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E-alert: Preventing the enforcement of security in a construction setting

By ,

With respect to Portia[1], a party seeking to prevent a call upon security is likely to need to mount an argument which is stronger than an appeal to the quality of mercy or to unspecified and unclear negative stipulations.[2] The recent Supreme Court of Western Australia decision of *CPB Contractors Pty Ltd v JKC Australia LNG Pty Ltd*[3] (**CPB v JKC**) confirms the difficulties which such a party will face in seeking to restrain a call upon a security.

Background

JKC was the head contractor responsible for the delivery of a substantial oil and gas project in northern Australia. CPB entered into a subcontract with JKC (**Subcontract**). Article 35.3 of the Subcontract provided:

> *Contractor* [JKC] *may have recourse to the Bank Guarantee(s) at any time in order to recover any amounts that are payable by Subcontractor* [CPB] *to Contractor* [JKC] *on demand.*
>
> and
>
> *Subcontractor [CPB] waives any right that it may have to obtain an injunction or any other remedy or right against any party in respect of Contractor [JKC] having recourse to the Bank Guarantee(s).*

JKC demanded over $39M in liquidated damages from CPB; which CPB disputed. CPB sought an injunction to restrain JKC from having recourse to the security.

CPB argued that article 35.3 contained an implied negative stipulation which only allowed JKC to call upon the security where an amount was 'actually and indisputably' due.[4] CPB submitted that an amount was only 'payable' when the amount was properly determined as so, such as in an arbitral award.[5] JKC resisted the existence of the negative implied stipulation on the grounds that the Bank Guarantee was a risk allocation device.[6]

The decision

First, Le Miere J decided that article 35.3(b) of the Subcontract was void; as the clause sought to 'oust' the jurisdiction of the Court. In that regard, it may be noted that article 35.3(b) not only prevented CPB from seeking an injunction, but also from seeking damages in the event that JKC wrongly called upon the security.[7]

Second, having reviewed the customary authorities[8] His Honour confirmed that, in order to ascertain whether a negative stipulation existed, it was necessary to properly construe the Subcontract according to usual principles.[9] In that context, the commercial purpose behind the giving of the security (ie, whether it is a risk allocation device or not) will need to be given due weight.

Ultimately, His Honour held that he words 'at any time' and 'on demand' could not be construed to require CPB to pay only after some process of determining the disputed amount.[10] Further, His Honour accepted that the security existed to protect JKC from CPB's insolvency and to ensure JKC would have security over the funds in the event of a dispute (making it a risk allocation device).[11] CPB's application for an injunction was consequently refused.

His Honour also indicated that he would have refused relief on the balance of convenience in any event (as to grant the injunction would frustrate the purpose of the security).[12]

Take home points

First, if a party wants to condition another party's right to call upon a security (for example, the provision of a notice period, a requirement that there be an objective entitlement to be paid), then those preconditions should be clearly set out in the contract.[13] Lack of clarity will make it difficult to prevent the other party from calling upon the security.

Second, if a party wants to ensure that they can call upon a security in circumstances where there may be dispute as to the right to be paid, then the contract ought to refer to that party's **opinion** as to their right to be paid.

Third, a party should be careful when drafting clauses which restrict a party's right to seek relief in relation to a call upon a security. The clause in CPB v JKC prevented CPB from seeking any relief (including damages) in the event of an inappropriate call upon the security by JKC. It is probable that a more moderate clause, aimed at preventing CPB from seeking an injunction might have 'passed muster'.[14] In that regard, contractors and subcontractors ought to be aware of the impact of such clauses.

If you are looking at entering into a contract which contains an obligation to provide security, or you are having a dispute which could lead to a call being made upon a security, we recommend that you obtain legal advice as a matter of urgency.

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[1] The Merchant of Venice; Act 4, Scene 1 - Portia

[2] 'This bond doth give thee here no jot of blood'; The Merchant of Venice; Act 4, Scene 1 - Portia

[3] [2017] WASC 112

[4] Ibid, [65]

[5] Ibid, [73]

[6] Ibid, [80]-[81]

[7] Ibid, [56]

[8] *Wood Hall Ltd v Pipeline Authority*(1979) 141 CLR 443; *Clough Engineering Ltd v Oil & Natural Gas Corp Ltd* (2008) 249 ALR 458; *Lucas Smart Pty Ltd v Hemmes Hermitage Pty Ltd* [2010] NSWCA 283.

[9] Though not cited by His Honour; see generally *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd*(2015) 256 CLR 104

[10] *CPB Contractors Pty Ltd v JKC Australia LNG Pty Ltd*[2017] WASC 112 at [77]

[11] Ibid, [81]

[12] Ibid, [84]

[13] An example of such a precondition (and the Court's willingness to grant an injunction to prevent recourse to security in absence of compliance with same) can be seen in *RCR O'Donnell Griffin Pty Ltd v Forge Group Power Pty Ltd (Receivers and Manager Appointed) (in liq) & Ors*[2016] QCA 214

[14] Clause 2.6(g) of the contract referred to in *Telvent Australia Pty Ltd v Acciona Infrastructure Australia Pty Ltd* [2016] QSC 201 at [6] might be more sustainable as it only refers to an injunction

Should you wish to discuss any matters arising out of this article, please contact the author:

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