tracts, recognising the damage caused by contractual claims. Rather than using our best legal brains to advise on a dispute after it has happened, we would be better advised to use our legal advisers much more widely prior to signing the agreement. Meddling with the standard forms is unhelpful and leads to disputes.

Future contract practice must, therefore, concentrate on the product to be delivered and establish clearly the roles of design, management, and site assembly. Once the roles and responsibilities are established within a consistent project strategy, the liability for execution (or failure) will be unequivocal."

10. WAGE CLAIMS/NATIONAL WAGE CASE

As the assumptions of the Federal Government's last budget are one by one proved wrong, so the 1989 wage-fixing scenario becomes more and more uncertain.

In September last year, things appeared reasonably predictable. There would be tax cuts in July which would remove pressures for a general wage increase. Wage increases for particular industries would only be available if substantial progress had been made in implementing changes under the "structural efficiency" principle.

That orderly procedure is getting less and less likely. Unions in more and more industries are realising that "structural efficiency" is a difficult concept, and that it is not easy even to identify the sort of issue which should be discussed, let alone achieve substantial change. At the same time there is growing support for a general wage claim based on traditional cost of living grounds.

The situation is still very fluid. Much will depend on the Federal Government's position on tax cuts, and on the outcome of the Arbitration Commission's review of the wage-fixing principles which is to begin soon.

It is expected that the unions are likely to claim two elements:

- an unconditional across-the-board increase in the second half of 1989;
- a further increase in the second half of 1989 based on industry restructuring.

There may also be concerted efforts to increase the prevailing level of site allowances later this year. It is too early to predict the extent to which this will be a co-ordinated national campaign.

11. OPERATING LEASES

Due to the importance of leasing and financial arrangements to the construction industry, particularly in relation to plant and equipment, in this article Sydney solicitor John Hewitt considers the leasing implications of one of the new accounting standards.

There is a widely held conviction amongst many members of the corporate and financial fraternity that they have been drawn into a "paper chase" by Australia's beloved official bureaucracies. One of the trying issues is the understanding and application of the accounting standard ASRB 1008, which relates to leases and how they are to be shown in a set of financial accounts.

The problem for the lessee (i.e. the user of the leased asset) is that all leases, other than operating leases, must be shown on the balance sheet. This is in stark contrast to previous reporting requirements.

As an illustration, assume that a company with issued share capital of $5 million leases $10 million worth of equipment which, in turn, it hires to a third party which guaranties an income stream.

In pre-ASRB 1008 times, the balance sheet would carry a note on the amount of lease payments that were due in future years, but would not show the $10 million asset or the corresponding liability on the face of the accounts.

In ASRB 1008 times (i.e. from January 1, 1988) the asset is shown net of depreciation, whereas the liability is shown on the full pay-out figure. In other words, after one year the asset may have been depreciated down to $8 million whereas the pay-out liability may well be $9.5 million.

The problem in the post-ASRB 1008 example is that the lessee's gearing ratio is approximately 195 per cent. This (irrespective of the revenue stream generated by the asset) will directly affect the company's ability to raise further credit.

A solution is to remove the liability from the balance sheet by writing an operating lease. This new lease form differs in a number of ways from the traditional finance lease. Without going into the finer details, one can simply follow the rule that, with an operating lease, the lessee has no rights or obligations over the asset at the end of the lease.

The lessee no longer pays out a lump sum at the end of the lease in order to own the asset. Instead, the lessee purely rents the article for the term, after which it is returned to the lessor (the finance company) in good working order and repair. By giving up the rights to such an asset, the lessee loses the "upside" resale profit potential on the residual. But the lessee also achieves the desired off-balance sheet goal, with the added advantage that the lessee carries no residual risk.

The finance company (lessor) will be the party taking that long term residual risk, which will be a very real risk if the market value declines to below the residual value written into the lease.

The problem is to find lessors willing and able to take asset positions at the end of the lease term. No bank or finance company wishes to own or become a dealer in used assets.

The lessor may turn to the supplier of the equipment for some form of buy-back agreement, but in the majority of cases these days the supplier will decline. Why? You've guessed it - quite apart from the commercial risk, the supplier does not want to load its balance sheet.

A solution to the lessor's residual problem appears to lie with the insurance industry taking the residual risk. There is at least one Australian company, Asset Underwriting Pty Ltd specialising in placing residual value insurance cover.

Asset Underwriting's insurers will guarantee a future residual value on an asset whereby the lessor is protected against any major diminution of asset resale values.

Peter Wedgewood of Asset Underwriting says, "the role of the insurer is to remove the contingent risk of residual loss from the lessor's own balance sheet, without taking commercial risk in future resale values. For example, if traditionally an asset sells for 60 per cent of its original value after a four-year period, Asset Underwriting would probably insure at a 40 per cent level."

Real property naturally falls into a different category, as real property value underwriting can be in the 85 per cent of costs bracket.

To write residual value insurance, an insurer would need a thorough understanding of asset values and markets. Asset Underwriting's role is to compile as much information as possible on past, present and future resale markets. They must be aware of any likely event that could cause a major decline in values of assets.

With the availability of residual value insurance, financial institutions can now enter the operating lease arena with the knowledge that the residual risk is covered. The size of the operating lease market can be gauged by such markets in the USA and the United Kingdom, where it is estimated that 15-29 per cent of all leases written are operating leases. In dollar terms the market would automatically draw in the majority of Australian Bank and finance groups.

A whole new industry has been spawned on the back of one accounting standard. The Accounting Review Board responsible for its implementation probably had no idea of such positive side effects.

- John Hewitt, Solicitor.

12. USE OF COMPANY SEALS

In Registrar-General v Northside Developments Pty Ltd, Supreme Court of New South Wales, Court of Appeal, 1 November 1988 CA No 227/87, it was held that a company is bound by the affixing of its seal to a document, if the company might have had power under its memorandum or articles of association to enter into the transaction and the seal is affixed in the presence of and countersigned by persons who by virtue of their positions in the company might have had authority to be present and countersign the document.

In this case, without authority of the company, a director and a person who purported to be but who was not the company secretary affixed the company's seal to a mortgage of land owned by the company to secure a loan to it. In reaching its decision, the Court of Appeal held that the rule that persons contracting with a company in good faith may assume that acts within its powers and constitution are properly and duly performed and are not obliged to make inquiries is not dependant upon agency principles, but is a special rule of company law. It is not necessary that the party dealing with the company has or should have relied upon the memorandum or articles or acts of the company. The forgery exception to the rule does not apply to the genuine but unauthorised countersigning the affixing of the seal. For a person to be put on inquiry, there must be some factor or circumstances which indicates that all is not as it should be. No distinction is to be made between commercial and conveyancing transactions.

Lock up the company seal!

13. LETTERS OF COMFORT

Guarantees, undertakings and letters of comfort are quite often requested by clients from contractors' parent companies and by head contractors from the parent companies of subcontractors, manufacturers or suppliers, particularly in relation to Pty Ltd companies with few assets. In a recent English case the Commercial Court was asked to consider whether a letter of comfort was legally binding.

A letter of comfort is a letter usually written by a parent company to a lender giving comfort (reassurance) to the lender about a loan made to a subsidiary of the parent company. Comfort letters are commonly taken when the parent company is unwilling to give a guarantee and thereby accept legal commitment.

In the case of *Kleinwort Benson Ltd v Malaysia Mining Corporation BHD* [1988] 1 All ER 714, a parent company, Malaysia Mining Corporation Bhd (MMC), secured from a financier Kleinwort Benson Ltd (KB) a credit facility to its wholly owned subsidiary MMC Metals Limited (ML). Despite MMC refusing at KB's suggestion to guarantee the facility to its subsidiary the credit was secured after MMC agreed to provide a letter of comfort to the financier.

Upon the collapse of the tin market in October 1985 ML ceased trading and on 11 November 1985 KB terminated its facility to ML and called up the outstanding debt. ML went into liquidation and KB advised MMC of the default and its reliance upon the letter of comfort.

The issue of whether the letter of comfort was legally binding on MMC ultimately turned on a consideration of the last paragraph of the letter in question. This paragraph was as follows:

> "It is our policy to ensure that the business of MMC Metals Limited is at all times in a position to meet its liabilities to you under the above arrangements."

The issue before the Court was whether such statement as contained in the last paragraph by MMC was made with the intention of creating legal relations. If so, then KB had an enforceable contract by which damages could be recovered once MMC failed to honour its obligation.

Hurst J. held that the letter of comfort and the last paragraph in particular did create a set of legally enforceable obligations.

He found that KB clearly acted in reliance upon the last paragraph in agreeing to provide the credit facility and that it was of "paramount importance" to KB that MMC should ensure that ML was at all times able to meet its obligations. He found also that the letter of comfort was treated as a matter of importance by MMC as their Board had formally resolved to issue the letter of comfort to KB in the first instance. Hurst J. concluded that it was the intention of the parties to create legal relations. He found therefore that the last paragraph and the letter of comfort as a whole had contractual force and was legally enforceable.

While the judgement is under appeal it would seem wise for holding companies as givers of letters of comfort to ensure that such letters are little more than letters of awareness (of the proposed transaction). Letters of comfort should be drafted carefully so as not to inadvertently create legally binding agreements where not desired. Phrases such as "it is not intended that this letter will create a binding agreement" should appear.

Further, companies that have in the past given letters of comfort in preference to guarantees so as to avoid creating a legal obligation should now review such letters in light of this recent decision.

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14. BUILDING CONTRACTS - NOTICE PROVISIONS

A recent decision of the Supreme Court of New South Wales has emphasised the importance of notice provisions in standard form contracts and continued an emerging trend to construe a failure to comply with notice provisions as a bar to