## Article Information

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# Updates on the principles applicable to attempts to restrain recourse to unconditional bank guarantees

**Construction contracts typically require the provision of security to secure the performance by the contractor of its obligations under the contract. To assist with cash flow, instead of retention monies being withheld from progress payment otherwise due, it is common for contractors to provide security by way of bank guarantees under which a financial institution unconditionally agrees to pay on demand to the beneficiary the amount of the guarantee.**

Notwithstanding that these bank guarantees are expressed to be unconditional, contract drafters frequently seek to incorporate clauses into contracts which regulate when the contracting parties are entitled to have recourse to security.

As a result, contractors will from time to time seek injunctive relief to restrain the beneficiary from calling on a bank guarantee in the event of a dispute.

The recently flurry of activity in Courts across the eastern seaboard by applicants attempting to restrain recourse to unconditional bank guarantees has, on the whole, resulted in unhappy outcomes for the applicants with the Victorian Court of Appeal bringing the Victorian position back into line with that of its State counterparts and a recent decision of the Queensland Supreme Court refusing to restrain recourse, even where the party having recourse is in external administration. This article looks at those decisions and provides an overview of the principles applicable to restraining recourse.

Generally, the Courts will not prevent a party from having recourse to security except in the following circumstance:

- a party is acting fraudulently in seeking to have recourse, or
- the party in whose favour the guarantee was issued is acting unconscionably in contravention of the *Competition and Consumer Act 2010* (Cth) or the State equivalent, or
- the party in whose favour the guarantee was issued made a contractual promise not to call on the guarantee in a particular circumstance and a refusal to grant the injunction would breach that promise.

To be successful in obtaining injunctive relief, the following must be demonstrated:

***1. There is a serious question to be tried as to a party's entitlement to have recourse to security.***

While this is a question that would usually turn on the facts of the particular case, there is guidance, most recently in the *Victorian decision of Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd* [2015] VSCA 98, as to the approach that the Court may adopt in considering this question:

- In order to assess the facts and evidence relating to whether there is a serious question to be tried, the Court must first construe the relevant security clause.
- The commercial purpose of the clause (i.e. whether a bank guarantee is provided as security only or is intended to allocate the risk of a party being be out of pocket pending resolution of any dispute) informs the construction of a security clause so that the Court would not readily favour a construction that is inconsistent with that commercial purpose.

***2. The balance of convenience favours the granting of an injunction.***

The recent Victoria and Queensland decisions have moved away from an applicant friendly approach to this question. However, in a NSW decision handed down this month, the Court has restrained recourse so as to maintain the "status quo" and in doing so adopted an anomalous position by effectively reversing the onerous of proof from the party seeking the injunction to the party defending the application for the injunction. Given the divergence of this authority to earlier NSW decisions including that of the *NSW Court of Appeal in Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd* [2010] NSWCA 283, the recent decisions in other Australian States and the specific drafting of the clause under consideration, we consider it probable that the NSW decision will be confined to its facts.

**RCR O'Donnell Griffin Pty Ltd ACN 003 905 093 v Forge Group Power Pty Ltd and Ors [2015] QSC 186**

In 2011, Diamantina Power Station Pty Ltd (Diamantina) entered into a contract with Forge Group Power Pty Ltd (Forge) to carry out the design, engineering, construction and commissioning of a power station. In turn, Forge entered into a subcontract with RCR O'Donnell Griffin Pty Ltd (RCR) to perform electrical work in the construction of a power station (Subcontract).

In February 2014, receivers and managers were appointed to Forge and it entered into voluntary administration. A winding up order was subsequently made and the administrators became Forge's liquidators.

As a result, Forge, RCR and Diamantina entered into a deed of novation pursuant to which the Subcontract was "discharged", a new contract was created between Diamantina and RCR, and RCR provided certain releases to Forge. However, the deed of novation only required Forge to return any security held under the Subcontract "*to the extent that [Forge] does not, in its own absolute discretion, consider that it has or may have any outstanding claims against [RCR]…*"

The receivers claimed that Forge had outstanding claims against RCR and intended to convert the bank guarantee provided by RCR as security under the Subcontract. RCR disputed liability for the alleged debts.

Clause 5.2 is the relevant provision under the Subcontract concerning Forge's entitlement to recourse to security:

"*Security shall be subject to recourse by the Principal where it remains unpaid after the time for payment.*"

Forge contended firstly that converting a bank guarantee to cash is different to having recourse to the bank guarantee as the second involves appropriating the cash for one's own purposes such as a claimed entitlement and secondly that clause 5 is a risk allocation mechanism which enables Forge to appropriate the cash where it has a bona fide claim against RCR.

***Decision***

The Court rejected the argument that there was any distinction between conversion of a bank guarantee and recourse.

The Court found that the recourse provision allocates the risk to RCR of being out of pocket pending resolution of a dispute as the Subcontract was "consistent with recourse being permitted upon a bona fide claim, not only where a debt is undisputedly payable". In arriving at this construction of clause 5.2, the Court points to the following indications in the Subcontract:

- RCR is not entitled to any payment if security is not provided
- the security is an unconditional, irrevocable, on demand bank guarantee
- clause 5.2 does not refer to a "debt due and payable"
- "unpaid after the time for payment" does not mean "indisputably due and payable".

RCR submitted that such interpretation of the recourse provision would put RCR at considerable risk in the event of Forge's insolvency. However, the Court did not consider this to be a good reason to construe clause 5.2 as permitting resort to the bank guarantee only where a debt by RCR is due and payable. The risk of insolvency is one that RCR taken.

The decision in Forge may assist practitioners in construing the recourse provisions contained in various unamended standard form contracts, including AS4901 (subcontract for use with AS4000), AS4000 (construct only), AS4902 (design and construct), AS4911 (supply) and AS4905 (minor works) which, save for the additional notice requirement, have the same wording as that under consideration in Forge.

The decision can also be contrasted with recent Security of Payment cases in which insolvent claimants are generally prevented from taking enforcement action under the Security of Payment legislation. See for example the decisions in *Facade Treatment Engineering Pty Ltd (in liquidation) v Brookfield Multiplex Constructions Pty Ltd [2015] VSC 41* and *Hamersley Iron Pty Ltd v James [2015] WASC 10*.

**Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd [2015] VSCA 98 (13 May 2015)**

Lend Lease Services Pty Ltd (Lend Lease) sought an injunction to restrain Sugar Australia Pty Ltd (Sugar) from having recourse to its bank guarantee. The contract under consideration was a severely modified AS4910-2002.

The relevant recourse provision in the contract provides as follows:

*5.2 Availability of Security*
*Any security provided by the Contractor in accordance with the Contract shall be available to the Principal whenever the Principal may claim (acting reasonably) to be entitled to:*

*(i) the payment of moneys or an indemnity by the Contractor under or in consequence of or in connection with the Contract;*
*(ii) reimbursement of any moneys paid to others under or in connection with the Contract; or*
*(iii) other moneys payable by the Contractor to the Principal (whether by way of set-off or otherwise).*

*Recourse to security shall only be subject to the Principal having given the Contractor 5 days' notice of its intention to have recourse to the security for the purpose of allowing the Contractor to replace the security with cash where it has been issued in a form other than cash.*

The trial Judge granted the injunction sought by Lend Lease on the basis, inter alia, that there was a serious question to be tried as to the proper construction of clause 5.2. However, this was appealed by Sugar to the Court of Appeal.

***Decision***

The Court of Appeal held that the trial Judge was obliged to determine the proper construction of the recourse provision for the purpose of an application for an interlocutory injunction by Lend Lease and that the trial Judge's failure to do so was an error in the exercise of the Court's discretion.

Justices Osborn and Ferguson considered the commercial purpose of the security and found that it was intended to allocate risk pending the resolution of the dispute. This "*fundamentally alters the context in which the Court must exercise its discretion by changing the complexion of the status quo and raising the prospect of substantial injustice if the purpose of the provision is defected*".

Associate Justice Kaye found that the particular clause under consideration required Sugar to act reasonably in making the claim based on the information and facts then known, or which ought to have been known to Sugar at the time. Based on this construction of the recourse provision, Associate Justice Kaye went on to find that there was a serious question to be tried as to whether Sugar had acted reasonably but the balance of convenience did not support the grant of an injunction. In this respect, the decision departed from the earlier decision in *Rejan Constructions Pty Ltd v Manningham Medical Centre Pty Ltd* [2002] VSC 579 in which the Court had found that reputational damage and commercial ramifications were enough to justify the injunction because it placed the provider of the bank guarantee at a "grave disadvantage".

**Saipem Australia Pty Ltd v GLNG Operations Pty Ltd (No 2) [2015] QSC 173**

This case examines the interaction between the recourse provision under a construction contract and the notice requirement pursuant to s67J of the *Queensland Building and Construction Commission Act 1991* (QLD) (QBCC Act). The requirements of s67J of the QBCC Act are peculiar to Queensland.

Section 67J provides that a party under a building contract may use a security to obtain an amount owed under the contract if that party has given notice in writing to the other party within 28 days of becoming aware, or ought reasonably to have become aware, of the right to obtain that amount owed.

***Facts***

In an earlier proceeding, Saipem Australia Pty Ltd (Saipem) was refused an injunction to restrain GLNG Operations Pty Ltd (GLNG) from calling on the bank guarantees under a contract to construct a gas pipeline and related infrastructure. The application to which this case relates involves different issues.

Saipem was required to complete certain stages of the work by certain dates. The 2 stages of work in question were the "Mechanical Completion" which must be achieved by 30 June 2014 and "Practical Completion" which must be achieved within 60 days from the date for Mechanical Completion. GLNG claimed liquidated damages against Saipem for delays in achieving Mechanical Completion and Practical Completion, and sought to call on the security.

Saipem sought an injunction to prevent GLNG from having recourse to the security.

There are a number of issues contended by the parties. One of the central issues to the determination of the balance of convenience is GLNG's failure to provide the notice required under s67J of the QBCC Act within 28 days.

***Decision***

The Court held that Saipem has established a serious case to be tried but the balance of convenience did not favour the grant of an injunction. The risk of damage, including adverse effect on credit rating, increased costs of obtaining future finance and decreased competitiveness in bidding for future contracts, was one which the parties agreed should be borne by Saipem in such circumstance.

The question then turned on whether non-compliance with s67J of the QBCC Act should tilt the balance of convenience in favour of an injunction?

The Court held that there was a strong case of non-compliance in relation to the Mechanical Completion damages and accordingly, an injunction was granted restraining GLNG from having recourse to the bank guarantees to recover any sum claimed in relation to the Mechanical Completion. However, the case of non-compliance was weak in relation to Practical Completion and as a result only a short injunction was granted to permit Saipem to pay the amounts claimed so as to avoid a demand upon the bank guarantees.

**Heyday5 Pty Ltd v Cockram Constructions NSW Pty Ltd [2015] NSWSC 884**

Heyday5 Pty Ltd (Heyday5) entered into a subcontract with Cockram Constructions NSW Pty Ltd and M&W Singapore Pty Ltd (MWC) in relation to a project in Ultimo known as the "Global Switch Sydney East Stage 1".

The recourse provision under the subcontract provides as follows:

*"MWC can have recourse to the security if MWC has a bona fide claim that [Heyday5] is in default under this Agreement or has suffered an event in clause 32(b)(ii), 32(b)(iii) or 32(b)(iv). MWC is not required to give notice of its intention to have recourse to security or to convert security into money."*

Heyday5 contended that MWC were bound to release the bank guarantee upon practical completion. Despite repeated calls on MWC to release the security, MWC had not done so but nor had it threatened to call on the bank guarantee.

***Decision***

The Court found that there was a serious question to be tried. However, it then appeared to depart from the approach adopted in the recent Victorian and Queensland decisions by determining that the balance of convenience favoured the granting of the injunction to maintain the "status quo". In arriving at this conclusion, the Court took into account the following:

- MWC had not made any threat to call on the bank guarantees and manifested no intention to do so
- MWC did not assert that they would be prejudiced by the granting of an injunction
- there was no evidence produced by MWC that it would be able to meet any award for damages if Heyday5 was able to establish that MWC were not justified in calling on the bank guarantee so the Court was unable to form the view that damages would be an adequate remedy if (albeit that the adequacy of damages was not disputed by Heyday5)
- there was no evidence to justify the submission that Heyday5 would suffer "reputational and financial harm"
- Heyday5 had a strong prima facie case in relation to the serious question to be tried.

The Court also considered, but rejected, Heyday5's argument that MWC would obtain an unfair commerce edge in any commercial negotiations to resolve the underlying dispute if recourse was had.

The above factors were "finely balanced" but the Court was ultimately persuaded to grant the injunction sought by Heyday5.

Whilst this decision would appear to shift the burden of establishing the balance of convenience from the party applying for the injunction to the party defending the application and signals a willingness by the NSW Courts to grant an injunction to restrain recourse where there is no obvious prejudice in doing so, we consider it unlikely that the decision will be followed.