BANKING IMPLICATIONS OF CONTRACTING WITH GOVERNMENT

Commentary

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I commend Brad Selway on his paper. It is a thorough and perceptive coverage of many of the key issues relevant to contracting with government.

Over the last 5 years, banks and other financiers have been heavily involved with government in projects involving the development of new infrastructure. In these projects, private sector funds - both debt and equity - have enabled the development of new power stations, water filtration plants, tollroads, hospitals and the like. Typically, whilst the infrastructure may be owned and operated by the private sector, there is no sponsor with a large balance sheet which guarantees debt repayment. Rather, in the operating phase of project, the banks will have no recourse to a sponsor; they will be repaid only out of the revenue from the project.

In this commentary I will address briefly three issues which have either arisen in or been relevant to such projects with government. The first is the proper characterisation of the government counterparty in the project and its relevance in the bank credit process. The second is the relationship between the host government agency and the consortiums bidding for the project during the "tender" phase. The third - somewhat arcane - is the power of government to enter into contracts in the caretaker period prior to an election.

1. CHARACTERISATION OF THE GOVERNMENT COUNTERPARTY AND ITS RELEVANCE IN THE BANK CREDIT PROCESS

In any infrastructure project the nature of the commitment by government will be important to the viability of the project. Especially so when the project is likely to be financed on a project finance basis with only limited recourse to the sponsors. Examples of the constraints imposed by or commitments given by government in such projects are: in the case of a power station or water filtration plant, an undertaking by the government agency to pay the revenue stream, that is, the agreed tariff for power supplied or water filtered; in the case of a tollroad, undertakings by the roads authority as to how the tollroad will be operated in conjunction with the wider road network and protection from any future construction by the roads authority of another road which competed directly with the tollroad.

Accordingly, in carrying out an assessment of the risks inherent in an infrastructure project, a financier will analyse the nature and credit-standing of the host government agency providing the commitments.

In international project financing there is also a threshold issue - sovereign risk. Each financier in the international market will operate under an internally established country limit. It will be a determinant of whether the financier is prepared to accept further exposure to the country concerned. Financiers do not have limits applying to Australian States - that is, internal limits on their exposure to specific States. However, it is said that in the deepest part of the last recession some banks did have a limit on their exposure to the State of Victoria.

In an Australian project financing, the threshold question is usually whether the contract with government in question is with the Crown (or an agent of the Crown). In other words, will the revenue stream undertaking or other commitments be those of the Crown or will they be those of an entity with a credit rating/status less than that of the Crown?

One way of obtaining the credit of the Crown is to contract with the relevant Minister of the Crown. Leaving aside for the moment any constitutional questions as to whether the Government has a power to enter into the contract, a contract entered into by a Minister within the scope of his authority will bind the Crown.

In many projects, however, the contracting party is a statutory authority of similar Government body. Financiers should be aware that the actions of a statutory authority do not automatically bind the Crown. Determining whether a statutory authority is contracting as an agent of the Crown is largely a matter of statutory interpretation of the provisions of the constituent legislation of the authority. A telling provision is one that the authority "for the purposes of any act, is a statutory body representing the Crown". Or one specifying that the chief executive of the authority "is in the exercise of his or her function subject to the control and direction of the Minister. Cases have tended to focus on the degree of control which the relevant Minister has over the authority. Accordingly, the Commissioner of Queensland Railways has been held to be a representative of the Crown (see *Bradken Consolidated Ltd v Broken Hill Pty Co Ltd* (1979) 145 CLR 107) as was the Metropolitan Water Sewerage and Drainage Board (see *F Sharkey & Co Pty Ltd v Fisher* (1980) 50 FLR 139). In *State Superannuation Board v Trade Practices Commission* ((1982) 60 FLR 165), the State Superannuation Board of Victoria was held not to be an emanation of the Crown.

It is a general principle of law that a principal is bound to all agreements entered into by its agent within the actual or ostensible authority of the agent. It is also well established that this principle is equally applicable to the Crown when a statutory authority acts as its agent. The principal is, however, only bound to the extent to which the agent acts within the terms of its authority. Accordingly, the Crown will only be bound by a commitment of a statutory authority to the extent to which the commitment is within the power of the statutory authority concerned.

In New South Wales there has been an argument that the 1991 amendments to the *Public Authorities (Financial Arrangements) Act* 1987 which introduced provisions relating to "joint financing arrangements" have for the purposes of such arrangements supplanted the principles of agency referred to above. The Act provides a mechanism for government to provide guarantees of the obligations of specified statutory authorities in respect of arrangements otherwise authorised by the Treasurer under the Act. In 1991 the Act was amended to require that the Treasurer approve in advance all "joint financing arrangements" (as defined). It has been argued that these amendments have the effect that the only way that "joint financing arrangements" can become binding on the Crown is by the government providing a guarantee under the Act.

2. TENDER PROCESS — RELATIONSHIP WITH GOVERNMENT

In infrastructure projects financial institutions often find themselves involved for lengthy periods in tender processes with government. Typically, a government agency which is putting to the market a proposed infrastructure project will call for expressions of interest from the private sector and, after evaluating them, ask for a shortlist of those who responded to submit tenders or detailed proposals. It is not unusual for tenderers and their financiers to be involved in this tender process and the negotiating of the project documentation for 12 months or longer. Both tenderers and their financiers have enormous amounts of time and money at risk in this process.

What then are the rules of law governing the tender process? The tender process is essentially one of contract formation. In its simple form a tender constitutes an offer on the part of the tenderer which may be either accepted or rejected by the government agency which receives it. Typically, the position of the government is that no binding contractual relationship is created until the tender is awarded or, in the case of major projects, until the preferred tenderer and the government have negotiated and signed project documentation.

There are no uniform rules governing a tendering process. The process is governed by the terms determined by the government agency inviting tenders or proposals, the policies and guidelines of government from time-to-time and a diverse body of law.

For a tenderer to bring an action before a court seeking redress in respect of an aspect of the tendering process or seeking to impugn it, the tenderer must identify a legal right which has been infringed. The question therefore becomes one of identifying a right which the tenderer is entitled to have enforced by a court. An examination of case law would suggest that a tenderer has the following rights which may be enforceable:

Implied contract

The courts have recognised the right in a tenderer to have its tender duly considered in conjunction with other conforming tenders. The English Court of Appeal in *Blackpool Aero Club v Blackpool Borough Council* ([1990] 1 WLR 1195) recognised such an implied contract. In that case a tenderer delivered its tender to a Council's mailbox prior to the expiry of the tender period deadline. Council staff failed to empty the mailbox and as a result the tender was received too late and was not considered and the Council accepted another tender. In the leading judgment Bingham LJ stated:

> Where, as here, tenders are solicited from selected parties all of them known to the invitor and where a local authority's invitation prescribes a clear orderly and familiar procedure ... invitee is in my judgment protected at least to this extent: if he submits a conforming tender before the deadline he is entitled, not as a matter of mere expectation but of contractual right, to be sure that his tender will after the deadline be opened and considered in conjunction with all other conforming tenders."

In subsequent cases English courts have espoused this principle "to exercise some level of control" over government tendering processes. In most cases this right will be of limited use to a tenderer. Its ambit has been narrowly defined. In addition, a breach of the implied contract will presumably only entitle the tenderer to damages. Even though a plaintiff need only prove the amount of loss on the balance of probabilities there are obvious difficulties in ascertaining whether the tenderer would have won the tender if the implied contract had not been breached and, secondly, the amount of the profit which would have been made by the tenderer if it had won.

Legitimate expectation

There is a principle of law that in circumstances where the exercise by a government agency of a power affects the rights of a person or disappoints a "legitimate expectation" of a person, the government agency is bound to observe rules of natural justice or procedural fairness. Where a government agency has invited tenders and circumstances are such that a legitimate expectation has arisen on the part of a tenderer, the government agency must observe procedural fairness.

Case law suggests that the courts will not interfere in a tender process and infer an entitlement to have a tender process handled in accordance with the principles of natural justice in all cases. Rather there must be some additional circumstances. Such circumstances may be that the aggrieved tenderer held the previous contract or licence in respect of which tenders were being called. Alternatively it may arise by reason of the particular rules applying to the tendering process in question. The case of *Century Metals and Mining NL v Yeomans* ([1989] 100 ALR 303) is a case in

point. In that case, the Commonwealth Government appointed a liquidator to the Phosphate Mining Corporation of Christmas Island, a company wholly owned by the Commonwealth. The Minister who appointed the liquidator required the liquidator to consider a sale of the company's assets to parties intending to recommence phosphate mining on the Island. In a media release the Minister had stated that the assessment of proposals to purchase the assets would be undertaken by an independent third party and that the evaluation process would be carried out in an impartial and thorough manner. Three companies lodged proposals. Century Metals was unsuccessful and sought judicial review of the decisions of the liquidator and Minister. On appeal the court held the rules of natural justice were applicable, and that Century had a legitimate expectation that it would be given a fair opportunity to present its case and that no decision would be made by the liquidator or the Minister until there had been an independent, impartial and thorough assessment of the proposals.

Section 52 Trade Practices Act

Section 52(1) of the *Trade Practices Act* provides that a corporation shall not in trade or commerce engage in conduct that is misleading or deceptive or is likely to mislead or deceive. There is an issue as to whether government or government agencies will be subject to the provisions of the *Trade Practices Act* or the corresponding provisions in the *Fair Trading Acts* of the States. If they do apply, there is potential for section 52 and its equivalent provisions to assist tenderers. One could, for example, see section 52 applying to circumstances such as those in the *Century Metals* case.

Section 52 could also extend to provide a right of action to a government agency which is misled or deceived by statements made or information provided by a tenderer.

3. CONSTITUTIONAL CONVENTIONS GOVERNING CONTRACTING WITH GOVERNMENT DURING AN ELECTION PERIOD

Several constitutional conventions have evolved in Australia regarding the conduct of government in the period following the proroguing or dissolution of Parliament and leading up to an election. However, there is little text or commentary on these constitutional conventions. This is probably because the conventions are not based on formal legal principles and have evolved, and continue to evolve, from parliamentary procedure and practice.

These constitutional conventions may impact on contracts with government which are being negotiated in the lead-up to a State or Federal election.

The "caretaker period" and the "caretaker convention"

The "caretaker period", as it is commonly known, extends from the proroguing or dissolution of Parliament prior to an election until the election result is clear or, in the event of a change of government, until the new government is appointed.

During this period the government assumes a "caretaker" role in that it ensures that decisions are not taken which would bind an incoming government and limit its freedom of action.

Accordingly, during the caretaker period governments by convention avoid:

(a) entering into major undertakings or contracts;

(b) taking major policy decisions likely to commit an incoming government; and

(c) making significant appointments.

This is not to say, however, that the business of government is "frozen" during the caretaker period: ordinary matters of governmental administration continue and the government's inability to act is generally confined to the matters referred to above.

It is the first of these matters (entering major undertakings or contracts) with which this paper is concerned.

The philosophy behind the convention is clear: in an election, political policies are put to the electorate and decisions which implement these policies should not be taken unless and until the electorate has ratified them.

The convention applies to both Federal and State Governments.

It should be noted that the caretaker convention is only directed to the taking of decisions, and not to their announcement. Accordingly, the convention will not be infringed where a decision which has been taken before the proroguing or dissolution of Parliament is announced during the caretaker period. However, in the case of decisions which are politically contentious, it is usually regarded by governments as preferable if they are announced prior to the proroguing or dissolution of Parliament in order to avoid controversy.

Agreements entered into following consultation with the Opposition

There appears to be only one exception to the convention regarding the prohibition on entering into major contracts or undertakings during the caretaker period. This is where a contract is entered into by the government during the caretaker period following consultation with the Opposition and with its approval.

There is at least one precedent for this, which occurred in the context of the 1987 Federal election where the Commonwealth Minister for Science obtained the agreement of the Opposition Spokesperson before proceeding with arrangements to sign a memorandum of understanding on science and technology with the Thai Government.

Status of the caretaker convention

It is clear that the caretaker convention has no legal standing. Rather, it is merely a constitutional convention - an accepted parliamentary practice which is based on established precedent.

One commentator has defined constitutional conventions as "extra-legal rules of structure, procedure or principle, established by precedent, consolidated by usage and generally observed by all concerned ... [they] may affect the working of the law but they themselves have not the force of law".

Since constitutional conventions are based on parliamentary practice and procedure, it follows that they are not immutable and can evolve to take account of changing practices and procedures. The convention against entering into major contracts or undertakings in the lead up to an election is thought to go back at least as far as the beginning of the second administration of Sir Robert Menzies, in the form of a suggestion to Ministers at the time of dissolution of the Commonwealth Parliament in the lead up to the 1951 Commonwealth election. By 1961 the convention had become established practice, at least in the Commonwealth context.

To which governmental bodies does the convention apply?

One interesting aspect of the caretaker convention concerns the range of governmental bodies to which it applies - obviously, the convention applies to contracts with governments per se, but what about semi-governmental bodies and corporatised entities? How far does the convention extend?

There appears to have been little or no discussion or commentary on this issue.

Obviously, contracts that are entered into by a corporatised entity (such as an Area Health Service in New South Wales) and which require the approval of a Minister under legislation (for example, under section 27 of the *Area Health Services Act*, NSW) will be subject to the convention.

At the other end of the spectrum, contracts entered into by fully privatised entities (for example, the GIO) would not be subject to the convention.

But what about those bodies in between?

The answer to this question will presumably depend upon the degree of autonomy granted to the entity and the nature of its powers and functions. For example, an entity which is by statute subject to the direction of a Minister and which is incapable of exercising its powers contrary to such a direction will, as a matter of law, be able to be directed to comply with the convention and, as a matter of practice, will probably do so even in the absence of a Ministerial direction.

Consequences of the caretaker convention

Most governments, both Federal and State, are not prepared to enter into any contracts of ***any*** political significance during the caretaker period.

Governments are at this time usually only prepared to sign contracts which are completely non-contentious. For example, a standard contract to provide linen services to a hospital probably falls within the non-contentious sphere. A contract implementing one of the government's major health policies would, on the other hand, be the sort of contract that a government would not be prepared to sign during the caretaker period as a result of the caretaker convention.

Non-government transaction participants may also be disinclined to sign contracts of political significance during the caretaker period, particularly if they are concerned to start their relationship with a potential new government "on the right foot".

Accordingly, parties to transactions involving a government need to be aware of the convention against entering into major contracts during the caretaker period, and need to take this into account if the transaction is expected to be finalised or signed at or about the time of an election.