Performance bonds: "risk-allocation", construction, fraud, and overpayment*

What is a performance bond? Although sometimes called a "first demand guarantee", a performance bond is not a guarantee at all but a type of strict indemnity. As Carr J has noted in *Spliethoff's Bevrachting Ltd BV v Bank of China Ltd*[1]

> "Performance bonds create an independent obligation to pay on demand by way of primary obligation on the party giving the guarantee and not by way of surety. They are irrevocable undertakings to pay a specified sum to the beneficiary in the event of a breach of contract, rather than a promise to see to it that the contract will be performed. They are also often called "*performance guarantees*" or "*demand guarantees*", although they are not guarantees in the true sense, but rather a strict form of contract of indemnity. Thus the various equitable defences available to a surety are not available to the issuer of a performance.[2] The issuer of a performance bond is as a general rule not concerned with the rights or wrongs of any underlying dispute between the beneficiary and the account party. His obligation to pay in accordance with the terms of the contract is entirely independent of the ultimate contract between the account party and the beneficiary. In practice, performance bonds are treated as substitutes for cash."

Cash flow is the lifeblood of all commerce. Prompt payment of any obligation is essential to the reputation of any financial institution lest nasty rumours begin to circulate on the Rialto. Debts and securities must be easily and readily recoverable, and autonomous payment obligations (such as letters of credit, "guarantees" and performance bonds) must be performed as and when stipulated, pretty much without exception.[3]

A performance bond may thus be seen as a "risk-allocation" device with respect to the availability of cash flow[4] – the grantor must in the usual case pay first and then argue later about the breach of the underlying contract. This approach has been explored in a number of cases and is most clearly set out in the judgment of the Full Federal Court in *Clough Engineering Ltd v Oil and Natural Gas Corp Ltd*[5]

"(a) It has been recognised that one of the exceptions to the rule that a court will not enjoin a claim upon a performance guarantee, or bond, from performing its unconditional obligation to make payment is where the party in whose favour the bond has been given has made a contract promising not to call upon the bond by way of a negative stipulation in the contract. However, that is best not described as an exception to a rule because the primary focus must always be on the construction of the contract: *Clough* at [77].

---

[1] [2015] EWHC 999 (Comm) at [69].

[2] Her Ladyship cited *Marubeni Hong Kong and South China Ltd v Mongolia* [2005] 2 Lloyd's Rep 231.

[3] It may be that the obligor contends as a matter of construction that the payee is not entitled to payment of the amount under the bond, but only to *retain* the bond as a form of security pending determination of the underlying dispute – this will turn on a proper construction of the instrument: see *Central Petroleum Ltd v Century Energy Services Pty Ltd* [2011] WASC 211 (Martin J) and *Marcon Pty Ltd v Kerman Contracting Pty Ltd* [2015] WASCA 7. Related to this question is whether a bond may be retained once the underlying contract has come to an end: *Lucas Drilling Pty Ltd v Armour Energy Ltd* [2013] QCA 111.

[4] For a recent discussion see *Heyday5 Pty Ltd v Cockram Constructions NSW Pty Ltd* [2015] NSWSC 884 (Stevenson J) and *Saipem Australia Pty Ltd v GLNG Operations Pty Ltd (No 2)* [2015] QSC 173 (Philip McMurdo J).

[5] (2008) 249 ALR 458 as summarised by Mossop J in *Walton Construction Pty Ltd v Pines Living Pty Ltd* [2013] ACTSC 2387 at [49].

(b) There are generally two purposes for which a performance guarantee may be required, first, to provide security for a valid claim against the contractor and second, to allocate risk between the parties as to who shall be out of pocket pending the resolution of a dispute between them. It is a question of construction of the contract as to whether the guarantee is provided solely as security or also as a risk allocation device: *Clough* at [79].

(c) Commercial practice will play a significant role in interpreting such provisions. In determining whether or not the underlying contract confers an unfettered right to call upon a performance guarantee the importance of such instruments to the construction industry nationally and internationally is a factor to be taken into account: *Clough* at [81]".

But requiring a payment under the bond first of course confers a considerable forensic tactical advantage on the payee since the obligor is out of pocket until such time as that underlying dispute is resolved. So it is that a large amount of recent authority, now discussed, has analysed in detail the ways in which an obligor may circumvent immediate payment by, say, alleging some "fraud" in the call on the bond, or some risk of over payment to the oblige because of it, or some breach of an implied stipulation that the bond not be called in the circumstances then prevailing.

Given that timely payment is always of the utmost importance, it is only occasionally that what is essentially an interlocutory resolution of the "pay\don't pay" conundrum attracts appellate review.

Implied negative stipulations and the "reputational damage" of a "cold call"?

To the hapless pleader, nothing is more attractive than recourse to some *equitable* nostrum when no other "defence" avails. (In over thirty years of practice, no drunk, insane, infant who has suffered duress at law – all good *legal* grounds for an absence of consensus ad idem – has ever presented herself as a client). In particular, a claim of equitable (or statutory unconscionability) requires no more than an affidavit and some factitious complaint on the part of the counterparty.

When acting in its auxiliary jurisdiction, equity operates to supplement the common law by providing an equitable remedy for breach of a common law obligation. In the context of a performance bond, an obvious breach will be a breach of an implied negative stipulation that the bond will only be called by the obligee when the relevant triggering event has occurred.

The operation of this aspect of equity's jurisdiction was analysed in *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd*.[6] It is a difficult question to what extent the reasoning of the majority in *Lucas Stuart* has undercut the basic proposition that a performance bond acts to allocate risk and if that is clear then it must be paid forthwith. As Mossop J has observed in *Walton Construction Pty Ltd v Pines Living Pty Ltd*[7]

> "The different results in these cases[8] indicates that whether or not there is power to call upon security when the entitlement is disputed will depend upon subtleties of the particular contractual provisions. *Lucas Stuart* appears on its face to take a substantially different approach to that adopted in *Clough* and the two Victorian cases. The reasoning on the

[6] [2010] NSWCA 283.

[7] [2013] ACTSC 237 at [55].

[8] His Honour was referring to *Clough* and *Lucas Stuart* which is discussed in detail below.

critical point in *Lucas Stuart* is not very detailed. However it turns on precisely what is necessary to provide an indication that the second of the two recognised purposes of performance guarantees exists. It appears that in *Lucas Stuart* their Honours took as a starting point the existence of only the first purpose and looked for indications that might support the second. In the Victorian cases the presumption appears to have been, having regard to the nature of the unconditional undertaking, that both purposes were intended unless there was some indication of a qualification on the entitlement to call upon the guarantee. In *Clough* there were clear words in the terms of the guarantee which was incorporated into the contract itself that were consistent with both purposes existing. If indeed there is a difference in emphasis between these cases as opposed merely to differing contractual positions then that is something for the High Court to resolve".

To begin it is important to remember a basic matter: in the dealings of well-advised commercial parties, it will be rare for the doctrines of equity to play any part. Pembroke J made an important commercial point in *FMT Aircraft Gate Support Systems v Sydney Ports Corp*[9] to the following effect:

> "Caution is required when equitable principles are sought to be imposed on well resourced and well advised commercial parties. In any given case, there might possibly be a proper basis to put submissions based on the equitable doctrine of unconscionability or its statutory equivalent in Section 51AA of the Trade Practices Act. However, the opportunities will be limited. That is because the state of affairs on which the application of equitable doctrines is usually predicated – vulnerability, dependence, mistaken assumption or inducement – will rarely exist in such circumstances".

In that case, a large, well-advised, corporation, sought to rely upon "unconscionability" as a reason for failing to pay on a performance bond. As Pembroke J noted, such a bond is treated commercially as being "as good as cash" and the course of case-law suggests almost no basis upon which payment can be resisted. (It is interesting to compare the more "flexible" Singaporean approach where unconscionability may specifically be invoked if it appear that a call on the bond is with respect to a liability which has been grossly inflated by the obligee: *Gammon Pte Ltd v JBE Properties Pte Ltd*.[10]

To similar effect is the recent statement of Windeyer AJ in *Miwa Pty Ltd v Siantan Properties Pty Ltd*:[11] "As a general proposition and subject to exceptions which do not apply here then unless terms of an underlying contract are incorporated into the performance bond or guarantee a bond

[9] [2010] NSWSC 1108 at [35].

[10] [2010] 3 SLR 799.

[11] [2010] NSWSC 1203 at [32]. His Honour's grant of an injunction was subsequently overturned by the Court of Appeal [2011] NSWCA 297; 15 BPR 29,545 for reasons set out by Basten JA at [36] – [45] who characterised the issue in terms of implied negative stipulation already discussed: "The real issue is, therefore, whether the lessor could properly be injuncted from making a demand on the bank pursuant to the guarantee. As suggested by Austin J in *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158 at 164-165, the question may properly be identified as whether there was a negative stipulation, expressed or implied in the lease, precluding the lessor from calling upon the guarantee in the present circumstances. This approach was approved by a Full Court of the Federal Court (French, Jacobson and Graham JJ) in *Clough Engineering Ltd v Oil and Natural Gas Corporation Ltd* [2008] FCAFC 136; 249 ALR 458 at [77], referring at [78] also to *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812 (Charles, Callaway and Batt JJA) .

beneficiary or obligee ought to be able to call on it holding the proceeds as security until any underlying dispute between obligee and other contracting parties is determined."

Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd

In *Lucas Stuart* the Court of Appeal (Campbell and Macfarlan JJA; Young JA dissenting as to the result) overturned the decision of Macready AsJ who had refused injunctive relief to restrain a call upon a performance bond which had been given to support a large building contract. There was already "pending in the Building and Technology List … a weighty building case involving the construction of a large building in George Street Sydney".[12] It was said by the contractor that the condition which permitted the bond to be called (a breach of clause 16 of the Contract) had not been satisfied.

Thus, in calling on the bond, there was breach of an implied negative stipulation in the contract which would support the grant of an injunction. In order to obtain the order, as discussed in detail below, the plaintiff needed to demonstrate the inadequacy of the remedy (damages) at law. The majority found that the "reputational" loss which might be sustained due to the improper call on the bond sufficed to satisfy this requirement.[13]

The judgment of Campbell JA and the nature of the "auxiliary jurisdiction"

Campbell JA examined the "auxiliary" jurisdiction of equity in detail. He noted, to begin,[14] that "the only justification for equity ever involving itself in providing a remedy for breach of a common law obligation is if the remedy provided by the common law is inadequate." Usually, the common law remedy which is in issue is damages but as Dr Spry has demonstrated, there may , albeit rarely, be some other remedy at law which means that no injunction will issue.[15]

There may be some other *discretionary* reason why the injunction will not issue. (So, for example, in *Orleans Investments Pty Ltd v Mindshare Communications Ltd*[16] (which was not cited in *Lucas Stuart*) Giles JA (with whom Spigelman CJ and Allsop P concurred) directed detailed attention to the imprecision in the terms of the particular covenant which was sought to be enforced as a matter going to discretion, especially since any breach of the injunction would leave the defendant open to contempt charges). However, it also important to remember, as the High Court observed, although only in a footnote, in *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd*[17] that "Even so, it

---

[12] At [53] per Young JA.
[13] See per Campbell JA at [9] – [10]; Macfarlan JA at [44] – [45], [50] citing *Barclay Mowlem Construction Ltd v Simon Engineering (Aust) Pty Ltd* (1991) 23 NSWLR 451 at 461 – 462; *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158 at 167).

[14] At [5].
[15] See Dr ICF Spry, Equitable Remedies (8th ed 2010 Law Book Co) at 389 cited by Campbell JA. Thus, it is not true that an injunction will *always* issue to restrain the breach of a negative stipulation: cp Lord Cairns in *Doherty v Allman* (1878) 3 App Cas 709 at 720.

[16] [2009] NSWCA 40 at [93] – [98]
[17] [2009] HCA 8 at footnote 11

is certainly true that in such a case in normal circumstances, in both interlocutory and final hearings, the position of the plaintiff is much stronger than that of the defendant."

In *Midland Brick Company Ltd v Welsh and anor*[18] (which was not cited in *Lucas Stuart*) Hasluck J noted:

> "This statement [in *Doherty v Allman*] has been frequently cited with approval and suggests that the courts are willing to order a defendant not to breach the negative terms of a covenant, even though the agreement as a whole is not subject to specific performance. However, it is clear from the reasoning of the High Court in *Dalgety Wine Estates Pty Ltd v Rizzon & Anor* (1979) 141 CLR 552 that the statement made by Lord Cairns puts the position too strongly. The correct position is that if a negative term exists, then *prima facie* it is to be enforced by injunction but the courts have a discretion to refuse an injunction if good reasons exist for doing so."

In *Lucas Stuart* Campbell JA stressed[19] the conceptual structure of the law and the need to demonstrate the inadequacy of the legal remedy as the foundation for the exercise of the equitable jurisdiction. Thus, whether or not an interlocutory injunction should issue depended upon two questions: first, whether or not there was a serious question to be tried, and secondly, whether the balance of convenience favoured the grant of the injunction.[20]

It follows, as Campbell JA observed,[21] that when the claim is that a negative stipulation has been breached,

> "whether there is a serious question to be tried must include not only whether there is a serious question to be tried concerning whether there has been a breach of the negative stipulation in question, but also whether there is a serious question to be tried concerning whether the common law's remedy or remedies for the claimed breach will be inadequate".

As Campbell JA noted, the bifurcation of jurisdiction and discretion has an important consequence in relation to the negative stipulation, since the plaintiff must demonstrate the foundation of the jurisdiction, but does not need to negative every possible discretionary element which may go to the granting of relief.[22] Thus, although it is empirically no doubt correct that it will only be in an exceptional case that the inadequacy of the legal remedy will not be made out, that is a "generalization, not a legal principle".[23] Macfarlan JA reached a similar conclusion without any detailedanalysis of basic principle.

Young JA dissented on the question whether it was appropriate to grant an injunction on the facts. As his Honour observed, the claim is in the auxiliary jurisdiction and thus "injunctive relief `would ordinarily only be ordered if damages were not ascertainable or otherwise not an adequate

---

[18] [2006] WASC 122 at [411]
[19] At [6].
[20] See *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* (1998) 195 CLR 1 at 24, [21] per Brennan CJ, McHugh, Kirby and Hayne JJ.

[21] At [6].
[22] At [7].
[23] At [8] citing Dr Spry op cit at 587.

remedy".[24] What was the position with respect to calculation of damages here? There should be no problem, subject to the question of the difficulty of obtaining contract damages for loss of reputation. The whole notion of a performance bond[25] is to substitute a cash payment with "a bond which can be instantly accessed by the proprietor …. It would completely destroy the purpose of the contractual provision for the Court to be too ready to grant injunctions, particularly just to grant injunctions on the basis that the builder's reputation would be tarnished if the security were called up". His Honour noted that the builder already had a judgment for some $4 million in its favour under the provisions of the *Building and Construction Industry Security of Payment Act 1999.*

Young AJA also took a far harder view with respect to any notional "reputational risk". He commented[26] taking into account the question of reputation eroded the principle of commercial certainty (as to which see the comments of Pembroke J above as well). As a matter of fact, it was hard to take into account alleged reputational harm when "it is alleged that the building which [the builder] and its subcontractors constructed has over a thousand defects and is not watertight.[27] As a general matter, when there is a question of construction of the contract which will resolve the case on a final basis, then an appropriate declaration ought to be made.[28] (It was not made at first instance, apparently because neither party requested it). Finally, as a matter of discretion, it appeared that the owner had already called up some sort of security so in one sense, "the horse had bolted".

The "bright line" approach of both Pembroke J and Young JA has appeal from a commercial point of view – after all, it is always possible to stipulate as a precondition of a proper call on the bond that some independent, third party, is to certify that the condition has been satisfied.[29]

Subsequently, in *Universal Publisher Pty Ltd v Australian Executor Trustees Ltd*[30] White J applied the reasoning in *Lucas Stuart* on the negative stipulation to grant an injunction to restrain the call of a demand guarantee given by a lessee to secure various covenanted obligations under a lease. His Honour reasoned that it was arguable that the bond could only be called in certain specified contractual circumstances which could not irrefutably be shown to exist, and that damages would not be an adequate remedy in the absence of an injunction because of the likely impecuniosity of the payee for the funds. White J observed[31]:

> There need be no dichotomy between, on the one hand, a party's being entitled to claim on an unconditional performance bond because it claims in good faith that the other party is in default and, on the other hand, a party's entitlement to call on a security being indisputable or capable of being established objectively when the demand is made. There is a middle ground; that the claim of default may be raised in good faith but may be disputed. Whether

[24] At [62] citing *Bankstown City Council v Alamdo Holdings Pty Ltd* [2005] HCA 46; 223 CLR 660 at 665.
[25] Per Young AJA at [65].
[26] At [69].
[27] At [70].
[28] At [73].
[29] As to this last topic, see a detailed, although ageing article, L Aitken, "Performance Bonds" (1989) Vol 5 No 5 Banking Law Bulletin pages 167 – 168 in which discussed all the cases arising from spurious claims against UK contractors by Iraqi counterparties.

[30] [2013] NSWSC 2012.
[31] [2013] NSWSC 2012 at [59].

> the raising of a dispute as to the existence of a breach provides an answer to a claim being made on the performance bond will depend on the proper construction of the contract, including any evidence as to commercial practice that may be admissible or about which judicial notice can be taken.

Recent authority on the danger of "reputational risk" to support an injunction

Since *Lucas Stuart* there has been a series of cases which, while recognising the availability of the argument on reputational damage has not treated it as a decisive factor in the award to injunctive relief.

In *Central Petroleum Ltd v Century Energy Service Pty Ltd*[32] Kenneth Martin J observed:

> "… there may well be instances where the cold calling of a performance guarantee may deliver reputational damage to the exposed party (who has caused the guarantee to be provided by the financial institution).

In that case, however, Martin J did not think that such reputational damage would occur since it was easy for the obligor to remove the risk of the call by paying the amount "secured" – "it could in swift time (effectively on a without prejudice basis) render a payment of relatively modest amount (assessed in a commercial context) to [the payee]."[33] It follows that equity will be reluctant to intervene by way of injunction when the party seeking the assistance of the court is in a position to assist itself. It should be noted that the amount which had to be paid was in the order of $320,000 – not a large sum in the overall context of the contract.

More recently, in *Saipem Australia Pty Ltd v GLNG Operations Pty Ltd*[34] Philip McMurdo J examined a similar argument where a much larger potential sum (in the order of $12 million) was required to satisfy the nascent claim which the bond supported. There, the applicant for injunctive relief put on uncontradicted evidence that it would suffer "damage to its reputation" if a demand were permitted. It would also have a likely adverse effect on the company's credit rating, increase its cost of obtaining future finance and decrease its competitiveness in bidding for future contracts.[35] It would appear that "credit reporting agencies maintain records of instances where bank guarantees are called upon and reports of those agencies are used by suppliers of materials used in the types of projects undertaken by [the applicant]".[36]

However, on a previous occasion the obligor had been able to pay in the order of $28 million to prevent a call being made and his Honour was not presented with any evidence to suggest that it could not do so again.

At first instance in *Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd*[37] Vickery J had relied on the reputational damage likely to be suffered by the obligor as a basis for granting relief. In *Lend*

---

[32] [2011] WASC 211, 25 – 26; [75] – [80].
[33] [2011] WASC 211 at [79].
[34] [2015] QSC 173.
[35] [2015] QSC 173 per Philip McMurdo J at [44].
[36] [2015] QSC 173 at [44].
[37] [2014] VSC 476.

Lease the key point of construction was whether or not the defendant was "acting reasonably" within the terms of clause 5.2 of the relevant contract and whether that issue was to be assessed subjectively, or objectively. Vickery J concluded that the second interpretation was possible and thus generated a serious question to be tried.[38]

What of the balance of convenience? The defendant was a $4 company. It was said that if payment were made under the guarantee the funds might be dissipated, so that Sugar Australia could not meet the subsequent claim by Lend Lease for damages. Further, it was contended that Lend Lease would suffer "reputational damage" should the guarantee be drawn on.[39] On the facts, Vickery J concluded that damages would not be an adequate response.

On appeal, that decision was set aside.[40] On the topic of "reputational risk" Kaye JA mordantly observed "… it is notorious that disputes are commonly part and parcel of building contracts".[41]

Unfortunately, the Court of Appeal's approach to resolving the question at the interlocutory stage, with respect, seems likely to confuse what should be a relatively simple determination of an important issue in commercial practice viz how have the parties respectively allocated the risk contractually of one being kept out of its funds for a particular period? It does so because implicit in the reasoning is the acceptance that an obligor on a performance guarantee which seeks to restrain its exercise is entitled to put before the trial court voluminous material with a view to persuading a busy Commercial List judge that the obligor has some countervailing claim that casts doubt on the "bona fides" of the obligee which makes the call.

This threatens to turn what should be a short, sharp interlocutory application into a full-blown examination (via a Scott Schedule, and affidavits on which, one assumes, no cross-examination is allowed) of the multifarious claims and counter-allegations that inevitably arise in any large construction project! If one correctly assumes that large commercial enterprises are well-advised, and they have come to a contractual agreement about the allocation of risk in the event of a dispute to the effect that one will pay on demand if a claim is made by the other, and litigate about that later, then the latest judgment adds a large and dangerous uncertainty to the situation, and invites adventitious litigation. The court recognised the importance of such allocation – "recourse provisions" variously worded provide "security to a building owner, … and they also allocate the risk as to which party shall be out of pocket pending resolution of a dispute".[42]

Brief facts

The respondent, Lend Lease, as contractor, had agreed to design, construct, supply and install a new sugar refinery at Yarraville for the appellant as owner. As part of the contract, it provided two unconditional bank guarantees for an amount representing 5% of the original contract sum - $4.19 million in total. General Condition 5.2 of the contract provided that "any security"

---

[38] [2014] VSC 476 at [64] – [68]. In addition, the "recourse notice" making demand failed to comply with the terms of the contract – it had the wrong addressee and claimed too much.
[39] [2014] VSC 476 at [72].
[40] [2015] VSCA 98 – the decision is analysed below at text to footnotes 40 to
[41] [2015] VSCA 98 at [233].
[42] [2015] VSCA 98 per Kaye JA at [123].

provided by the contractor "shall be available [to the owner] whenever [the owner] "may claim (*acting reasonably*) to be entitled to:

(i) the payment of monies or an indemnity … under or in connection with the contract;
(ii) …; or
(iii) … " (emphasis supplied).

Recourse to the security required 5 days' notice. The owner called on the security after disputes arose under the contract, and commenced proceedings for $9.4 million by way of damages. Some days later the contractor commenced proceedings for a much larger amount comprising sums allegedly due under the agreement ($17.9 million odd) and damages for "project losses" ($67.1 million odd). The contractor also sought declarations that the owner had wrongfully called on the security and a permanent injunction to prevent the owner from having recourse to it. The notice provision would seem to be the reason why the dispute was between the contractor and owner directly and did not involve the bank. As noted, Vickery J granted the relief sought.

His Honour declined to construe what was involved in the owner "acting reasonably" in making the call on the security.[43] "His Honour … concluded that he should proceed on the basis that the construction of that condition raised a serious issue to be tried at a future date". In doing so, his Honour ignored the usual position that it is "ordinarily appropriate to resolve construction issues which are capable of resolution at the interlocutory stage and which bear squarely on the justice of preventing reliance upon a performance bond pending trial".[44] Yet, this was the key "threshold" decision on appeal. Vickery J concluded that he should no construe clause 5.2 because of the "difficulties raised", the general importance of the term and the potential on-going effect as a precedent, the limited time available, and the degree of hardship involved in the payment.

The practical position of Vickery J

As to the time available, Kaye JA noted that Vickery J was in "a particularly invidious position.[45] His Honour was trial judge in charge of a busy list with very limited time. The parties put "quite voluminous factual material" before the court at trial, and on appeal. Thus, in a future case, "the parties should prepare a document setting out … the evidence relied on by each side in support of each item claimed in a recourse notice. It is not appropriate, or feasible, for a trial judge to be left in a position of having to sift through the material to identify, and assess, parts of voluminous affidavits that relate to the various claims and cross-claims asserted".[46] At trial, Vickery J had held that the balance of convenience strongly favoured the grant of an injunction. His Honour reasoned that the contractor would suffer reputational damage were the security to

[43] [2015] VSCA 98 per Osborn and Ferguson JJA at [16].
[44] [2015] VSCA 98 at [43],
[45] [2015] VSCA 98 at [240].
[46] [2015] VSCA 98 per Kaye JA at [241].

be enforced, the owner would not be able to satisfy an award of damages, and further would suffer at most minimal inconvenience by the grant of an injunction."[47]

The majority judgment – Osborn and Ferguson JJA

The majority concisely reasoned that the parties had entered a commercial agreement as to "when and how the performance bonds might be called upon. In doing so, they effectively determined which of them would bear the financial risk (up to approximately $4.2 million) without the need for the [owner] to prove an entitlement to be paid".[48] Such a conclusion was, with respect, on the facts, impeccable. But their Honours then agreed with Kaye JA on the "remaining issues".[49] It is suggested that what that judgment implicitly condones as appropriate in determining the interlocutory issue is where the real danger lies.

"Acting reasonably"

What did clause 5.2 mean when it provided that the owner in making a "claim" had to "act reasonably"? Does it in fact add anything at all to the owner's obligation? An owner could not act fraudulently, or unconscionably, in making a call. In *Beyfield Pty Ltd v Northbuild Construction Sunshine Coast Pty Ltd*[50] Martin J observed: "The existence of a bona fide claim is a necessary element in the exercise of a right to convert a security."[51]

In *FMT Aircraft Gate Support Systems v Sydney Ports Corp*[52] Pembroke J had to construe a clause which permitted a call on security when the obligee had a "claim or entitlement" to damages. The clause there construed was very similar to that in the present case where the owner may "claim (acting reasonably) to be entitled". The same concepts, a "claim" to an "entitlement" are operative in both. What then does it add to require that the owner be "acting reasonably" in making a "claim"? Surely a valid "claim" must be "reasonable" in and of itself? Put the other way, if the claim is "unreasonable" then the owner cannot properly be said to be "entitled" to anything.

Pembroke J observed:

"It is stating the obvious to say that a valid claim within the meaning of clause 5.2 must be non-fraudulent. In that sense, it must be a genuine claim. It adds nothing to say that it must be bona fide. On the other hand, despite occasional suggestions to the contrary, I am satisfied that a mere honest or bona fide "belief" in a claim is insufficient: cf *Clough Engineering Ltd v Oil & Natural Gas Corporation Ltd* [2008] FCAFC 136 at [102]. The test could not be subjective honesty or bona fides. More is required. A claim that is irrational and misconceived could not justify recourse to the security simply because the claimant had an honest, but wrongheaded, belief in the correctness of its claim. *Equally, it is inappropriate to insist that the claim be "genuine and fair" as the plaintiff submitted. And it is certainly not necessary that the claim be reasonable. Both would impose requirements on the principal that could well be onerous and productive of disputes.* What is required in my view is an arguable claim - one that is not specious, fanciful or untenable: *Hughes*

[47] [2015] VSCA 98 per Kaye JA at [95].
[48] [2015] VSCA 98 at [68].
[49] [2015] VSCA 98 at [69].
[50] [2014] QSC 12 at [67].
[51] His Honour cited *Buchmann Pty Ltd v BHP Power New Zealand Ltd* [1998] VSCA 44; [1999] 1 VR 420.
[52] [2011] NSWSC 1108 at [12] – [15] discussed very briefly by Kaye JA at [132].

Bros v Telede Pty Ltd [(1989) 7 BCL 210] at 216 (Cole J). This is at least consistent with decisions that have held that an "entitlement" for the purpose of such a clause will have been established even though there is a genuine dispute or serious issue to be tried as to the existence of the right which underpins the entitlement: *Fletcher Construction v Varnsdorf* [[1998] 3 VR 812] at 821-3 (per Charles JA). For my part, I think that the test of what is a "claim" for the purpose of a contractual provision such as clause 5.2 is relatively undemanding. An appropriate analogy is the criterion used for determining whether there should, or should not be, summary dismissal of a claim or proceeding: *General Steel Industries v Commissioner for Railways* [1964] HCA 69; (1964) 112 CLR 125. Such an approach would, in my view, reflect the commercial purpose and the allocation of risk which I have explained (emphasis supplied)."

Argument of the contractor

On appeal from the decision of Vickery J, the contractor argued that the "[owner] was not acting reasonably in claiming to be entitled to monies or indemnity under the contract" where, it was variously contended:[53]

(a) the contractor had terminated the contract;
(b) the contractor had no indebtedness to the owner;
(c) the contractor's claims against the owner "far exceeded" the latter's claims, and the contractor enjoyed a contractual liability cap which limited its potential liability to a little over $2 million.

Osborn and Ferguson JJA recognised that the "commercial purpose of the performance bond was to allocate risk" and that recognising 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 defeated".[54] Kaye JA noted[55] the applicable law as set out in *Clough Engineering.*[56] He concluded that "acting reasonably" imported a temporal element so that it was necessary that the "[owner] at the time it made the claim, then be acting reasonably, in an objective sense, based on information and facts then known, or which reasonably ought to have been known … at that time".[57] But, the relevant knowledge did not have to be "such knowledge that would decisively establish its entitlement to payment, indemnity or reimbursement of the monies claimed in the recourse notice. … [T]he clause required no more than that the [owner] have acted reasonably in making the claim, based on the facts and circumstances …". Furthermore, as a matter of construction, the claim was not restricted to amounts that had already been paid.[58]

Serious issue to be tried?

[53] [2015] VSCA 98 at [135].
[54] [2015] VSCA 98 at [31].

[55] [2015] VSCA at [138].
[56] (2008) 249 ALR 458 at 479.
[57] [2005] VSCA 98 at [144].
[58] [2015] VSCA 98 at [145] – [147].

One might have thought that on that basis the appeal would be allowed and that the parties (and anyone seeking similar relief in the future) would be adjured from seeking to adduce much evidence at all before a beleaguered Duty Judge. But that is not what occurred.

Both sides "relied on a large body of evidence relating to the various claims, and cross-claims, arising from the works performed by the [contractor], and the circumstances in which the [contractor] (and subsequently the [owner]) terminated the contract"![59] There was, however, apparently "little by way of analysis undertaken in respect of that evidence, for the purposes of agitating the question whether there was a serious issue to be tried".

One might have expected that in the absence of "reputational risk" the question whether the owner had acted "reasonably" would be shortly answered. There was of course no suggestion of fraud, or "unconscionability" (although one wonders why that that Delphic concept was not thrown invoked). The reasoning (without "reputational damage") is almost syllogistic: there was an undoubted bona fide claim – if it proved to be an overstatement then subsequently that amount could be recovered – the contract allocated the risk to the contractor as is almost invariably the case, since if you want the tender you must submit to the terms as negotiated – *cadit quaestio*.

For unclear reasons Kaye JA (with whom albeit not expressly Osborn and Ferguson JJA must be taken to agree) decided that all the "materials" put before the court had to be examined to determine "whether there was a serious issue to be tried that the [owner] had acted reasonably in making the claims …".[60] Much of the background concerned allegation and counter-allegation about who was entitled to terminate the contract.[61] His Honour then looked at whether the owner was entitled to claim increased costs of completion. "In essence, that issue is to be resolved by determining whether there is a serious issue to be tried as to whether the [owner] acted reasonably in considering that it had validly terminated the contract …"! But once it is assumed that the owner is bona fide that must be the end of the matter. As Pembroke J put it, was it "arguable" that such a termination had occurred? Obviously, yes!

Kaye JA went on to say that the "substantive issue" for trial would be whether increased cost of works on the basis of a breach of contract by the contractor would be recoverable at trial – and this issue somehow feeds into the availability of the interlocutory relief.[62] That issue was said to be "difficult to resolve".[63] Various matters of dispute were said to demonstrate that the owner's representative had engaged in conduct "which, if established at trial, could fairly be characterised as significantly obstructive of the work of [the contractor] under the contract".[64] It is not clear why this is relevant at any interlocutory stage.

Kaye JA then looked in detail at the amounts claimed by the recourse notice.[65] His Honour concluded after a detailed analysis of the evidence that some of the claims could not be supported.

---

[59] [2015] VSCA per Kaye JA at [153].
[60] [2015] VSCA 98 per Kaye JA at [153].
[61] [2015] VSCA 98 per Kaye JA at [156] – [163].
[62] [2015] VSCA 98 at [169].
[63] [2015] VSCA 98 at [171].
[64] [2015] VSCA 98 at [172].
[65] [2015] VSCA 98 [175] – [196].

Only in relation to some $1.9 million odd was there no argument that the owner had "acted reasonably".[66]

As to the alleged cross-claims, the contractor had not demonstrated that the owner was aware of them at the time of the claim.[67] Furthermore, ultimately the balance of convenience did not support the grant of an injunction to restrain the owner from calling on security in excess of $1.9 million odd.[68] This was because the owner had offered an undertaking to ensure that there was no risk of it being unable to satisfy an award of damages if it failed at trial[69] and the owner's delay (from November 2011 to March 2014!) did not disentitle it from calling on the security. The Court, with respect, reached the correct conclusion. But it took a judgment of 241 paragraphs to do so. Vickery J went astray because he did not construe the term "acting reasonably" and was beguiled by the notion of "reputational damage".

Statutory "unconscionability"

It is always attractive to attempt to avoid the impact of the "usual" rule with respect to fraud by invoking a federal statute which also provides relief (in the same way that it is sometimes possible in a mortgagee case to avoid the effect of *Inglis v Commonwealth Bank of Australia* by praying in aid of the Consumer Law). In *Orrcon Operations Pty Ltd v Capital Steel & Pipe Pty Ltd and Ors*[70] Besanko J considered whether interlocutory relief could be sought to restrain further demand, or any payment, on a letter of credit on the basis that no payment was due for the sale of certain piping unless it was in accordance with specification.

It was contended for the applicant that the favouree of the letter of credit, a large Korean manufacturer, had engaged in misleading and deceptive conduct contrary to the norm established by section 52 of the Trade Practices Act 1974 (now partially replicated in practice by clause 18 of the Australian Consumer Law) because of inaccuracies in certain "mill test certificates": per Besanko J at [24]. It was also asserted that the Korean manufacturer had engaged in "unconscionable conduct" contrary to the norm established by section 51AA of the Trade Practices Act 1974. It was said to be acting unconscionably because it sort to draw down on the letter of credit without have the financial capacity to repay the drawn down amount in due course.

As Besanko J noted (at [53]), a key issue was the "relationship between the autonomy principle and unconscionable conduct within section 51AA of the TPA". Apart from the "fraud" exception, the manufacturer conceded that an injunction might also be sought on the basis of "breach of a negative stipulation" and "unconscionable conduct" within section 51AA: at [57]. What may constitute "unconscionability" within the meaning of section 51AA was considered in detail in *Competition and Consumer Commission v Samton Holdings Pty Ltd.*[71]

---

[66] [2015] VSCA 98 at [198].

[67] [2015] VSCA 98 at [212] – [223].
[68] [2015] VSCA 98 at [238].
[69] [2015] VSCA 98 at [235].
[70] [2007] FCA 1319.
[71] (2002) 117 FCR 301 at 383, [48]. The five "heads" of unconscionability listed (in a non-exhaustive list) were (i) setting aside a contract from knowing exploitation of a special disadvantage of which one party is aware the other suffers, (ii) setting aside a transaction because of defective comprehension, or undue influence, (iii)

In *Olex Focas Pty Ltd v Skodaexport Co Ltd*[72] Batt J granted injunctions to prevent the calling on of construction guarantees on the basis that there was a serious questionto be tried whether the demand had been made unconscionably (this decision, of course, pre-dates *Samton Holdings*). Subsequently, Austin J in *Boral Formwork and Scaffolding Pty Ltd v Action Makers Ltd*[73] held that the "autonomy" principle could not override the statutory provisions of the Trade Practices Act. There, the beneficiary was insolvent. His Honour noted the importance of the autonomy principle and observed that "it is not normally unfair or unreasonable or otherwise unconscionable to exercise commercial rights under an autonomous commercial contract, even if (for example) for the purposes of applying pressure to resolve a dispute"[74]. "Autonomy" was relevant to the exercise of the Court's discretion and in *Boral* the claim was being made "on a false basis" which made the case "sufficiently special" to overcome the "autonomy" principle.

In *Clough Engineering Limited v Oil and Natural Gas Corporation Ltd*[75] Gilmour J granted leave to serve out to restrain the making of a further demand, or the obtaining of payment by the favouree of performance guarantees on the basis that *Samton* "unconscionability" might justify relief and because of the possibility of an express negative stipulation.[76]

In *Orrcon* Besanko J concluded that it was arguable that "a seller of goods who presents the necessary documents under a letter of credit and at the time of doing so has a level of knowledge about the goods and whether the comply with the contract may be guilty of unconscionable conduct within section 51AA"[77] while holding that the facts did not demonstrate a serious question to be tried.

In *Lend Lease* Vickery J observed that "looking at the contract as a whole, the question becomes whether the provision of the bank guarantee was merely for the purpose of provision of security or *was a risk allocation device as between the parties pending resolution of a dispute, or had both of these purposes."*[78] A similar point was made expressly by White J in *Patterson Building Group Pty Ltd v Holroyd City Council*[79] where his Honour said:

> "Clause 5.2 entitles the defendant to call on the security in two cases: namely, either where the defendant remains unpaid after the time for payment, or where it claims to be owed moneys by the plaintiff. The defendant relies on the second limb of the clause. Under the second limb of the clause the defendant does not have to demonstrate that it is in fact owed moneys. It is entitled to have recourse to the security if it claims to be owed moneys. Contrary to the submissions of counsel for the plaintiff this clause does not merely provide security to the defendant for amounts that might be found to be due to it. The clause is a

---

preventing the unconscionable departure from representation as to the exercise of a legal right (iv) relief against forfeiture and penalty, and (v) rescission of a contract for unilateral mistake.

[72] [1998] 3 VR 380.

[73] (2003) ATPR 41-953.

[74] Per Austin J at [94].

[75] [2007] FCA 881.

[76] See *Clough Engineering Ltd v Oil and Natural Gas Corporation Limited (No 2)* [2007] FCA 927 at [43] on the banks' application to have the service set aside.

[77] *Orrcon* at [70] per Besanko J.

[78] [2014] VSC 476 at [41] per Vickery J emphasis supplied.

[79] [2013] NSWSC 1484 at [38] – [39].

risk allocation device that addresses the issue of who is to be out of pocket while the dispute under the contract is determined"[80].

The essential question is whether the contract confers "an unfettered right to call upon the performance guarantee or whether exercise of the right is limited by some, and if so what, consideration or body of considerations".[81] Is there a "contractual fetter" or "qualification" on the ability of the favouree to call on the bond?[82]

The recent authority illustrates a number of points. First, the notion of an untrammelled "autonomy" with respect to the payment of a guarantee, bond, or letter of credit, continues to control the jurisprudence. The exception of obtaining injunctive relief by invoking "fraud" is a narrow one – it is difficult to make out on the facts, and at the level of balance of convenience an injunction against the financial institution to restrain it from paying on the obligation will likely be refused. More effective, if circumstances allow, is an injunction aimed at the favouree to restrain it from making any claim on the obligation in the first place, either because in doing so it breaches some negative stipulation in the underlying contract, or because the mere making of the demand will see the other contracting party suffer harm, either real or reputational, which no subsequent payment of damages can salve.

The "fraud" exception

A difficulty will arise if the party who has requested the credit to be opened alleges fraud against the beneficiary – what then is the bank to do?[83]

As White J stated in *Patterson Building Group Pty Ltd v Holroyd City Council*[84]

> "In such a case where the contract permits a call on a performance bond or guarantee where the principal has a claim to an entitlement to moneys, the principal may be restrained from having recourse to the security if the claim is made fraudulently, that is, if it knows that it does not have such an entitlement, or if it does not act in good faith, for example, if it capriciously selects the amount called on[85] or if its exercise of its contractual right is unconscionable and in breach of sections 20 or 21 of the *Australian Consumer Law*."

It will be observed that the statement by White J includes lack of good faith, and unconscionability as further bases in addition to fraud for justifying the grant of interlocutory relief.[86] In addition, as already discussed in detail above, it is clear that it may be possible to obtain an injunction to restrain

[80] His Honour cited *Fletcher Construction Australia Limited v Varnsdorf Proprietary Limited* [1998] 3 VR 812 at 821, 826; *Clough Engineering Limited v Oil and Natural Gas Corporation Limited* [2008] FCAFC 136; (2008) 249 ALR 458 at [79]; *FMT Aircraft Gate Support Systems v Sydney Ports Corporation* [2010] NSWSC 1108 at [7]- [11].
[81] [2014] VSC 476 at [41].
[82] [2014] VSC 476 at [43].
[83] For a general analysis, see X Gao, "The identity of the fraudulent party under the fraud rule in the law of letters of credit" [2001] UNSWLJ 14.
[84] [2013] NSWSC 1484 at [40].
[85] His Honour cited *Clough Engineering Limited v Oil and Natural Gas Corporation Limited* (2008) 249 ALR 458 at [59], 116.
[86] See, for an earlier discussion, J Browne, "The fraud exception to the standby letter of credit in Australia – does it embrace statutory unconscionability?" [1999] Bond LR 5. This issue is explored below in the context of *Orrcon Operations Pty Ltd v Capital Steel & Pipe Pty Ltd* [2007] FCA 1319 per Besanko J.

payment on the basis of breach of an implied negative stipulation in the underlying contract which is supported by the autonomous obligation.

In *Cerasola TLS AG v Thiess Pty Ltd & John Holland*[87] Daubney J noted that "while the Court will not restrain the issuer of performance guarantee from acting on an unqualified promise to pay if the party in whose favour the guarantee has been given had made a contractual promise not to call upon the bond, breach of that contractual promise may be enjoined on normal principles relating to the enforcement by injunction of negative stipulations in contracts".

In *Alternative Power Solution Ltd v Central Electricity Board*[88] the Privy Council has recently considered the scope and operation of the "fraud" exception to the usual rule that a letter of credit must be satisfied against conforming documents in terms of the credit. In particular, the Judicial Committee has drawn an important distinction between the standard of proof required to obtain an interlocutory injunction in the usual case, and an injunction to restrain payment under a credit.

In the former case it suffices that there is a serious question to be tried, and the balance of convenience (supported by an undertaking as to damages by the applicant) favours the grant of interim relief. In the latter case "it must be clearly established at the interlocutory stage that the only realistic inference is (a) that the beneficiary could not honestly have believed in the validity of its demands under the letter of credit and (b) that the bank was aware of the fraud.[89]

Facts of *Alternative Power Solution*

The facts were complex. In brief, electric light bulbs were manufactured in China and to be shipped, under the terms of the credit, to Mauritius. A question arose whether or not the bulbs had to be manufactured by an enterprise which enjoyed a right to do so under licence from Philips. Further issues arose with inspection of the bulbs. The beneficiary was intransigent in not taking up offers to inspect the bulbs and the trial judge seemed to take a set against the beneficiary's representative because of his mistaken belief about the position in transit of the bulbs. But, significantly, at no time was any relevant complaint made about the documents presented to the bank under the credit. There was no suggestion that they were forgeries, nor that to the knowledge of either the beneficiary, or the bank, they contained "any material express misrepresentation" nor that the beneficiary "made any implied misrepresentation, whether innocently, or knowingly and dishonestly".[90] Nevertheless, the trial judge granted an injunction to prevent the payment under the credit and the Court of Appeal of Mauritius confirmed his decision. The Privy Council held otherwise.

Interlocutory relief – the "fraud" exception

As UCP 600 Article 4a provides: "a credit is by its nature a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the

---

[87] [2011] QSC 115 at [16] cited by Hollingworth J in *Otter Group Pty Ltd v Wylaars and Anor* [2013] VSC 98 at [16].

[88] [2014] UKPC 31 per Lord Clarke giving the advice of the Judicial Committee.

[89] [2014] UKPC 31 per Lord Clarke at [59].

[90] Per Lord Clarke at [60].

undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary".

"The unique value of such a letter, bond or guarantee is that the beneficiary can be completely satisfied that whatever disputes may thereafter arise between him and the bank's customer in relation to the performance or indeed existence of the underlying contract, the bank is personally undertaking to pay him provided that the specified conditions are met".[91] Thus, upon presentation of conforming documents the bank is bound to pay.[92] From its point of view, a bank does not want to be bound by an injunction – "irreparable damage can be done to a bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it discharged".[93]

What then is the relevant approach? It suffices to obtain interlocutory relief in the usual case to demonstrate that there is a serious question to be tried between the parties. "The expression 'serious question' should be understood as conveying the notion that the seriousness of the question depends upon considerations of the nature of the rights the plaintiff asserts and the practical consequences likely to flow from the order he seeks".[94]

The Privy Council expressly acknowledged that the test for interlocutory relief does not usually require that "[the applicant] will probably succeed, or that he has a prima facie case or a strong prima facie case".[95] It is usually sufficient that it cannot be contended that it "frivolous or vexatious"; in other words, it is "serious": Lord Diplock in *American Cyanamid* at 407G.

That is not the test with respect to a letter of credit, or (one would infer) other autonomous payment obligations. It seems on the authorities that the applicant for relief must be able to demonstrate that "the only realistic inference is that [the beneficiary] could not honestly have believed in the validity of its demands on the performance bonds".[96] Thus, there must be more than a mere mistake, or an unreasonable call on the bond - "In the context of a performance bond or

---

[91] *Bolivinter Oil SA v Chase Manhattan Bank NA* [1984] 1 WLR 393 per Donaldson MR.

[92] *United City Merchants (Investments) Ltd v Royal Bank of Canada (The "American Accord")* [1983] 1 AC 168.
[93] Per Donaldson MR in *Bolivinter* at 393.

[94] *Goh v Murdoch Eye Pty Ltd* [2014] WASC 344 at [10] per Chaney J citing *Australian Broadcasting Commission v O'Neill* [2006] HCA 46; (2006) 227 CLR 57 , 82 83 (Gummow & Hayne JJ); *Beecham Group Ltd v Bristol Laboratories Pty Ltd* [1968] HCA 1; (1968) 118 CLR 618, 622 623 (the Court). It is question for another day what, if any, relevant practical difference exists between the UK approach to the grant of interlocutory relief as discussed in *American Cyanamid Co v Ethicon Ltd* [1975] AC 396 and *Australian Broadcasting Commission v O'Neill*.

[95] Per Lord Clarke at [53].
[96] Per Ackner LJ in *United Trading Corp SA v Allied Arab Bank Ltd* [1985] 2 Ll LR 554 at 561 and see *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 WLR 1152 at 1160 per Staughton LJ. In *United City Merchants* Lord Diplock (at 183) had made it clear that the beneficiary must act fraudulently in presenting documents "that to his knowledge are untrue".

advance payment guarantee, a demand which the maker does not honestly believe to be correct as to its amount is a fraudulent demand".[97]

The problem is practical and temporal. The usual test for interlocutory relief permits the court to "hold the ring" by making an initial assessment of the strength of the applicant's claim and protecting the defendant by an undertaking in the event that the injunction is ultimately discharged. There should not, in theory, be a different approach with respect to the grant of interlocutory or final relief with respect to a letter of credit.

But, as Rix J noted in *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London Ltd*[98], the assessment for relief must be made in the context of "a strong presumption in favour of fulfilment of the independent banking commitments". It follows, as Lord Clarke noted[99] that "the test [for interlocutory relief] cannot be quite the same as at trial" – the test at the interlocutory stage requires it to be "seriously arguable" that the "only realistic inference" is that the beneficiary does not believe in the honesty of the presentation and the bank is aware of that fact.

So, on the issue of whether a serious issue arose, the Board disagreed with the trial judge. In addition, the balance of convenience did not favour the grant of an injunction. As Lord Clarke observed,[100] "the reasons why reported cases of injunctions being granted (or continued) under the fraud exception are so rare are (a) because it is almost never possible to establish the test for fraud as opposed to the mere possibility of fraud, but also (b) because the balance of convenience will almost always militate against the grant of an injunction".

Kerr J identified the real mischief and the "insuperable difficulty" in seeking interlocutory relief in *RD Harbottle (Mercantile) Ltd v National Westminster Bank*[101] as follows. If the bank is entitled to pay under the contract then the applicant has no cause of action, while if the threatened action to pay is in breach then damages are an adequate remedy. Further, any interference with the bank's obligation to pay the beneficiary might cause greater damage to the bank than the applicant could pay on its undertaking as to damages. As a result, the balance of convenience is "hopelessly weighted" against the applicant.

That assumes, of course, that the relief is sought against *the bank or other payor.* It is another question entirely whether the same considerations apply when the injunctive relief is sought either to prevent the favouree making a claim in the first place, or subsequently disposing of the proceeds of a payment made by the bank under the instrument in satisfaction of the demand.

A recent practical example – *Aria v Credit Agricole*

---

[97] *Uzinterimpex v Standard Bank Plc* [2007] 2 Lloyd's Rep. 187 at [107] per Steel J discussed in detail by Ramsey J in *AES-3C Maritza East v Credit Agricole* [2011] EWHC 123 (TCC) at [43] – [48].

[98] [1999] 2 Ll LR 187 at [202].
[99] Per Lord Clarke at [59].
[100] Per Lord Clarke at [79].
[101] [1978] QB 146 at 155.

The practical application of this approach can be seen in *Aria Inc v Credit Agricole Corporate and Investment Bank and World Fuels Services (Singapore) Ltd ("WFS")*[102]. There, Leggatt J had to determine whether to grant interlocutory relief to restrain payment of a performance guarantee which had been provided to obtain release of vessel, the "Aria", owned by the claimant which had been arrested in France. Could the claimant show a "seriously arguable case of a clear fraud" of which the bank had knowledge, or, in the alternative, was "fraud … the only realistic inference" which the court could draw?[103] The facts were complex with transnational elements involving English, French and Greek law.

A guarantee had been provided to obtain the release of a ship, "The Aria", owned by the claimant that had been arrested in France. Prior to arrest, the ship had been successively chartered, and then sub-chartered to Allied Maritime. While under the sub-charter, bunkers were supplied by the second defendant, WFS, although the claimant made it clear that the bunkers were at Allied Maritime's account, not the ship's. WFS arrested the ship for non-payment at a time when it seems clear that Allied Maritime was in financial difficulties. The guarantee was conditioned on the making of an enforceable decision of a competent court, or arbitration award, in settlement or resolution of the French arrest.

Under the Greek insolvency regime, it was clear that the operation of the Greek Insolvency Code was to render invalid any proceedings against Allied Maritime. The effect of this would be to render futile the arrest proceedings in France, and thus deprive the guarantee of any operation. On the available evidence Leggatt J concluded that the lawyer for the favouree had failed to inform the French court of the making of the Greek order as he should have done – he was thus satisfied that "there is a seriously arguable case of a clearly established fraud".[104] However, on the balance of convenience, it was clear that damages would be an adequate remedy.[105]

As Leggatt J observed[106] (discussing the analysis of Kerr J in *RD Harbottle*[107])

"If no injunction is granted in the present case, the Bank might still decide that it should not make payment under the guarantee. In that event Aria would suffer no loss. If, however, the Bank decided to make payment under the guarantee, the same dilemma [identified by Kerr J] would arise".

The treatment of "excess" payments under the bond

Even if a call on the bond will result in an "overpayment" in the sense that the payee will receive more than the total of any possible loss, that fact does not, according to classical theory,

---

[102] [2014] EWHC 872 (Comm).
[103] [2014] EWHC 872 per Leggatt J at [18].
[104] [2014] EWHC 872 at [46]. Relief was, however, granted on the basis of the EU Insolvency Regulation in favour of Allied's liquidator on bases which need not concern us.
[105] See, generally, L Aitken, "When are damages and adequate remedy?" (2004) 78 Australian LJ 544.
[106] [2014] EWHC 872 at [48].
[107] [1978] QB 146 at 155.

provide any reason for not paying, rather than reclaiming the excess subsequently. And this is so, even when it is pellucidly clear (say because of an arbitration award), that an excess will be paid.[108]

There is an implied term in the "underlying contract" between seller and buyer, or between beneficiary and the party at whose instance the guarantee is procured, that "the beneficiary will account to the other party to the underlying contract to the extent to which the beneficiary has been over-compensated by the guarantor".[109] Staughton LJ in *Cargill SA* said that the final determination of the amount owing between the parties was to be resolved on the basis of "an accounting" between them. Thus, the bond guarantees due performance – it is not a pre-estimate of the amount of damages which may be payable to the beneficiary for the breach of contract so that any excess is recoverable.[110] The large danger in the approach of the Court of Appeal is that it seems to invite the party called on to pay immediately to put as much material before the trial judge as possible in a context in which, by the very nature of the obligation under the bond, only a short, sharp argument is called for – something akin to the entry of summary judgment, or the setting aside of a statutory demand *pace* Pembroke J. Once bona fides is conceded (as it inevitably must when dealing with well-conducted commercial counterparties) there is no scope for clogging a busy commercial List with numerous affidavits replete with allegation and counter-allegation else the underlying purpose of entering a "first-demand" bond will be comprehensively undermined.

Does the law of restitution, have any part to play in the analysis of whether the sum so paid is recoverable? Is that sum paid held on trust? If so, for whom? In *Wuhan Guoyu Logistics Group Co Ltd and anor v Emporiki Bank of Greece SA* [2013] EWCA Civ 1679 the Court of Appeal has grappled with these basic issues.

Earlier, the Court of Appeal had held ([2012] EWCA Civ 1629 at [25] – [29] per Longmore LJ citing *Paget's Law of Banking* 11th ed with whom Rimer and Tomlinson LJJ agreed) that the document in question in *Wuhan* did, indeed, involve a performance bond *stricto sensu,* rather than a guarantee. This was so because in interpreting it, a virtual presumption arose that an obligation should be characterised as a bond when the instrument relates to an underlying transaction between parties in different jurisdictions, was issued by a bank, required payment "on demand", and did not contain any of the traditional clauses which limit a *guarantor's* liability. To hold otherwise would stultify the commercial usefulness of the obligation.

Wuhan involved a ship-building contract, payable by three instalments, supported by a bond issued by the bank to the seller beneficiary. It had been determined at arbitration commenced after a *bona fide* demand for, and consequent payment of, the second instalment to the seller that the second payment was never payable by the buyer. Was it possible for the obligor bank to recover the funds? Was the buyer entitled to reclaim it from the seller, and then obliged to hold any amount so

---

[108] *Wuhan Guoyu Logistics Group Co Ltd and anor v Emporiki Bank of Greece SA* [2013] EWCA Civ 1679 per Tomlinson LJ.

[109] Per Tomlinson LJ at [21] citing Staughton LJ in *Cargill SA v Bangladesh Sugar Corporation* [1998] 1 WLR 461 at 471F

[110] Per Potter LJ in *Comdel Commodities Ltd v Siporex Trade SA* [1997] 1 Ll LR 424 at 431.

recovered on a trust of some sort for the bank? Did the law of recovery of mistaken payments have any part to play?

Why was the instalment not recoverable as paid under a mistake? Tomlison LJ noted the problems which arise in treating money paid by mistake as impressed with a trust with proprietary consequences.[111] There is, however, a more fundamental difficulty. It is of the very nature of a performance bond that a complete and enforceable obligation to pay arises upon making of the demand. From that point forward the claim is "indefeasible"[112] and it makes no difference that the claimant finds out subsequently that the demand was made, in good faith, on a mistaken premise. If a demand in appropriate terms is issued, that is the end of the matter. In this regard, the approach of Lord Diplock to a letter of credit as set out in *United City Merchants (Investments) Ltd v Royal Bank of Canada*[113] applies – once a conforming document is issued, it is nothing to the point that subsequent events illustrate some mistake has been made by the parties.

Absent words to the contrary in the bond, there must be an ultimate "accounting" between the parties but to maintain cash-flow, vital in all commerce, whether domestic or international, the disaffected obligor must pay first, then litigate at leisure. Nowhere explained was why it mattered to the bank commercially, if as well-advised, it enjoyed either an enforceable indemnity, or it had taken a security deposit, from the buyer as a condition of providing the bond to the seller in the first place. It was an "international commercial organisation in the business of providing external guarantees in return for the taking of fees and security".[114]

Since what is involved is always a tripartite arrangement – obligor\issuingbank; obligor\obligee; oblige\issuing bank – how is the "accounting" which will arise in an overpayment to be made? In *Spiersbridge Property Developments Ltd v Muir Construction Ltd*[115] the contractor and owner sought the court's view on to whom any excess should be paid. The contractor\obligor argued that it should be paid by the obligee to it with a correlative obligation then to account to the bank; the owner\obligee argued that its obligation was to account directly to the bank without paying anything to the contractor – "its concern is that if it were to make payment of [the] excess to the [obligor], it would run the risk of being sued for the same amount by the bank".[116] The parties agreed that it was necessary to resolve the question by implying a term into one of the interconnected contracts (since none of the contracts severally provided for or contemplated any overpayment). One problem in implying a term into the building contract was the risk of insolvency where any overpayment "would go into the pot for the general body of creditors of [the contractor]. Unless it had already been paid by the [contractor], the bank would lose out".[117]

---

[111] [2013] EWCA Civ 1679 at [19] referring to his own discussion in *Fitzalan-Howard v Hibbert* [2009] EWHC 2855 QB at [49], para 37-22 of Goff and Jones, *Law of Unjust Enrichment* 8th ed, Rimer LJ in *Shalson v Russo* [2005] Ch 281 at 320, and Lord Millett in "Restitution and constructive trusts" (1998) 114 LQR 399.
[112] [2013] EWCA Civ 1679 per Tomlinson LJ at [20].
[113] [1983] 1 AC 168 at 183.
[114] To adapt the words of Carr J in *Spliethoff's Bevrachtingskantoor BV v Bank of China* [2015] EWHC 999 at [224].
[115] [2008] CSOH 44 (Lord Glennie).
[116] Per Lord Glennie at [6].
[117] Per Lord Glennie at [8].

If, on the other hand, the bank were to be paid directly, then the overpayment would be reversed; if the bank had already been paid on the indemnity by the obligor then it would account for the excess. However, the terms of the bond relevantly prohibited the bank from assigning its interest without the consent of the owner – thus by refusing its consent to any assignment (but already having been paid under the bond), the owner could stymie any attempted recovery since, by definition, the bank would not be out of pocket and would not have any standing to seek recovery in its own right. Furthermore, the bank itself had no interest whatsoever in the underlying contract.

It followed that the most appropriate solution was to require the owner to restore so much of the amount as had been overpaid in the context of the contractual default. The notional insolvency risk was simply a commercial matter for the bank; "if the bank has not taken security, it is true that it will stand to lose … . It is simply a risk that the bank takes, a commercial risk which it will decide whether or not to take depending upon its own assessment of the [contractor's] creditworthiness. It can always refuse to issue the bond, or require some security before agreeing to issue it".[118] Lord Glennie held that although there was no case which had directly decided the point, the weight of authority was strongly in favour of the recovery by the contractor, not the bank.[119] In particular, the reasoning in *Australasian Conference Association v Mainline Constructions Pty Ltd (in liq)*[120] was clear that on the facts of that case the obligation to account was to account to the other contracting party, the builder, not to the paying bank.

Conclusion

The law with respect to construing a performance bond is complex. On the one hand, there are any number of statements which asseverate that a bond is as "good as cash" and must be paid out prontissimo. On the other, as the most recent authorities reveal, there is a large contractual tension in determining whether the bond is, in fact, a "risk-allocation" device. If it is not then larger issues come into play including most likely looking to read into the terms surrounding the demand the possibility of a negative stipulation if "damage" has not been "claimed", or "proved" or the like, and whether that issue of construction attracts a purely objective assessment.

Since the draftsman of the bond is seldom sufficiently alive to the likely meanderings of litigation once the contractual saraband has foundered, it may be predicted that the range of this species of litigation will only increase, not least because frequently the sum that must be paid without demur "upon first demand" is beyond the dreams of avarice.

Lee Aitken TC Beirne School of Law, University of Queensland

[118] Per Lord Glennie at [19].
[119] Per Lord Glennie at [20] – [25]
[120] (1978) 141 CLR 335.