A perilous enterprise

Paul Clarke explores the challenges of establishing that trust obligations have arisen after the failure of a joint venture

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'It is surprisingly easy for parties, even experienced commercial parties, to invest large amounts of time and resources in the hope of a joint venture agreement being reached, but fail to reach a binding agreement before purchase of the land in question takes place.'

In the recent Court of Appeal decision earlier in 2018 in *Generator Developments Ltd v Lidl UK GmbH*, Lidl had purchased in its sole name a site at Wates Way Industrial Estate, Brentwood, Essex on which it intended to build a supermarket, and Generator, a property development company, claimed that the purchase was a joint venture and that Lidl held the site on trust for both parties.

Equity and joint venture arrangements

Generator's claim was based upon a little known, but important, equity which applies only to joint venture arrangements. The equity, known as a *Pallant v Morgan* equity, derives from the case of that name. In *Pallant v Morgan* [1953] two neighbours were interested in acquiring a piece of land being sold at auction. Each instructed an agent. Shortly before the auction the two agents agreed that one agent would refrain from bidding and that if the other was successful in obtaining the land, he would divide it between them. Having acquired the land, the successful agent refused to divide it up. Harman J held that the agent purchased the land on behalf of both parties and was required to divide it.

In *Banner Homes Holdings Ltd v Luff Developments Ltd* [2000], Chadwick LJ conducted a thorough review of the cases in which a *Pallant v Morgan* equity had been considered. He concluded that the *Pallant v Morgan* equity was a species of constructive trust. He then set out the conditions under which such an equity could arise which, in summary, were the following:

- There must be a pre-acquisition arrangement or understanding.
- It is unnecessary that the arrangement or understanding should be contractually enforceable. In particular it is no bar that the arrangement is too uncertain to be enforced, nor that it is plainly not intended to have contractual effect.
- It is necessary that the pre-acquisition arrangement or understanding should contemplate that one party will take steps to acquire the property and that if they do so the other party will obtain some interest in it. Further, the acquiring party must not have informed the non-acquiring party before acquisition that they no longer intend to honour the arrangement.
- In reliance on the arrangement or understanding, the non-acquiring party does or omits to do something which confers an advantage on the acquiring party, or is detrimental to the ability of the non-acquiring party to acquire the property on equal terms such that it would be inequitable or unconscionable to allow the acquiring party to retain the property for themselves.
- In many cases the advantage/detriment will be found in the agreement of the non-acquiring party to keep out of the market, although this is not a necessary feature; and the existence of both advantage and detriment is not essential: either will do. What is essential is that the circumstances make it inequitable for the acquiring party to retain the property for themselves in

a manner inconsistent to the arrangement.

Facts of *Generator*

In *Generator*, the parties had made a joint bid for Wates Way. The parties had then agreed that Lidl would buy the property in its sole name. While the purchase of Wates Way was proceeding towards exchange, several drafts of heads of terms for the proposed joint venture were sent back and forth between the parties. These drafts were all headed 'subject to contract' and 'subject to board approval'.

The basic structure of the proposed joint venture was that it would be conditional on the grant of planning permission for the development of a retail store with a number of residential flats. Lidl was to buy the property and if Generator obtained planning permission, Lidl would then sell the freehold of the property to Generator, Generator would build the store and the flats and Generator would then grant a 999-year lease of the store to Lidl.

It was expected that the joint venture agreement would be exchanged on the same date as the date of exchange of contracts on the purchase of Wates Way, set for 14 February 2014.

However, agreement on the joint venture heads of terms proved more difficult to reach than had been anticipated, and by the time the date for exchange of contracts on the purchase of the property by Lidl had arrived, the heads of terms had still not been agreed, still less reduced to a formal contract. Nevertheless, Lidl went ahead and exchanged contracts with the vendor on 14 February 2014 as intended.

The parties remained far apart on certain key terms, such as the price, and what was to happen in the event planning permission for residential development could not be obtained by Generator. Post exchange, and even post completion, further attempts were made to agree the joint venture heads of terms, but in the absence of agreement, Lidl decided that it would market the property to other parties. This led to proceedings being issued by Generator.

At first instance, Mr Nicholas Lavender QC, sitting as a deputy High Court judge, held that Generator's claim must fail since Generator had not demonstrated an arrangement or understanding that if Lidl acquired Wates Way, Generator would obtain some interest in it. He relied on nine considerations in support of this conclusion.

The Court of Appeal upheld the decision, albeit for slightly different reasons. Lewison LJ, giving the only judgment, regarded the case as a clear one and said that Generator's claim could not succeed for eight cumulative reasons, being in summary that:

- the case concerned commercial parties, advised by lawyers, working at arms-length towards the conclusion of an agreement for purely commercial enterprise, the terms of which were never agreed;
- the proposed joint venture was expressly made subject to contract;
- Generator knew there was an ongoing risk that Lidl might do a deal with a different developer;
- a draft lock-out agreement circulated between the parties stated in terms that neither party was committed to the sale;
- both parties were aware that Lidl's board had not approved the joint venture;

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- it was not alleged by Generator in its claim that Lidl owed any pre-existing fiduciary duties to Generator or that it acted as Generator's agent – in fact, Generator was not prepared to commit itself to indemnify Lidl against any part of the purchase price, and this was a clear signal that no agency was created, since an agent is usually entitled to an indemnity from its principal against costs incurred within the scope of its agency;

- the judge at first instance had made no finding that Generator had relied upon any assurance that it would acquire an interest in the property; and

- it cannot be unconscionable to exercise a right (to withdraw) which has been expressly reserved to both parties by means of the 'subject to contract' formula, and which Generator had even more clearly reserved to itself in the draft lock-out agreement.

Practical points arising from the decision

The fact that two commercial entities fought this case out to Court of Appeal level indicates the dangers which the *Pallant v Morgan* equity can create in a joint venture case. The principles set out by Chadwick LJ in *Banner* are expressed in very broad terms. In particular, the question whether a sufficiently clear arrangement or understanding has been reached in any given case gives considerable scope for argument between the parties.

Further, the facts of the case, and the facts of other cases involving *Pallant v Morgan* arguments, show that it is surprisingly easy for parties, even experienced commercial parties, to invest large amounts of time and resources in the hope of a joint venture agreement being reached, but fail to reach a binding agreement before purchase of the land in question takes place. In *Generator*, the heads of terms took far longer to agree than had been anticipated, with the result that they were not agreed before exchange of contracts to purchase Wates Way.

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Lessons for practitioners

If acting for the non-acquiring party, the case highlights the need to put in place, before exchange of the purchase of the property, contractually binding documentation protecting the party's position. Without this, one is opening that party up to, at best, an argument over its rights in the acquired property, and at worst substantial litigation costs, quite likely to result ultimately in a failure to establish any interest.

This may require the non-acquiring party to be fairly pragmatic on the nature of the agreement it is trying to reach with the acquiring party, and to make concessions in order to make sure that an agreement is reached prior to exchange. Holding out for the precise terms which it wishes to obtain may not be sensible if the trade-off is that the parties will risk being unable to reach agreement prior to exchange on the main purchase.

In order to establish the equity, as set out previously in Chadwick LJ's fifth principle in *Banner*, it is normally the case that the non-acquiring party has kept out of the market. The non-acquiring party should consider the possibility of making clear its right to re-enter the market prior to exchange, as a means of encouraging the acquiring party to agree terms prior to exchange of contracts on the main purchase. If it waits until after exchange for this agreement, it may well be too late.

If acting for the acquiring party, the 'subject to contract' label should be introduced into negotiations at the earliest possible time. One important point to come out of Lewison LJ's judgment is to emphasise that, where draft documentation has been expressly stated as being 'subject to contract', this will be a powerful factor against a finding that the equity has arisen. It had been argued on behalf of Generator, that the 'subject to contract' label had no effect (relying on the broad expression of the second principle in *Banner*). This argument failed.

It may well be advisable to go further and make express in all documentation that the non-acquiring party will not have any interest in the property unless and until formal contracts are signed giving rise to such interest, and that there is no common understanding or arrangement that the non-acquiring party will have any interest in the property until that time, or words to similar effect.

Conclusions

- If acting for a party involved in a joint venture purchase of property, whether private individual or commercial entity, be aware of the *Pallant v Morgan* equity.

- If acting for the non-acquiring party, be aware that they are at considerable risk of being left with no rights in the property, and that it is vital that they secure their rights by way of a formal agreement prior to exchange of contracts on the purchase.

- If necessary, it may be sensible to take a commercial view on compromising on the terms of such agreement, in order to speed the process of reaching agreement up and ensure a formal agreement is in place prior to exchange on the purchase.

- If acting for the acquiring party, it is vital to make very clear from the outset that the non-acquiring party will have no rights in the property unless and until formal agreement is reached, and that it proceeds entirely at its own risk. ■

Banner Homes Holdings Ltd v Luff Developments Ltd & anor [2000] Ch 372

Generator Developments Ltd v LIDL UK GmbH [2018] EWCA Civ 396

Pallant v Morgan [1953] Ch 43