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LOVEGROVE SOLICITORS

Risk for Bankers and Building Contracting

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The construction industry is fraught with risks for the uninitiated. The government has had to legislate to protect owners from the vagaries of building contracting through vehicles like the Domestic Building Contracts Act. Security for payment legislation has been implemented to protect the payment rights of sub contractors. Unions from time to time enter into the foray and use unorthodox measures to exact payment from builders, developers and the like.

There is no Act of parliament that protects banks from defaulting parties. The remedies reside in

- Legal instruments
- Due diligence
- Being savvy and understanding the vagaries of the building industry.

This paper will deal with some of the main ways by which bankers and financiers alleviate risk. It will also identify what the writer has identified as being a flawed approach in the way some of the security instruments are used and developed. One of the main focuses will be upon the use of tripartite agreements.

The Tripartite agreement

Many funders use tripartite agreements to avail themselves of the ability to, in a defacto sense, control the activates of contractors and customers or developers. Unless a higher degree of science is applied to the way in which these deals are put together there can be seriously negative and unintended consequences for the funder.

Tripartite deeds typically give the funder the ability to veto variations, contractual termination or contractual suspension; yet these deeds in the main stipitate that these veto powers exist without there being any possibility of liability to the funders, this is naive. Third party intervention generates legal and logistical consequences and it impacts upon the way by which builders

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and developers operate under their head contracts.

Tender Considerations

If the funder is intent on a builder coming within the jurisdiction of a tripartite agreement the funder should make sure that the tender documents contain a document that requires the builder to enter into a tripartite deed. If this does not exist the funder will have no ability to compel the builder to execute a tripartite agreement.

Harmonisation amendments

The funder should get a construction lawyer to check the head contract i.e. the contract that the builder enters into with the developer to ensure that relevant provisions of the tripartite deed are harmonised with the key provisions of the building contract.

If that is not contained the deed must contain an overrider condition. An overrider clause is one that states that where a conflict between two clauses then one of them will take precedence.

However if there is a residential building contract it will be governed by the Domestic Building Contracts Act. This Act regulates construction contracts in the building industry. If the deed contains a provision that cuts across or is at odds with a provision of a legislatively compliant housing contract or multi unit development contract then the provision in the deed will be read down or will be null and void.

Considerations to do with Contractual Suspension

A typical provision in a tripartite agreement dictates that the builder cannot suspend the building work without the permission of the financier or until the expiration of a certain number of days.

One such provision came across our desk a fortnight ago, see below

> *In the case of the fault by the customer, the builder may not suspend the works unless within 21 days from the receipt of the notice… the financier does…*
>
> *Neither the customer nor the builder may suspend the works as a result of any fault by the other unless the financier has been first notified of the breach containing reasonable defaults.*

Compare this with a suspension clause in a building contract will often read along the following lines:-

If the owner delays payment by more than 10 days, then the builder can suspend the works pending payment of outstanding progress payments.

The problem with the deed provision is that it will be at odds with the suspension provision in a standard industry building contract. Such provisions do not contemplate any third party intervention right, hence the provisions cut across one another.

The Impact of the Building and Construction Industry Security of Payment Act 2002 (SPA)

Large scale developments usually have sophisticated inspection and claim assessment procedures. The bank will appoint an independent qs, whom once armed with a progress claim will inspect the work and recommend payment in full or in part.

Under the SPA when a progress claim is lodged by the contractor, the developer needs to then provide a payment schedule either within the time required by the building contract or within 10 business days after the date upon which claim is served, whichever period of time expires earlier.

If the developer fails to deliver the payment schedule by the due date, then the developer becomes liable to pay the claimed amount to the builder by the due date (under the contract) for the progress payment to which the payment claim relates.

If the developer fails to pay by the due date, then the amount claimed becomes a debt due and may be recovered in court. The builder is then entitled to suspend the work upon two days notice. The entitlement to suspend the work under these circumstances does not constitute a breach by the builder of the Building Contract.

Termination clauses

A typical tripartite condition will provide that neither the builder nor the developer can terminate a contract unless the prior permission of the financier is forthcoming. The below provision is typical case in point

The builder cannot terminate or rescind the building contract as a result of any breach of the building contract by the other party unless

- *The builder has given notice to the financier giving details of the breach*

- *In the case of default by the customer, within 21 days of receipt of the notice in sub clause… the financier does not…… and [so forth]*

Standard industry building contracts have comprehensive termination clauses. They ordinarily provide a "menu" of defaults. They also ordinarily provide that in the event of one of the prescribed defaults a notice of default has to be dispatched to the offending party stating the nature of the default. There will be a period of time afforded under the notice, to remedy the default and if the default is not remedied the contract will ordinarily provide that the contract can be terminated by dispatching a notice of termination.

There is unlikely to be any standard industry building contract that either contemplates or stipulates the involvement of the financier in termination. As the above italised provision is a standard tripartite clause it follows that it either has to be deleted or the head contract has to be amended to make mention of the juxtaposition or the involvement of the financier.

The freedom to terminate a contract goes to the very core of contracting just like a financier would not like a third party to inhibit or corral its ability to terminate the contract of a defaulting borrower, the builder will be loathe to afford weight to such a provision when push comes to shove. The builder will; want to reach for the contractual arsenal and utilise it. The builder will not be terribly worried about occasioning a breach under the tripartite agreement because his primary relief lies with the developer, the pragmatics of survival will prevail and the conflicting provision under the deed will probably be rendered benign.

Furthermore the overwhelming majority of terminations or suspensions that are generated by builders are on account of non payment. Regardless of the reasons for a financier withholding payment under the head contract, if the builder has done the work and the developer owes the money, the developer will have to pay the money under the head contract.

If the developer invokes a provision unde the tripartite agreement, the net effect of which is to delay payment, the financier could force the developer into a repudiation of contract. In such circumstances the developer regardless of any disclaimer under the tripartite agreement may contend that the funder in so far as it hampered or interfered with head contractor rights, occasioned a serious and fundamental head contractor breach and in so doing breached an implied term of the loan facility.

NOVATION

Typically a tripartite agreement will allow the developer to step into the shoes of the developer if certain calamities occur. This is a minefield and should be approached with considerable trepidation. When developments "go off the rails" one will generally find that there has been short changing of payments or payment defaults.

If the developer through the novation becomes the new contracting party then it will have to make good payment defaults that have been occasioned by the developer. The short fall could be monumental, Lovegroves have had conduct of cases where completion costs on multi million dollar projects have blown out by as much as 100%. If the novation is exercised then the developer may unwittingly assume that liability. It may have been better to liquidate the asset and through an administrator on sell the site to another party.

Amusingly, tripartite agreements often have blanket denial of liability clauses the import of which is that the funder cannot be held liable for anything. These blanket provisions are in reality "red herrings", if a novation is exercised the financier will become completely liable to the builder because the financier "steps into the shoes" of the developer and the contractual obligations cut both ways.

Variation Clauses

Typically tripartite clauses provide that variations cannot be augmented unless there is financier sanction, again standard industry building contracts do not afford such third party involvement any status. Harmonisation amendments are therefore required so that the head contract provides that in addition to all of the other criteria that are required to generate a variation the consent of the financier is required.

Conclusion

It is clear that many tripartite agreements in circulation are Performa templates that are designed to operate in a vacuum. If you take a standard industry building contract and a "garden variety" tripartite agreement straight of the word processor, on the overwhelming balance of probabilities the two instruments will work against each other rather than complement one another. This is dangerous, it is dangerous because in so far as the instruments lack homogenization they will as a matter of course lead to a legal minefield. The combined effect of a

lack of harmonisation will be the escalation of a dispute and the potential prejudicing of the security that the tripartite agreement is designed to achieve rather than the enhancement of it.

In the absence of "off the shelf" tripartite agreements that are tailor made for the standard industry building contracts likes of the

- ABIC
- AS4000
- Uniform housing contracts published by the HIA and MBA

the financier is trying to put Tony Locket into a jockeys uniform, in other words one is left with an anathema. Construction lawyers have to work in unison with finance lawyers to ensure that this does into occur.

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