PAYMENT RISK

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The reality is that as a result of inequality in bargaining power and the desire of contractors in a competitive market to secure the project, risks are not always allocated to the party best able to manage them and there is not always the ability to insist upon an appropriate risk premium in exchange for having taken on that risk. Clearly one of the key factors in ensuring that risk factors are costed in appropriately (or at very least understanding the risk factor being assumed without requisite compensation) is firstly the accurate identification of risks and then an appropriate assessment of both their likelihood and consequences. The use by contractors of their own 'base case' estimates, with their constituent parts being broken down and subject to percentage based optimistic and pessimistic outcomes, can often be the basis to arrive at an overall risk premium in arriving at a final bid price.

While initially it may be the case that risks are assessed from several dimensions, these considerations are subsequently translated into financial terms. In terms of appropriately 'costing in' risk factors, different organisations will use different approaches. After assessing every risk an organisation may identify those risks with a high probability and/or impact and then price its full impact into the bid. Another and arguably more realistic approach is to price all identifiable risks but to seek to control their cost consequences through probabilistic considerations.

For example, if the probability of encountering certain ground conditions is assessed at 20% and the cost of contending with those conditions is estimated at $200,000, a contractor—rather than ignore the risk altogether and potentially leave itself exposed, or building in the full $200,000 into its bid price and thus potentially rendering its bid uncompetitive, may elect to price the risk in accordance with a simple formula to determine risk cover such as:

'0.20 x 200,000 = $40,000'.[1]

The effect of each risk (where the probability of it occurring is uncertain) is treated accordingly and the cumulative effect will feed into the final bid price and act as the contractor's 'risk buffer' or 'risk premium'.

As has been noted, the reality is that this 'risk premium' is often eroded during the course of the 'sharpening the pencil' discussions at the preferred tenderer stage of negotiations. Moreover the ability of contracting parties to adopt innovative risk management and transfer strategies can in a very real sense be impacted upon by the involvement of a project financier who will see completion risk as one of the key drivers.[2]

Notwithstanding a desire by contracting parties to achieve an appropriate allocation of risk in accordance with the Abrahamson principle or otherwise, the necessity to make the project 'bankable' will often see the contractor being asked to assume a greater amount of risk than might otherwise be the case. But while market driven completion risk is a key driver for a project financier, the ability to secure guaranteed and timely payment is a key market driven risk for a contractor looking to undertake a project.

If acting on behalf of a contractor considering a building works proposal, the first question which needs to be considered is the ability of the principal to make payment for the finished works. While this may seem on its face to be an obvious consideration, it is one which is sometimes seemingly overlooked in the desire to secure the contract.

The first enquiry which one should make in those circumstances relates to the financial wherewithal of the principal. Is the principal a blue chip public company with all of the comfort its balance sheet affords, or is it a so called '$2.00 company'? If it is a $2.00 company, is it a subsidiary of a substantial entity whereby the parent company is in a position to guarantee payment, or is it in fact proposed to have the entire project funded by an external financier?

In circumstances where the principal is regarded as less than 'blue chip', the contractor may wish to ensure that the contract contains a 'change of control' clause which will enable it to terminate if there is a change of ownership of the client. It will also wish to ensure that the contract cannot be novated to another party without its prior approval.

In the absence of the provision of parent company guarantees, the contractor may be unwilling to proceed unless the principal is able to furnish significant security, sufficient to cover its exposure to unpaid progress claims and work in progress. The contractor would also wish to ensure that it has an early right of suspension for non payment and that payments for work are made on a regular basis and on the basis of work completed and not the difference between the contract sum and value of work remaining.

If the entire project is to be funded by an external financier, substantial due diligence is required in relation to the principal's proposed funding arrangements, before a contractor would feel secure in proceeding to undertake the works. Such an exercise extends beyond the contractor merely satisfying itself in relation to the extent of finance available for the project. For example, the contractor would wish to ensure that the project financier's funding for the project was not capped at the contract value of the works, and that there was sufficient 'buffer' available in the event of cost overruns which may arise as a result of variations or delays to the project.

A related reason why this is important is to guard against the consequences which may flow from a situation arising at or near the completion of a project, whereby the funding has been effectively exhausted, and the principal remains in possession of significant securities from the contractor.

Assume for example that the total funding available for the project has been exhausted by the time of lodgement of the penultimate progress payment claim. By the time that the contractor is entitled to exercise its rights to suspend the works under the contract for non–payment, it will have been obliged to proceed for a further month to complete the project and increase its unfunded exposure accordingly.

The principal may, in these circumstances, find itself under significant financial strain and may, as a last resort, seek to have recourse to the contractors' unconditional security. In those circumstances, the contractor faces a real risk of being contractually compelled to complete the project and not only face the prospects of conversion of its securities, but also of being 'out of pocket' to the extent of its final two progress payment claims.

Additionally, the contractor would wish to satisfy itself that the facility funding available for construction was 'earmarked' and

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'quarantined' to ensure that there was no shortfall in funding to pay the contractor at the end of the project.

Entry into a tripartite arrangement between the principal, contractor and financier is a common means of seeking to ensure that payment to the contractor is adequately secured and a contractor will commonly insist upon independent certification of payment claims by the financier's agent with direct payment to be received from the financier. In the absence however of appropriate due diligence undertaken in relation to the facility deed between the financier and principal, a contractor may still face a potential funds shortfall at the completion of the project. A material adverse effect / change condition clause may also be embedded in finance document which enables the financier to withdraw funding.

Accordingly, it is necessary to ensure that in the event of default by the principal under the terms of its arrangements with the financier, the contractor has an ability to be paid for work undertaken to that point in time (and not just in respect of amounts currently certified for payment). In the absence of such arrangements, at the time of default, a contractor can find itself awaiting payment on a prior assessment or certificate and have undertaken further significant work in the ensuing period, with no commensurate right to seek that payment from the financier. The financier on the other hand will have undoubtedly reserved to itself the right to 'step into the shoes of' the principal and complete the project.

Further matters which require consideration to adequately ensure the contractor's security of payment are the ability to be paid for offsite materials and to be able to control any purported assignment of the contract, given the consequences which may flow from an attempt by the principal to on–sell the property on which the construction is to take place, prior to or during construction. Serious attention must also be given in circumstances where the owner of the property upon which construction is to take place is not the principal contracting with the contractor. It is necessary in those circumstances to fully understand the relationship between the two entities (who may be acting in a form of joint venture or alternatively simply an arrangement of vendor/ purchaser) and guard against a circumstance where the property owner's lender may have an ability to exercise rights in respect of the property.

Contracting with joint venture parties (or commonly in mining projects, the joint venture manager) can create a myriad of payment risks which need to be clearly understood, particularly in circumstances where the joint venturer's liability for payment under the contract is several and not joint. Similar concerns arise when contracting with a principal as trustee of a trust seeking to limit its liability to the assets of the trust. In that scenario due diligence in relation to the trust deed and the trust's financial statements should be undertaken.

THE ROLE OF CONTRACT SECURITIES

As has been noted by Dorter & Sharkey,[3] from a contractor's point of view it is not just payment, but cash flow which is crucial, because most of what the contractor receives by way of progress payment each month must be paid out to the contractor's employees, subcontractors and suppliers. The deduction of retention monies can seriously impact on a contractor's cash flow position and accordingly, the contractor's preference is usually for the provision of a bank guarantee or insurance bond, rather than money being retained out of the contractor's progress payments.

Threats (or indeed actions taken) by principals to 'pull the guarantees' have seen a number of instances of contractors seeking injunctions to restrain the presentation or the taking of the proceeds of the guarantee, or alternatively seeking declarations that funds that are the subject of the guarantee, once pulled, are held on an express or resulting trust.

Leaving aside a situation where evidence can be adduced that 'pulling the guarantees' would be fraudulent (in which case, it is almost always possible to obtain an injunction), the success of the relief sought by the contractor has most commonly turned on the existence or otherwise of a limiting clause in the contract.

There are two recent cases however, which are worthy of further consideration.

BORAL FORMWORK AND SCAFFOLDING PTY LTD V ACTION MAKERS LTD

The first is a decision handed down by the NSW Supreme Court in Boral Formwork & Scaffolding Pty Ltd v Action Makers Ltd[4] in which Austin J made declarations and granted injunctions in favour of Boral Formwork & Scaffolding Pty Ltd pursuant to s 51AC of the Trade Practices Act 1974 (Cth) and in doing so made substantial inroads to the principle of 'autonomy' attaching to the performance of unconditional commercial obligations.

In the proceedings the plaintiff Boral sought to prevent the second defendant (a bank) from paying Action Makers Ltd any amount in excess of $634,821.53 (the undisputed amount) on a letter of credit issued by the bank for the benefit of Action Makers. The proceeding began on 18 June 2003 and on that day Campbell J granted Boral interim ex parte relief. The case returned to Austin J who agreed to deal with the matter on a final basis.

FACTS

Boral and Action Makers entered into an agreement under which Action Makers, an English company, was to manufacture and deliver to Boral approximately 48 containers of scaffolding equipment. A supply agreement governed the parties' contractual relationship and this agreement provided for Boral to place purchase orders from time to time for product which was sold CIF (cost, insurance and freight) for delivery to ports in Australia. Action Makers warranted that all products would conform to the drawings and specifications and had been manufactured in accordance with procedures set out in an annexure to the agreement. The agreement itself provided for a system of inspection and warranty claims should the goods not conform. Under the agreement Boral provided a letter of credit, the subject of the proceedings, described as an 'irrevocable standby documentary credit'.

Action Makers delivered only 18 containers of scaffolding components to Boral. After inspecting the goods delivered, Boral determined that the product was defective because it did not meet the specifications set out in the supply agreement. On 21 February 2003 it wrote a letter setout out details of defects. Later, Boral carried out rectification works on the goods, incurring expenditure for that purpose.

In their letter to Carter Newell Lawyers (who acted on behalf of the plaintiff), dated 30 June 2003, the solicitors for Action Makers made the following concession, upon the basis of which the final hearing was conducted:

Your client may proceed on the understanding that, without admissions and solely to enable the convenient disposal of the injunction proceedings on a final basis … our client will not argue that your client does not have a valid claim against our client in the nature of the claim described in your client's letter of 21 February 2003.

On 3 February 2003 administrative receivers were appointed to Action Makers in the UK. On 5 June 2003 they made a demand on the bank, purporting to act as agents for Action makers, for payment of $808,886.92, the full amount of the invoices rendered by Action Makers for scaffolding components supplied to Boral. By the time of the final hearing, the bank had paid the part of that amount Boral admitted to be owing, namely the undisputed amount. The balance of the amount claimed was alleged by Boral to be the cost of the rectification work which Boral claimed to be entitled to deduct from the invoice amount.

QUESTION FOR DETERMINATION AND RELIEF SOUGHT

The question for determination was whether Boral was entitled to prevent the bank from responding to the receivers' demand on the letter of credit for the disputed amount. By its amended summons, Boral sought the following relief:

- Declaratory orders that, in calling for payment under the letter of credit in a sum greater than the undisputed amount, Action Makers was engaging in conduct that was in all the circumstances unconscionable, or unconscionable within the meaning of the unwritten law of NSW; and
- Injunctions restraining the bank from paying to Action Makers any amount in excess of the undisputed amount, requiring Action Makers to countermand the demand it had made for payment upon the letter of credit and restraining Action Makers from making any further demand under the letter of credit.

Boral claimed to be entitled to this relief on three grounds:

- On the basis of an implied negative stipulation in the supply agreement;
- Pursuant to s 51AA of the Trade Practices Act; or
- Pursuant to s 51AC of the Trade Practices Act.

PRINCIPLE OF AUTONOMY

In the action Boral sought to overcome what is often referred to as the principle of autonomous operation of instruments such as letters of credit, performance bonds and bank guarantees.

Broadly speaking, the principle of autonomy provides that the financier's unconditional payment obligation in commercial instruments is independent of the underlying contract between the applicant for the instrument and the beneficiary of the instrument. With limited exceptions, courts do not interfere with performance of the payment obligation. As his Honour noted in the case, standby letters of credit, bank guarantees and performance bonds are often considered together in the cases and by commentators because they have the same commercial purpose.

The court identified three possible exceptions to the principle of autonomy. The first related to the so called 'fraud exception'; however, it was not contended

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that the facts of the present case fell within that exception.

Another exception to the principle invoked by Boral in the present case, was the notion that the court may, at the suit of the account party, grant an injunction to restrain breach by the beneficiary of the instrument of an expressed or implied negative stipulation in the underlying contract. The judge concluded in the present case however that Boral had failed to establish that there was an implied negative stipulation in the supply agreement grounding an entitlement to an injunction.

The third exception to the principle of autonomy, and one relied upon by Boral, arises out of the Australian Statutory Provisions dealing with unconscionable conduct—ss 51AA and 51AC of the Trade Practices Act. The question was whether, by calling for payment of the invoice amount and supplying the certificate to the bank, in circumstances where the certification that the invoice amount represented funds due to be paid to Action Makers, by the administrative receivers, engaged in conduct which was unconscionable for the purposes of those sections.

REASONING

In giving careful consideration to the arguments of both counsel, his Honour noted that the principle of autonomy, applicable to a standby letter of credit, cannot override the statute.

His Honour referred to a decision in Olex Focas Pty Ltd v Skodaexport Co Ltd,[5] a case in which a head contractor called up the full amount of some performance bonds provided by the subcontractor plaintiffs while there was a continuing dispute between them. In that case, Batt J declined to grant interlocutory injunctions pursuant to s 51AA of the Trade Practices Act to require the head contractor to countermand the calls made on the bonds. While Austin J was influenced by the matters considered by Batt J in that previous case, his Honour concluded that Boral's claim to unconscionable conduct pursuant to s 51AA went beyond the matters considered by the judge in that previous case. Austin J stated at [82]:

It is the case where, effectively, the dispute had been settled by virtue of the administrative receivers' acquiescence in Boral undertaking repairs… and then later, notwithstanding that acquiescence, Action Makers made a call on the letter of credit as if all those circumstances had not occurred.

Section 51 AC(1), which commenced after Batt J's decision in Olex Focas, is in the following terms:

A corporation must not, in trade of commerce, in connection with:

(a) the supply or possible supply of good or services to a corporation (other than a listed public company); or

(b) the acquisition or possible acquisition of goods or services from a corporation (other than a listed public company);

engage in conduct that is, in all the circumstances, unconscionable.

Austin J concluded that s 51AC potentially applied. His Honour determined that Boral was a proprietary company within the meaning of the section. The transaction was within the monetary limit prescribed and the conduct challenged in the present case was held to be clearly 'in connection with' the supply of goods.

His Honour then dealt with the contention raised by counsel for

Action Makers that the section, being circumstantial in nature, was directed at protecting the weak and inexperienced and has no application to conduct affecting a commercial entity such as Boral. His Honour concluded that there was nothing in the section that in those terms imposed a limitation of that kind.

His Honour concluded that for the same reasons as outlined in his findings under s 51AA, the presumption of autonomy did not provide an adequate discretionary reason for not granting declaratory and injunctive relief on the basis of a contravention of s 51AC. His Honour noted that, having regard to s 51AA(2), relief in such circumstances is to be granted under s 51AC to the exclusion of s 51AA.

DECISION

Austin J held that Boral was entitled to declaratory orders under s 51AC that, in calling on payment under the letter of credit in a sum greater than the undisputed amount, Action Makers, by the administrative receivers, engaged in conduct that was in all the circumstances unconscionable. His Honour held that Boral had established its entitlement to final orders requiring Action Makers, by the administrative receivers, to countermand the demand for payment of the disputed amount under the letter of credit and restraining it from making any further demands under the instrument. Given the injunctions granted it was unnecessary to consider whether an order should be made against the bank.

In concluding, his Honour stated at [94]:

I hope it is clear that, in deciding to grant the relief sought by Boral, I have given anxious consideration to the principle of autonomy and the dangers associated with any judicial intervention with the performance of unconditional commercial obligations … It is not normally unfair or unreasonable or otherwise unconscionable to exercise commercial rights under an autonomous commercial contract, even if (for example) for the purpose of applying pressure to resolve a dispute. Even if the conduct is unconscionable, the principle of autonomy is relevant to the exercise of the Court's discretion to grant injunctive relief or leave the plaintiff to other remedies. Here the circumstances, involving as they do a call on the letter of credit on a false basis, are sufficiently special to overcome the hesitation which the principle of autonomy generates.

IMPLICATIONS

The decision is a significant one and should be of interest to all parties who transact business on the basis of instruments such as letters of credit, performance bonds and bank guarantees. While Batt J observed in the Olex Focas case (at 404) that the effect of the Trade Practices Act 'is to work a substantial inroad into the well established common law autonomy of letters of credit and performance bonds and other bank guarantees', his Honour ultimately declined to grant the interlocutory relief sought in that case.

In the circumstances of the present case, Austin J gave full force and effect to the relevant sections of the Trade Practices Act to override well established principle. There seems no reason why in appropriate circumstances the same relief could not be granted in relation to unconditional performance bonds or bank guarantees under a construction contract.

BMD MAJOR PROJECTS PTY LTD V VICTORIAN URBAN DEVELOPMENT AUTHORITY

The second case relates to the circumstances (if any) in which a court would be prepared to make a mandatory order for the return of such a form of security by way of summary relief, in circumstances where there was no immediate threat to call upon the instrument.

This scenario was recently considered by the Victorian Supreme Court in BMD Major Projects Pty Ltd v Victorian Urban Development Authority, in an unreported judgment of Master Kings delivered on 25 November 2004.

In that matter the plaintiff sought, (amongst other relief), summary judgment against the defendant for an order for the release by the defendant of the first of two bank guarantees provided by the plaintiff to the defendant in relation to certain contract works.

FACTS

On 22 March 2002, the plaintiff ('the contractor'), and the defendant ('the principal'), entered into a contract ('the contract') in which the plaintiff agreed to carry out excavation, filling and quarry rehabilitation works ('the works') at the disused former Niddrie Quarry in Keilor East, Victoria ('the quarry').

The contract involved two areas of works designated as separable portion (1) Steele Creek works and separable portion (2) balance of site. The contractor agreed to perform the works for the guaranteed upper limit contract sum at the date of acceptance of $15,915,726.10 (exclusive of GST) for separable portions 1 and 2.

On 7 May 2002, in accordance with clause 5.2 of the General Conditions and Part A of the Annexure, the contractor provided the superintendent with four bank guarantees by way of security, two bank guarantees each for separable portions 1 and 2.

Pursuant to clause 5.7 and Part A of the General Conditions, upon issue of the Certificate of Practical Completion of each separable portion, the principal's entitlement to security was to be reduced, whereby one of the bank guarantees would be released.

The two bank guarantees provided by the contractor for separable portion 2 were each in the amount of $762,615.80.

On 5 December 2003, the superintendent certified separable portion 2 as having reached practical completion on that date.

On 23 December 2003, the superintendent wrote to the principal requesting that arrangements be made to return one of the bank guarantees to the contractor.

By letter dated 16 January 2004 to the contractor, the principal:

• Enclosed a bank guarantee in the amount of $33,170.50 being 50% of the securities provided for separable portion 1 of the contract;

• Failed and refused to return the bank guarantee relating to separable portion 2 of the contract in the amount of $762,615.80 except upon the imposition of conditions involving the provision of a substitute bank guarantee for a lesser amount of $70,000.00 to cover the estimated potential value of unsatisfied claims.

THE QUESTION FOR DETERMINATION

The Master firstly had regard to Rule 22.06(b) of the Victorian Supreme Court which provides that unless the defendant satisfies the court that there is a question that ought to be tried or that there ought, for some other reason be a trial, the court should give judgment for the plaintiff.

The Master also considered that it is well established that summary judgment should not be ordered unless it is clear that there is no real question to be tried.[6]

The question for the court was whether the contractor was able to compel the return of the bank guarantee, and that question turned on the proper construction of clause 5 of the General Conditions and certain clauses contained in Appendix 8 'General Description of Works'.

Clause 5.7 was the clause which required one of the two bank guarantees to be returned consequent upon the Certificate of Practical Completion. The obligation to do so was qualified by the terms of clause 5.8A. That clause provided:

5.8A Unsatisfied Claims
Despite clauses 5.8, 5.9 and 42.6 if at anytime that the Principal is otherwise required to release security or retention money to the Contractor, the Principal considers it has any unsatisfied claim against the Contractor (including without limitation for any liquidated or unliquidated damages), the Principal shall only be obliged to release the security or retention monies to the extent that the aggregate of the security and retention monies exceeds the aggregate of:

(a) the amount the Principal is otherwise still entitled to retain under the Contract; and

(b) the amount of the Principal's unsatisfied claim, but the Principal shall release the excess amount of security or retention monies withheld under this clause (if any), within fourteen (14) days of the unsatisfied claim being satisfied.

The guarantee provided by the contractor was in a form which was contained in the Annexure to the contract and made express provision for a partial call. It was submitted by the contractor that this was consistent with and indeed was as required by clause 5.8A of the General Conditions.

It was further argued on behalf of the contractor that any orders involving a substitution of the bank guarantee provided pursuant to the contract with a bank guarantee of a lesser amount would not reflect any obligation imposed upon the contractor by thecontract.

The principal claimed that under clause 2.13 of the Specification, Appendix 8, the contractor was to provide the superintendent with certain clearances in writing, which it had not.

The contractor submitted however, that clause 2.13 was concerned with clearances required before the issue of Practical Completion. Clearances which were to be provided after Practical Completion were covered under clause 2.11. This required clearances to be provided prior to the issue of the Final Payment Certificate which was secured by the remaining bank guarantee of $762,615.80.

JUDGMENT

Master Kings found that there was no dispute that Practical Completion had issued and she accepted that the superintendent had given Practical Completion unconditionally. Accordingly, the Master found that any remaining obligations on the contractor were in relation to matters after Practical Completion.

In the circumstances, the Master ordered that the principal release to the contractor the first bank guarantee for $762,615.80 relating to separable portion 2 of the contract.

IMPLICATIONS OF THE DECISION

The decision is instructive in that it demonstrates a mechanism to compel, by way of summary relief, the return of a security in circumstances where there was no imminent threat of conversion of that security by the security holder. In the absence of an ability to obtain such an order, a contractor may find itself unable to compel the return of its security until the determination of the substantive issues arising in the action.

While it is certainly the case that a finding at trial that a security had been wrongfully detained would give a contractor a right to compensation by way of an award of damages, the inability to otherwise compel the timely return of the security may impact on the totality of financial facilities otherwise available to a contractor—damage far more nebulous and difficult to quantify.

A SUPPLIER'S PERSPECTIVE

A situation may arise where a supplier of building materials to a project finds itself owed funds by a contractor whose contract is terminated in consequence of solvency concerns and is in turn placed into administration. The supplier of the building materials has often provided those materials to the contractor in accordance with its standard credit terms. The materials are subsequently incorporated into the works, often prior to payment for those materials to the supplier.

Not uncommonly, the supplier of those materials seeks to afford itself some protection for payment within its credit terms by including what is commonly known as a 'Romalpa Clause'. Such a clause will ordinarily state that the goods supplied remain the property of the supplier until payment in full is received and that until full payment is made the customer holds the goods as bailee. Such a clause often goes on further to provide that while holding the goods as bailee, a fiduciary relationship exists between the customer and supplier and that if the customer sells any of the goods, it does so as fiduciary agent of the supplier.

In such circumstances the question arises whether, by virtue of such a clause, the contractor will hold any funds received by it (by its administrators) in payment of any outstanding progress claims, on trust for the supplier.

ANALYSIS

The description in the suppliers credit terms of the contractor as fiduciary agent of the supplier, suggests that the contractor is obliged to subordinate its own interests in a sale, and also supports an argument that the parties thereby intended that the supplier has the right to trace any proceeds of a sale by the contractor.[7]

The case of Associated Alloys Pty Ltd v ACN 001 452 160 Pty Ltd (in liq) (formerly Metropolitan Engineering and Fabrications Pty Ltd),[8] demonstrates that in some cases it is legally possible for a Romalpa Clause in a contract for the sale of goods, to produce the consequence that the borrower holds such a part of the proceeds of a construction process utilising the seller's goods as it relates to the use of those goods, in trust for the seller; and a trust of that kind, if effective, is not struck down as an unregistered charge void against an administrator under S266(i) of the Corporations Law.

Whether that result is produced or not, principally turns upon the careful construction of the words used in the Romalpa Clause and the application of those words to the particular facts of the case.

In the Associated Alloys Pty Ltd case, the relevant provision of the Romalpa Clause provided:

[5] in the event that the [buyer] uses the goods/product in some manufacturing or construction process of its own or some third party, the [buyer] shall hold such a part of the proceeds of such manufacturing or construction process as relates to the goods/product in trust for the [seller]. Such parts shall be deemed to equal in dollar terms the amount owing by the [buyer] to the [seller] at the time of the receipt of such proceeds.

Whether such words are sufficient to impose upon the contractor, an obligation to hold any part of the proceeds it receives from the principal upon trust for the supplier may turn on a number of matters including the necessity for there to be a 'sale' by the contractor of the kind referred to in the Romalpa Clause. Commonly the contract by which the contractor 'on–sells' the building materials will not constitute a 'sale' within the legal context of that word, but rather would be a contract for work and materials. This type of contract has been regularly distinguished from a sale.

On the other hand, while a simple resale by the contractor of building materials purchased from the supplier could result in the contractor holding the proceeds of sale as a 'fiduciary agent', perhaps on trust for the supplier, it may be extremely difficult to attribute an intention to the parties that the contractor would hold any particular progress payment on such a trust. Similarly, a progress payment is likely to include one payment as the value of the work done (including materials supplied) over a period, rather than simply the price of the materials supplied.

Assuming a clause was otherwise effective to constitute the contractor as trustee of the proceeds, to construe the clause as extending beyond a 'sale' to a contract by the contractor for the performance of work and associated supply of materials would either constitute the contractor as the trustee of the whole proceeds of the progress payment for a period in which some of the supplier's material was supplied, or would require an implication that only some part of the proceeds of the progress payment, in some way attributable to the supply of the supplier's material, was held on trust for the supplier.

Either of these constructions would involve the unintended consequence that the contractor would hold the entire payment on trust for the supplier in circumstances where there is no criterion for determining how much of a particular progress payment is to be held on trust.

It also seems inherently unlikely that any contractor would assume an obligation to keep all or any part of the proceeds of any progress payments separate from its own money to the detriment of its own cash flow, making it very difficult to infer the relevant intention in circumstances where the clause does not in terms provide for such a trust.

CONCLUSION

Even if the supplier were either a nominated supplier of the principal or, perhaps more relevantly, if the contractor had a right under its contract to separate payment with respect to on or off site materials (which may encapsulate the supplier's goods), it seems that this would only impact on the outcome, if the effect of that arrangement was to constitute a 'sale' of the goods. While ordinarily any payment for on or off site materials would still be on account only (falling within the overall payment referable to the contract for work and materials), a regime pursuant to which the contractor received a separate payment for off site materials pursuant to which property in those goods passed to the principal, may be sufficient to constitute a sale in the relevant sense.

Only if such a circumstance were encountered, would there appear to be a sound basis to assert rights as a preferential creditor against the administrators of a contractor. In those circumstances, an undertaking could be sought from the administrator to set aside any funds recovered by the contractor from the principal referable to the supply of the supplier's goods, on trust for that supplier.

REFERENCES

1. Chinyio and Fergusson 'A Construction Perspective on Risk Management in Public–Private Partnership', from Public–Private Partnerships—Managing Risks and Opportunities—Blackwell, at p109

2. As McConnel notes—ibid at p154, there can be a wide variety of covenants and guarantees contained in completion agreements between the lender and parties providing completion covenants including:

- unconditional agreements to provide funds to ensure completion;
- financial guarantees to takeover project debt;
- cash or working capital deficiency agreements; and
- best efforts and undertakings to use prudent commercial practice to secure completion (see McMurtrie J 'Project Financing: A Lender's Perspective', The Economic Society of Australia—Economic Papers, October 1983, Vol 2, No. 3 p56)

3. Building & Construction Contracts in Australia 1990 Thomson at [10.370]

4. (2003) NSWC 713 (5 August 2003); BC2003004470

5. [1998] 3 VR 380 at 397

6. Aquatec–Maxcon Pty Ltd v Minson Nacap Pty Ltd [2004] VSCA 18 at 59

7. BHP Steel Ltd v Robertson (Aust) Pty Ltd [2002] NSW SC 336 per Barrett J at 9–11

8. [2000] HCA 25