



Joint ventures in Software Projects

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A software project that starts out as an informal venture between friends imposes obligations on the parties to act “loyally” to the venture. This has the potential to become problematic if the arrangement is not formalised within an appropriate time, and disputes arise.

When two or more people work together on a software project, there is a good chance that they have (or will soon have) created what the law terms a joint venture relationship. People often identify a joint venture with large projects carried out between companies. But joint ventures can arise between individuals in many situations both formal and informal.

The term “joint venture” describes a relationship between parties working together to achieve a common objective and may be as formal or informal as the participants want.

An informal joint venture is not recognised by the law as a separate entity such as a company or a limited partnership. But the law does impose enforceable duties upon the parties to a joint venture.

How a joint venture is established

A joint venture can be formed by contract, but it can also be formed automatically in the absence of any written contract when two or more people begin working together on a common project. There is no need for there to be any written documentation between the parties – the arrangement can be entirely informal.

When there is no contract, the key requirement is that the parties **intend** to form a joint venture:

“The essence of a joint venture which is not yet contractual is that it is an arrangement or understanding between

two or more parties that they will work together towards achieving a common objective. ... A joint venture will come into being once the parties have proceeded to the point where, pursuant to their arrangement or understanding, they are depending on each other to make progress towards the common objective.”

Chirnside v Fay (6 September 2006, NZ Supreme Court)

Once the parties have taken steps towards a “common objective” (such as an “idea” to jointly develop and market a computer program) the law can recognise that a joint venture exists.

The longer that the parties work together, and by doing so confirm a common purpose and intention, the more likely that the law will recognise a joint venture has arisen. A joint venture can be thought of as similar to a partnership, but they are not the same. A partnership has more specific rules governed by the Partnership Act 1908 and the Limited Partnership Act 2008.

Joint venture obligations

In general, joint ventures impose a “relationship of trust and confidence” between the parties, which includes a duty of loyalty to the venture:

“[Each] party is entitled to expect from the others loyalty to the joint cause,

loose as the formalities of the joint venture may still be”.

Chirnside v Fay (above)

In practice, this means:

- A party must not compete against the joint venture;
- A party must not deliberately undermine the joint venture in some other way;
- A party must not attempt to exclude another party from the venture, act disloyally or “appropriate to themselves” another party’s benefits under the joint venture; and
- A party must keep the commitments that are promised to the venture (for example, a commitment to spend a certain amount of time on the venture).

If two or more friends have been working on a joint venture, it may come as a surprise to learn that they owe legal duties to each other, especially if nothing has been formalised in writing or by any agreement.

The basis on which these duties are imposed is under the *equitable jurisdiction* of our Courts. As the name suggests, this jurisdiction is a set of rules founded on principles of “equity” and fairness. It is under this jurisdiction that the Courts have the power to enforce duties to protect parties to a joint venture.

Example

If one party put a lot of time and effort into a joint venture, it would be unfair for the other party to walk out at the last minute and set up a competing venture, using all of the jointly-developed ideas, opportunities and knowledge.

This is the situation that arose in the case of *Chirnside v Fay* (which, though not involving software, illustrates some of the key principles of a joint venture).

Chirnside and Fay had each separately identified that a particular property in Dunedin was a good retail development opportunity. They shared their ideas for the property and performed a feasibility study. Over the period of about one year they set about working up various proposals, researching financial options, dealing with the local council and architects, and identifying possible tenants. They also negotiated a conditional purchase of the property (effectively under the control of Chirnside).

However, Chirnside then brought in other investors and went ahead with the project without Fay. Fay sued Chirnside for excluding him from what he claimed was a joint venture.

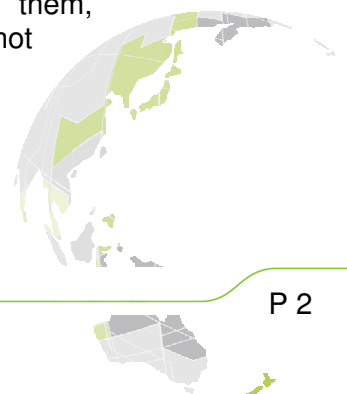
The Court found that a joint venture existed between Chirnside and Fay. This was despite:

- There being no formal agreement between them, but only what the judge described as a “loose arrangement”; and
- Fay acknowledging that Chirnside had performed “much more of the legwork on the project” than Fay had up to the time of his exclusion.

The Court said:

“The fact that the parties were not contractually bound or had not contractually worked out all the details of their relationship should not, in present circumstances, preclude the ability of Mr Fay to turn to equity for assistance ... It is fallacious to think that there can be no joint venture unless and until all the necessary details have been contractually agreed.”

Even though Chirnside had performed more of the work than Fay, because there was a joint venture between them, Chirnside could not unilaterally exclude Fay from the project. The Court found that Chirnside had



breached his duties of loyalty, trust and confidence that he owed to Fay. Chirnside was ordered to pay a considerable sum of damages to Fay.

The problem of freeloading

While the case above involved one party excluding another and “appropriating” the entire joint venture to himself, problems can also arise with freeloading.

This occurs when one party to a joint venture consistently fails to do what they had agreed to do. For example, the parties may have agreed (albeit informally) to put equal time and effort into the venture. Another example is that one party would develop the software, while the other would handle the marketing.

In these situations, the law can provide a remedy to prevent one party to a joint venture from unfairly freeloading off the work of the other(s). The remedies available to an aggrieved party will depend on the details of the situation.

In any situation, though, much will depend upon what the parties are assumed to have intended. If it is clear that the parties only intended a very limited co-operation with minimal contributions, then the parties will not be able to be held to any greater commitment.

Avoiding problems

Joint ventures are not inherently problematic. In fact, they provide useful and fair protections for parties working on a common project but who have not yet formalised their arrangements.

The law will not hold parties to a higher commitment than they had themselves agreed (either expressly or implicitly), but will prevent a party from unfairly acting contrary to their commitments.

Participating in a joint venture does not prevent the parties from have existing businesses or jobs. Indeed, many joint ventures are set up as “side projects” and are intended to be

performed in the parties’ spare time. In such cases, there is likely to be only a low level of time and effort required by the parties to meet their commitments to the joint venture.

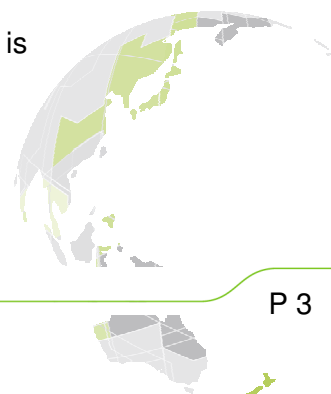
However, once an informal joint venture reaches a certain point, it becomes risky and unwieldy to continue without a more appropriate arrangement in place. This is because:

- An informal joint venture is not a separate legal entity, meaning it cannot own property (including software), enter into contracts, raise money or trade;
- The ownership of any copyright created by the parties could be owned by one or more of the parties (jointly), which can be difficult to manage in the event of a dissolution of the venture;
- A joint venture does not provide any limitation on liability, such as provided by a limited liability company; and
- The informality of the arrangement is unlikely to be able to meet and protect the ongoing expectations and interests of the parties.

When an informal joint venture should be changed into a formal arrangement (such as forming a company) will depend on the circumstances of each venture, but should ideally occur before:

- One or more parties begin to expend any substantial amounts of money on the venture;
- Money is borrowed or funding is sought; or
- Valuable intellectual property has been created.

Forming a company is quick and inexpensive and provides an appropriate vehicle for



furthering the venture without the limitations mentioned above.

It is highly advisable that the parties also enter into a Shareholders' Agreement, which sets out the rules to apply between shareholders, including:

- The joint venture objective(s);
- Relative contributions;
- Responsibilities;

- Adding or exiting partners;
- Dispute resolution processes; and
- Winding up / sale arrangements.

For more information, please see the paper on our website entitled "The Benefits of a Shareholders' Agreement".

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