

# Who can the sub-contractor trust?

Stork claimed Leighton implied trust in the original agreement.

by DOUG JONES

IF AN OWNER wants to make sure the sub-contractors on a project get paid by the head contractor for the work they have done, what can it do?

Quite often, the answer is: establish a trust.

Under these arrangements, whenever the owner makes a payment to the head contractor, the portion of the payment owed by the head contractor to its sub-contractors must be paid directly into this trust account.

In this way, the head contractor can't simply head for the hills with the lot, and the sub-contractors are protected if the head contractor runs into financial difficulties.

Or so the theory goes.

But what if the owner and the head contractor subsequently decide to get rid of these arrangements? What if the project contract is amended to delete the requirement to pay into the trust account and the owner starts paying all the money to the head contractor instead?

Can the sub-contractors do anything to preserve the protection provided by the original trust scheme? Or are owners and head contractors free to tear up this protection at will, potentially leaving the sub-contractors short-changed (as unsecured creditors) if the head contractor is unwilling or unable to pay?

Unfortunately, the answer often depends on the precise wording and timing of multiple contracts, and is not always clear.

A good illustration is provided by *Stork Electrical Pty Ltd v Leighton Contractors Pty Ltd*, a recent Queensland Supreme Court case where precisely these questions have arisen.

The score so far is four judges, four sets of reasons and two all - or 2:1 in favour of the head contractor, if only the Court of Appeal's decision is taken into account.

*Stork v Leighton* arose from the Brisbane Convention and Exhibition Centre project of the early 1990s.

The State of Queensland engaged Leighton as managing contractor for the project in February 1993. Although the head contract was not formalised until May 1994, it was agreed that its provisions applied from the start.

Under this head contract, the State had

to open a trust bank account in Leighton's name and pay all money certified as owing to Leighton's sub-contractors and consultants into this account, with the balance being paid direct to Leighton.

In April 1993 Leighton and the State formally executed a trust deed establishing the trust account.

Stork became Leighton's electrical sub-contractor in November 1993. The trust arrangement featured prominently in pre-contract discussions between Leighton and Stork. Progress payments were made to Stork from the trust account from January 1994.

The sub-contract was not formalised until March 1994, when the State, Leighton and Stork also executed a tripartite agreement, under which Stork acknowledged that the State had no obligations to it other than as agreed under that agreement.

All went well until December 1994. By this stage Stork had completed about 90 percent of its work and Leighton about 80 percent of the overall project. During the course of the project significant design changes had been made, increasing its scope and costs, and the State was keen to lock Leighton into achieving practical completion by May 1995, in return for an increase in the total contract price.

## \$45 million payment

Accordingly, in December 1994 Leighton and the State made a series of amendments to the head contract. Leighton agreed to new timeframes, the State agreed to pay Leighton a fixed sum for the remaining works - and both agreed to scrap the head contract's requirement for payments into the trust account.

Stork and the other sub-contractors did not know about or consent to this change.

Shortly afterwards, Leighton received a \$45m payment directly from the State.

Stork subsequently launched court proceedings against Leighton, claiming it had not been fully paid. Among other things, it argued Leighton and the State had not been entitled to terminate the trust arrangements before completion of the project and were therefore in breach of the trust.

The initial issue the court had to decide was simply whether there had been a breach of trust. The issues of whether Leighton had obtained any monetary benefit or Stork had suffered any loss were reserved for later consideration.

The trial judge and one of the Court of Appeal judges sided with Stork. They found that:

□ The head contract's original requirement for a trust account had created a "primary", implied trust, with the property being held by Leighton on trust for the sub-contractors being Leighton's right to enforce the State's promise to make payments into the trust account.

□ Part, but not all, of Leighton's obligations under this original trust had been performed when the formal trust deed was executed.

□ The intentions of Leighton and the State at the time they created the original implied trust had been that the trust payment arrangements would apply throughout the project. Any later concessions by Stork, in the March 1994 tripartite agreement, could not change this original intention, which was supported by the terms of the head contract itself, an attached "contract manual" and the minutes of Leighton's pre-contractual meetings with Stork.

□ There had been no express provisions in the head contract permitting termination of the arrangements before project completion, even though the State had a right to terminate the trust more quickly than originally planned after completion. Further, the contract's general provisions for variations did not cover this type of amendment, and none of the sub-contractors or consultants had agreed.

□ Leighton had therefore been in breach of its trust obligations when it agreed with the State to destroy the trust payment regime.

But on the same agreed set of facts and from exactly the same contracts and other documentation the other two Court of Appeal judges sided with Leighton.

These judges decided:

□ The formal trust deed implemented all of the trust arrangements promised in the head contract.

□ The trust arrangements could be varied at any time if Leighton and the State agreed to do so, exercising the normal

rights of the parties to any contract, for commercial or any other reasons and without the consent of the trust beneficiaries.

□ This right to discard the original trust arrangements was reinforced by a "contractual matrix" of the terms of the head contract (as interpreted by these judges, including its variation provisions and a provision which they decided amounted to a right by the State to terminate the trust at any time prior to project completion) and the terms of the later tripartite agreement (which they saw as a "significant indication" of the original intention).

□ Contrary indications, such as the minutes of Leighton's pre-contractual discussions with Stork, were merely "descriptive" and could not be used to argue the trust arrangements could not be varied.

□ At the time of the amendments, no sums had been owing to any sub-contractor or consultant, so there had been no duty at that particular time to make any payments into the trust account.

## Leighton won

With two of the three senior judges on their side, Leighton won - this time.

But the real lesson is that in this instance, as in many others, it was and can be a very close call.

In the end, it was a matter of differing interpretations of contracts, some only formalised well into the project, which decided whether a commercially driven decision by Leighton and the State, reflecting a desire for "flexibility", could validly override a trust arrangement which at least one sub-contractor seems to have been told would apply for the whole project.

Whether it is desired to retain this, sort of flexibility or to entrench the protection of a trust payment scheme for the duration of a project, careful drafting of the relevant contract provisions is essential.

There are enough nasty surprises for everyone in the construction industry without adding to them through ambiguity on an issue such as this. ■

*Ed.: Doug Jones is a construction partner in the national law firm Clayton Utz.*

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