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Sweet result for principal in call on security - *Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd* [2015] VSCA 98

The Victorian Court of Appeal in *Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd* overturned an interlocutory injunction restraining the principal (**Sugar**) from having recourse to performance security in the form of two unconditional bank guarantees. The Court of Appeal held that questions of interpretation relating to contractual rights to call on the guarantees should not have been deferred to trial as this would result in the principal being deprived of its agreed contractual rights to immediate call on the security pending resolution of the underlying dispute.

Background

Sugar engaged Lend Lease Services Pty Ltd (**Lend Lease**) in 2007 to design, construct, supply and install a refined sugar plant. The parties agreed that Lend Lease would provide two unconditional bank guarantees totalling some $4.2 million as security for Lend Lease's performance.

After alleging delayed completion, failure to comply with the principal's directions and other breaches by Lend Lease (including defective works) (**Disputes**), Sugar gave notice of intention to draw on the bank guarantees. Lend Lease applied for an interlocutory injunction to restrain Sugar from having recourse to the bank guarantees before the trial of the Disputes or further order.

The Victorian Supreme Court granted the injunction to Lend Lease on the grounds that entitlement in Sugar to damages for the breaches of contract it alleged against Lend Lease would need to be proved before the bank guarantees could be called upon.

Sugar sought to have the injunction set aside.

Decision

The Victorian Court of Appeal unanimously upheld Sugar's appeal, setting aside the injunction.

The contract provided that the appellant must 'act reasonably' when claiming an entitlement to payment and drawing on the guarantees.

The recourse clause (general condition 5.2 (**GC 5.2**)) was an amended version of the standard AS4910-2002 provision. It read:

> *"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:*
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> *(i) the payment of monies or an indemnity by the Contractor under or in consequence of or in connection with the Contract;*
>
> *(ii) reimbursement of any monies paid to others under or in connection with the Contract; or*
>
> *(iii) other monies 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 five 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 Court of Appeal referred to the case of Fletcher Construction v Varnsdorf[1], where it was observed:

> *"There are broadly two reasons why the beneficiary may have stipulated for a guarantee. One is to provide security. If it has a valid claim and there are difficulties about recovering from the party in default, it has recourse against the bank. The second reason, which is additional to the first, is to allocate the risk as to who shall be out of pocket pending resolution of a dispute. The beneficiary is then able to call upon the guarantee even if it turns out, in the end, that the other party was not in default. It is a question of construction of the underlying contract whether the guarantee is provided solely by way of security or also as a risk allocation device."*

The Court of Appeal in this case found that the trial Judge (and the Court of Appeal itself) was required to determine whether GC 5.2 was intended to allocate the risk as to which party would be out of pocket pending resolution of the dispute between the parties. Failure to do so would deprive the parties of the commercial bargain they struck.

The Appeal judges held that GC 5.2 was intended by the parties to allocate the risk of which party should be out of pocket pending determination of the dispute. Further, the judges' view was this consideration was fundamental to assessing both the issues of whether there was a serious issue to be tried and whether the balance of convenience favoured the grant of an injunction.

The Court of Appeal confirmed that answering the key threshold question in an application for an injunction in bank guarantee cases – whether there is a serious question to be tried as to whether recourse to the guarantees was available – required the interpretation of the words in GC 5.2, 'acting reasonably'. The Court of Appeal found that the omission to construe the phrase 'acting reasonably' meant that the issue of whether Sugar was entitled to seek recourse to the bank guarantees could not properly be determined.

The Court of Appeal went on to find that GC 5.2 did not require the claim on the guarantees to be reasonable, just that Sugar was 'acting reasonably' at the time the claim was made based on what was known by Sugar at that time (or ought to have been known by Sugar at that time). The judges of appeal found that there was a serious issue to be tried as to whether Sugar had 'acted reasonably' for all but three of the claims made.

The Court also found that the balance of GC 5.2 did not limit Sugar's right to claim only in respect of moneys or liabilities already incurred by Sugar in rectifying the refined sugar plant.

The Court found that Lend Lease had not established that the balance of convenience supported granting the injunction. The Court rejected the argument that allowing Sugar to call on the guarantee would damage Lend Lease's reputation; and that there was a risk that Sugar might not satisfy any later damages award in favour of Lend Lease. The Court contrasted this with Sugar being deprived of its rights to access the security till after trial of the underlying Disputes, if the interlocutory inunction were granted.

1 [1998] 3 VR 812, 826-7 (per Callaway JA)

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Implications

Sugar's appeal from the decision of the primary judge first required the leave of the Court of Appeal. Caselaw provides that appeal courts must exercise caution in reviewing the decision of a primary judge, limiting intervention to where the decision appealed against works a substantial injustice to one of the parties or discloses an error in principle.[2]

In overturning the decision of the primary judge in this case, the Court of Appeal has confirmed and reinforced the accepted principles governing the grant of interlocutory injunctions and the ordinary practice adopted in cases concerning calls on performance bonds.[3] The Court determining the injunction application must consider and resolve the interpretation issues raised by the parties in order properly to determine whether an injunction should be granted. Without this, parties would be deprived of their commercial bargain.

Each case will depend on the relevant contractual wording. Parties seeking to call on security or restrain a call on security must consider carefully the risk of substantial adverse costs orders should one or the other fail as Lend Lease ultimately did.

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2 *Mendonca v Mason* [2013] VSCA 280 at [34]

3 *Sugar Australia v Lend Lease Services* [2015] VSCA 98 at [68]