions). On this basis, I conclude that implying an extra-contractual duty of good faith into the contractual joint venture through the mechanism of fiduciary law affords the co-venturers (who the law must presume to be constrained maximisers) the highest utility, understood as both risk mitigation and maximisation of long-term self-interest.

[124] *FHR European Ventures*, n.28; the judgment overruled the position under *Lister*, n.28, and *Sinclair v. Versailes* [2011] EWCA Civ. 347 Notably, the Australian courts had reached this point sooner: *Grimaldi v. Chameleon Mining NL (No2)* (2012) 200 FCR 296, which expressly did not follow *Sinclair*.

[125] E.g. see *Vercoe*, n.119, where no fiduciary duty could be established.

7 CONCLUSION

In this thesis I set out to demonstrate that the English law on contractual joint ventures is outdated and neither reflects nor accommodates the commercial realities, which make the contractual joint venture a popular vehicle for economic growth. I argued that to address this problem, English law must recognise a new legal model of commercial association to fit the contractual (project specific) joint venture. The new model should be governed by the joint venture agreement as interpreted in light of all of the relevant context, including the economic drivers behind the parties' intention to cooperate – both from an individual and a collective perspective. To determine which parts of the context are relevant to the interpretation of the agreement, I argued for the implementation of David Gauthier's 'Morals by Agreement', which provides a framework for discerning what rational (i.e. self-interested) agents would intend in the context of cooperation, when pursuing the maximisation of their *long-term* self-interest. By applying this theory of rational bargaining, I argued that such agents would expect certain duties to be implied extra-contractually into the agreement, so as to effectively deal with the problem of a co-venturer defecting from the joint strategy to pursue short-term gain. I then examined the two main jurisprudential avenues available for such exercise, namely the mechanisms of contract and fiduciary doctrine respectively. Having demonstrated that the fiduciary mechanism affords the highest utility option in terms of enforcement and remedies for implying legally effective duties into the joint venture relationship, I argued what these duties would consist of a general duty of loyalty to the joint strategy, comprising both negative duties of avoiding conflicts of interest and a positive duty of disclosure.

My central premise can be expressed in terms of the principle of instrumental reason (i.e. the principle of hypothetical imperatives), whereby to pursue a goal is to pursue the necessary means of achieving that goal or to give up that goal.[1] I have argued that the long-established goal of the law on contractual joint ventures is to give effect to the contracting intentions of prudent (utility maximising) commercial parties. I have also argued that the necessary means of achieving that goal is that the law takes into account both the inevitable limitations of attempts to contract for the future and the wider economic factors driving collaboration between frequently competing, economic

[1] M. Adcock and D. Beyleveld 'Morality in intellectual property law: a concept-theoretic framework' (2016) 4(1) *Intellectual property rights* 154, 155.

agents. Thus, the law's *ex post* determination of the parties' intentions must take proper account of those considerations or give up the goal of giving effect to the intentions of prudent commercial parties at the time of contracting. Specifically, the law on contractual joint ventures must first accept the following presumptions or give up the identified goal. Thus, the law must:

a) presume that the parties to the joint venture are rational (i.e. self-interested) economic agents, who have chosen to cooperate with like-minded economic agents, so as to mitigate the cost (and overall risk) of dealing with externalities;

b) presume that these agents have chosen, in this context, to become, what Gauthier terms, 'constrained maximisers' or 'utility optimisers', namely that they have chosen to constrain the pursuit of their short-term self-interest, so as to maximise their self-interest *overall*;

c) presume that the constraints the parties have agreed to in the bargaining process are by definition other-regarding, for they must each concede the other party's pursuit of its own interests (up to a point determined by Gauthier's adaptation of the Lockean proviso, which he terms 'minimax relative concession' or 'maximin relative benefit' – namely, conceding just short of the point where the agent becomes worse off *by reason of* the bargain than they would have been had they never bargained at all);

d) presume that the parties, as constrained maximisers, have agreed to those other-regarding conduct constraints, which afford them the highest utility in the long run;

e) presume that, as the law stands and given its historical evolution, the conduct constraints which afford the parties the highest utility are fiduciary in nature and effect; and

f) presume that the parties must have accepted mutual fiduciary duties as part of the bargaining process.

The collective effect of those presumptions can be expressed as follows: if a rational agent's goal is to maximise their self-interest in a joint venture operating within the constraints of English law, then, since the necessary means of giving effect to that goal is to accept fiduciary duties, that agent must accept fiduciary duties or give up that goal. On this basis, in order to achieve its objective of giving effect to the expectations of rational commercial parties, the law on contractual joint ventures must imply by default mutually binding fiduciary duties into the joint venture relationship (on the basis that this is what the parties must have accepted), or give up this objective.

My contention is that while Gauthier's reliance on self-interest alone cannot provide a complete justification for being a constrained maximiser, his theory of rational bargaining provides two crucial insights. First, when compared to the law's current approach to determining the intentions of reasonable parties to a contract, it provides a more accurate and comprehensive understanding of what it means to reason from a contractual party's self-interested perspective, which is, incidentally, how the law purports to apply in the context of commercial relations. Secondly, when implemented in the existing legal framework, it provides a coherent and replicable basis for the implication of other-regarding duties in commercial relations. From the outset this tracks the objective of commercial law to give effect to the intentions of rational commercial parties. But more importantly, it addresses the inconsistencies in the courts' expectations of what constitutes acceptable conduct in the context of joint ventures (by reference to the parties' own presumed intentions).

Crucially, the incentive to act in an other-regarding manner (i.e. to act morally) *every time*, which is missing from Gauthier's reasoning, is provided by the legal framework, in which Gauthier's approach to rational bargaining is implemented. Specifically, this is achieved through the operation of strict other-regarding legal duties imposed through the fiduciary doctrine. On a superficial level, this point might appear circular. The criticism would hold that using Gauthier's approach to rational bargaining as a justification for the imposition of extra-contractual defaults into joint venture relationships is question-begging, if those defaults are relied on to fill the gaps in Gauthier's reasoning. However, it must be remembered that unlike the other-regarding duties which Gauthier's contractarian morality seeks to justify on the basis of (long-term) self-interest, the other-regarding legal duties imposed through the fiduciary (or contractual, for that matter) mechanism require no justification, for they operate by fiat. The purpose of implementing Gauthier's methodology into existing law is to deliver a predictable and replicable regulatory framework for contractual joint ventures, which gives effect to the intentions of rational commercial parties. As long as it is accepted that Gauthier's methodology for rational bargaining is merely the means necessary to achieve the end of rationalising the existing law on contractual joint ventures, there is no circularity to the argument, for whereas Gauthier's methodology is limited by its fundamental reliance on self-interest, the law is not.

Ultimately, English law already recognises that self-interest is not a sufficient foundation for the law as such. In fact, it is plain that many areas of English law recognise and impose duties, which expect the individual to not only act against their self-interest, but also to actively give effect to the interests of others. Examples range from the law for the protection of fundamental human rights and freedoms, to the laws of property rights, family relations, civil wrongs, industrial relations and, to an extent, even company law. In every case, the law provides for substantive other-regarding duties, namely duties which do not rest, and apply irrespective of, the self-interest of the individual. A prime example of such duties is fiduciary duties. In fact, if it is accepted that the validity of such duties is not dependent on their recognition by positive law, then they are properly described as legally effective moral duties.

By way of conclusion, I contend that English law's reliance on constraints, which go beyond the individual self-interest, cannot be meaningfully restrained to one area of law, nor should it be. This however is an argument to be made in the context of a fully developed theory on the norms underlying the law as whole, which is beyond the remit of this thesis. However, as a final observation, it may be argued that in order for the law to be valid the values underlying the law as a whole must be reflected in all areas which ultimately regulate and/or affect human activity and relations.[2] In other words, to be fully rational, in the sense of avoiding contradiction, the law must be *normatively* consistent. As a matter of normative consistency, therefore, the other-regarding values reflected in many other areas of English law must feed back into the law of commercial relations, whether this refers to joint ventures, corporations or spot contracts. I contend that this would rationalise the law of commercial relations as a whole (at the very least, with respect to the good-faith-in-contract debate) but there is another benefit to achieving such normative consistency. This is the acknowledgment that the law, particularly commercial law, is not in the business of protecting and/or regulating legal fictions (e.g. the limited company) in their various guises and interactions, but is ultimately concerned with regulating market relations, as a cornerstone of *human* life and activity.

[2] For an argument along these lines focusing on the interaction of human rights and intellectual property law, see Adcock and Beyleveld, *ibid*.

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