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.

- Reprinted with permission from Colin Biggers and Paisley, Solicitors, News Vol. 23.

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

recovery for monies due.

Wormald Engineering Pty. Limited v Resources Conservations Co. International (unreported, Supreme Court of New South Wales Common Law Division, Building and Engineering List, No 11277 of 1988, 2 November 1988) came before Mr Justice Rogers on appeal from an arbitration. The matter concerned a contract in the form of Australian Standard AS2124 - 1978 General Conditions of Contract for a lump sum payable to the Contractor of $1,649,856. The decision of the Court barred the claim by the Contractor for a further $0.5M in respect of disruption and prolongation claims.

During the Contract, the Superintendent had issued a number of variation orders. The work was executed and the Contractor was paid for the extra work. The payments did not take into account the disruptive effect of the variations on the programme, which, it was claimed by the Contractor, resulted in an extra 6,716 work hours.

The payments also failed to account for prolongation costs caused by the variations, which it was claimed by the Contractor, resulted in a further 2,000 work hours.

Although the claim for payment was made under a number of the provisions of the Contract, the important provision for present consideration was a claim under Clause 40.2 of the Contract.

That clause sets out a mechanism for the valuation of variations. However the provision continued:

> "If, in the opinion of the Contractor, compliance with the Superintendent's order, pursuant to this sub-clause, is likely to prevent him from or prejudice him in fulfilling any of his obligations (including guarantees) under the Contract he shall forthwith notify the Superintendent thereof in writing and the Superintendent shall as speedily as is practicable determine whether or not his order shall be complied with."

The arbitrator had found that there was no evidence that the Contractor had given any notice pursuant to this provision. The Court held that it was unable to disturb this finding by the arbitrator.

The essential question before the Court was whether the notice provisions were a condition precedent for payment for disruption and prolongation claims under the Contract. Mr Justice Rogers had regard to the Contract as a whole. He noted that it was to be varied only in accordance with carefully constructed machinery which depended upon the role of the Superintendent.

It was, therefore, of vital importance to the Court that the mechanism of control by the Superintendent was to require the giving of notices by the Contractor to the Superintendent at the earliest possible time to alert the Superintendent to the fact that a change may be required in either the program or quantum payable. His honour concluded that the purpose of the contentious provision was to provide the Principal, through the Superintendent, with the information to enable an informed assessment prior to the implementation of variation orders as to whether or not those orders should be confirmed.

The Court laid out the step by step route by which the variation order should have been dealt with by the Contractor. The steps were as follows:

(a) the Superintendent should have provided a variation order in ample time before hand, to allow the Contractor to re-programme and to form an opinion as to its likely impact;

(b) the Contractor should have formed an opinion as to the likely effect of the variation order and, if appropriate, given notice to the Superintendent; and

(c) the Superintendent had to decide on the information in the notice whether or not to proceed with the variation and if he did so determine he should have as directed in writing.

The arbitrator had found that there was no evidence of service of the notices.

His Honour noted that the Contractor was obliged to form an opinion which was merely as to whether something was likely to occur. He described this as a low threshold of requirement.

The case indicates that this and other such notice provisions may well be held to be essential preconditions to payment and the notice provisions should be complied with where there is any likelihood that a claim may arise. Accordingly, the prudent contractor will initiate administrative procedures to deal with any time requirements imposed by a contract.

Finally, the case is indicative of the dangers of any notice provision. It stands as a clear warning to contractors to carefully consider the notice responsibilities inherent in standard form contracts and to pursue them with vigour.

- Reprinted with permission from Colin Biggers and Paisley, Solicitors, News, Vol.23.

15. APPOINTMENT OF ARBITRATOR - DUTY OF APPOINTOR TO ACT FAIRLY

In *Hooper Bailie Associated Ltd v President, M.B.A. of the A.C.T. and Others*, unreported, ACT Supreme Court, Davies J. 24.11.88, the A.C.T. Supreme Court considered the nature of the obligation cast upon a person nominated by a building contract to select an arbitrator to determine a dispute between the contracting parties. The relevant contract was SCNPWC3 (cl. 44) and the power to select an arbitrator had been given to the President of the A.C.T. Branch of the M.B.A. (as it then was).

After the President was advised of the dispute and asked to select an arbitrator, there was correspondence and telephone discussions between each of the parties and employees of the A.C.T. Branch of the M.B.A. concerning the selection of an arbitrator. Subsequently the President selected as arbitrator one of two people originally suggested by the sub-contractor. The contractor had expressed a preference for the other person suggested by the sub-contractor.

Davies J. found that "the parties did not agree to be bound by the appointment of an arbitrator, if the appointment were made in a manner procedurally unfair to one of the parties". The requirement for procedural fairness (i.e. exercise of natural justice) did not require the President to give the parties a hearing before making an appointment. The judge did not explore the precise requirements of procedural fairness, but noted that it was not uncommon for there to be an inquiry as to the nature of the dispute, the qualifications and experience required of an arbitrator and whether there is any objection to the appointment of any person who is being considered.

The M.B.A. had provided the parties with a list of 5 names