Unconditional bank guarantees

1. What This Article is About

This article addresses two issues:

- What are the essential features of unconditional bank guarantees?
- How does the law respond to alleged abuses of unconditional bank guarantees, where an allegedly unjustified demand for payment has been made?

2. Introduction

2.1 Almost without exception, principals in construction projects require the provision and maintenance of some form of security from their contractor,[1] to secure the performance of the contractor's obligations. The general skew of bargaining power allows principals to insist upon this.[2]

2.2 One reason why principals generally insist upon contractors providing security to them is that it provides an incentive to the contractor to perform all of its obligations under the contract, and to complete the project. Rather than abandoning a partially-completed job and going off to perform more profitable work at another site, a contractor may decide that it is worth its while to complete the project if it has supplied security, and if it wishes to reacquire that security upon completion of the project.

2.3 A second reason, and perhaps the more important one, is to ensure that if the contractor does not perform its obligations under the underlying construction contract,[3] the principal may exercise a right (i.e. to realise the security) additional to any claim for

---

[1] And likewise, main contractors require security from subcontractors, for the same reasons. This article focusses principally upon the principal / contractor paradigm.

[2] Having said that, it is not unusual to encounter large contractors requiring security for payment from developers of unknown financial standing.

[3] Or the contractor otherwise owes money to the principal under the underlying contract, for example as repayment of moneys advanced by the principal for the contractor's benefit: see, for example, *Wahda Bank v Arab Bank PLC* [1994] 2 Lloyd's Rep 411; *Pedna Pty Ltd v Sitep Societa per Azioni* (unreported, Sup Ct NSW, Santow J, 8 Jan 1997).

damages which it has for the contractor's breach of obligation,[4] so as to compensate the principal for that breach, or at least some part of it.

2.4 There are, of course, many forms of security which can be employed by a principal to satisfy these objectives. Examples include a money retention of progress payments,[5] a charge or pledge over the contractor's materials, plant and equipment,[6] and a policy of insurance in the principal's favour in respect of the contractor's obligations.[7]

2.5 Another form of security is the so-called "unconditional bank guarantee". In the Australian construction industry, it is commonplace for contractors to be required by principals to provide security for performance of the contractor's obligations in the form of an unconditional bank guarantee. In England it is less common, largely because of the perception that it is open to abuse (by principals making unjustified demands upon the bank guarantee).

2.6 Unconditional bank guarantees would appear to have gained currency as security in the 1970's. Since that time, a considerable body of case law has developed in relation to them in both Australia and England.

3. The Nature of Unconditional Bank Guarantees

3.1 The expression "unconditional bank guarantee" is used in this article to describe an

---

[4] As a general proposition: the security does not, in the absence of express words to the contrary in the underlying contract, exhaust the principal's remedy against the contractor for the breach: see *Saffron v Société Minière Cafrika* (1958) 100 CLR 231 at 243-244, per Dixon CJ, McTiernan and Menzies JJ; *Newman Industries Ltd v Indo-British Industries Ltd* [1956] 2 Lloyd's Rep 219 at 236, per Sellers J [QB]; *Maran Road Saw Mill v Austin Taylor & Co Ltd* [1975] 1 Lloyd's Rep 156 at 158-159, per Ackner J; *ED & F Man Ltd v Nigerian Sweets & Confectionery Co Ltd* [1977] 2 Lloyd's Rep 50; *North Western Shipping & Towage Co Pty Ltd v Commonwealth Bank of Australia* (1993) 118 ALR 453 at 463, per Gummow, Hill and Cooper JJ [Full Ct Fed Ct].

[5] Cf *Washington Constructions Co Pty Ltd v Westpac Banking Corporation* [1983] Qd R 179 at 182, per Thomas J; *Malaysia Hotel (Aust) Pty Ltd v Sabemo Pty Ltd* (1995) 11 BCL 50 at 51, per Mahoney JA [NSWCA]; *Australian Winch and Haulage Co Pty Ltd (administrator appointed) v Walter Construction Group Limited* [2002] FCA 1181 at [32], per Allsop J.

[6] E.g. *Forestry Commission of New South Wales v Stefanetto* (1976) 133 CLR 507; cf *Smith (Administrator of Cosslett (Contractors) Ltd) v Bridgend County Borough Council* [2002] 1 AC 336 (HL(E)).

[7] Cf *The Clydebank and District Water Trustees v The Fidelity and Deposit Company of Maryland* 1915 SC 362; *Trade Indemnity Co Ltd v Workington Harbour and Dock Board* [1937] AC 1 at 16-17, per Lord Atkin. The principal may be entitled to enforce the insurance policy whether because the principal is named as a beneficiary in the insurance policy, or because it was contemplated by the contractor and the insurance company that the principal was to be a beneficiary of that insurance contract (event though not a party to it): *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107. See also *The Mahkutai* [1996] AC 650; *Contracts (Rights of Third Parties) Act* 1999 (UK) ss1(1).

unconditional undertaking by a bank,[8] to a principal, to pay the principal an amount of money, or a maximum amount of money,[9] upon the principal making a demand for payment to the bank.[10] Sometimes the bank guarantee, if it takes the form of a deed, may also be called a "performance bond", a "clean bond"[11] or an "on-demand bond".[12] These forms of security are to be contrasted with *conditional* bank guarantees, where the obligation of the bank to make payment is conditioned upon the contractor actually being in default. This article touches upon, but is not predominantly concerned with, conditional bank guarantees (although such a variety of bank guarantee is not uncommon).

3.2 A principal will ordinarily dictate to their contractor the form which the unconditional bank guarantee is to take. Here is a typical example of the wording of an unconditional

---

[8] Unconditional bank guarantees are often issued by entities other than banks, notably insurance companies. In this article, however, for the sake of convenience, the issuer of an unconditional bank guarantee will be referred to as the "bank".

[9] Usually 5% or 10% of the contract price.

[10] See also the *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* 1996 article 2. Unconditional bank guarantees are used extensively in international trade and international construction contracts, and in the international idiom the ICC's Uniform Rules for Demand Guarantees ("URDG") are adopted by parties not infrequently as a standard form of unconditional bank guarantee. Lamentably, the URDG provisions - which possess a commendable clarity of expression - are virtually never used in domestic construction contracts in Australia. A most useful commentary on the URDG has been written by Sir Roy Goode: *Guide to the ICC Uniform Rules for Demand Guarantees* (International Chamber of Commerce, Paris, 1992). Indeed, in the author's experience it is quite extraordinary how often banks and other financial institutions issue unconditional bank guarantees - often for very large sums of money - which fail to articulate clearly as to when a demand for payment may be made, and what the consequences are of making a demand; and moreover they often bear little relation to the factual substrate out of which the need for the unconditional bank guarantee arose: see, for example, *Spitfire Nominees Pty Ltd v Hall & Thompson (a firm)* [2000] VSCA 243.

[11] *Australian Winch and Haulage Co Pty Ltd (administrator appointed) v Walter Construction Group Limited* [2002] FCA 1181 at [16] and [36], per Allsop J.

[12] Cf *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545 at 551, per Young J; White, "Bankers Guarantees and the Problem of Unfair Calling" (1979) 11 *Journal of Maritime Law and Commerce* 121 at 122-123. This is to be distinguished from the arcanely-worded undertaking contained in a "penalty bond", which (i) is defeasible upon performance by the contractor of its relevant obligations; (ii) is, in truth, in the nature of a guarantee; and (iii) is still, anachronistically, utilised in commerce today: see *Trade Indemnity Co Ltd v Workington Harbour and Dock Board* [1937] AC 1 at 37, per Lord Atkin; *Trafalgar House Construction (Regions) Ltd v General Surety & Guarantee Co Ltd* [1996] 1 AC 199 at 208-209, per Lord Jauncey of Tullichettle; *George Fischer Holding Ltd v Multi Design Consultants Ltd* (Unreported, English High Court, Official Referees' Court, Judge Hicks QC, 6 April 1998) paras 53 - 57; *Paddington Churches Housing Association v Technical and General Guarantee Co Ltd* [1999] BLR 244 at 249, per Judge Bowsher QC [TCC]; Goode, "Abstract Payment Undertakings" in Cane and Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press, Oxford, 1991) pp213-215. It may also be noted that the expression "performance bond" is used sometimes to describe an undertaking on the part of a person which entitles the person to choose between either indemnifying the principal against the contractor's default or, if possible, remedying the contractor's default: Coleman, "Performance Guarantees" [1990] *Lloyd's Maritime and Commercial Law Quarterly* 223 at 225; *Cates Construction Inc v Talbot Partners*, 86 Cal.Rptr. 2d 855 (1999).

bank guarantee:

> *"At the request of [the contractor] and in consideration of [the principal] accepting this undertaking in relation to the obligation of [the contractor] to provide to [the principal] security for the purpose of ensuring the due and proper performance of the contractor's obligations under the [underlying contract], [the bank] unconditionally undertakes to pay on demand any sums which may from time to time be demanded by [the principal] to a maximum aggregate sum of [$X] (the* ***"Sum"****).*
>
> *The undertaking is to continue until notification has been received from [the principal] or until this undertaking has been returned to [the bank] or until payment to [the principal] by [the bank] of the whole of the Sum or such part as [the principal] may require. Should [the bank] be notified in writing purporting to be signed by or on behalf of [the principal] that [the principal] desires payment to be made of the whole or any part or parts of the Sum, it is unconditionally agreed that such payment or payments will be made to [the principal] forthwith without reference to [the contractor] and notwithstanding any notice given by [the contractor] to [the bank] not to pay same".*

3.3 What is apparent about the undertaking by the bank to the principal is the fact that, notwithstanding that the unconditional bank guarantee is provided to ensure that the principal may have recourse to certain funds to remedy a default of the contractor, there is no requirement in the unconditional bank guarantee that the contractor actually be in default before the principal is entitled to make its demand, and before the bank is obliged to pay the principal. Thus, the principal is entitled, *as between itself and the bank*, to make a demand for payment under the unconditional bank guarantee regardless of what state of affairs subsists between the principal and the contractor pursuant to the underlying construction contract. Obversely, the obligation of the bank to pay the principal is predicated simply upon the principal making a demand for payment to the bank. The bank's obligation to pay is therefore not secondary to (i.e. it is not conditioned by the existence of) a breach by the contractor of the underlying contract.[13] Indeed, the bank's obligation to pay is not even predicated upon the principal

---

[13] Cf *Cargill International SA v Bangladesh Sugar and Food Industries Corp* [1998] 1 WLR 461 at 468, per Potter LJ; and see also *Trafalgar House Construction (Regions) Ltd v General Surety & Guarantee Co Ltd* [1996] 1 AC 199 at 206-207, per Lord Jauncey of Tullichettle. It almost goes without saying that the bank will only provide an unconditional bank guarantee to the principal if it obtains a counter-indemnity from its customer, the contractor (or possibly a related entity of the contractor), in respect of the amounts which the bank pays out pursuant to a demand for payment made in accordance with the terms of the unconditional bank guarantee: see *American Home Assurance Co v The London Assurance* (unreported, Sup Ct NSW, Bowen CJ in Eq, 6 Sept 1974) pp6-7; *Bache & Co (London) Ltd v Banque Vernes et Commerciale de Paris SA* [1973] 2 Lloyd's Rep 437 at 441, per Scarman LJ. As a condition to the issuing of the unconditional bank guarantee, the bank will invariably require that some kind of security be provided to it by the contractor, for example, that the contractor deposit with the bank an amount of money which, it is agreed, the bank is entitled to debit immediately in the event that the bank makes payment under the unconditional bank guarantee.

providing to the bank *evidence* of the contractor being in default.[14]

3.4 Properly speaking, then, an unconditional bank guarantee is not a "guarantee" at all. There is no element of suretyship on the part of the bank.[15] Of course, the principal may require the contractor to procure (as security) for the principal a guarantee proper from a bank, or perhaps from the parent company of the contractor,[16] in respect of the contractor's obligations under the underlying construction contract.[17] But generally, a principal will prefer to be given an unconditional bank guarantee as security rather than a guarantee proper, largely due to the fact that, for example, when there is a contract of guarantee:[18]

(a) The value of the guarantee is dependent upon the financial position of the

---

[14] *Cargill International SA v Bangladesh Sugar and Food Industries Corp* [1998] 1 WLR 461 at 468-469, per Potter LJ. This said, some unconditional bank guarantees are expressed so that the bank's obligation to pay is dependent upon the principal providing to the bank evidence of the contractor's default, such as a certificate of the superintendent or an expert to this effect. But ordinarily, even if the bank guarantee is worded so that the principal's right to make a demand is predicated upon the contractor being in default, all that the principal needs to do to enliven its right to payment is to make a demand which *asserts* that the contractor is in default: see, for example, *Esal (Commodities) Ltd v Oriental Credit Ltd* [1985] 2 Lloyd's Rep 546 at 549-550, per Ackner LJ; *Siporex Trade SA v Banque Indosuez* [1986] 2 Lloyd's Rep 146 at 158, Hirst J; *Trafalgar House Construction (Regions) Ltd v General Surety & Guarantee Co Ltd* [1996] 1 AC 199 at 206-207, per Lord Jauncey of Tullichettle; *Roehampton Developments Pty Ltd v FAI General Insurance Co Ltd* (Unreported, Sup Ct WA, Hasluck J, 26 Sept 2000) pp36-44.

[15] *Australasian Conference Association Ltd v Mainline Constructions Pty Ltd (in liq)* (1978) 141 CLR 335 at 375-377, per Aickin J; *BI (Aust) Pty Ltd v Cigna Insurance Australia Ltd* (1990) 11 BCL 64 at 66-67, per Giles J [Sup Ct NSW]; *Wahda Bank v Arab Bank PLC* [1994] 2 Lloyd's Rep 411 at 417, per Clarke J; *House of Bertram Pty Ltd v Love* (unreported, Sup Ct NSW, Windeyer J, 21 Oct 1994); *Oval (717) Ltd v Aegon Insurance Co (UK) Ltd* (1997) 82 BLR 103 at 111-112 (Mr Recorder Colin Reece QC); *Fletcher Construction Australia Pty Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812 at 826, per Callaway JA.

[16] A guarantee provided by a parent company (or other third-party) is to be distinguished from an undertaking by the parent company (or other third-party) to ensure that the contractor performs its contractual obligations. An undertaking of the latter type will usually take the form of a so-called "letter of comfort". Letters of comfort generally constitute nothing more than non-contractual representations by a third-party, and simply provide moral assurance to the principal of the contractor's ability to render performance: *Kleinwort Benson Ltd v Malaysian Mining Corp* [1989] 1 All ER 785; *Commonwealth Bank of Australia v TLI Management pty Ltd* [1990] VR 510; *Walford v Miles* [1992] 2 AC 128; *Thiess Contractors Pty Ltd v Montgomery Watson Australia Pty Ltd* (Unreported, Sup Ct NSW, Hunter J, 15 March 1996); cf *Banque Brussels Lambert SA v Australian National Industries Ltd* (1989) 21 NSWLR 502.

[17] For example, *Perrara v The National Surety Co* [1917] 11 WWR 719 [SCC]; *General Surety & Guarantee Co Ltd v Francis Parker Ltd* (1977) 6 BLR 16; *Nene Housing Society Ltd v The National Westminster Bank Ltd* (1980) 16 BLR 22; *Roux v Langtree* [1985] VR 799; *Matelot Holdings Pty Ltd v Gold Coast City Council* [1993] 2 Qd R 168; *Perar BV v General Surety and Guarantee Co Ltd* (1994) 66 BLR 77 (CA); *Re Butlers Wharf Ltd* [1995] 2 BCLC 43 at 47-48, per Richard Sykes QC; *Paddington Churches Housing Association v Technical and General Guarantee Co Ltd* [1999] BLR 244; Phillips, "Unconditional Performance Bonds - Or Are They?" (1991) 9 *Building and Construction Law* 81 at 81.

[18] These principles apply, with equal strictness, for the benefit of compensated, corporate sureties: *Tricontinental Corporation v HDFI Ltd* (1990) 21 NSWLR 689 at 706-708, per Samuels JA.

guarantor. A guarantee will be all-but-worthless to the principal if the guarantor is a "man of straw". Although it is also true that the value of a bank guarantee is dependent upon the solvency of the particular bank which provides the undertaking to the principal, the capacity of a bank to meet a demand will be an issue only in the most exceptional of cases.[19]

(b) The value of the guarantee will usually only be obtained by the principal once proceedings have been brought successfully against the guarantor.[20] This process may be time consuming, expensive and frustrating to the principal, who will ordinarily wish to obtain the benefit of the security straight away. With an unconditional bank guarantee, the principal usually has to do no more than make a written assertion to the bank that the contractor is in default of its obligations, without actually having to *prove* default.

(c) The guarantor agrees to guarantee the performance of *particular* obligations, namely the obligations of the contractor under the building contract. To state the obvious: the guarantor does not guarantee obligations which it has not agreed to guarantee.[21] This means, for example, that if the principal and the contractor agree to vary the terms and conditions of the underlying contract so as to modify the obligations of the contractor,[22] and the guarantor's consent is not obtained to this variation; the guarantor will not be liable to the principal under the contract of guarantee vis-à-vis the new obligations if the guarantor is prejudiced by the variation.[23] With an unconditional bank guarantee, variations to the terms of the

---

[19] Cf *Balmedie Pty Ltd v Russo* (unreported, Fed Ct Aust, Ryan, Whitlam and Goldberg JJ, 19 Aug 1998).

[20] Proceedings need not be commenced by the principal against the contractor first - the principal may proceed directly against the guarantor: *Moschi v Lep Air Services Ltd* [1973] AC 331 at 348, per Lord Diplock.

[21] *Trafalgar House Construction (Regions) Ltd v General Surety & Guarantee Co Ltd* [1996] 1 AC 199 at 205-206, per Lord Jauncey of Tullichettle; and see also *The Wardens and Commonalty of the Mystery of Mercers of the City of London v New Hampshire Insurance Co Ltd* [1992] 1 WLR 792.

[22] Which is different to the principal directing, pursuant to a contractual power, a "variation" to the works to be performed under the underlying contract: *Wren v Emmett Contractors Pty Ltd* (1969) 43 ALJR 213 at 215-216, per Barwick CJ.

[23] *Doe v The Canadian Surety Company* [1936] SCR 1; *Wren v Emmett Contractors Pty Ltd* (1969) 43 ALJR 213. The guarantor will be liable where (a) it has consented (contractually) to remaining liable as guarantor after the variation (*Hancock v Williams* (1942) 42 SR (NSW) 252 at 255-257, per Jordan CJ; *Manulife Bank of Canada v Conlin* [1996] 3 SCR 415 at 423-424, per Cory J; *Commonwealth Development Bank of Australia Ltd v Wood* (Unreported, Sup Ct Vic, Coldrey J, 3 Oct 1997); cf *Burnes v Trade Credits Ltd* [1981] 1 NSWLR 93 at 94 (PC)); (b) it is estopped from denying its liability as guarantor (*Corumo Holdings Pty Ltd v C Itoh Ltd* (1991) 24 NSWLR 370); or (c) the variation is "unsubstantial and not prejudicial to" the guarantor (*Ankar Pty Ltd v National Westminster Finance (Australia) Ltd* (1987) 162 CLR 549 at 559, per Mason ACJ, Wilson, Brennan and Dawson JJ; *Credit Lyonnais Australia Ltd v Darling* (1991) 5 ACSR 703 at 707-708, per Kirby P [CA (NSW)]).

underlying construction contract do not vitiate the security.

(d) If the principal makes advance payments to the contractor where the principal is not required to do so,[24] or if the principal grants an indulgence of time to the contractor with regard to moneys owed and payable to the principal, this will discharge – often *in toto*[25] - the guarantor from its liability under the guarantee.[26] The principal reasons for this are, in the case of advances, that the incentive to the contractor to fulfil its obligations under the underlying contract is reduced (i.e. the contractor gets money, up front, without having performed the relevant obligations which entitle it to payment); and in the case of indulgence of time, the guarantor may lose its ability to pay the principal, or its advantage in paying the principal, the money claimed, and then seeking to be subrogated to the principal's rights against the contractor (i.e. the financial condition of the creditor may deteriorate in the extended period for payment).[27] These difficulties can, of course, be overcome by suitable wording in the relevant contract of guarantee, or by using an alternative form of security – such as an unconditional bank guarantee.

(e) Yet another difficulty which may arise for the principal is that its rights under the guarantee will, in the absence of express provision in the guarantee to the contrary,[28] be subject to any defence[29] or right of equitable or contractual set-off which the

---

[24] Leo, "The Construction Contract Surety and Some Surety Defenses" (1993) 34 *William and Mary Law Review* 1225 at 1238-1240.

[25] Although not invariably. The extent of the guarantor's discharge will depend upon the dictates of equity, i.e. there is no absolute rule that the guarantor is always discharged (see, for example *Egbert v National Crown Bank* [1918] AC 908).

[26] As to the granting of an indulgence of time, see *Rees v Berrington* (1795) 2 Ves Jun 540 at 542, 30 ER 765 at 767, per Lord Loughborough LC; *Mactaggart v Watson* (1835) 3 Cl & Fi 525 at 541-543, 6 ER 1534 at 1540-1541, per Lord Brougham; *Calvert v The London Dock Company* (1838) 2 Keen 637, 48 ER 774; *The General Steam-Navigation Co v Rolt* (1858) 6 CB (NSW) 550, 141 ER 572; *Mayor, Alderman, and Burgesses of Kingston-upon-Hull v Harding* [1892] 2 QB 494 at 502-503, per Lord Esher MR, at 508, per Bowen LJ; *Thomas Fuller Construction Co (1958) Ltd v Continental Insurance Co* (1970) 36 DLR (3d) 336 at 346, per Houlden J [Ont HC]. See also *Watts v Shuttleworth* (1861) 7 H & N 353 at 355, 158 ER 510 at 511; *In re Sherry* (1884) 25 Ch D 692 at 703, per Earl of Selborne LC.

[27] *Lloyds TSB Bank plc v Shorney* [2001] EWCA 1161 at [41], per Waller LJ.

[28] E.g. *The "Fedora"* [1986] 2 Lloyd's Rep 441 at 445, per Parker LJ.

[29] *Cellulose Products Pty Ltd v Truda* (1970) 92 WN (NSW) 561 at 565, per Isaacs J; *National Westminster Bank plc v Riley* [1986] BCLC 268 at 273, per May LJ; Ward and McCormack, "Subrogation and Bankers' Autonomous Undertakings" (2000) 116 *LQR* 121 at 139.

contractor had.[30]

3.5 In contrast to the position with guarantees proper: a principal, with an unconditional bank guarantee in its hands, has a congerie of rights against a bank, which may generally be enforced against the bank without reference to the contractual position between the principal and the contractor. Subject to the exceptional cases discussed later in this article, the right of the principal to demand payment, and the obligation of the bank to make payment, exist and operate autonomously of the state of affairs obtaining pursuant to the underlying contract.[31] The unconditional bank guarantee is expressed in terms which are not conditioned by the terms of the underlying construction contract. In this sense, the bank guarantee is *unconditional*[32] and *autonomous*[33] of the underlying construction contract. Those are critical features of unconditional bank guarantees.[34]

3.5 They are also important features of the *standby letter of credit*,[35] which is another type of

---

[30] *Modern Engineering (Bristol) Ltd v Gilbert-Ash (Northern) Ltd* [1974] AC 689; *Trafalgar House Construction (Regions) Ltd v General Surety & Guarantee Co Ltd* [1996] 1 AC 199 at 208, per Lord Jauncey of Tullichettle; cf *Cellulose Products Pty Ltd v Truda* (1970) 92 WN (NSW) 561.

[31] See URDG article 2(b). It may be noted that there are certain types of bank guarantees, which appear to be relatively common in the United States, and which confer upon the bank the option of stepping-in to perform construction work in the place of the errant contractor, rather than simply pay money to the principal: see, for example, *The Bay Hotel and Resort Ltd v Cavalier Construction Co Ltd* (Unreported, Privy Council, 16 July 2001) para 4.

[32] However, a bank guarantee could be regarded as "conditional" insofar as the obligation of the bank to pay is dependent upon (i) the principal making a demand for payment; and (ii) if the terms of the bank guarantee so require, the principal asserting or certifying that the contractor is in default of its obligations under the underlying contract: *Lumley General Insurance Ltd v Oceanfast Marine Pty Ltd* [2000] NSWSC 1178 at [29] - [33], [39] - [41], per Austin J; *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420 at 425, Brooking JA; cf Goode, "Unconditional bonds: the common law" in Lloyd (ed), *The Liability of Contractors* (Queen Mary College, London, 1986) p99. If the underlying contract is expressly incorporated into the bank guarantee, the principal's rights to call upon the bank guarantee *may* be conditioned by the terms of the underlying contract: *Barclay Mowlem Construction Ltd v Simon Engineering (Aust)* (1991) 23 NSWLR 451; and see also *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1998) 15 BCL 158 at 161, per Austin J [Sup Ct NSW]; *Tisaren Holdings Pty Ltd v Corumo Holdings Pty Ltd* (unreported, Sup Ct NSW, Cole J, 14 Nov 1991) pp68-69. However, the mere fact that the bank guarantee recites or mentions that the security has been provided to the principal pursuant to the relevant underlying contract does not convert the bank guarantee into a conditional bank guarantee: *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545 at 550, per Young J; *NEI Pacific Ltd v Cigna Insurance Australia Ltd* (unreported, Sup Ct NSW, Giles J, 29 Aug 1991) p9. It is largely a question of semantics as to whether the provision of evidence of default, or the assertion of default, amount to "conditions" upon the making of a demand pursuant to an "unconditional" bank guarantee.

[33] *Lumley General Insurance Ltd v Oceanfast Marine Pty Ltd* [2000] NSWSC 1178 at [24] - [28], per Austin J.

[34] Cf IN Duncan Wallace, *Hudson's Building and Engineering Contracts* (London, Sweet & Maxwell, 11th ed 1995) paras 17•011F, 17•076.

[35] See Phillips, "Unconditional Performance Bonds - Or Are They?" (1991) 9 *Building and Construction Law* 81 at 83; cf *Uniform Customs and Practice for Documentary Credits* (ICC Publication No.500, 1993 revision) (hereafter

security that is closely aligned to the bank guarantee, and which is used, not infrequently, in construction contracts as security for the contractor's performance.[36] A standby letter of credit is a binding undertaking by a bank that it will pay an amount of money to a (named) person upon presentation of specified documents by that person to the bank;[37] where, in the construction paradigm, the specified documents will usually be documents evidencing the default of the contractor, or which evidence an amount of money being owed by the contractor to the principal, pursuant to the underlying construction contract.[38] The obligation of the bank to pay under the standby letter of credit is thus conditional upon the principal providing to the bank documents which conform with the documents required by the standby letter of credit.[39]

"UCP 500") article 2; Schmitthoff, "The New Uniform Customs for Letters of Credit" [1983] *Journal of Business Law* 193 at 195. As to the law relating to letters of credit generally, see Jack, *Documentary Credits* (2nd ed, 1995); Dolan, *Law of Letters of Credit* (AS Pratt & Sons, revised ed, 1999).

[36] Cf *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420 at 428-429, per Brooking JA.

[37] One issue which this article does not seek to address - and which is of academic interest only - is why, if the unconditional bank guarantee or letter of credit does not take the form of a deed, the principal is entitled to enforce the unconditional bank guarantee or letter of credit against the bank (i.e. what consideration moves from the principal to give rise to a contract with the bank?). The issue has been discussed extensively elsewhere: Mead, "Documentary Letters of Credit" (1922) 22 *Columbia Law Review* 297 at 300-305; Davis, "The Relationship Between Banker and Seller Under a Confirmed Credit" (1936) 52 *LQR* 225; *Bank of New South Wales v Commonwealth Steel Co Ltd* [1983] 1 NSWLR 69 at 73-74, per Rogers J; *Westpac Banking Corp v Commonwealth Steel Co Ltd* [1983] 1 NSWLR 735; Goode, *Legal Problems of Credit and Security* (Sweet & Maxwell, London, 2nd ed 1988) p162; Goode, "Abstract Payment Undertakings" in Cane and Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press, Oxford, 1991).

[38] The required documents will ordinarily include a certificate issued by the superintendent (or equivalent) to this effect under the underlying contract. However, it is not uncommon to find letters of credit which are payable "at sight", i.e. where, in essence, the letter of credit simply needs to be presented for payment together with a statutory declaration by an officer of the principal confirming its right *under the letter of credit* to claim the amount demanded: see, for example, *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812.

[39] The documents presented by the principal must comply strictly with the terms of the credit, otherwise the bank's mandate to make payment is not enlivened: *Alexander Cross and Sons Ltd v Hasell* [1908] VLR 194; *English, Scottish and Australian Bank Ltd v The Bank of South Africa* (1922) 13 Ll L LR 21 at 24, per Bailhache J; *Bank Melli Iran v Barclays Bank* [1951] 2 Lloyd's Rep 367; *Pavia & Co SPA v Thurmann-Nielsen* [1952] 2 QB 84 at 88, per Denning LJ; *The "Lena"* [1981] 1 Lloyd's Rep 68 at 76, per Parker J; *South Carolina National Bank v Westpac Banking Corporation Ltd* (unreported, Sup Ct NSW, Ct App, Samuels, Mahoney and Priestley JJA, 21 Dec 1984) pp9-10, per Priestley JA; *Gill v Eagle Star Nominees Ltd* (unreported, Sup Ct NSW, Gleeson CJ, 22 Sept 1993) p11; *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran* [1993] 1 Lloyd's Rep 236; *Glencore International AG v Bank of China* [1996] 1 Lloyd's Rep 135 at 141-142, per Rix J, at 150, per Sir Thomas Bingham MR; *Habib Bank Ltd v Bank of South Australia* (1997) 70 SASR 14 at 18, per Williams J; *Chailease Finance Corporation v Credit Agricole Indosuez* [2000] 1 Lloyd's Rep 348 at 357-358, per Potter LJ; Bennett, "Strict Compliance Under UCP 500" [1997] *Lloyd's Maritime and Commercial Law Quarterly* 7; and see also *Siporex Trade SA v Banque Indosuez* [1986] 2 Lloyd's Rep 146 at 158, per Hirst J. "Strict" compliance does not necessarily mean "absolute literal compliance". For example, a document presented to a bank under a letter of credit should not be rejected simply because it contains an obvious typographical error: see McLaughlin, "The Standard of Strict Documentary Compliance: An American Perspective" (1990) 1 *Journal of Banking and Finance Law and Practice* 81 at 81-82; *Kredietbank Antwerp v Midland Bank plc* [1999] 1 All ER (Comm) 801 at 806, per Evans LJ; cf *Equitable Trust Company of New York v Dawson Partners Ltd* (1927) 27 Ll L LR 49. Where there is ambiguity as to the form of the documents to be presented, the obligation of the bank is simply to act reasonably in deciding whether the documents presented meet the description referred to in the letter of credit: *Commercial Banking Co of Sydney Ltd v*

3.6 One could be forgiven for thinking that the obligation of the bank under a standby letter of credit is secondary in nature, i.e. that it is activated by a breach of the underlying construction contract by the contractor, so that the standby letter of credit operates in the nature of a contract of guarantee. However, it would be inaccurate to describe the bank as occupying the position of a surety. The bank's obligation is enlivened by the presentation to it of appropriate *documents*.[40] The bank's obligation is *not* triggered by the contractor's default under the underlying construction contract.[41]

3.7 It can be seen, then, that unconditional bank guarantees and standby letters of credit have a common property: they may both be realised by a principal without having to establish the existence of a default of the contractor under the underlying construction contract.[42] This is of considerable utility to principals, and it makes unconditional bank guarantees and standby letters of credit all-the-more attractive as forms of security over, say, a traditional contract of guarantee where the contractor's default must be shown.[43] With both the unconditional bank guarantee and the standby letter of credit, the principal is in the position where it has a reliable paymaster[44] in its hands - a security

---

Jalsard Pty Ltd [1973] AC 279 at 285-286 (PC); *Credit Agricole Indosuez v Muslim Commercial Bank Ltd* [2000] 1 Lloyd's Rep 275. Similar considerations apply where documents are required to be presented pursuant to an "unconditional" bank guarantee: *IE Contractors Ltd v Lloyds Bank plc* [1989] 2 Lloyd's Rep 205 at 207, per Leggatt J.

[40] *Hamzeh Malas & Sons v British Imex Industries Ltd* [1958] 2 QB 127; *Banque de L'Indochine et de Suez SA v JH Rayner (Mincing Lane) Ltd* [1983] 1 QB 711 at 728, per Sir John Donaldson MR; *The "Messiniaki Tolmi"* [1986] 1 Lloyd's Rep 455 at 462-463, per Leggatt J; *Tukan Timber Ltd v Barclays Bank plc* [1987] 1 Lloyd's Rep 171 at 174, per Hirst J; *Bank of Nova Scotia v Angelica-Whitewear Ltd* [1987] 1 SCR 59 at 70, per Le Dain J; *The "Royan"* [1988] 2 Lloyd's Rep 250 at 256, per Lloyd LJ; *Themehelp Ltd v West* [1996] QB 84 at 89, per Waite LJ; *Turkiye Is Bankasi AS v Bank of China* [1998] 1 Lloyd's Rep 250 at 251, per Hirst LJ; *Standard Chartered Bank v Pakistan National Shipping Co* [1998] 1 Lloyd's Rep 684 at 701-702, per Creswell J; *St George Bank Ltd v Salzberger* [2001] NSWCA 67; and see also *Guaranty Trust of New York v Van Den Berghs Ltd* (1925) 22 Ll L Rep 286 at 454-455, per Scrutton LJ. The documents prescribed for presentation by the standby letter of credit will usually be documents which evidence a breach of the underlying contract by the contractor, but they need not be so. Cf *Commercial Banking Co of Sydney Ltd v Patrick Intermarine Acceptances Ltd (in liq)* (1978) 52 ALJR 404 at 406 (PC).

[41] See Penn, "On-Demand Bonds - Primary or Secondary Obligations" (1986) 4 *Journal of International Banking Law* 224 at 225.

[42] The two forms of security are seen as being virtually the same in terms of their liquidity: cf *Wood Hall Ltd v The Pipeline Authority* (1979) 141 CLR 443 at 458-459, per Stephen J; *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* (unreported, Sup Ct Vic, Byrne J, 2 Oct 1997) p12; *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420 at 437, per Brooking JA.

[43] If, however, the standby letter of credit requires the principal to present to the bank documentary evidence (in a particular form) of the contractor being in default, the principal faces the obstacle of obtaining such evidence. With unconditional bank guarantees, it is usually sufficient for the principal to make a demand of the bank, without providing documentary evidence of the contractor's default. It is for this reason that principals generally prefer to be provided with unconditional bank guarantees than standby letters of credit.

[44] *Urquhart Lindsay and Company Ltd v Eastern Bank Ltd* [1922] 1 KB 318 at 324, per Rowlatt J; *Trans Trust SPRL v Danubian Trading Co Ld* [1952] 2 QB 297 at 304-305, per Denning LJ; *Soproma SpA v Marine & Animal By-Products Corp* [1966] 1 Lloyd's Rep 367 at 385-386, per McNair J; *Aspen Planners Ltd v Commerce Masonry &*

which is functionally equivalent to cash[45] - which it may call upon, and receive payment under, to remedy the contractor's default. Thus, the principal is entitled to receive payment from the bank in the full amount claimed, the contractor having no right of set-off against the amount payable by the bank to the principal.[46]

3.8 What this means is that if a dispute exists pursuant to the underlying construction contract between the principal and the contractor, whereunder the principal claims to be entitled to the payment of money from the contractor; the principal may ordinarily realise the unconditional bank guarantee or standby letter of credit, and allow the dispute to wend its way towards resolution with money in its pocket, rather than in the pocket of the contractor.[47] In this way, the unconditional bank guarantee and the standby letter of credit possess a liquidity which is almost as good as that of a money retention.[48]

Forming Ltd (1979) 100 DLR (3d) 546 at 548, per Henry J [Ont HCJ]; *Cruickshank v Westpac Banking Corp* [1989] 1 NZLR 114 at 125, per Sinclair J.

[45] *Wood Hall Ltd v The Pipeline Authority* (1979) 141 CLR 443 at 457, per Stephen J; *Bains Harding Ltd v State Electricity Commission of Victoria* (unreported, Sup Ct Vic, Ct App, Brooking, Callaway and Kenny JJA, 12 Aug 1997) p12, per Callaway JA. In *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159 at 170, Lord Denning MR described the unconditional performance guarantees under consideration by the Court of Appeal to be "virtually promissory notes repayable on demand". See also *Re Sogex International Ltd* (unreported, Sup Ct NT, Nader J, 23 Oct 1986) para 40. From the contractor's perspective, the fact that the unconditional bank guarantee or letter of credit is "as good as cash" is useful because it may mean that a principal is prepared to accept such an undertaking instead of being provided with a cash deposit by the contractor, i.e. the contractor receives a greater cash flow during the course of the project (unless, of course, the principal calls upon the security!): *Wood Hall Ltd v The Pipeline Authority* (1979) 141 CLR 443 at 457, per Stephen J; *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 399-400, per Batt J.

[46] *Power Curber International Ltd v National Bank of Kuwait SAK* [1981] 3 All ER 607 at 612-613, per Lord Denning MR; cf Derham, *Set-Off* (Clarendon Press, Oxford, 2nd ed 1996) p100. If, coincidentally, the principal also owes money to the bank, the bank may be entitled to set-off that amount against the amount of the payment to the principal, unless this right is excluded by agreement: *HKSBC v Kloeckner & Co AG* [1989] 2 Lloyd's Rep 323 at 330-331, per Hirst J [QB (Com Ct)]. It is suggested that similar reasoning can apply where it is an unconditional bank guarantee which is called upon: cf *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 24 at 26-27, per Eveleigh LJ.

[47] *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420 at 436, per Brooking JA. See also *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812. See also *Elian v Matsas* [1966] 2 Lloyd's Rep 495 at 497, per Lord Denning MR; *GKN Contractors Ltd v Lloyds Bank plc* (1985) 30 BLR 53 at 62, per Parker LJ; Buckley, "Potential Pitfalls With Letters of Credit" (1996) 70 *Australian Law Journal* 217 at 229; *Benjamin's Sale of Goods* (Sweet & Maxwell, London, 5th ed 1997) para 23-217; cf *Historic Holdings Pty Ltd v Cigna Insurance Australia Ltd* (unreported, Sup Ct Qld, White J, 29 April 1992). Of course, the money which the principal receives is not the contractor's money - it is the bank's money: *Morgan v Larivière* (1875) LR 7 HL 423. The bank then recoups the amount which it has paid to the principal by looking to the contractor on the bank's counter-indemnity. There are limits as to the circumstances in which the principal is entitled to allow a dispute to run its course with money in the principal's pocket. These are discussed below.

[48] However, unconditional bank guarantees and standby letters of credit differ from money retentions in accessibility in some important respects: cf *St Martins Grosvenor Pty Ltd v American Homes Assurance Co Ltd* (unreported, NSW Ct App, Moffitt P, Hutley and Samuels JJA, 18 March 1977) per Hutley JA. Apart from the obvious fact that money retentions involve the principal withholding contract moneys, whereas with an unconditional bank guarantee or a letter of credit the contractor is paid the full price of the work performed;

3.9 From the bank's perspective, unconditional bank guarantees and standby letters of credit are generally more easily-managed forms of security to provide than a guarantee proper. With unconditional bank guarantees and standby letters of credit, the bank can ordinarily adopt a fairly simple and mechanical function in respect of any demand for payment which the principal makes. In the case of unconditional bank guarantees, the bank is usually bound to pay the principal upon a demand for payment being made. The position is essentially the same with regard to standby letters of credit, the only added complication being that the bank must check whether the documents presented by the principal to the bank (accompanying its demand for payment) answer the description of the documents specified in the standby letter of credit.[49] The basic position which the bank is usually entitled to take is that if a correct demand for payment has been made, the bank must pay the principal, and the bank can then look to the contractor for indemnification in respect of the amount paid to the principal.

3.10 This position is preferable to that of a bank acting as a surety, where the bank's liability to pay is conditional upon the principal having some right against the contractor under the underlying construction contract. In such a case, the bank may become embroiled in a dispute with the principal and the contractor as to whether the contractor is in default under the relevant construction contract. In contrast, the bank is not usually brought into the conflict where the principal has made a demand for payment under an unconditional bank guarantee or standby letter of credit. The unconditional bank guarantee or standby letter of credit isolates the bank from the dispute.

3.11 Given, therefore, the common characteristics of unconditional bank guarantees and standby letters of credit, it is possible, and moreover expedient, to simply discuss the law relating to unconditional bank guarantees without discussing specifically the law relating to standby letters of credit, save where there are any important differences between the

---

unconditional bank guarantees and letters of credit may also be revocable by the contractor or they may expire automatically after a particular period of time. The unconditional bank guarantee or letter of credit will usually say whether it is revocable or irrevocable, i.e. whether or not the contractor may countermand the bank's mandate to pay (cf UCP 500 articles 6 and 42A). If an unconditional bank guarantee or standby letter of credit is silent as to whether it is revocable or irrevocable, it will ordinarily be construed as being irrevocable: *CDN Research and Development Ltd v Bank of Nova Scotia* (1982) 136 DLR (3d) 656 at 660-661 [Ont HC]; and see also *Forestal Mimosa Ltd v Oriental Credit Ltd* [1986] 1 Lloyd's Rep 329 at 332-333, per Sir John Megaw LJ. To eliminate any room for a purported revocation by the contractor, the most prudent course for a principal to take is to insist upon the contractor procuring for the principal an unconditional bank guarantee or standby letter of credit which is expressed to be irrevocable. A security which is expressed to be irrevocable cannot be revoked by the contractor: *Urquhart Lindsay and Company Ltd v Eastern Bank Ltd* [1922] 1 KB 318 at 321-322, per Rowlatt J.

[49] *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran* [1993] 1 Lloyd's Rep 236 at 249, per Stuart-Smith LJ.

two which require identification.[50] That is the approach which will be taken in the remainder of this article.

3.12 It has been seen that unconditional bank guarantees are very liquid due to the fact that the law permits a principal to call upon an unconditional bank guarantee, and to require payment from the bank, without regard being had as to whether the contractor has discharged its obligations under the underlying construction contract. That is a felicitous position for a principal to be in. However, the contractor who procured the unconditional bank guarantee for the principal may feel that the principal is acting wrongfully if the principal seeks to call upon, or actually calls upon, the unconditional bank guarantee in circumstances where - at least by the contractor's reckoning - the contractor has performed its obligations under the underlying contract. The contractor may (and usually does) take the view: the unconditional bank guarantee can only be called upon if I am in breach of contract. The unconditional bank guarantee is security for my performance, and nothing more. I am not in default under the construction contract, so the principal is not entitled to encash the unconditional bank guarantee.

3.13 If the principal does make a wrongful demand for payment, and it receives payment from the bank, the contractor may bring proceedings against the principal to recover the loss or damage which may accrue to the contractor as a result of the principal's wrongful calling-up of the unconditional bank guarantee.[51] The contractor may seek to recover

---

[50] The preponderance of case law favours a homogenous analysis of unconditional bank guarantees and standby letters of credit: see *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159 at 171, per Lord Denning MR; *Wood Hall Ltd v The Pipeline Authority* (1979) 141 CLR 443 at 457-458, per Stephen J; *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 24 at 31, per May LJ; *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545 at 551, per Young J; *Tins Industrial Co Ltd v Kono Insurance Ltd* (1987) 42 BLR 110 at 117, per Hunter JA [HKCA]; and see also *Sinason-Teicher Inter American Grain Corp v Oilcakes & Oilseeds Trading Co Ltd* [1954] 1 Lloyd's Rep 376 at 381, per Devlin J; *Olex Focas Pty Ltd v Skodaexport Co Ltd* (unreported, Vic Ct App, Brooking, Tadgell and Charles JJA, 17 Sept 1996) pp2-3, per Charles JA; *Pedna Pty Ltd v Sitep Societa per Azioni* (unreported, Sup Ct NSW, Santow J, 8 Jan 1997) p2; Ward and McCormack, "Subrogation and Bankers' Undertakings" (2000) 116 *Law Quarterly Review* 121 at 134-135; cf *GKN Contractors Ltd v Lloyds Bank plc* (1985) 30 BLR 53 at 62-63, per Parker LJ; *Reed Constructions Pty Ltd v Redelman* (unreported, Sup Ct NSW, Giles CJ Comm D, 1 Sept 1995); *Austal Ships Pty Ltd v National Australia Bank Ltd* (unreported, Sup Ct WA, Templeman J, 13 Feb 1997) pp14-15; Debattista, "Performance Bonds and Letters of Credit: a Cracked Mirror Image" [1997] *Journal of Business Law* 289. This has occurred principally because the unconditional bank guarantee itself is a modern scion of the much older documentary credit being the letter of credit (of which the standby letter of credit is a species). As the law relating to unconditional bank guarantees is relatively new (its evolution began in the 1970's), there are many areas of this law which have not been explored by the courts. However, because of the similarity between unconditional bank guarantees and standby letters of credit, these gaps in the law relating to unconditional bank guarantees have been filled by the law relating to standby letters of credit.

[51] *Discount Records Ltd v Barclays Bank Ltd* [1975] 1 All ER 1071 at 1075, per Megarry J; *Thiess Watkins (Construction) Ltd v Canberra Permanent Co-operative Building Society Ltd* (unreported, Sup Ct ACT, Gallop J, 25 Sept 1986) paras 11, 12; *Devico Pty Ltd v The Sydney Cove Redevelopment Authority* (unreported, Sup Ct NSW,

the amount which it has had to pay to its bank as a result of the principal's wrongful demand, as well as lost interest on the amount which it has paid away,[52] and possibly also consequential loss or damage.[53] Damages may, to some contractors, be a totally satisfactory remedy.

3.14 But not to most contractors. The reason the contractor will be concerned if the principal calls upon the unconditional bank guarantee is that if the principal receives payment from the bank, the bank will then come looking for reimbursement from the contractor on the bank's counter-indemnity against the contractor. Particularly if the unconditional bank guarantee is for a large amount of money (and they frequently are): if the bank seeks to enforce its counter-indemnity against the contractor, the contractor may face the prospect of becoming insolvent, or at least having a major disruption to its cash flows when the bank exercises its right of counter-indemnity.

3.15 It is understandable, then, that a contractor would seek to take whatever steps it could to prevent the principal from calling upon, or receiving payment pursuant to, the unconditional bank guarantee. The question then arises: when, if at all, may a contractor have restrained a principal from making demand upon an unconditional bank guarantee, or dealing with the proceeds of the unconditional bank guarantee if payment has already been made? The answer to this question, as will be seen, depends upon a number of factors, the major one being the lawfulness of the demand for payment made by the principal.

4. Interlocutory Relief and the Ambit of the Autonomy Principle

Introduction

4.1 As was mentioned earlier, unconditional bank guarantees have a particular value, both to principals and banks, largely because they can be encashed without reference or inquiry as to the state of affairs subsisting between principal and contractor under the underlying construction contract. That is, under the terms of the unconditional bank

---

Cole J, 15 April 1991).

[52] See *Devico Pty Ltd v The Sydney Cove Redevelopment Authority* (unreported, Sup Ct NSW, Cole J, 15 April 1991) p40; *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812 at 822, per Charles JA.

[53] E.g. if, as a result of the unconditional bank guarantee being called upon, the contractor finds it more difficult to successfully tender for work, the contractor's reduced opportunity to obtain work and derive income may be compensable: see *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451 at 461-462, per Rolfe J.

guarantee, the principal is entitled to make a demand for payment, and the bank is obliged to meet that demand, regardless of whether or not the contractor is actually in default pursuant to the underlying construction contract.

4.2 The "autonomous" value of unconditional bank guarantees would be diminished if contractors were readily able, through obtaining an order of the court, to restrain principals from making demand upon unconditional bank guarantees on the basis that the principal was not entitled to do so vis-à-vis the contractor pursuant to the underlying construction contract.

4.3 However, the law also recognises that there should be certain circumstances in which, notwithstanding that the contractor is not a party to the contract of security (scil. the unconditional bank guarantee), the contractor should be entitled to have the principal restrained from calling upon the security (or, if payment has been made, from dealing with the proceeds of the unconditional bank guarantee).

4.4 The circumstances in which the law permits the contractor to restrain the principal are few, and the courts are reluctant to restrain - at the behest of contractors - principals from exercising their rights under security contracts. Nevertheless, there are exceptional cases.

4.5 These exceptions to the "autonomy principle"[54] impact not only upon when a contractor may, potentially, be able to have a principal restrained from calling upon a guarantee or dealing with the proceeds. They also go to the issue of whether the bank is entitled to make payment to the principal if the principal calls upon the unconditional bank guarantee, and whether the bank itself may be restrained from making payment to the principal. There are, however, important differences between the liability of the principal for wrongfully calling upon the unconditional bank guarantee and receiving payment from the bank, and the liability of the bank for paying the principal who wrongfully calls for payment. These difference are discussed later in this article.

4.6 Before discussing the circumstances in which a demand for payment under an unconditional bank guarantee by a principal will be unlawful, it is useful to mention the usual context in which the issue arises as to whether an exception to the autonomy principle exists.

---

[54] Also known as the "abstraction principle": Kozolchyk, "The Emerging Law of Standby Letters of Credit and Bank Guarantees" (1982) 24 *Arizona Law Review* 319. In this article, references to “exceptions” to the “autonomy principle” denote circumstances in which a principal may be enjoined from making a demand for payment pursuant

4.7 One scenario is that the principal threatens to call upon the unconditional bank guarantee, but the contractor maintains that the principal is not entitled to do so pursuant to the underlying construction contract. If the contractor is possessed of celerity, it may commence proceedings against the principal seeking, in addition to final relief,[55] an interlocutory injunction against the principal to restrain it from making demand for payment under the unconditional bank guarantee.[56] The contractor will ordinarily seek to have the injunction endure for the period leading up to the final determination of the principal's entitlement to make a demand for payment.

4.8 If, however, a demand has already been made the contractor may seek a declaration that the demand was unlawful, combined with an interlocutory injunction against the bank to restrain it from paying to the principal the amount demanded pursuant to the unconditional bank guarantee.[57] Alternatively, the contractor may seek a mandatory injunction pursuant to which the principal is required to withdraw its demand and not re-make it.[58]

4.9 As a further alternative, if payment has already been made to the principal by the bank, the contractor may seek an order that the principal is to repay the proceeds of the unconditional bank guarantee to the bank or to the contractor pending final resolution

---

to an unconditional bank guarantee, or from dealing with the proceeds of the unconditional bank guarantee.

[55] Which may be to the effect that the principal be restrained permanently from making demand for payment under the unconditional bank guarantee: see, for example, *JH Evins Industries (NT) Pty Ltd v Diano Nominees Pty Ltd* (unreported, Sup Ct NT, Kearney J, 30 Jan 1989). However, if it is still possible that the principal may, *after* the time of the final hearing, still have a legitimate reason for calling upon the unconditional bank guarantee (although that legitimate reason does not exist at the time of the final hearing) the order for a permanent injunction may be conditioned by the principal being given liberty to apply to the court to have the injunction dissolved once the circumstances for the cashing of the unconditional bank guarantee are ripe. An example of such a circumstance could be where there is a possibility of latent defects in the contractor's work manifesting themselves after the final hearing, in which case the principal may (depending upon the terms of the construction contract) be entitled to make a demand under the unconditional bank guarantee to compensate it for the cost of rectifying the defects.

[56] It is not uncommon to find contractors seeking urgent injunctions against the principal *ex parte*, with a subsequent interlocutory hearing taking place shortly after that application with both the principal and the contractor represented. A further point is that if there is no dispute at an interlocutory stage as to the facts of the case, it may be appropriate for the court to make final orders: *Sabemo Pty Ltd v Malaysia Hotel* (unreported, Sup Ct NSW, Hodgson J, 5 July 1990) pp15-16.

[57] The usual course for a bank to take if it is brought into the melee is to take a neutral stance, i.e. to submit to the orders of the Court save as to costs: see, for example, *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 382.

[58] See, for example, *JH Evins Industries (NT) Pty Ltd v Diano Nominees Pty Ltd* (unreported, Sup Ct NT, Kearney J, 30 Jan 1989) para 23; *Hughes Bros v Telede Pty Ltd* (1989) 7 BCL 210 at 213, per Cole J [Sup Ct NSW]; *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1998) 15 BCL 158 at 160, per Austin J [Sup Ct NSW].

of the dispute between the principal and the contractor (on the proviso that the contractor provides a new unconditional bank guarantee in substitution for the original unconditional bank guarantee, in respect of which new guarantee the principal may be restrained on terms from making a demand for payment).[59] Or it may even be that the contractor seeks an order that the proceeds of the unconditional bank guarantee are to be held in an account in the names of the solicitors for the principal and the contractor pending resolution of the underlying dispute between the two.[60] A multifarious range of orders may be invoked by the court depending upon the state of play between the parties.

4.10 In each of the scenarios described above, the relief sought by the contractor is interlocutory in nature. That is, the contractor is asking the court to make an order or orders before the underlying dispute between the parties (i.e. whether or not the contractor was in default) has been determined on a final basis. There are discrete principles applicable to the determination of when such relief will be granted. These are discussed below.

Interlocutory Injunctions

4.11 The purpose of an interlocutory injunction is to attempt to maintain the state of affairs existing between the parties during the period immediately preceding the commencement of court proceedings by the contractor against the principal; or, if the interlocutory injunction was sought subsequent to proceedings being commenced, and there was unreasonable delay on the contractor's part in seeking that injunction, the state of affairs to be preserved is that existing between the contractor and the principal immediately prior to the contractor seeking the interlocutory injunction.[61] If granted - and interlocutory injunctions are not granted lightly[62] - an interlocutory injunction maintains the status quo between the parties pending the determination of their

---

[59] See *Thiess Watkins (Construction) Ltd v Canberra Permanent Co-operative Building Society Ltd* (unreported, Sup Ct ACT, Gallop J, 25 Sept 1986); *Walter Construction Group Ltd v Secretary to the Department of Infrastructure* (unreported, Sup Ct Vic, Byrne J, 6 June 2000).

[60] E.g. *Fletcher Construction Australia Ltd v Savday Pty Ltd* (unreported, Sup Ct NSW, Bryson J, 7 Jan 1999) para [18].

[61] See *Garden Cottage Foods Ltd v Milk Marketing Board* [1984] 1 AC 130 at 140, per Lord Diplock; ***A-G (UK) v Punch Ltd* [2002] UKHL 50 at [99], per Lord Hope of Craighead;** cf *Patrick Stevedores Operations No.2 Pty Ltd v Maritime Union of Australia* (1998) 195 CLR 1 at 59, per Gaudron J.

[62] *Orbit Travel Services Pty Ltd v Trustees - Travel Compensation Fund* (unreported, Sup Ct NSW, Hodgson J, 4 June 1997).

respective rights and obligations at the final hearing.[63] It is this temporal characteristic of interlocutory injunctions which distinguishes them from permanent injunctions.

4.12 When will an interlocutory injunction be granted? In Australia and in England, the guidelines[64] for the granting of an interlocutory injunction are essentially the same.[65] Leaving to one side the considerations which apply when a contractor seeks an interlocutory injunction against a bank from paying a principal who has made a demand on an unconditional bank guarantee, the guidelines which a court will adopt in considering an application for an interlocutory injunction by a contractor against a principal are set out below.

4.13 The first, and most basic, element to the granting of an interlocutory injunction is the demonstration by the contractor[66] that it has (or, to put it more precisely, that there is a sufficient probability that the contractor has) a pre-existing cause of action against the

---

[63] An interlocutory injunction is to be distinguished from an interim injunction. An interlocutory injunction lasts up until the final determination of the proceedings. An interim injunction simply lasts for a specific period of time, and may cease to operate prior to the final determination of the proceedings.

[64] *R v Secretary of State for Transport; ex parte Factortame Ltd (No.2)* [1991] 1 AC 603 at 671, per Lord Goff of Chieveley. An interlocutory injunction is a discretionary remedy, and the circumstances in which an injunction may be granted are not circumscribed by rigid rules: *Bristol City Council v Lovell* [1998] 1 All ER 775 at 782, per Lord Hoffmann. For example, an applicant may be denied an interlocutory injunction on the basis that the applicant does not have "clean hands" (*Attorney-General v Heinemann Publishers Australia Pty Ltd* (1987) 8 NSWLR 341), or if the opponent has undertaken to the court not to do the things, or some of them, which the applicant seeks to restrain the opponent from doing: see Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (Butterworths, Sydney, 3rd ed 1992) para [2174]. The discretion, however, is not to be exercised according to the fancy or whim of the court, but according to established equitable principles: *Doherty v Allman* (1878) 3 App Cas 709 at 728-729, per Lord Blackburn.

[65] In both countries (although the position in Australia is not free from doubt), the principles enunciated by Lord Diplock in *American Cyanamid Co v Ethicon Ltd* [1975] AC 396 hold sway (cf *Deutsche Rückversicherung AG v Walbrook Insurance Co Ltd* [1995] 1 WLR 1017 at 1028-1029, per Phillips J). Different guidelines for the granting of interlocutory injunctions existed in Australia prior to the *American Cyanamid* case (one aspect, in particular, being the requirement that the applicant demonstrate the existence of a "prima facie case"): *Beecham Group Ltd v Bristol Laboratories Pty Ltd* (1968) 118 CLR 618 at 622-623; *Ashburton Oil NL v Alpha Minerals NL* (1971) 123 CLR 614 at 627, per Menzies J, at 641, per Gibbs J. Those guidelines, however, would now appear to have been abandoned by the High Court: see *The Australian Coarse Grain Pool Pty Ltd v The Barley Marketing Board of Queensland* (1982) 57 ALJR 425; *Castlemaine Tooheys Ltd v South Australia* (1986) 161 CLR 148 at 153-154, per Mason ACJ; *ABC v Lenah Game Meats Pty Ltd* (2001) 76 ALJR 1 at [13], per Gleeson CJ; cf *Firth Industries Ltd v Polyglas Engineering Pty Ltd* (1975) 132 CLR 489 at 491-492, per Stephen J; *Hornsby Building Information Centre Pty Ltd v Sydney Building Information Centre Ltd* (1978) 140 CLR 216 at 231-232, per Stephen J; *Administrative and Clerical Officers Association v Commonwealth* (1979) 26 ALR 497 at 502, per Mason J; *Commonwealth v John Fairfax & Sons Ltd* (1980) 147 CLR 39 at 49, per Mason J; *A v Hayden* (1984) 56 ALR 73 at 77-79, per Dawson J. See also Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (Butterworths, Sydney, 3rd ed 1992) paras [2169] - [2173]; *Re Minister for Immigration and Multicultural Affairs; Ex parte Fejzullahu* (2000) 74 ALJR 830 at [7], per Gleeson CJ.

[66] It is for the contractor to show that the principal's demand is unlawful, not for the principal to show that it was not unlawful: see *Bains Harding Ltd v State Electricity Commission of Victoria* (unreported, Sup Ct Vic, Ct App, Brooking, Callaway and Kenny JJA, 12 August 1997) p5, per Brooking JA.

principal. An interlocutory injunction, if granted, will provide protection against an invasion, actual or threatened, of a legal or equitable right of the contractor.[67] In the case of the calling- up of an unconditional bank guarantee by the principal, the contractor's cause of action will be predicated upon the unlawfulness (as between principal and contractor) of the principal's actions in making a demand for payment on the bank.[68] If the principal has not actually called upon the unconditional bank guarantee, but has threatened to do so, or (if it has not threatened to do so) if the principal refuses to give an undertaking that it will not call up the unconditional bank guarantee without giving prior notice to the contractor of its intention to do so,[69] the contractor's putative cause of action will not have arisen.[70] Despite this, *quia timet* injunctive relief may be granted to prevent the principal from calling upon the unconditional bank guarantee where there is a sufficiently serious apprehension that the principal may do so unlawfully, and that this demand will cause immediate and substantial damage to the contractor's property or business.[71]

---

[67] *Siskina v Distos Compania Naviera SA* [1979] AC 210 at 256, per Lord Diplock; *Gouriet v Union of Post Office Workers* [1978] AC 435 at 516, per Lord Edmund-Davies; *Bank of Queensland Ltd v Grant* [1984] 1 NSWLR 409 at 412-413, per Clarke J; *Vereker v Choi* (1985) 4 NSWLR 277 at 283, per Clarke J; *McGuid v Office de Commercialisation et D'Exportation* (Unreported, Sup Ct NSW, Hunter J, 8 June 2000) paras 19-20; *Walsh v Deloitte & Touche Inc* (Unreported, Privy Council, 17 December 2001) para 10; cf *South Carolina Insurance Co v Asssurantie Maatschappij "De Zeven Provincien" NV* [1987] AC 24 at 39-40, per Lord Brandon of Oakbrook. However, the "rule" that a cause of action is needed in order to obtain injunctive relief is not without exceptions, one of them being where the relevant cause of action to which the application for an injunction relates is not amenable to the jurisdiction of the court in which the injunction is sought: *Channel Tunnel Group Ltd v Balfour Beatty Construction Ltd* [1993] AC 334 at 362, per Lord Mustill. Another exception is where an injunction is sought (e.g. a Mareva order) to prevent the frustration of the court's process, rather than the vindication of a private right: *ABC v Lenah Game Meats Pty Ltd* (2001) 76 ALJR 1 at [62], [94]. See also Spry, *The Principles of Equitable Remedies* (Law Book Co, Sydney, 5th ed 1997) pp452-453.

[68] *Hi-Struct Constructions Pty Ltd v ACN 064 828 520 Pty Ltd* (unreported, Sup Ct Vic, McDonald J, 18 June 1996) p15.

[69] Cf *Baulderstone Hornibrook Pty Ltd v Qantas Airways Ltd* (unreported, Fed Ct, Finkelstein J, 19 May 2000) para 9.

[70] Not unless the principal's threat to call upon the unconditional bank guarantee can be construed as an anticipatory breach of contract. In *Comco Constructions Pty Ltd v Westminster Properties Pty Ltd* (unreported, Sup Ct WA, Ipp J, 22 March 1990), an interlocutory injunction was refused for reasons which included the fact that no threat had been made to call up the unconditional bank guarantee. See also *Robert Salzer Constructions Pty Ltd v Elmbee Pty Ltd* (unreported, Sup Ct Vic, Smith J, 29 June 1990) pp9-10.

[71] *Themehelp Ltd v West* [1996] QB 84 at 98-99, per Waite LJ, at 103-104, per Evans LJ, at 106-107, per Balcombe LJ; *Bank of Nova Scotia v Angelica-Whitewear Ltd* [1987] 1 SCR 59 at 84-85, per Le Dain J; *Eddy Lau Constructions Pty Ltd v Transdevelopment Enterprise Pty Ltd* (unreported, Sup Ct NSW, Brownie AJ, 13 May 1999) paras [15] - [16]; cf *GKN Contractors Ltd v Lloyds Bank plc* (1985) 30 BLR 53 at 65, per Parker LJ, at 66, per Sir John Arnold P; *Mercedes Benz AG v Leiduck* [1996] 1 AC 284 at 301 (PC); *Matthew Hall Mechanical Electrical & Engineers Pty Ltd v Baulderstone Pty Ltd* (1991) 10 BCL 148 [Sup Ct Vic]; *Baulderstone Hornibrook Pty Ltd v Qantas Airways Ltd* (unreported, Fed Ct, Finkelstein J, 19 May 2000). As to the requirement of immediate and substantial damage to the contractor's property or business, see *Royal Insurance Co Ltd v Midland Insurance Co Ltd*

4.14 Applications for interlocutory injunctions concerning the conversion into cash of unconditional bank guarantees are usually commenced, heard and determined on an urgent basis. Time does not permit the preparation of the case to a stage where it is ready to go to final hearing. Therefore, at the interlocutory stage of the proceedings, the court will not usually have before it the full range of evidence which may be adduced at the final hearing, and the evidence which it does have may not have been tested in the crucible of cross-examination.[72] The facts may be hotly controverted by the principal and the contractor. It is for this reason that the courts do not insist, as a precondition to the granting of an interlocutory injunction, that the contractor proves *to the standard required at a final hearing* that it has a cause of action against the principal and/or the bank.[73] That would be to place, in many cases, an impossible burden upon an applicant for interlocutory relief. Thus, the law does not require the contractor to prove its cause of action, but only to show that there is a serious or a substantial question to be tried.[74]

4.15 The second matter which a court will consider in deciding whether or not to grant an interlocutory injunction is whether or not damages would be an adequate remedy to the

---

(1908) 26 RPC 95 at 97, per Cozens-Hardy MR; *The Bendigo and Country Districts Trustees and Executors Co v The Sandhurst and Northern District Trustees, Executors and Agency Co Ltd* (1909) 9 CLR 474 at 478, per Griffith CJ, at 482-483, per O'Connor J, at 485, per Isaacs J; *Commonwealth v The Progress Advertising and Press Agency Company Pty Ltd* (1910) 10 CLR 457 at 461, per Griffith CJ; and see also *Attorney-General for the Dominion of Canada v Ritchie Contracting and Supply Co Ltd* [1919] AC 999 at 1005 (PC); *Redland Bricks Ltd v Morris* [1970] AC 652 at 664-665, per Lord Upjohn. An alternative to seeking a *quia timet* injunction may be for the contractor to simply seek a declaration that the principal is not entitled to make a demand for payment: *Geraldton Building Co Ltd v Christmas Island Resort Pty Ltd* (1996) 12 BCL 64 [Sup Ct WA].

[72] Cf *R v Secretary of State for Transport; ex parte Factortame Ltd (No.2)* [1991] 1 AC 603 at 677, per Lord Goff of Chieveley.

[73] This said, the courts will insist upon a higher standard of proof, viz. the demonstration by the applicant of a *prima facie* case, in circumstances where the granting of an interlocutory injunction will have the practical effect of granting final relief: *Australian Rugby Union Ltd v Hospitality Group Ltd* [1999] FCA 1136 at [31], per Sackville J. Furthermore, if the facts are not in issue at all, and the only issue relates to the construction of the underlying contract and/or the unconditional bank guarantee (i.e. it relates to an issue of law), it may be appropriate for the Court to consider whether there is a serious issue to be tried by applying a higher evidentiary requirement of the contractor: see *Hitchcock v TCN Channel 9* (2000) AustContractR ¶90-108 paras [21] - [26], per Austin J [Sup Ct NSW].

[74] *Yule Inc v Atlantic Pizza Delight Franchise (1968) Ltd* (1977) 80 DLR (3d) 725 at 733; *Eng Mee Yong v Letchumanan* [1980] AC 331 at 337 (PC); *Murphy v Lush* (1986) 60 ALJR 523 at 524; ***A-G (UK) v Punch Ltd* [2002] UKHL 50 at [74], per Lord Hoffmann;** cf *Inflatable Toy Company Pty Ltd v State Bank of New South Wales* (1994) 34 NSWLR 243 at 251, per Young J. The evidence adduced to demonstrate this position will, of course, not ordinarily be as complete as the evidence which is to be relied upon at the final hearing of the matter. In determining whether or not there is a serious or substantial issue to be tried, the court does not evaluate the evidence (if contested) or conduct a preliminary hearing (*American Cyanamid Co v Ethicon Ltd* [1975] AC 396 at 406-407, per Lord Diplock; *Fejo v Northern Territory* (1998) 195 CLR 96 at 141, per Kirby J) - the court exercises its common sense as to the strength of the contractor's case: see *Ultra Refurbishing & Construction Pty Ltd v John Goubran & Associates Pty Ltd* (1997) 13 BCL 330 at 334, per Young J [Sup Ct NSW].

contractor if an injunction were not granted.[75] If damages are adequate, an injunction will usually be refused. And if, after such a refusal, the principal continues with its proposed course of conduct and actually calls upon (unlawfully), and receives payment under, the unconditional bank guarantee, the contractor will have to make do with its remedy of damages against the principal.[76] In the ordinary case, damages should be an adequate remedy. Unconditional bank guarantee disputes are, in essence, battles fought over money; and money paid back later by the principal (i.e. after the final hearing, with interest and any other identifiable loss or damage) is equivalent (roughly, if not actually) to the contractor having had the money in its pocket all along. This is one reason why, ordinarily, an application for an injunction to restrain the making of a demand will be refused.[77]

4.16 However, damages may not be an adequate remedy if, for instance, the principal is insolvent or of doubtful solvency, so that if the principal receives payment under the unconditional bank guarantee, and it turns out (after the final hearing) that the principal had no entitlement to call upon the unconditional bank guarantee, and that the contractor is entitled to recover from the principal (by way of damages) the amount received; the contractor is left to prove as an unsecured creditor in the liquidation of the principal.[78] But could it not also be said that a contractor, as a commercial person, in

---

[75] *McCarty v The Council of the Municipality of North Sydney* (1918) 18 SR (NSW) 210; cf *Shelfer v City of London Electric Lighting Co* [1895] 1 Ch 287 at 322-323, per AL Smith LJ. This second consideration is sometimes viewed as a matter going to the balance of convenience (which is discussed below): see *Fejo v Northern Territory* (1998) 195 CLR 96 at 140-141, per Kirby J; *Australian Rugby Union Ltd v Hospitality Group Ltd* [1999] FCA 1136 at [29], per Sackville J; Meagher, Gummow and Lehane, *Equity: Doctrines and Remedies* (Butterworths, Sydney, 3rd ed 1992) para [2171].

[76] It is vital for principals to remember, when deciding whether or not to make demand for payment under an unconditional bank guarantee, that the mere fact that the principal may succeed in fending-off an application for an interlocutory injunction if a demand is made does not mean that that demand is lawful (and that the principal will succeed at any final hearing). The principal may be liable for damages (and potentially for a very large amount of money) should it be determined at the final hearing that the principal's demand was unlawful.

[77] *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] QB 146 at 155, per Kerr LJ; *Thiess Watkins (Construction) Ltd v Canberra Permanent Co-operative Building Society Ltd* (unreported, Sup Ct ACT, Gallop J, 25 Sept 1986)**; *Ergoline (Vic) Pty Ltd v Ergoline (Australia) Pty Ltd* [2001] VSC 270 at [19], per Beach J**.

[78] Cf *JH Evins Industries (NT) Pty Ltd v Diano Nominees Pty Ltd* (unreported, Sup Ct NT, Kearney J, 30 Jan 1989); *Australian Gasfields Ltd v Kvaerner Process Systesms Pty Ltd* [2001] WASCA at [41] –[43], per Templeman J. In order to obtain an interlocutory injunction, a contractor will be required to give to the principal an undertaking to pay the damages of the principal which may arise through the principal having to comply with the injunction, i.e. if it turns out, as a result of the main hearing, that the contractor's cause of action was not made out: *Kerridge v Foley* (1968) 70 SR (NSW) 251 at 255; *Day v Pinglen Pty Ltd* (1981) 148 CLR 289 at 302; *National Australia Bank Ltd v Bond Brewing Holdings Ltd* (1990) 169 CLR 271; cf *Kirklees Metropolitan Borough Council v Wickes Building Supplies Ltd* [1993] AC 227 (and the court will also consider whether the contractor is of sufficient financial substance for that undertaking to be made good: *R v Secretary of State for Transport; ex parte Factortame Ltd*

providing the unconditional bank guarantee to the principal, accepts the risk that the principal may become insolvent, and unable to repay to the contractor any amount of money which the principal obtains through a wrongful conversion of the unconditional bank guarantee?[79]

4.17 The third matter to be considered by a court in determining whether to grant an interlocutory injunction is to ask: does the balance of convenience favour the granting, rather than the refusal, of an injunction? In this enquiry, the court leaves the relative strengths and weaknesses of the parties' cases to one side, and seeks to determine whether the inconvenience or injury which the applicant for the injunction (scil. the contractor) would be likely to suffer if an injunction were refused, outweighs, or is outweighed, by the inconvenience or injury which the opponent (scil. the principal) would suffer if an injunction were granted.[80] A relevant factor in this determination is the fact that the calling up of an unconditional bank guarantee is usually regarded as quite a serious matter for the contractor from a reputational or integrity perspective.[81] That is, if the principal is not prevented from calling upon and receiving payment under

---

(No.2) [1991] 1 AC 603 at 672, per Lord Goff of Chieveley; *Planet Build (NSW) Pty Ltd v Lassgol Pty Ltd* (Unreported, Sup Ct NSW, Hodgson CJ in Eq, 30 Aug 2000) paras 26-29). If the contractor is of dubious solvency, it may be appropriate to make the granting of an interlocutory injunction conditional upon the contractor giving security for its undertaking: *First Netcom Pty Ltd v Telstra Corporation Ltd* (Unreported, Fed Ct Aust, Beaumont, Burchett and Emmett JJ, 8 Sept 2000) para [24]). This undertaking is of tremendous importance, because in the absence of the undertaking an injuncted party will not be entitled to damages for complying with the injunction, even if that party is successful at the final hearing: *ACCC v Giraffe World Australia Pty Ltd* (1998) 84 FCR 512 at 537, per Lindgren J. The damages which the principal may obtain include interest on the proceeds of the unconditional bank guarantee: *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545 at 559, per Young J. A further point is that damages may be awarded in addition to the granting of an injunction under *Lord Cairns' Act* (22 & 21 Vic c 27) and its statutory offspring.

[79] *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545 at 553, per Young J; and see also *Cargill International SA v Bangladesh Sugar and Food Industries Corp* [1998] 1 WLR 461 at 471, per Staughton LJ**; *Kvaerner Process Systems Pty Ltd v Australian Gasfields Ltd* [2001] WASC 155 at [65], per Parker J**.

[80] *Beecham Group Ltd v Bristol Laboratories Pty Ltd* (1968) 118 CLR 618 at 623; *American Cyanamid Co v Ethicon Ltd* [1975] AC 396 at 408-409, per Lord Diplock; *NWL Ltd v Woods* [1979] 3 All ER 614 at 625-626, per Lord Diplock; *Films Rover International Ltd v Cannon Film Sales Ltd* [1987] 1 WLR 670 at 680, per Hoffmann J; *Businessworld Computers Pty Ltd v Australian Telecommunications Commission* (1988) 82 ALR 499 at 502-503, per Gummow J; *R v Secretary of State for Transport; ex parte Factortame Ltd (No.2)* [1991] 1 AC 603 at 682-683, per Lord Jauncey of Tullichettle.

[81] *Pearson Bridge (NSW) Pty Ltd v The State Rail Authority of New South Wales* (1982) 1 Aust Const LR 81 at 83-85, per Yeldham J; *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1998) 15 BCL 158 at 167, per Austin J [Sup Ct NSW]; cf *JH Evins Industries (NT) Pty Ltd v Diano Nominees Pty Ltd* (unreported, Sup Ct NT, Kearney J, 30 Jan 1989) paras 33, 34. On the other hand, the reputation of the bank may also be affected as a result of non-payment, through the unconditional bank guarantee being, perhaps, "devalued" in the eyes of customers. This said, it is difficult to see how a bank's reputation is damaged if it refuses to pay simply because it has been prevented by a court order from doing so: cf *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London Ltd* [1999] 2 Lloyd's Rep 187 at 191, per Rix J.

the unconditional bank guarantee, the contractor may find it more difficult - or more expensive - to obtain unconditional bank guarantees in the future, and furthermore the contractor may find it more difficult to obtain construction work.[82]

4.18 An even more serious consideration is the immediate financial effect that the cashing of the unconditional bank guarantee will have upon the contractor. If payment is made under the unconditional bank guarantee, the bank will invariably seek immediately to enforce its counter-indemnity against the contractor. The contractor will then be required to obtain what may be a very large amount of money to repay the bank. That may be very difficult for the contractor to do. The converting of the unconditional bank guarantee may have the effect of bringing the contractor to a state of insolvency. It may even drive the contractor out of business altogether.

4.19 If that is the effect of not restraining the principal from encashing the unconditional bank guarantee (or returning any proceeds, already received, to the contractor or the bank), that will weigh heavily in the court's mind in determining whether to grant or to refuse an interlocutory injunction.[83] Tied into this is the issue of the probability of the principal being "good for the amount called up" if it turns out that the principal was not entitled, pursuant to the underlying construction contract, to call upon the unconditional bank guarantee.[84] The concern is that the contractor may be deprived of any recompense (due to the principal's impecuniosity) as a result of the principal's unlawful demand.

4.20 A further consideration is the duration for which the contractor seeks the injunction. The longer the period of the injunction, the greater the injustice to the principal should it turn out, at the final hearing, that the principal *was* entitled to seek payment under the unconditional bank guarantee. The element of time is also relevant to the potential

---

[82] *Hi-Struct Constructions Pty Ltd v ACN 064 828 520 Pty Ltd* (unreported, Sup Ct Vic, McDonald J, 18 June 1996) pp10-11, 18-19; cf *Malik v Bank of Credit and Commerce International SA* [1998] AC 20. Although, this consideration may not be applicable where the contractor is in liquidation: *Glass Reinforced Products (GRP) Pty Ltd v White Constructions (ACT) Pty Ltd* (unreported, Sup Ct ACT, Miles CJ, 1 Dec 1987) para 9. It is relatively common for contractors, in tendering for work, to be required by principals to disclose the previous occasions on which they had unconditional bank guarantees encashed against them. There is an obvious stigma associated with disclosing this information.

[83] See *J Lyons & Sons v Wilkins* [1896] 1 Ch 811 at 827, per Kay LJ; *Garden Cottage Foods Ltd v Milk Marketing Board* [1984] 1 AC 130 at 153, per Lord Wilberforce; *Inter Image Homes Pty Ltd v Commonwealth Bank of Australia* (unreported, Sup Ct NSW, Young J, 10 April 1997); cf *Allco Newsteel Pty Ltd v Remm Construction (SA) Pty Ltd* (Unreported, Sup Ct NSW, Young J, 11 April 1990) p11.

[84] *Window Installations Pty Ltd v Australco Industries Pty Ltd* (unreported, Sup Ct NSW, Windeyer J, 10 May 1995) p5; and see also *GKN Contractors ltd v Lloyds Bank plc* (1985) 30 BLR 53 at 64, per Parker LJ; *Mitsui Kensetsu Corporation (Australia) Pty Ltd v State Bank of South Australia* (unreported, Sup Ct Qld, Byrne J, 9 Aug 1990) p7.

injustice to the principal if the unconditional bank guarantee is expressed to expire on a particular date (which it usually is).[85] If the duration of the injunction exceeds the expiry date of the unconditional bank guarantee, and it turns out, at the final hearing, that the principal *was* entitled to call upon the unconditional bank guarantee; the principal will, in that situation, be deprived entirely of the benefit of the unconditional bank guarantee upon its extinguishment.[86]

4.21 Those are the three principal matters which a court will have regard to in deciding whether or not to grant an interlocutory injunction against the principal. It can be seen that there will almost be a *prima facie* inclination on the part of the courts to refuse to grant an injunction. But, as was mentioned earlier, there are certain exceptional circumstances in which an interlocutory injunction will be granted. These circumstances will now be discussed.

Exceptions to the Autonomy Principle

4.22 Under the law of Australia there are certainly five, and possibly even six, exceptions to the autonomy principle.[87] Under English law, the only established exception is that of fraud.[88]

(i) Fraud

4.23 The first exception, and perhaps the most notable one, is where there is fraud on the part of the principal (or possibly the bank).[89] In this context, "fraud" certainly

---

[85] Cf *Tynan Nominees Pty Ltd v ANZ Bank* [2001] VSC 493.

[86] *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420 at 437, per Brooking JA.

[87] Cf *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1998) 15 BCL 158 at 164, per Austin J [Sup Ct NSW].

[88] *Themehelp Ltd v West* [1996] QB 84 at 89, per Waite LJ; cf IN Duncan Wallace, *Hudson's Building and Engineering Contracts* (Sweet & Maxwell, London, 11th ed 1995) paras 17•070, 17•071; Goode, "Unconditional bonds: the common law" in Lloyd (ed), *The Liability of Contractors* (Queen Mary College, London, 1986) p103. The position would appear to be the same under Scottish law: *Centri-Force Engineering Ltd v Bank of Scotland* 1993 SLT 190 at 193.

[89] *Societe Metallurgique D'Aubrives & Villerupt v British Bank for Foreign Trade* (1922) 11 Ll L LR 168 at 170, per Bailhache J; *Discount Records Ltd v Barclays Bank Ltd* [1975] 1 All ER 1071; *Power Curber International Ltd v National Bank of Kuwait SAK* [1981] 3 All ER 607 at 614, per Griffiths LJ; *United City Merchants (Investments) Ltd v Glass Fibres and Equipments Ltd* [1983] AC 168 at 183-184, per Lord Diplock; *Contronic Distributors Pty Ltd v Bank of New South Wales* [1984] 3 NSWLR 110 at 115-116, per Helsham J; *Banco Santander SA v Bayfern Ltd* [1999] 2 All ER (Comm) 18 at 25-27, per Langley J. As a matter of historical interest, at common law it was no defence to an action on a bond that the bond was procured by fraud: Ames, "Specialty Contracts and Equitable Defences" (1895) 9 *Harvard Law Review* 49 at 51.

comprehends fraud at common law (i.e. conduct involving a dishonest intent, or recklessness as to the truth),[90] and there seems to be no good reason why it should not include the broader concept of fraud in equity (i.e. conduct which is offensive to the conscience, but which does not necessarily involve a dishonest intent or recklessness as to truth).[91]

4.24 A principal is not entitled to call upon an unconditional bank guarantee where it would be fraudulent of the principal to do so. This is axiomatic. The difficulty, however, with this exception to the autonomy principle is that the allegation or suggestion of fraud will usually arise at an interlocutory stage, i.e. before the full evidence of and argument relating to fraud, from all parties, can be put before the court. The court will generally have to make its decision at an interlocutory level with less circumspection than it would in granting final relief.

4.25 Because of this, and because to grant interlocutory relief cheaply would be to emasculate the benefits of having an autonomous contractual security, the courts insist upon very strong evidence of fraud before they will lend their assistance to a contractor by making interlocutory orders. The test which a court will apply in determining whether or not to grant interlocutory relief will be to ask whether it is *seriously arguable* that fraud is the *only realistic inference*.[92] A mere allegation of fraud or dishonesty - without any supporting evidence - is insufficient.[93] That is understandable: otherwise a recalcitrant contractor could easily frustrate (at an interlocutory stage - with a final hearing to take place many months later) the rights of a principal to realise an unconditional bank

---

[90] *Derry v Peek* (1889) 14 App Cas 336; *Stuart v Kingston* (1923) 32 CLR 309 at 344-345, per Higgins J.

[91] Cf *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545 at 554, per Young J; *GKN Contractors Ltd v Lloyds Bank plc* (1985) 30 BLR 53 at 63-64, per Parker LJ. As to the distinction between fraud at common law and fraud in equity, see Sir Anthony Mason, "The Impact of Equitable Doctrine on the Law of Contract" (1998) 27 *Anglo-American Law Review* 1 at 3-4; and see also *Kitchen v Royal Air Force Association* [1958] 1 WLR 563 at 572-573, per Lord Evershed MR. The case law concerning unconditional bank guarantees and letters of credit does not address explicitly the issue of whether "fraud" also includes equitable fraud: see Buckley, "Sections 51AA and 51AC of the Trade Practices Act 1974: The Need for Reform" (2000) 8 *Trade Practices Law Journal* 5 at 11-12.

[92] *United Trading Corporation SA v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554 at 561, per Ackner LJ; *Korea Industry Co Ltd v Andoll Ltd* [1990] 2 Lloyd's Rep 183 at 188 [Singapore Ct App]; *Themehelp Ltd v West* [1996] QB 84 at 90, per Waite LJ; *Fletcher Construction Australia Pty Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812 at 823, per Charles JA; cf *CDN Research and Development Ltd v Bank of Nova Scotia* (1982) 136 DLR (3d) 656 at 662, per Smith J [Ont HC]. This test is to be taken in conjunction with all of the other usual considerations in terms of granting interlocutory relief.

[93] *Turkiye Is Bankasi AS v Bank of China* [1998] 1 Lloyd's Rep 250 at 255, per Hirst LJ; cf *Flower & Hart (a firm) v White Industries (Qld) Pty Ltd* (1999) 163 ALR 744.

guarantee by crying "fraud". The evidentiary hurdle is set high for very good reasons.[94]

(ii) No Underlying Contract

4.26 The second exception to the autonomy principle is where there is no underlying contract extant, for example where a contract was in one sense made but is void due to illegality,[95] or where there never was a contract (e.g. where the parties were never *ad idem*) in respect of which the unconditional bank guarantee was purportedly given.[96] If it was contemplated by the principal and the contractor that the unconditional bank guarantee, which the contractor procured for the principal's benefit, was to secure the performance of the contractor's obligations under an underlying contract, and that underlying contract has, for whatever reason, failed to materialise: the unconditional bank guarantee can serve no legitimate purpose in the principal's hands. The contractor owes no contractual obligations to the principal, i.e. there are no contractual obligations which the unconditional bank guarantee can secure the performance of, so what possible justification can the principal have in holding, or in calling upon, the unconditional bank guarantee?[97]

---

[94] It has been stated in several cases that, where the contractor is seeking interlocutory relief against the bank, the contractor must, in addition to adducing sufficient evidence of fraud on the principal's part, also adduce clear evidence of the bank's knowledge of the fraud: see *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 QB 159 at 175, per Geoffrey Lane LJ; *United Trading Corporation SA v Allied Arab Bank* [1985] 2 Lloyd's Rep 554 at 561, per Ackner LJ; *Turkiye Is Bankasi AS v Bank of China* [1996] 2 Lloyd's Rep 611 at 616, per Waller J; *Austal Ships Pty Ltd v National Australia Bank Ltd* (unreported, Sup Ct WA, Templeman J, 13 Feb 1997) pp12-13. It has been pointed out, though, that this requirement of proving the bank's knowledge of the fraud becomes academic once it is established that fraud (on the principal's part) is the only reasonable inference, i.e. if the bank did not know of the fraud prior to the interlocutory hearing, it will certainly know that fraud is the only realistic inference once that is determined to be the case at the interlocutory hearing: *Deutsche Rückversicherung AG v Walbrook Insurance Co Ltd* [1995] 1 WLR 1017 at 1030, per Phillips J; *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 397, per Batt J. The bank's knowledge of the fraud only becomes relevant in circumstances where the bank has actually paid the principal the amount demanded. The issue of the bank's liability is dealt with below.

[95] *Deutsche Rückversicherung AG v Wallbrook Insurance Co Ltd* [1996] 1 All ER 791 at 803-804, per Staughton LJ; *Fletcher Construction Australia Ltd v Varnsdorf* [1998] 3 VR 812 at 830, per Callaway JA; and see also *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 24 at 28, per Eveleigh LJ; *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 395, per Batt J; cf Goode, "Reflections on Letters of Credit - I" [1980] *JBL* 291 at 291.

[96] *Thiess Watkins White Constructions Ltd (in liq) v National Mutual Life Nominees Ltd* (unreported, Sup Ct NSW, Cole J, 2 Oct 1991); *Lert Australia Pty Ltd v R and A Dalley & Co Pty Ltd* (unreported, Sup Ct NSW, McLelland CJ in Eq, 9 Nov 1993) pp6-7; cf Mason and Carter, *Restitution Law in Australia* (Butterworths, Sydney, 1995) para [1135].

[97] It is suggested that the same result obtains if the underlying contract is *voidable* at the election of the contractor (for example, where the principal's fraudulent misrepresentation induced the contractor to enter into the underlying contract), and the contractor elects to terminate the contract (and *restitutio in integrum* is otherwise possible): cf Goode, "Abstract Payment Undertakings" in Cane and Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press, Oxford, 1991) pp226-227. See also *Scott v Forster Pastoral Co Pty Ltd* (Unreported, NSW Ct App, Meagher and

4.27 The position may be otherwise if the principal and the contractor contemplated that the unconditional bank guarantee would provide security for the performance by the contractor of works requested by the principal, whether those works are performed pursuant to a contract *or not*. In that situation, it may be that the parties intended, for example, that the principal should be able to have recourse to the unconditional bank guarantee to remedy any defective works performed by the contractor even though the contractor did not perform those works on a contractual basis.[98]

4.28 But leaving such a situation to one side, if it was contemplated that the principal was *only* to have recourse to the unconditional bank guarantee in the event of non-performance by the contractor of its *contractual* obligations, the fact that the contractor has never owed contractual obligations to the principal compels the conclusion that the principal has no right, as against the contractor, to the unconditional bank guarantee. In these circumstances, perhaps it could be said to be fraudulent of the principal to call upon the unconditional bank guarantee or to refuse to return it to the contractor.[99]

4.29 What of the situation where there was a valid underlying contract in existence, and the unconditional bank guarantee was procured by the contractor for the principal's benefit under that contract, but the underlying contract has been terminated for repudiatory breach by either party, or it has been frustrated, and the principal retains the unconditional bank guarantee? And what of the situation where the contractor has, ostensibly, performed all of its obligations under the underlying contract, so that there are no executory obligations left on the contractor's part in respect of which the principal needs to be secured by way of the provision of an unconditional bank guarantee? Can the principal be restrained from calling upon the unconditional bank guarantee in any of these situations?

4.30 We know that where a contract is terminated for repudiatory breach, the contract is, generally, not rendered void *ab initio*. Accrued rights and causes of action may subsist.[100]

Giles JJA, Foster AJA, 31 Aug 2000). **It is another matter altogether as to whether the bank is entitled to enforce its counter-indemnity against its customer in circumstances where the underlying contract, or even the unconditional bank guarantee itself, was void: see *Gulf Bank KSC v Mitsubishi Heavy Industries Ltd (No.2)* [1994] 2 Lloyd's Rep 145 at 151, per Sir Thomas Bingham MR.**

[98] Cf *Walter Construction Group Ltd v Secretary to the Department of Infrastructure* (unreported, Sup Ct Vic, Byrne J, 6 June 2000).

[99] **However, the wording of the unconditional bank guarantee may indicate that the beneficiary is entitled to make a demand even if there is no underlying contract: see *Standard Bank London Ltd v Canara Bank* [2002] EWHC 1032 (Comm) at [68] – [69], per Moore-Bick J.**

[100] *McDonald v Dennys Lascelles Ltd* (1933) 48 CLR 457 at 476-477, per Dixon J; *Heyman v Darwins Ltd* [1942]

The position is similar where the underlying contract has been frustrated.[101] It may, therefore, be the case that, after termination of the underlying contract (whether after an accepted repudiation or after frustration), the principal still has some accrued right or entitlement against the contractor pursuant to the underlying contract. In the absence of an express provision in the underlying contract to make it clear what the principal's rights are post-termination,[102] it may ordinarily be inferred that the parties intended that the principal's ability to call upon the unconditional bank guarantee should survive the termination of the underlying contract, so as to provide the principal with recourse against a security in respect of the principal's accrued rights.[103]

4.31 If, however, the contractor has discharged all of its obligations pursuant to the underlying contract, there would seem to be little justification in the principal calling upon the unconditional bank guarantee.[104] The underlying contract may, indeed, provide that the principal is to return the unconditional bank guarantee to the contractor once it has performed its obligations or at a particular time.

4.32 But if, for example, the contractor has performed its obligations and the principal has no express right, under the underlying contract, to retain or to call upon the unconditional bank guarantee, should not the contractor, in this situation, be able to have the principal restrained from calling upon the unconditional bank guarantee? In principle, if the contractor has no outstanding obligations under the underlying contract, and if the

---

AC 356; *Johnson v Agnew* [1980] AC 367 at 393-397, per Lord Wilberforce; *Hurst v Bryk* [2000] 2 WLR 740.

[101] *Codelfa Construction Pty Limited v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 356-365, per Mason J.

[102] Cf *Thiess Watkins (Construction) Ltd v Canberra Permanent Co-operative Building Society Ltd* (unreported, Sup Ct ACT, Gallop J, 25 Sept 1986) para 5.

[103] *Geraldton Building Co Pty Ltd v Christmas Island Resort Pty Ltd* (1996) 12 BCL 64 at 66, per Kennedy J, at 73-74, per Franklyn J [Sup Ct WA]; *Bains Harding Ltd v State Electricity Commission of Victoria* (unreported, Sup Ct Vic, Ct App, Brooking, Callaway and Kenny JJA, 12 Aug 1997) pp11-12, per Brooking JA; *Kennedy Taylor (Victoria) Pty Ltd v Baulderstone Hornibrook Pty Ltd* (2000) 16 BCL 374 [Sup Ct Vic, Beach J]; *Planet Build (NSW) Pty Ltd v Lassgol Pty Ltd* (Unreported, Sup Ct NSW, Hodgson CJ in Eq, 30 Aug 2000) para 15; *Queensland Investment Corporation v Kern Corporation Ltd* (2001) 17 BCL 123. A similar result will ordinarily ensue, unless excluded by the underlying contract, in the event that the underlying contract is terminated "for convenience" (i.e. not for default or repudiation): *ADI Ltd v State Electricity Commission of Victoria* (unreported, Sup Ct Vic, Ct App, Brooking, Callaway and Kenny JJA, 12 Aug 1997).

[104] *Road Surfaces Group Pty Ltd v Brown* [1987] 2 Qd R 792 at 803, per Williams J. One might even draw an analogy between the circumstances of the contractor and the circumstances of a mortgagor of real property who has discharged its obligations in respect of the mortgage. The mortgagor, in such a case, has an equity of redemption in respect of the legal estate. Perhaps one could say that a contractor who has discharged all of its obligations in respect of an unconditional bank guarantee, provided by it, has an equity to have the unconditional bank guarantee returned to it. If that is correct, the principal could be regarded as holding the unconditional bank guarantee on a constructive trust pending its return to the contractor.

principal is not otherwise entitled to retain and make use of the unconditional bank guarantee under the underlying contract, there would seem to be no reason why the contractor should be unable to have the principal restrained from calling upon the unconditional bank guarantee.[105]

4.33 The problem for a court, however, where interlocutory relief is being sought is that very often it will be difficult for the court to ascertain whether, in fact, the contractor *has* discharged its obligations under the underlying contract. No doubt, the contractor will claim that it has, and the principal will claim that the contractor has not discharged its obligations. Evidence will be adduced by both parties, but that evidence will not, generally, be the complete evidence that each party would seek to rely upon at the final hearing, and moreover the evidence may not have been tested in cross-examination.

4.34 What is a court to do? Should it grant or refuse interlocutory relief? No hard-and-fast rule can be laid down as to whether a principal should be restrained from calling upon an unconditional bank guarantee in circumstances where the contractor claims that all of its obligations under the underlying contract have been discharged. It is suggested, however, that bearing in mind the importance, in the commercial world, of unconditional bank guarantees being readily convertible to cash, the courts - sensible of this value - will be very slow to grant interlocutory relief to contractors, save in cases where there would appear to be a compelling case that all of the contractor's obligations under the construction contract, whether or not those obligations have fallen due for performance, are discharged. As with the fraud exception to the autonomy principle, the threshold for the granting of interlocutory relief should be very high for contractors who claim to have discharged all of their contractual obligations.

(iii) Defective Demand for Payment

4.35 The third exception to the autonomy principle is where the bank pays the principal, or proposes to pay the principal, in circumstances which are not those contemplated by the terms of the unconditional bank guarantee.[106] For example, if the unconditional bank guarantee provides that the principal is entitled to be paid by the bank if it presents to

---

[105] Similarly, if the contract is silent as to the circumstances in which the contractor is entitled to the return of the unconditional bank guarantee, the contractor should be entitled to the return of the unconditional bank guarantee upon performance of its obligations under the contract. The ability of a contractor to seek the return of an unconditional bank guarantee is considered below.

[106] See *GKN Contractors Ltd v Lloyds Bank plc* (1985) 30 BLR 53 at 64, per Parker LJ; cf *Thompson Land Ltd v Lend Lease Shopping Centre Pty Ltd* (unreported, Sup Ct Vic, McDonald J, 30 March 2000) para [74].

the bank a certificate from the superintendent stating that the contractor is in default of its obligations under the underlying contract, the bank would not be entitled to pay the principal[107] if the principal arrived at the bank without any such certificate, and simply demanded payment. This is also true of a case where the unconditional bank guarantee requires that a notice of default be served on the contractor before a demand on the unconditional bank guarantee can be made (with evidence of service of the notice being given to the bank), and no such notice has been served.[108] In both cases, the contractor may seek to restrain the bank from making payment (if the bank proposes to make payment, and to thereby exceed its mandate), and it may seek to have the principal withdraw its demand.[109]

(iv) Unconscionability

4.36 The fourth exception to the autonomy principle exists where it would be unconscionable of the principal to call upon the unconditional bank guarantee.[110] "Unconscionability" is

---

[107] Or, perhaps, to be more precise: the bank is entitled to make the payment, but if it does so it is not entitled to enforce its counter-indemnity against the contractor - the bank having exceeded its mandate.

[108] *Lorne Stewart plc v Hermes Kreditversicherungs AG* [2001] All ER (D) 286.

[109] Cf *JH Rayner and Co Ltd v Hambro's Bank Ltd* [1943] 1 KB 37 at 42, per Goddard LJ; *GKN Contractors Ltd v Lloyds Bank plc* (1985) 30 BLR 53 at 64, per Parker LJ; and see also *Majesty Restaurant Pty Ltd v Commonwealth Bank of Australia Ltd* (1998) 47 NSWLR 593 at 602-603, per Hunter J. The mandate of the bank will be exceeded if it makes payment under a demand which was made by a person other than the beneficiary (or its agent) referred to in the unconditional bank guarantee: *Besse v Bank of Australasia* (1904) 90 LTR 618 at 620, per Bigham J. Although the ultimate purpose of the bank making payment to the principal is to discharge the contractor's obligations to the principal, the fact is that the bank pays the principal pursuant to an obligation which is autonomous of the underlying contract, and for that reason the bank does not make payment as agent of the contractor: cf *Friedlander v The Bank of Australasia* (1909) 8 CLR 85 at 94, per Griffith CJ; Goode, "Abstract Payment Undertakings" in Cane and Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press, Oxford, 1991) p218.

[110] *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545 at 554, per Young J; *Tenore Pty Ltd v Roleystone Pty Ltd* (unreported, Sup Ct NSW, Giles J, 14 Sept 1990) pp30, 35-37; *Pedna Pty Ltd v Sitep Societa per Azioni* (unreported, Sup Ct NSW, Santow J, 8 Jan 1997) pp4-5; *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1998) 15 BCL 158 at 164, per Austin J [Sup Ct NSW]; *Commonwealth Bank v White (No.2)* (unreported, Sup Ct Vic, Byrne J, 22 Oct 1999) para [14]. See also *ABC v Lenah Game Meats Pty Ltd* [2001] HCA 63 at [17], per Gleeson CJ; ***McConnell Dowell Construction (Aust) Pty Ltd v Sembcorp Engineering & Constructions Pte Ltd* [2002] BLR 450 at 457-458 [HC Sing]; *Samwoh Asphalt Premix Pte Ltd v Sum Cheong Piling Pte Ltd* [2002] BLR 459 at 462 [Ct App Sing]**. In *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380, Batt J (somewhat extraordinarily) denied interlocutory relief *in equity* to a contractor for *proven* unconscionability in making demand for payment on the basis that no such exception existed (at 400), but granted injunctive relief to the contractor on the basis of the principal having acted unconscionably, in contravention of *Trade Practices Act* 1974 (Cth) s51AA (at 404) (and see also section 51AC of the *Trade Practices Act*; *CG Berbatis Holdings Pty Ltd v ACCC* (2001) ATPR 41-826; *Project Blue Moon Pty Ltd v Fairway Trading Pty Ltd* (unreported, Fed Ct Aust, Gallop, Mathews and Sundberg JJ, 18 Feb 2000) paras 17 and 18; *Hurley v McDonald's Australia Ltd* (2000) ATPR ¶41-741 at 40,585-40,586; *GPG (Australia Trading) Pty Ltd v GIO Australia Holdings Ltd* [2001] FCA 1761; **O'Brien, "The ACCC v Berbatis Litigation and Section 51AA of the Trade Practices Act" (2002) 10 *Trade Practices Law Journal* 201**). If "unconscionability" is viewed as a species of equitable fraud, *ex hypothesi* it would be preferable to view the unconscionability exception to the autonomy principle as a sub-set of the fraud

an amphibolous concept. Perhaps it could best be described as something which "shocks the conscience, something which is harsh or oppressive in that it involves taking advantage of another's special disability or disadvantage".[111] Potentially, unconscionability provides to a contractor another basis upon which it can seek to impugn an attempt by the principal to make demand upon the unconditional bank guarantee.

4.37 In commercial dealings, however, such as those between principal and contractor, examples of relief being obtained by one commercial person against another on the basis of unconscionability are infrequent. Indeed, where the principal and the contractor are persons (usually companies) of some sophistication, where they each have available to them consultants and advisers as to contractual matters (including lawyers), where they deal with each other at arm's length and with eyes wide open, and, importantly, where they agree that an unconditional bank guarantee is to be provided by the contractor to the principal, knowing full well that the principal is entitled under the terms of the unconditional bank guarantee to call upon it, and that the bank is obliged to pay the principal, in the absence of either proving a breach of the underlying contract and without reference to the underlying contract; it would take a fairly extreme set of circumstances for it to be said that the principal, by calling upon the unconditional bank guarantee, has acted "unconscionably" so as to entitle the contractor to seek interlocutory or even final relief against the principal for so acting.[112]

4.38 Perhaps, it may be suggested, such an example would occur where the principal calls upon the unconditional bank guarantee, or threatens to call upon the unconditional

---

exception.

[111] Sir Anthony Mason, "The Impact of Equitable Doctrine on the Law of Contract" (1998) 27 *Anglo-American Law Review* 1 at 12; and see also *Gregg v Tasmanian Trustees Ltd* (1997) 73 FCR 91 at 108-109, per Merkel J. It is beyond the scope of this article to describe in detail the nature and scope of unconscionability, but see, for example, *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447 at 461, per Mason J; *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395 at 407-410; Parkinson, *The Principles of Equity* (Law Book Co, Sydney, 1996) ch. 2; cf Birks, "Annual Miegunyah Lecture: Equity, Conscience and Unjust Enrichment" (1999) 23 *Melbourne University Law Review* 1 at 20-22.

[112] In *Hortico (Australia) Pty Ltd v Energy Equipment Co (Aust) Pty Ltd* (1985) 1 NSWLR 545 at 554, Young J acknowledged the existence of the equitable jurisdiction to remedy an unconscionable exercise of a contractual power (such as a power to call upon a security), but said that, in commercial transactions, a "hands off" approach should (generally) be taken. In earlier times, performance bonds between contractors and principals (being penal bonds, for the payment of an amount of money, defeasible upon the contractor performing the thing which it covenanted to do) were liable to be struck down as penalties, subject to the ability of the principal to recover damages in equity on a *quantum damnificatus*: as to which, see for example *Errington v Aynesly* (1788) 2 Bro CC 341, 29 ER 191; AWB Simpson, "The Penal Bond With Conditional Defeasance" (1966) 82 *LQR* 392 at 417-421). Equity would relieve the bondsman against an unconscientious assertion by the beneficiary of its legal rights under the performance bond.

bank guarantee, not for the purpose of recouping any losses which it may have suffered as a result of any breach of the underlying contract by the contractor, but for the sole purpose of driving the contractor into a financially precarious position so as to procure an agreement with the principal (i.e. a settlement of a dispute between the two) on terms which are very advantageous to the principal and very disadvantageous to the contractor. But again, very strong evidence of such a urpose would be required in order for the contractor to succeed in its application.[113]

(v) Breach of Negative Stipulation in the Underlying Contract

4.39 The fifth exception to the autonomy principle obtains where the principal seeks to call upon the unconditional bank guarantee in circumstances where it is not entitled to do so pursuant to the underlying contract, i.e. where it would be a breach of the underlying contract for the principal to make a demand for payment.[114] Cases dealing with this

---

[113] Cf *Wood Hall Ltd v The Pipeline Authority* (1979) 141 CLR 443 where an interlocutory injunction did not issue against *the bank* to restrain it from making payment pursuant to four unconditional bank guarantees in circumstances where there was evidence which suggested that the principal had made demand upon the unconditional bank guarantees for the purpose of pressuring the contractor into a settlement which was advantageous to the principal: at 449-450, per Gibbs J. One aspect of the principal's conduct which was consistent with this intent was the fact that the principal called upon the unconditional bank guarantees without giving prior notification to the contractor of its intention to call upon the unconditional bank guarantees. It should be noted, however, that the contractor did not seek relief against the bank on the basis of any alleged unconscientious behaviour on the principal's part (cf *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 403, per Batt J). Furthermore, the unconditional bank guarantee itself provided that the principal was entitled to call for payment without prior notice to the contractor. That is a fairly standard provision in unconditional bank guarantees (cf *Transfield Pty Ltd v Fuller-FL Smidth (Pacific) Pty Ltd* (unreported, Sup Ct NSW, Bainton J, 9 May 1997) where the underlying contract required that the principal give notification to the contractor prior to making a demand for payment under the unconditional bank guarantee). In one recent case, it was held that a failure on the principal's part to notify the contractor of its intention to call upon an unconditional bank guarantee did not amount to unconscionable conduct: *Minson Constructions Pty Ltd v Aquatec-Maxon Pty Ltd* (unreported, Sup Ct Vic, Beach J, 5 Feb 1999); cf *Fletcher Construction Australia Ltd v Savday Pty Ltd* (unreported, Sup Ct NSW, Bryson J, 7 Jan 1999) paras [21], [22]. Similarly, a bank is not, in the absence of an express contractual provision in the contract of counter-indemnity with the contractor, obliged to notify the contractor either than a demand for payment has been made or that payment has actually been made by the bank to the principal: *Esal (Commodities) Ltd v Oriental Credit Ltd* [1985] 2 Lloyd's Rep 546 at 553, per Ackner LJ.

[114] In Australia, the origin of this exception is to be found in obiter dictum of Stephen J in *Wood Hall Ltd v The Pipeline Authority* (1979) 141 CLR 443 at 459, where his Honour said, in refusing an application for an injunction to restrain a bank from making payment to a principal, "[h]ad the construction contract itself contained some qualification upon the [principal's] power to make a demand under the [unconditional bank guarantee], the position might well have been different". Subsequent cases which have adopted this (apparent) exception to the autonomy principle adverted to by Stephen J include *Pearson Bridge (NSW) Pty Ltd v The State Rail Authority of New South Wales* (1982) 1 Aust Const LR 81; *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Ltd* [1985] 1 NSWLR 545 at 552, per Young J; *Selvas Pty Ltd v Hansen & Yuncken (SA) Pty Ltd* (1987) 6 Aust Const LR 36; *JH Evins Industries (NT) Pty Ltd v Diano Nominees Pty Ltd* (unreported, Sup Ct NT, Kearney J, 30 Jan 1989); *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451; *NEI Pacific Ltd v Cigna Insurance Australia Ltd* (unreported, Sup Ct NSW, Giles J, 29 Aug 1991); *Geraldton Building Co Ltd v*

exception usually focus upon express provisions in the underlying contract[115] which empower the principal to make demand upon the guarantee (e.g. "the principal shall be entitled to call upon the unconditional bank guarantee where X"), or which prohibit the principal from making demand unless certain circumstances exist (e.g. "the principal shall not be entitled to call upon the unconditional bank guarantee except where X").[116] In both instances, the argument of the contractor is that the principal is not entitled to make demand for payment because "X" has not occurred. In both instances, the contractor argues that the underlying contract limits the circumstances in which the principal may make demand for payment pursuant to the *unconditional* bank guarantee, and that the principal, in breach of contract, has (or proposes to) go beyond those limits.

4.40 The problem which arises in these circumstances is a conflict, or at least what appears to be a conflict, between, on the one hand, one of the important features of unconditional bank guarantees, namely that a principal who holds an autonomous instrument such as an unconditional bank guarantee should be able to access cash readily without reference to the underlying contract; and on the other hand, the notion that a principal should not be permitted to make a demand for payment on an unconditional bank guarantee where the underlying contract does not countenance the principal doing so.

4.41 How is this apparent conflict to be resolved? Perhaps it could be looked at this way: perhaps it could be said (although it sounds trite) that a principal who holds an unconditional bank guarantee is entitled to make a demand for payment under that unconditional bank guarantee, save where that demand is made unlawfully. And just as a fraudulent demand for payment is unlawful, so too is a demand which is made in circumstances where the principal is not entitled to make that demand pursuant to the

---

Christmas Island Resort Pty Ltd (1996) 12 BCL 64 at 73, per Franklyn J [Sup Ct WA]; *Pedna Pty Ltd v Sitep Societa per Azioni* (unreported, Sup Ct NSW, Santow J, 8 Jan 1997) p5; *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* (unreported, Sup Ct Vic, Byrne J, 2 Oct 1997) pp9-10; *Planet Build (NSW) Pty Ltd v Lassgol Pty Ltd* (unreported, Sup Ct NSW, Hodgson CJ in Eq, 9 August 2000); cf *Mitsui Kensetsu Corporation (Australia) Pty Ltd v State Bank of South Australia* (unreported, Sup Ct Qld, Byrne J, 9 Aug 1990) pp3-4. See also *ADI Ltd v State Electricity Commission of Victoria* (unreported, Sup Ct Vic, Ct App, Brooking, Callaway and Kenny JJA, 12 Aug 1997), where Brooking JA said "A proprietor will not be restrained from calling upon a bank to meet its obligations under the usual unconditional bond unless there is some stipulation in the contract between the builder and the proprietor which prevents them from doing so".

[115] A court will be very slow to find an implied prohibition on calling up an unconditional bank guarantee: *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812 at 826, per Callaway JA; *Anaconda Operations Pty Ltd v Fluor Daniel Pty Ltd* (2000) 16 BCL 230 at 234, per Brooking JA; cf *Transfield Pty Ltd v Fuller-FL Smidth (Pacific) Pty Ltd* (unreported, Sup Ct NSW, Bainton J, 9 May 1997) pp21-22. See also *Washington Constructions Co Pty Ltd v Westpac Banking Corporation* [1983] Qd R 179 at 183, per Thomas J.

[116] E.g. *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420 at 428, per Brooking JA. See also Byrne, "Rights of the Grantor under a Performance Bond" (2001) 17 BCL 4 at 9.

underlying contract. If, then, unlawful demands on unconditional bank guarantees should be restrained,[117] there is no reason for refusing to restrain a principal who purports to make a demand for payment in breach of the terms of the relevant underlying construction contract.[118] The commercial utility of unconditional bank guarantees is not impugned in this situation, because the very thing which is being restrained (the making of an unlawful demand) is, by definition, something which the parties have not agreed to. There is no commercial utility in a principal making an unlawful demand. Further, no-one would deny the importance, and the ability of a court exercising equitable jurisdiction, in appropriate circumstances, of restraining a breach of a negative stipulation under a contract (i.e. an undertaking to refrain from calling-up an unconditional bank guarantee unless certain circumstances exist), no matter how that obligation is expressed.[119] To take a different position would be to countenance a reallocation of the contractual risk which the parties have expressly accepted by their underlying contract.[120]

4.42 The most common circumstance in which the apparent conflict between the autonomous nature of unconditional bank guarantees on the one hand, and the desire to hold the principal to its underlying contract on the other, manifests itself is not one in which there is clear evidence that the principal has no right under the underlying contract to call upon the unconditional bank guarantee. Rather, the issue generally

---

[117] Subject to the usual discretionary considerations in granting injunctions.

[118] Where the determination of whether or not the principal is entitled pursuant to the underlying contract to call upon the unconditional bank guarantee is made as an ordinary matter of contractual interpretation: *Malaysia Hotel (Aust) Pty Ltd v Sabemo Pty Ltd* (1995) 11 BCL 50 at 52, per Mahoney JA [NSW Ct App]; *Coby Constructions Pty Ltd v Melbourne Glass Pty Ltd* (unreported, Sup Ct Vic, Gillard J, 7 April 1998) pp8-9; and see also *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] 1 QB 146 at 155-157, per Kerr J. The fact that the security is unconditional cannot, in itself, convert the principal's demand upon the bank for payment into one which is permitted by the underlying contract: *Transfield Pty Ltd v Fuller-FL Smidth (Pacific) Pty Ltd* (unreported, Sup Ct NSW, Bainton J, 9 May 1997) pp21-23.

[119] See *Doherty v Allman* (1878) 3 App Cas 709 at 719-720, per Lord Cairns LC; *JC Williamson Ltd v Lukey* (1931) 45 CLR 282 at 292, per Starke J, at 298-299, 301 per Dixon J; *Dalgety Wine Estates Pty Ltd v Rizzon* (1979) 141 CLR 552 at 573-574, per Mason J; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451 at 462-463, per Rolfe J; *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1998) 15 BCL 158 at 164-165, per Austin J [Sup Ct NSW]; *Maggbury Pty Ltd v Hafele Australia Pty Ltd* [2001] HCA 70 at [102], per Callinan J. Whether a stipulation is negative or positive is to be determined having regard to the substance of the obligation, not its semantic form. A positive stipulation in a contract will generally not be enforced (i.e. specific performance will not be ordered) unless the applicant for the injunction is seeking to enforce a proprietary right: see *Wolverhampton and Walsall Railway Co v London and Northwestern Railway Co* (1873) LR 16 Eq 433 at 440, per Lord Selborne LC; *Metropolitan Electric Supply Co Ltd v Ginder* [1901] 2 Ch 799 at 805-806, per Buckley J.

[120] Cf *Cargill International SA v Bangladesh Sugar and Food Industries Corp* [1996] 4 All ER 563 at 568, per Morison J; Zohrab, "Standby Letter of Credit: Autonomy" [1996] NZLJ 417.

arises at an interlocutory stage, when there is simply a bona fide dispute between the principal and the contractor as to the principal's entitlement to make a demand for payment, and it cannot be determined on a final basis whether or not the principal is entitled under the underlying contract to make a demand.

4.43 If, at that interlocutory stage, there is clear evidence as to the principal's entitlement; the decision of the court can be made easily, because the lawfulness or unlawfulness of the principal's demand is known.[121] However, what usually transpires at the interlocutory hearing is that the principal and the contractor each make bona fide and competing claims - based on limited and, perhaps, untested evidence - as to the principal's entitlement to call-up the unconditional bank guarantee. How are these competing claims to be dealt with?

4.44 What may be done, as a starting point, is to have regard to the criteria according to which interlocutory injunctions are ordinarily granted or refused.[122] It will be recalled that the first question to be asked is whether there is a serious issue to be tried. If it is not clear from the evidence, and from the terms of the underlying contract, as to whether the principal is or is not entitled to make a demand for payment, but there is some evidence of substance that the principal *may not have* such an entitlement, it might be said that this criterion is satisfied.[123]

---

[121] Cf *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451; *ADI Ltd v State Electricity Commission of Victoria* (1997) 13 BCL 337 at 338, per Byrne J [Sup Ct Vic].

[122] These criteria were discussed earlier in this article.

[123] See, for example, *GKN Contractors Ltd v Lloyds Bank plc* (1985) 30 BLR 53 at 64, per Parker LJ; *JH Evins Industries (NT) Pty Ltd v Diano Nominees Pty Ltd* (unreported, Sup Ct NT, Kearney J, 30 Jan 1989) para 32; *Mitsui Kensetsu Corporation (Australia) Pty Ltd v State Bank of South Australia* (unreported, Sup Ct Qld, Byrne J, 9 Aug 1990) pp6-7; cf *Robert Salzer Constructions Pty Ltd v Elmbee Pty Ltd* (unreported, Sup Ct Vic, Smith J, 29 June 1990) p5. Of course, if the underlying contract expressly provides that the principal is entitled to make a demand for payment in the event of a bona fide dispute arising between the parties (or where the principal's demand for payment is not "fanciful or far fetched": cf *Hughes Bros Pty Ltd v Telede Pty Ltd* (1989) 7 BCL 210 at 217, per Cole J [Sup Ct NSW]), prior to that dispute being determined finally, there will be no serious issue to be tried because the underlying contract expressly permits the principal to make such a demand. In several recent decisions, the Victorian Court of Appeal has interpreted the wording of provisions adverting to the calling-up of unconditional bank guarantees to this effect, even though there was nothing in those contracts which addressed the issue of the principal's entitlement to make a demand prior to the final determination of any bona fide dispute: *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812; *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420; *Anaconda Operations Pty Ltd v Fluor Daniel Pty Ltd* (2000) 16 BCL 230; and see also *Olex Focas Pty Ltd v Skodaexport Co Ltd* (Unreported, Vic Ct App, Brooking, Tadgell and Charles JJA, 17 Sept 1996); *Bains Harding Ltd v State Electricity Com*mission of Victoria (Unreported, Vic Ct App, Brooking, Callaway and Kenny JJA, 12 Aug 1997). In each case, the Court had regard to the fact that the security provided was an autonomous instrument, from which fact it could be inferred that the parties had agreed to allocate the contractual risk between them in accordance with the nature of the security, i.e. the principal could obtain the funds simply by making a demand, without having to establish liability on the part of the contractor. All Australian standard form construction contracts are deficient to the extent that they do not articulate clearly (or at all) the principal's rights to

4.45 The second consideration is that if the principal actually does make an unlawful demand for payment, and it receive payment from the bank; the contractor may be entitled to remedies against the principal, not the least of which is damages. As was seen earlier, damages will ordinarily be considered to be an adequate remedy.

4.46 The third issue to consider is the balance of convenience. As was discussed earlier, the principal utility of an unconditional bank guarantee is that, as a contract autonomous of the underlying construction contract, it may be converted into cash readily and independently of the quality of the contractor's performance under the underlying contract. Unconditional bank guarantees are generally understood, by contractors, principals and banks alike, to possess qualities which make them "as good as cash". Only the most inexperienced of contractors would not understand this feature of unconditional bank guarantees.

4.47 In the commercial world, then, a contractor may, unless the underlying contract provides otherwise, be taken to have accepted that it is a vital feature of the principal holding an unconditional bank guarantee that the principal should be able to convert it into cash readily - including where the principal has a bona fide claim to convert the unconditional bank guarantee for the purpose of remedying the contractor's alleged default under the underlying contract.

4.48 Almost as a matter of custom and usage, the risk allocation between the parties that the law will infer is: where a principal claims bona fide that it is entitled to make a demand for payment pursuant to the relevant underlying construction contract, and where the contractor disputes that claimed entitlement, saying that the making of a demand would constitute a breach of the underlying contract by the principal; the contractor accepts that the principal may not be restrained on the basis of it allegedly having made its demand in breach of a term of the underlying contract, and that the contractor may be out-of-pocket pending final resolution of the dispute between the parties.[124] This does

---

make a demand for payment pursuant to an unconditional bank guarantee supplied pursuant to the contract in circumstances where there is a genuine dispute as to the principal's entitlement to realise the unconditional bank guarantee pending resolution of that dispute (cf *Anaconda Operations Pty Ltd v Fluor Daniel Pty Ltd* (2000) 16 BCL 230 at 234, per Brooking JA). It may be noted further that it is very rare to find an underlying contract pursuant to which it is an express or implied condition precedent to the principal's entitlement to make a demand for payment that the principal obtain an arbitral or curial determination to that effect: cf *Thiess Watkins (Construction) Ltd v Canberra Permanent Co-operative Building Society Ltd* (unreported, Sup Ct ACT, Gallop J, 25 Sept 1986) para 9; Goode, *Guide to the ICC Uniform Rules for Demand Guarantees* (International Chamber of Commerce, Paris, 1992) p6.

[124] See *Deutsche Rückverischerung AG v Walbrook Insurance Co Ltd* [1995] 1 WLR 1017 at 1030-1031, per Phillips J; *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* (unreported, Sup Ct Vic, Byrne J, 2 Oct 1997) pp12-14; *Ultra Refurbishing & Construction Pty Ltd v John Goubran & Associates Pty Ltd* (1997) 13 BCL 330 at

not mean that, however, that the principal may not be enjoined at an interlocutory level on some other ground, e.g. fraud. Nor does it not mean that the principal is off-the-hook if it makes a bona fide demand for payment which turns out to be prohibited by the underlying construction contract. On the contrary, the contractor will be entitled to damages for the wrongful demand. In this sense, there is no conflict produced between the unconditional bank guarantee and the underlying construction contract which requires one to yield to the other.[125] Thus, the balance of convenience will in most cases lie against the granting of an interlocutory injunction.[126]

(vi) Lack of Good Faith / Absence of Reasonableness

4.49 A sixth exception, or perhaps more accurately a *potential* exception, to the autonomy principle exists where the principal seeks to call upon the unconditional bank guarantee in circumstances where the principal's demand is not made *in good faith* vis-à-vis the contractor, or maybe even where it can be said that the principal has not acted *reasonably* vis-à-vis the contractor in calling upon the unconditional bank guarantee.[127] There is, admittedly, not a single case which stands as direct authority for the proposition that a principal may be enjoined if it attempts to make a demand for payment under an unconditional bank guarantee in the absence of good faith, or in the absence of reasonableness on its part. However, if it is accepted, or if it comes to be accepted, by the law that lack of good faith, or even lack of reasonableness, in the exercise of contractual rights[128] is conduct which should be sanctioned by civil remedy, it is

---

335, per Young J [Sup Ct NSW]; *Australian Gasfields Ltd v Kvaerner Process Systesms Pty Ltd* [2001] WASCA at [26], per Templeman J; and see also *Power Curber International Ltd v National Bank of Kuwait SAK* [1981] 3 All ER 607 at 613, per Lord Denning MR; *Malaysia Hotel (Aust) Pty Ltd v Sabemo Pty Ltd* (1995) 11 BCL 50 at 57, per Sheller JA [NSWCA]; cf *FFE Minerals Aust Pty Ltd v Vanadium Pty Ltd* (2000) 16 BCL 305 at 307, per Heenan J [Sup Ct WA].

[125] Cf *Urquhart Lindsay and Company Ltd v Eastern Bank Ltd* [1922] 1 KB 318 at 322-323, per Rowlatt J; *Davis O'Brien Lumber Co Ltd v Bank of Montreal* [1951] 3 DLR 536 at 550, per Bridges J, at 558, per Harrison J [NB Sup Ct]; *The "American Accord"* [1979] 1 Lloyd's Rep 267 at 275, per Mocatta J [QB (Com Ct)].

[126] See also *Howe Richardson Scale Co Ltd v Polimex-Cekop* [1978] 1 Lloyd's Rep 161 at 165, per Roskill LJ.

[127] *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234; *Hughes Brothers Pty Ltd v Trustees of the Roman Catholic Church* (1993) 31 NSWLR 91; *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151; *Olex Focas Pty Ltd v Skodaexpoert Co Ltd* [1998] 3 VR 380 at 404, per Batt J; *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349; *Lumley General Insurance Ltd v Oceanfast Marine Pty Ltd* [2000] NSWSC 1178 at [34], per Austin J; *Burger King Corporation v Hungry Jack's Pty Limited* [2001] NSWCA 187 at [146] – [164]; and see also *Pierce Bell Sales Pty Ltd v Frazer* (1973) 130 CLR 575 at 587; cf *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* (unreported, Sup Ct Vic, Byrne J, 2 Oct 1997) p14.

[128] Including the exercise of contractual rights in respect of third parties, bearing in mind that the contractor is not a party to the unconditional bank guarantee: cf *Contronic Distributors Pty Ltd v Bank of New South Wales* [1984] 3 NSWLR 110 at 116, per Helsham J.

suggested that there should be no impediment to the law creating a further exception to the autonomy principle where a principal purports to exercise its contractual rights under an unconditional bank guarantee in circumstances where it does not do so in good faith and/or reasonably.[129]

5. Further Issues Concerning Remedies Against the Principal

5.1 In this article, particular attention has been directed to the interlocutory injunction as a remedy by which the contractor may have restrained the principal from making (or pressing) an *unlawful* demand for payment under an unconditional bank guarantee. An interlocutory injunction of this nature may be a very useful remedy (albeit a temporary one). So too will a permanent injunction.[130] Those are remedies which may be appropriate in many circumstances. But sometimes they may not be appropriate (or they may not be the best remedies available), and other remedies may then be called upon.

(i) Mareva Orders[131]

5.2 For example, what happens if the principal calls upon an unconditional bank guarantee *unlawfully*, the bank makes payment to the principal, and is otherwise not sufficiently aware of the principal's behaviour so as to be disentitled from enforcing its counter-indemnity, *and* there is a serious risk that the principal will dissipate the proceeds of the unconditional bank guarantee and will otherwise be impecunious? In that situation, the contractor may be able to obtain a Mareva order to restrain the principal from dealing with the proceeds of the unconditional bank guarantee, pending the resolution of the dispute between the parties (i.e. the order operates in a similar way to an interlocutory injunction to restrain a demand for payment[132]).

---

[129] It is beyond the scope of this article to provide any detailed discussion of principles of good faith and reasonableness. But perhaps one small comment can be made: if we can equate an absence of good faith with unconscionability, or something closely analogous to unconscionabilty (see Stapleton, "Good Faith in Private Law" [1999] *Current Legal Problems* 1 at 5-7; *Aiton Australia Pty Ltd v Transfield Pty Ltd* (2000) 16 BCL 70), the "good faith" exception - if indeed it is an exception - can be better characterised as a species of equitable fraud.

[130] The nature of permanent injunctions is not discussed in any detail in this article.

[131] Also known as “asset-preservation orders” or “freezing orders”.

[132] A Mareva order is a remedy which is not granted because a person has infringed some right of the plaintiff (although a Mareva order will not issue unless the claimant is capable of establishing some cause of action against the respondent). It is granted because there is a real threat that, if the defendant's assets are not "frozen", the defendant will put those assets out of reach of the plaintiff if the plaintiff ultimately obtains judgment against the defendant: see *Mercedes Benz AG v Leiduck* [1996] 1 AC 284 at 299-300, 306-307 (PC). It is an order to prevent the abuse or frustration of a court's process in relation to matters coming within its jurisdiction: *Witham v Holloway* (1995) 183 CLR 525 at 535; *Patrick Stevedores Operations No.2 Pty Ltd v Maritime Union of Australia* (1998) 195

5.3 In Australia, contractors have met with little success in attempting to obtain Mareva orders in relation to the proceeds of unconditional bank guarantees.[133] This is not surprising, given the potentially serious consequences to an enjoined party of having some or most of its assets "frozen". It is for this reason that the courts have taken the position that there must be powerful reasons for granting a Mareva order.[134] First of all, the contractor must show, prima facie, that it has a cause of action against the principal in relation to the unconditional bank guarantee, i.e. that there is some prospect of the contractor obtaining final relief against the principal. Secondly, there must be a threat of removal of assets or dissipation of assets, so that if the contractor succeeds in obtaining final judgment against the principal, the contractor will not (in the absence of the Mareva order) be able to have that judgment satisfied.[135] The apprehension that the

---

CLR 1 at 32-33, 44-45 and 61-62; *Polly Peck International plc v Nadir (No.2)* [1992] 4 All ER 769 at 785-786, per Lord Donaldson MR; cf Wyvill, "Law of Fraudulent Conveyances as the Jurisdictional Foundation for Mareva Injunctions" (1999) 73 *Australian Law Journal* 672. Nevertheless, an interlocutory injunction restraining the principal from making a demand for payment can have substantially the same effect as a Mareva injunction requiring the principal to deal with the proceeds of the unconditional bank guarantee in a particular way: see *Themehelp Ltd v West* [1996] QB 84 at 99, per Waite LJ, at 107, per Balcombe LJ; cf Hoyle, *The Mareva Injunction and Related Orders* (LLP, London, 3rd ed 1997) p93; Goode, "Reflections on Letters of Credit - II" [1980] *JBL* 378 at 380.

[133] There are very few examples of where a contractor has been granted a Mareva order (or an order equivalent to a Mareva order) in respect of the proceeds of an unconditional bank guarantee provided pursuant to a construction contract. One example is *Pedna Pty Ltd v Sitep Societa per Azioni* (unreported, Sup Ct NSW, Santow J, 8 Jan 1997). See also *Hortico (Australia) Pty Ltd v Energy Equipment Co (Aust) Pty Ltd* (1985) 1 NSWLR 545 at 556-559, per Young J; *Intraco Ltd v Notis Shipping Corporation (the "Bhoja Trader")* [1981] 2 Lloyd's Rep 256; *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 24; *Consolidated Constructions Pty Ltd v Bellenville Pty Ltd* [2002] FCA 1513. It was seen earlier that a prerequisite to the granting of an injunction is an existing cause of action. That prerequisite exists too where Mareva relief is concerned. Thus, a Mareva order will (or an "anticipatory Mareva order") not, save in very limited circumstances, obtain so as to restrain a principal from dealing with the proceeds of an unconditional bank guarantee where the principal has not even called upon, or threatened to call upon, the unconditional bank guarantee (where, if the principal did so, the principal would have acted unlawfully): see *The "Veracruz I"* [1992] 1 Lloyd's Rep 353 (where the English Court of Appeal doubted *A v B* [1989] 2 Lloyd's Rep 423. In *A v B*, Saville J granted a conditional Mareva injunction which was expressed to take effect upon the relevant cause of action arising *in the future*).

[134] *Frigo v Culhaci* (unreported, NSW Ct App, Mason P, Sheller JA and Sheppard AJA, 17 July 1998) pp9-10.

[135] *Establissement Esefka International Anstalt v Central Bank of Nigeria* [1979] 1 Lloyd's Rep 445 at 448, per Lord Denning MR; *Paterson v BTR Engineering (Aust) Ltd* (1989) 18 NSWLR 319 at 321-322, per Gleeson CJ; *Reches Pty Ltd v Tadiran Pty Ltd* (1998) 85 FCR 514 at 521, per Lehane J. Cf *Walsh v Deloitte & Touche Inc* (Unreported, Privy Council, 17 December 2001) para 10. It might be added that even if the principal has dissipated the proceeds of the unconditional bank guarantee, and the contractor is seeking contractual damages against the principal in respect of the unlawful encashment of the unconditional bank guarantee, the contractor may nevertheless seek to obtain a Mareva order against the principal dissipating the remainder of its assets if it appears that any judgment which the contractor may ultimately obtain will be frustrated due to the principal's impecuniosity. A further point is that a Mareva order does not confer upon the contractor any rights *in rem* in respect of the fund the subject of the order. Hence, the granting of the order does not allow the contractor to be prioritised higher in the ranking of creditors in bankruptcy or liquidation proceedings concerning the principal: *Jackson v Sterling Industries Ltd* (1987) 162 CLR 612 at 618, per Wilson and Dawson JJ; *Mercedes Benz AG v Leiduck* [1996] 1 AC 284 at 300, 306 (PC). But it should also be remembered that a court, exercising equitable jurisdiction, possesses the ability to restrain the disposition of assets (i.e. funds) if the contractor can establish some kind of proprietary claim to those

defendant may remove or dissipate its assets will be heightened - inferentially - where the contractor's cause of action is founded on the principal seeking to cash the unconditional bank guarantee *fraudulently*.[136]

(ii) Return of the Security

5.4 What happens where the contractor has performed its obligations under the underlying contract, and the principal retains the unconditional bank guarantee (without encashing it)? In that situation, the underlying contract will usually require the principal to return the unconditional bank guarantee to the contractor at a particular time, e.g. after a certificate of final completion has issued.[137] But what if the underlying contract makes no provision for the return of the unconditional bank guarantee? If the contractor *has* discharged all of its obligations to the principal, the principal has no justification for retaining the unconditional bank guarantee. The unconditional bank guarantee has fulfilled its purpose. In this situation, the appropriate remedy for the contractor will (almost invariably) be an order for the delivery up by the principal to the contractor of the unconditional bank guarantee.[138] This will usually be the equitable remedy which is the minimum necessary to do justice between the parties.[139] This should be the case even though the contractor is not a party to the performance guarantee - it only procures it.

---

funds: *A v C* [1981] 1 QB 956 at 958-959, per Robert Goff J; *PCW (Underwriting Agencies) Ltd v Dixon* [1983] 2 Lloyd's Rep 197 at 202, per Lloyd J; Devonshire, "Mareva Injunctions and Third Parties: Exposing the Subtext" (1999) 62 *Modern Law Review* 539 at 547-548.

[136] *Paterson v BTR Engineering (Aust) Ltd* (1989) 18 NSWLR 319 at 325, per Gleeson CJ, at 326, per Meagher JA; cf *Balfour Beatty Civil Engineering v Technical & General Guarantee Co Ltd* [1999] CILL 1574 (CA).

[137] In relation to Australian standard form contracts, see, for example, AS 4000 cl. 5.4; AS 2124 - 1992 cll. 5.8, 42.8; NPWC 3 cll. 5.8, 42.7; JCC-D 1994 cl. 11.10.

[138] *Geraldton Building Co Pty Ltd v Christmas Island Resort Pty Ltd* (1996) 12 BCL 64 [Sup Ct WA]; *Coby Constructions Pty Ltd v Melbourne Glass Pty Ltd* (unreported, Sup Ct Vic, Gillard J, 7 April 1998) p14; and see also *Hooker Corporation Ltd v The Darling Harbour Authority* (Unreported, Sup Ct NSW, Rogers J, 30 Oct 1987) p95. There is also the issue as to the *capacity* in which the principal holds the unconditional bank guarantee pending the order for delivery-up. It may be that the principal can be said to hold the unconditional bank guarantee under a resulting trust or a constructive trust, so that the contractor is in a position similar to a party who has perfected his or her equity of redemption: cf Millett, "Restitution and Constructive Trusts" (1998) 114 *LQR* 399 at 400-401. But then again, the capacity in which the principal holds the unconditional bank guarantee may be unimportant. *In the matter of 007 524 432 Pty Ltd (in liq)* (unreported, Sup Ct Vic, Hansen J, 18 Feb 1998), it was held that an unconditional bank guarantee provided by a subcontractor to a head contractor was not held on trust for the principal.

[139] *Bridgewater v Leahy* (1998) 194 CLR 457 at 493-494; *Bathurst City Council v PWD Properties Pty Ltd* (1998) 195 CLR 566 at 585; *Cardile v LED Builders Pty Ltd* (1999) 198 CLR 380 at [70]; *Patrick Jones Photographic Studios Pty Ltd v Catt* (unreported, Sup Ct NSW, Windeyer J, 10 May 1999) para [54]; and see also *Maguire v Makaronis* (1997) 188 CLR 449 at 467; *Plimmer v Mayor, Councillors and Citizens of the City of Wellington* (1884) 9 App Cas 699 at 713-714 (PC).

For as long as the principal retains the unconditional bank guarantee, the principal may, potentially, call upon that unconditional bank guarantee, and thereby expose the contractor to liability on its counter-indemnity to the bank.[140]

5.5 Thus, in *Hooker Corporation Ltd v The Darling Harbour Authority*,[141] Rogers J ordered the delivery up and cancellation of an unconditional bank guarantee in the amount of $25 million in circumstances where the provider of the unconditional bank guarantee had breached the underlying contract, but only nominal loss or damage was suffered by the beneficiary. Perhaps the reason for ordering this remedy in such a case is that it would be fraudulent for the principal to have the benefit of the unconditional bank guarantee (including the ability to call upon the unconditional bank guarantee or to assign it for consideration) in circumstances where there is no liability - or no liability of any significance - on the contractor's part under the underlying contract which could justify the principal retaining the unconditional bank guarantee.[142]

(iii) Surplus Proceeds

5.6 What of the situation where the contractor is in breach of its obligations, and the principal encashes the security? What is to be done with the proceeds of the unconditional bank guarantee?

5.7 Again, this depends upon what the underlying contract provides. It may be that the underlying contract provides that the principal is able to deal with the proceeds of the security in any way that it wishes; with the principal, ultimately, having to account to the contractor for any surplus over and above the amount required to remedy the contractor's default. It may be that the underlying contract provides that the principal is obliged to keep the proceeds of the security separate from its other moneys (possibly in a fiduciary capacity),[143] so that they may be applied in a particular way only.[144] Or it may be that the underlying contract is silent as to what is to be done with the proceeds of the

---

[140] Cf *Hi-Struct Constructions Pty Ltd v ACN 064 828 520 Pty Ltd* (unreported, Sup Ct Vic, McDonald J, 18 June 1996) pp17-18.

[141] Unreported, Sup Ct NSW, Rogers J, 4 Dec 1987.

[142] Cf *Edward Owen Engineering Ltd v Barclays Bank International* [1978] 1 QB 159 at 170, per Lord Denning MR; O'Driscoll, "Performance Bonds, Bankers' Guarantees and the Mareva Injunction" (1985) 7 *Northwestern Journal of International Law and Business* 380 at 396-397. See also *Henderson v Canadian Imperial Bank of Commerce* (1982) 40 BCLR 318.

[143] Cf *Associated Alloys Pty Ltd v ACN 001 452 106 Pty Ltd* (2000) 171 ALR 568 at [34].

[144] *Malaysia Hotel (Aust) Pty Ltd v Sabemo Pty Ltd* (1995) 11 BCL 50 at 58, per Sheller JA [NSWCA].

security.

5.8 What happens if the underlying contract *is* silent on this point? Are the proceeds of the unconditional bank guarantee to be kept separate from the principal's other moneys? Is the principal obliged to apply the proceeds in any particular way?

5.9 An argument could be propounded that if the parties had intended that the proceeds be dealt with in a particular way, and that the principal were to hold the proceeds in a particular capacity, they could have stipulated so. The failure, therefore, to make express provision as to the manner in which the proceeds are to be applied, and the failure to stipulate that the principal is to hold the proceeds in a particular capacity, suggests that the parties did not intend that the principal was to have any fetter placed upon the manner in which it could deal with the proceeds, i.e. the principal was free to treat the proceeds just like any other asset which the principal owned.[145]

5.10 But there is also the argument that, even without such a stipulation, the security is provided for a particular purpose (i.e. to secure the performance of the contractor's obligations), so that the proceeds cannot be used by the principal for any purpose it chooses - they are to be used to remedy the contractor's default.[146] This argument gained considerable impetus in Australia after Gibbs J held in *Wood Hall v The Pipeline Authority* that:[147]

> *"once demand has been made, and the money has been paid, the money must be held as security for the contractor's due and faithful performance of the work".*

5.11 It is suggested, however, that the better view is the former view, namely, that the proceeds of the encashed unconditional bank guarantee, in the absence of a contractual stipulation to the contrary, become a part of the principal's assets, and the principal is free to apply the proceeds of the unconditional bank guarantee as it chooses.[148] It should

---

[145] *Anaconda Operations Pty Ltd v Fluor Daniel Pty Ltd* (2000) 16 BCL 230 at 236-237, per Brooking JA.

[146] *Fletcher Construction Australia Ltd v Savday Pty Ltd* (unreported, Sup Ct NSW, Bryson J, 7 Jan 1999). However, the argument that the contractor (or even the bank) has some kind of a *beneficial, proprietary interest* in the proceeds of the security (in the absence of a contractual stipulation to that effect) would not appear to have been accepted in any of the reported cases: *Deutsche Rückversicherung AG v Walbrook Insurance Co Ltd* [1995] 1 WLR 1017 at 1035-1036, per Phillips J; and see also *Thiess Watkins White Ltd v Equiticorp Australia Ltd* [1990] 1 Qd R 82; *Roxborough v Rothmans of Pall Mall Australia Ltd* (1999) 161 ALR 253 at 265-267, per Emmett J [Fed Ct] (affirmed (1999) 95 FCR 185).

[147] (1979) 141 CLR 443 at 454. There was no provision in the underlying contract as to how the proceeds of the unconditional bank guarantee were to be applied.

[148] See *Anaconda Operations Pty Ltd v Fluor Daniel Pty Ltd* (2000) 16 BCL 230 at 236-237, per Brooking JA.

be a matter for the principal to decide the most appropriate way of dealing with the funds. If the contractor perceives that there is a serious risk that the principal will dissipate the funds, so that the contractor, if successful in obtaining damages against the principal for making a wrongful demand on the unconditional bank guarantee, will recover nothing: it is always open to the contractor to apply for a Mareva order to prevent the principal from dissipating the proceeds.

5.12 A further issue is: what happens to those proceeds of the unconditional bank guarantee which are not, at the end of the day, required to remedy the contractor's default? The basic rule, again, is that the proceeds of the security, including the surplus, are to be dealt with according to the terms prescribed by the underlying contract.[149]

5.13 Most standard form contracts in Australia make provision for the return of surplus after final completion has been reached.[150] But again, what happens to the proceeds if the underlying contract is silent? As one might expect, the principal is not entitled to reap a windfall by retaining the surplus: it must account for moneys received from the security over and above the principal's recoverable loss or damage.[151] Even if the underlying

---

Nevertheless, the court may order, on an interlocutory basis, that the proceeds of an unconditional bank guarantee are to be held in a separate account from the principal's other funds: *Window Installations Pty Ltd v Australco Industries Pty Ltd* (unreported, Sup Ct NSW, Windeyer J, 10 May 1995). See also *R v Morales* (unreported, Qld Ct App, Macrossan CJ, Davies and McPherson JJA, 29 April 1997) which concerned criminal charges for the dishonest application of the proceeds of an unconditional bank guarantee.

[149] *Australasian Conference Association Ltd v Mainline Constructions Pty Ltd (in liq)* (1978) 141 CLR 335 at 349-350, per Gibbs ACJ; *Road Surfaces Group Pty Ltd v Brown* [1987] 2 Qd R 792 at 801, per Williams J; *Malaysia Hotel (Aust) Pty Ltd v Sabemo Pty Ltd* (1995) 11 BCL 50 at 58, per Sheller JA [NSWCA].

[150] e.g. AS 4000 - 1997 cl. 5.4; AS 2124 - 1992 cl. 42.8; NPWC 3 cll. 5.8, 42.7; JCC-D 1994 cl. 11.10. Because most contracts make provision as to what the principal is to do with any surplus money, it may be inferred that the mere fact that the principal has called up more money than was needed to cover its loss or damage does not amount to a breach of the underlying contract by the principal: cf *George Feros Memorial v Hammat Constructions Pty Ltd* (Unreported, Sup Ct NSW, Windeyer J, 17 August 2000) paras 15 to 17. However, if the quantum of the principal's loss or damage is known, and the principal then calls upon the unconditional bank guarantee for an amount in excess of that loss or damage, to the extent that the proceeds of the unconditional bank guarantee exceed the amount of this loss or damage the principal may be in breach of the underlying contract: see *Comco Constructions Pty Ltd v Westminster Properties Pty Ltd* (unreported, Sup Ct WA, Ipp J, 22 March 1990) p13. See also *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 404, per Batt J.

[151] *General Surety & Guarantee Co Ltd v Francis Parker Ltd* (1977) 6 BLR 18 at 21, per Donaldson J; *Aspen Planners Ltd v Commerce Masonry & Forming Ltd* (1979) 100 DLR (3d) 546 at 552, per Henry J [Ont HCJ]; *The "Zeus"* [1993] 2 Lloyd's Rep 497 at 501, per Phillips J; *John Holland Construction & Engineering Pty Ltd v Kooralbyn Valley Pty Ltd* (unreported, Sup Ct Qld, Mackenzie J, 16 April 1993); *Cargill International SA v Bangladesh Sugar and Food Industries Corp* [1998] 1 WLR 461 at 471, per Staughton LJ; *O'Sullivan v National Australia Bank Ltd* (unreported, Sup Ct NSW, Young J, 11 June 1998); *Baulderstone Hornibrook Pty Ltd v Qantas Airways Ltd* (unreported, Fed Ct, Finkelstein J, 19 May 2000) para 14; Treitel, *The Law of Contract* (Sweet & Maxwell, London, 10th ed 1999) p934; cf *Thiess Watkins White Construction Ltd v Commonwealth* (1992) 14 BCL 61. See also *Comdel Commodities Ltd v Siporex Trade SA (No.2)* [1991] 1 AC 148. In *Australasian Conference Association Ltd v Mainline Constructions Pty Ltd (in liq)* (1978) 141 CLR 335, the issue before the High Court was *to whom* the principal must account - i.e. the bank or the contractor. The contractor in that case was in liquidation,

contract does provide expressly that the principal may keep any surplus upon realisation of the security, the underlying contract, to the extent that it operates this way, will be struck down as a penalty, and the principal will be made to account to the contractor for the surplus.[152]

6. The Position of the Bank

6.1 Banks, as prudent and conservative institutions, invariably have little or no desire to become embroiled in disputes between principals and contractors over their respective rights and obligations under the relevant building contract. That is why, in the event of a dispute erupting between principal and contractor in respect of an unconditional bank guarantee, the bank will seek - as it is entitled to do - to largely opt-out of the dispute, and take a fairly mechanical role, in relation to demands for payment which are made of it by the principal.[153]

6.2 The simplest position for the bank to be in is one whereby, if a demand is made in accordance with the unconditional bank guarantee,[154] the bank will pay the principal,

---

so it was important to the bank that the surplus be paid to it and not the contractor lest the surplus be divided amongst other of the contractor's creditors. By majority (Gibbs ACJ, Jacobs and Murphy JJ; Stephen and Aickin JJ dissenting) the High Court held that the surplus was to be repaid to the contractor and not the bank. (See also *Edward Owen Engineering Ltd v Barclays Bank International* [1978] 1 QB 159 at 169-170, per Browne LJ; *Establissement Esefka International Anstalt v Central Bank of Nigeria* [1979] 1 Lloyd's Rep 445 at 447-448, per Lord Denning MR; *Re A & P Constructions Pty Ltd (in liq)* (unreported, Qld Ct App, Davies JA, Derrington and de Jersey JJ, 24 Oct 1997)). However, the position may be otherwise if the unconditional bank guarantee itself provides that any surplus is to be repaid to the bank: see, for example, *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1998) 15 BCL 158 at 160 [Sup Ct NSW]. The accounting relationship between the principal and the contractor is one of debtor and creditor, not trustee and beneficiary: see *American Home Assurance Co v The London Assurance* (unreported, Sup Ct NSW, Bowen CJ in Eq, 6 Sept 1974) pp11-12.

[152] Cf *Cargill International SA v Bangladesh Sugar and Food Industries Corp* [1998] 1 WLR 461 at 467-469, per Potter LJ; *Fraser Gate Apartments Ltd v Western Surety Co* (unreported, Brit Col CA, Southin, Goldie and Finch JJA, 11 June 1998) para 16, per Southin JA; and see also *Egyptian International Foreign Trade Co v Soplex Wholesale Supplies Ltd (the "Raffaella")* [1984] 1 Lloyd's Rep 102 at 115, per Leggatt J; *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170; *Sepoong Engineering Construction Co Ltd v Formula One Management Ltd* [2000] 1 Lloyd's Rep 602. It does not follow, however, that because the principal has a duty to account to the contractor, the contractor may be said to have a proprietary interest in this surplus (entitling the provider of the security to trace that surplus): *Deutsche Rückversicherung AG v Walbrook Insurance Co Ltd* [1995] 1 WLR 1017 at 1035-1036, per Phillips J; and see also *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545 at 559, per Young J. This flows primarily from the fact that the moneys which are paid to the principal by the bank are the bank's moneys and not the contractor's: see *Thompson Land Ltd v Lend Lease Shopping Centre Pty Ltd* (unreported, Sup Ct Vic, McDonald J, 30 March 2000).

[153] See *Tenore Pty Ltd v Roleystone Pty Ltd* (unreported, Sup Ct NSW, Giles J, 14 Sept 1990) p34; Coleman, "Performance Guarantees" [1990] *Lloyd's Maritime and Commercial Law Quarterly* 223 at 230; *Woods v Thiedemann* (1862) 1 H & C 478 at 494-495; 158 ER 973 at 980, per Bramwell B.

[154] Which usually means (i) ensuring that the demand is consistent with the wording of the unconditional bank guarantee; and (ii) establishing the identity of the person making the demand and comparing it against the person named in the unconditional bank guarantee as beneficiary: see Kozolchyk, "The Emerging Law of Standby Letters of Credit and Bank Guarantees" (1982) 24 *Arizona Law Review* 319 at 329.

and then be entitled to recoup the amount paid from the contractor (or an associated entity of the contractor).[155] Conversely, if a demand is not made in accordance with the terms of the unconditional bank guarantee, the bank is under no obligation to pay the principal.[156] Taking this position, the bank does not have to descend to the details of the dispute between the principal and the contractor. It simply has to construe a single document, being the unconditional bank guarantee. It does not have the burden of interpreting a document to which it is not a party, scil. the underlying construction contract.

6.3 In most cases, the nature of the obligation of the bank - to pay or not to pay - will usually come down to whether or not the demand made by the principal complies with the relevant provisions of the unconditional bank guarantee. Ordinarily, the bank is entitled to only have regard to the correctness of the demand for payment in deciding whether or not to pay (in addition to verifying the identify of the person making the demand under the unconditional bank guarantee). If it turns out that the principal's demand for payment was made unlawfully vis-à-vis the contractor, but the demand was on its face lawful, the contractor must usually look to the principal for its remedy and not the bank.[157] That is an essential consequence of the unconditional bank guarantee being an autonomous instrument. The risk of an unlawful demand being made lies with the contractor, not the bank. It is for this reason that interlocutory injunctions against banks to restrain payment will not, without more (i.e. without considering whether an injunction ought to be granted against *the principal*), ordinarily issue.[158]

---

[155] E.g. *Prior v Kuji Pty Ltd* (unreported, Sup Ct Qld, Ambrose J, 22 Nov 1991). If it turns out that the contractor is unable to indemnify the bank, the bank will ordinarily *not* be subrogated to any rights or securities which the principal has against the contractor: *Australasian Conference Association Ltd v Mainline Constructions Pty Ltd (in liq)* (1978) 141 CLR 335; cf Ward and McCormack, "Subrogation and Bankers' Autonomous Undertakings" (2000) 116 *Law Quarterly Review* 121.

[156] *Wood Hall Ltd v The Pipeline Authority* (1979) 141 CLR 443 at 458, per Stephen J.

[157] See Mead, "Documentary Letter of Credit" (1922) 22 *Columbia Law Review* 297 at 309. *Paget's Law of Banking* (Butterworths, London, 11th ed 1996) p651-652 appears to take the view that if, at a final hearing, it is determined that the principal's demand was made fraudulently even though, at an interlocutory level, an injunction enjoining the principal from making a demand on the basis of fraud was refused; the bank, if it makes payment prior to the final hearing, will not be entitled to enforce its counter-indemnity because its mandate was exceeded (i.e. it paid the principal upon a fraudulent demand for payment) (and see also *The Society of Lloyd's v Canadian Imperial Bank of Commerce* [1993] 2 Lloyd's Rep 579 at 581, per Saville J). That view, it is respectfully suggested, is not correct. It is only if the bank is sufficiently cognisant of the fraud *at the time of payment* that it will not be entitled to enforce its counter-indemnity (although, of course, the bank's entitlement to be indemnified may vary depending upon the terms of its counter-indemnity).

[158] There are, however, exceptional circumstances in which an injunction will be granted where there is no cause of action against the bank: *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London Ltd* [1999] 2 Lloyd's Rep 187 at 198, per Rix J. If an interlocutory demand is made against the principal to restrain it from demanding

6.4 Having said this, the autonomous nature of unconditional bank guarantees does not provide a universal shield to the bank against a contractor. The bank, when confronted with a demand for payment by a principal, is not entitled to stick its head in the sand and disregard circumstances which it has knowledge of which go to the lawfulness of the principal's demand.[159]

6.5 If the bank receives a demand for payment by a principal, and the bank nevertheless makes payment to the principal in circumstances where the bank knew, at the time of making payment,[160] that the principal's demand was fraudulent, the bank cannot seek to enforce its counter-indemnity against the contractor.[161] The reason for this is that by making payment to the principal the bank becomes a party to the fraud of the principal.[162] Certainly, the bank is entitled, should it wish to do so, to transfer its own money to the principal; but if the bank transfers to the principal funds in circumstances where the bank knows that the principal has demanded those funds in fraud of the contractor, it would equally be fraudulent for the bank to seek to recoup those transferred funds from the contractor. Fraud is the specific gravamen, in this instance.

6.6 However, what would be the position if the principal were not making the demand for

---

payment, or requiring it to withdraw an existing demand, it may be appropriate for ancillary orders to be made against the bank to restrain it from making payment: see *Tenore Pty Ltd v Roleystone Pty Ltd* (unreported, Sup Ct NSW, Giles J, 14 Sept 1990).

[159] *Inflatable Toy Co Pty Ltd v State Bank of New South Wales* (1994) 34 NSWLR 243 at 252, per Young J. One method by which the bank may reduce its exposure to the allegation by the contractor of a wrongful payment is if both the unconditional bank guarantee and the contract of counter-indemnity from the contractor provide that the bank may pay the principal the amount of the unconditional bank guarantee (to the extent that it has not already been paid) regardless of whether the principal has demanded payment or not: see, for example, *HW Bevan & Co Pty Ltd v National & Commercial Banking Australia* (unreported, Sup Ct NSW, Hodgson J, 26 April 1985) pp2-4.

[160] *Rosen v Pullen* (1981) 126 DLR (3d) 62 at 69, per Craig J [Ont HCJ]; cf *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 Lloyd's Rep 251 at 256, per Sir John Donaldson MR; *Attock Cement Co Ltd v Romanian Bank for Foreign Trade* [1989] 1 WLR 1147 at 1160, per Staughton LJ.

[161] *Esal (Commodities) Ltd v Oriental Credit Ltd* [1985] 2 Lloyd's Rep 546 at 549, per Ackner LJ; *Bank of Credit & Commerce Canada v Alta Telecom International Ltd* (1988) 63 Alta LR (2d) 97 at 98; *Commonwealth Bank v White (No.2)* (unreported, Sup Ct Vic, Byrne J, 22 Oct 1999). An alternative way of putting it may be to say that the contractor *is* obliged to make payment under the counter-indemnity, but the contractor is entitled to make a countervailing cross-demand against the bank for the amount sought by the bank. The onus of proving fraud lies with the contractor: *Austal Ships Pty Ltd v National Australia Bank Ltd* (unreported, Sup Ct WA, Templeman J, 13 Feb 1997) p12. It seems doubtful that a provision in an unconditional bank guarantee that the bank is obliged to pay, even if it knows of fraud, would be enforceable: cf *Canadian Pioneer Petroleums Inc v Federal Deposit Insurance* (1984) 30 Sask R 315 at 319, per Halvorson J.

[162] *United City Merchants (Investments) Ltd v Glass Fibres and Equipments Ltd* [1983] AC 168 at 183, Lord Diplock. Perhaps one can say that it is an implied term of the contract of counter-indemnity that the bank will not pay in circumstances where clear proof of fraud is put before it before any payment has been made: *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London Ltd* [1999] 2 Lloyd's Rep 187 at 202, per Rix J.

payment fraudulently, but nevertheless the principal were making a demand in circumstances where, to the knowledge of the bank, it was unconscionable of the principal (vis-à-vis the contractor) to do so? Here, we might say that the bank is not entitled to enforce its counter-indemnity against the contractor because, as a knowing participant in the principal's unconscionable demand, it would be unconscionable of the bank to enforce that counter-indemnity. Similarly, where the principal *to the knowledge of the bank* makes its demand in breach of the underlying contract to make that demand, the bank is disentitled from enforcing its counter-indemnity because it has knowingly participated in the principal's breach of contract. This is the case notwithstanding that the bank is a stranger to the contract between the principal and the contractor.[163]

6.7 The principle which emerges from this is that the bank is not entitled to enforce its counter-indemnity in circumstances where it knows that the principal was not entitled to make a demand for payment (i.e. where the bank knows that an exception to the "autonomy principle" exists).[164]

6.8 The question which this provokes is: when is the bank to be taken to have had sufficient

---

[163] In *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420 at 429, Brooking JA said that a prohibition in the underlying contract against the principal converting the standby letter of credit save in certain circumstances where the contractor is in breach *"is efficacious, not in the sense, when the security is constituted by the obligation of a third person, that the third person can rely by way of defence as against the security holder on a term of the underlying contract, to which he was not a party, but in the sense that relief can be afforded to the person who procured the security in an action brought against the security holder on the promise contained in the underlying contract"*. It is suggested that his Honour's statement is too broad, in that a bank with sufficient knowledge of the fact that the principal's demand is made in breach of a prohibition in the underlying contract is entitled to – and moreover is positively obliged to - rely upon the breach of the prohibition in the underlying contract as a basis for refusing payment. The threshold issue, however, is the knowledge of the bank.

[164] If the relevant counter-indemnity is drafted such that the mere fact that the bank has paid the principal triggers the liability of the contractor to the bank under the counter-indemnity, the contractor may potentially meet any demand made by the bank with a defensive cross-claim for the same amount. The contractor's cross-demand may be predicated upon (i) the bank having acted negligently in making payment (*United Trading Corporation SA v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554 at 560, per Ackner LJ; cf *Deutsche Ruckversicherung AG v Wallbrook Insurance Co Ltd* [1996] 1 All ER 791 at 799, per Staughton LJ; Goode, "Reflections on Letters of Credit - III" [1980] *JBL* 443 at 444); (ii) possibly (although it will be very difficult to establish in most cases) even in the tort of intentional interference with contractual relations (*Northern Territory v Mengel* (1995) 185 CLR 307 at 341-343; *Allstate Life Insurance Co v Australia & New Zealand Banking Group Ltd* (1995) 58 FCR 26; *Australian Development Corporation Pty Ltd v White Constructions (ACT) Pty Ltd* (1996) 12 BCL 317 at 361, per Giles CJ Comm D (affirmed [2001] NSWCA 9); *John Holland Construction & Engineering Pty Ltd v Majorca Projects Pty Ltd* (1996) 13 BCL 235 at 260, per Byrne J [Sup Ct Vic]; *Forestview Nominees Pty Ltd v Perpetual Trustees WA Ltd* (1998) 193 CLR 154 at 165; Fleming, *The Law of Torts* (Law Book Co, Sydney, 9th ed 1998) pp757-758); or (iii) in the case of the principal making a demand which is unconscionable for the purposes of section 51AA of the *Trade Practices Act* (Cth), being knowingly concerned in a breach of section 51AA (see s75B of the *Trade Practices Act*, and *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 405, per Batt J). It almost goes without saying that the bank's liability under each of these heads of cross-claim is fault-based, i.e. not based on strict liability.

knowledge of the unlawfulness of the principal's demand so as to be disentitled from seeking to enforce its counter-indemnity?[165] In the cases which have come before the courts, the inquiry as to when a bank is to be taken to have sufficient knowledge of the unlawfulness of the principal's demand has been undertaken principally in the context of where a fraudulent demand has been made. The position which has emerged - certainly in England - is this: the bank will not be entitled to pay the contractor where, at the time of payment, the bank is "clearly aware of the fraud" or where it is seriously arguable that fraud is the only realistic inference.[166]

6.9 It is suggested that similar criteria should apply where the gravamen is not fraud, but unconscionability, illegality, or breach of the underlying contract.[167] The threshold of "knowledge" should be very high, lest banks be brought by the law from a position of almost neutrality in disputes concerning principal and contractor, to a party dragged into the arena of construction disputes. It is suggested, therefore, that the position of the law should be this: the bank is not entitled vis-à-vis the contractor (i.e. its customer) to pay the principal, and to enforce its counter-indemnity against the contractor, in circumstances where the bank is, at the time of payment, in possession of information which demonstrates clearly that the demand for payment made by the principal was unlawful *and* it can be said that the bank is, or that it ought to be, cognisant of this information and its meaning.[168]

---

[165] Some assistance in this inquiry can be gained, perhaps, from the recent case law and commentary concerning the issue of when a person is liable in equity for "knowing" participation in a breach of fiduciary duty (or, as it is traditionally formulated, engaging in a breach of the first limb ("knowing receipt") or the second limb ("knowing assistance") of *Barnes v Addy* (1874) 9 LR Ch App 244). The position which has emerged, at least apparently in England, is that the liability of an accessory to a breach of fiduciary duty is not to be ascertained according to what the putative accessory "knows", but whether his or her conduct may be characterised, in an objective sense, as "dishonest": *Royal Brunei Airlines v Tan* [1995] 2 AC 378; cf *Gertsch v Atsas* (unreported, Sup Ct NSW, Austin J, 1 Oct 1999). See also *Giumelli v Giumelli* (1999) 73 ALJR 547 at 548-549, per Gleeson CJ, McHugh, Gummow and Callinan JJ.

[166] *GKN Contractors Ltd v Lloyds Bank plc* (1985) 30 BLR 53 at 63-64, per Parker LJ, *Balfour Beatty Civil Engineering v Technical & General Guarantee Co Ltd* [1999] CILL 1574 (CA); and see also *Gian Singh & Co Ltd v Banque de L'Indochine* [1974] 2 All ER 754 at 757-758 (PC). Constructive knowledge of fraud will not suffice, but wilful blindness to fraud will: *Standard Bank London Ltd v The Bank of Toyko Ltd* [1995] 2 Lloyd's Rep 169 at 175, per Waller J; cf *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378.

[167] Although, in England at least, it would appear that a bank is only disentitled from paying a beneficiary in circumstances of fraud. The position in Australia is broader.

[168] Two further points: first, the fact that the contractor may not be in possession of the information which the bank has in its possession (indicating the unlawfulness of the demand) does not afford a defence to the bank in the event that it makes payment. Secondly, if the bank *does* make payment to the principal in circumstances where the bank ought not to have made payment, and as a consequence the bank is unable to enforce its counter-indemnity against the contractor, the bank may be able to recover the money paid to the principal, for example as damages for deceit: *KBC Bank v Industrial Steels (UK) Ltd* [2001] 1 Lloyd's Rep 370; *Standard Chartered Bank v Pakistan National*

6.10 Given the seriousness of the potentiality of a bank being unable to enforce counter-indemnity against its customer, as a matter of prudence one would expect a bank, prior to making payment, to conduct a review of the information which it has in its possession and ask the question: based on the information which we have, is the demand which is being made of us lawful or unlawful? It is a question the answer to which may require some thought on the bank's part. However, the bank is also in the unenviable position of being obliged, subject to the express terms of the unconditional bank guarantee, to make payment to the principal within a reasonable time of a (lawful) demand for payment being made.[169] The bank cannot labour on the issue, or seek a court's declaration as to the propriety of the principal's demand.[170] Failure to make timeous payment will thus expose the bank to proceedings by the principal against the bank in debt or for breach of the unconditional bank guarantee.[171]

6.11 The common law, however, is sensible of the potentially difficult positions that banks may find themselves in when dealing with demands for payment on unconditional bank guarantees. It is also sensible of the fact that the utility of unconditional bank guarantees – for banks and beneficiaries alike – lies in their relatively liquid nature, i.e. encashment is intended to be a relatively straightforward procedure. For these reasons, the common law allows banks to adopt the position that if a demand is made in accordance with the terms of the relevant unconditional bank guarantee, and if the bank does not have compelling information which shows that the demand was made unlawfully, the bank is entitled to (and indeed obliged to) make payment.[172]

Shipping Corporation [2002] UKHL 43.

[169] Cf *Davy Offshore Ltd v Emerald Field Contracting Ltd* [1992] 2 Lloyd's Rep 142 at 151, per Staughton LJ.

[170] See *Bankers Trust Co v State of India* [1991] 2 Lloyd's Rep 443; and see also *Seaconsar Far East Ltd v Bank Markazi Jomhouri Ismali Iran* [1999] 1 Lloyd's Rep 36; Bennett, "Stern Doctrine and Commercial Common Sense in the Law of Documentary Credits" [1999] *Lloyd's Maritime and Commercial Law Quarterly* 507; UCP 500 art 13(b); Buckley, "Potential Pitfalls With Letters of Credit" (1996) 70 *ALJ* 217 at 223-224.

[171] The claim will usually include a component for interest: see, for example, *Ozalid Group (Export) Ltd v African Continental Bank Ltd* [1979] 2 Lloyd's Rep 221. A further issue is that late payment, or non-payment, by a bank where a proper demand for payment has been made may have the effect of damaging the bank's reputation: see Pierce, *Demand Guarantees in International Trade* (Sweet & Maxwell, London, 1993) pp186-187. Professor Goode has suggested that where a bank is concerned as to the lawfulness of the demand for payment which has been made, it should, as a matter of prudence, notify its customer (scil. the contractor) of the bank's concerns and allow the customer a short time to apply for an injunction to restrain payment: "Abstract Payment Undertakings" in Cane and Stapleton (eds), *Essays for Patrick Atiyah* (Clarendon Press, Oxford, 1991) p234. See also *Esal (Commodities) Ltd v Oriental Credit Ltd* [1985] 2 Lloyd's Rep 546.

[172] If a bank refuses to make payment to a principal, on the basis that the principal's demand is not lawful, the bank must be prepared to prove that the demand is unlawful: see *Paget's Law of Banking* (Butterworths, London, 11th ed 1996) p649; *The Society of Lloyd's v Canadian Imperial Bank of Commerce* [1993] 2 Lloyd's Rep 579 at 581, per Saville J; *Balfour Beatty Civil Engineering v Technical & General Guarantee Co Ltd* [1999] CILL 1574 (CA).

Furthermore, banks are not required to actively seek out information from the principal or the contractor as to the propriety of the principal's demand: to impose such an obligation on the bank would make the task of processing demands for payment enormously difficult.[173] The bank, in assessing a principal's demand, is simply entitled to look at the information which it has.[174]

6.12 Rather than wait for the bank to make payment to the principal and then commence proceedings against the bank, the contractor may, if it has sufficient opportunity to do so, seek to restrain the bank from making payment to the principal if the principal has made a demand for payment.[175] If, however, the contractor does seek an interlocutory

---

However, even if a bank refuses to make a payment for a particular reason, but that reason is erroneous, it may, nevertheless, in any subsequent proceedings rely upon another valid reason as justifying the refusal to make payment payment: *Westpac Banking Corporation v South Carolina National Bank* (1986) 64 ALR 30 at 34 (PC); Goode, "Reflections on Letters of Credit - I" [1980] *JBL* 291 at 293-294; cf *Bayerische Vereinsbank Aktiengesellschaft v National Bank of Pakistan* [1997] 1 Lloyd's 59; UCP 500 art. 14(d)(i).

[173] *Howe Richardson Scale Co Ltd v Polimex-Cekop* [1978] 1 Lloyd's Rep 161 at 165, per Roskill LJ**; *Montrod Ltd v Grundkotter Fleischvertriebs GmbH* [2001] EWCA 1954 at [58], per Potter LJ**. It was, however, held in two English cases that where an allegation of fraud is made by the person who supplied the unconditional bank guarantee, the beneficiary should normally be given the opportunity to answer the allegation: *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 Lloyd's Rep 251 at 257; *United Trading Corporation SA v Allied Arab Bank Ltd* [1985] 2 Lloyd's Rep 554n at 461. It is suggested, however, that rather than the bank being under an *obligation* to provide the beneficiary with a right of reply, the bank may *choose* to seek a response from the beneficiary - if time permits - and, in the circumstances, if a response would be in order.

[174] *M Golodetz & Co Inc v Czarnikow-Rionda Inc* [1980] 1 WLR 495 at 510-511, per Donaldson J; *Banque de L'Indochine et de Suez SA v JH Rayner (Mincing Lane) Ltd* [1983] 1 QB 711 at 730, per Sir John Donaldson MR; Penn, "Performance Bonds: Are Bankers Free From the Underlying Contract" [1985] *Lloyd's Maritime and Commercial Law Quarterly* 132 at 134-135; and see also *Wood Hall v The Pipeline Authority* (1979) 141 CLR 443 at 451, per Gibbs J; cf Sir Anthony Mason, "The Impact of Equitable Doctrine on the Law of Contract" (1998) 27 *Anglo-American Law Review* 1 at 11-13. In *Westpac Banking Corporation v South Carolina National Bank* (1986) 64 ALR 30 at 36, Lord Goff of Chieveley, for the Privy Council, said: *"it is well settled that a bank which issues a letter of credit is concerned with the form of the documents presented to it and not the underlying facts. It forms no part of the bank's function, when considering whether to pay against the documents presented to it, to speculate about the underlying facts"*.

[175] Another point for the contractor to consider is that even if payment has been made to the principal pursuant to an unlawful demand, the contractor may seek a mandatory injunction against the principal requiring it to repay the bank the amount received and to reinstate the unconditional bank guarantee (i.e. provide a new guarantee) pending resolution of the dispute between the contractor and the principal, and perhaps additionally to require that the principal give a certain period of notice before it makes demand for payment in respect of that substitute unconditional bank guarantee: *Sabemo Pty Ltd v Malaysia (Hotel) Aust Pty Ltd* (unreported, Sup Ct NSW, Hodgson J, 5 July 1990); *CS Phillips Pty Ltd v Baulderstone Hornibrook Pty Ltd* (unreported, Sup Ct NSW, Giles J, 26 Oct 1994); cf *Malaysia Hotel (Aust) Pty Ltd v Sabemo Pty Ltd* (1995) 11 BCL 50 at 52, per Mahoney JA; *Minson Constructions Pty Ltd v Aquatec-Maxon Pty Ltd* (unreported, Sup Ct Vic, Beach J, 5 Feb 1999) para [14]. In Australia, it appears (although the issue is not free from doubt) that the same principles govern the granting of a mandatory interlocutory injunction as the granting of a prohibitory interlocutory injunction: *Films Rover International Ltd v Cannon Film Sales Ltd* [1986] 3 All ER 772 at 780-781, per Hoffmann J; *Businessworld Computers Pty Ltd v Australian Telecommunications Commission* (1988) 82 ALR 499 at 502-504, per Gummow J [Fed Ct]; *Australian Rubgy Union Ltd v Hospitality Group Ltd* (unreported, Fed Ct, Sackville J, 19 August 1999) paras [30] - [31]; cf *Hi-Struct Constructions Pty Ltd v ACN 064 828 520 Pty Ltd* (unreported, Sup Ct Vic, McDonald J, 18 June 1996).

injunction, the contractor must demonstrate that it has a cause of action against the bank. This is because a major purpose of injunctions in civil law is to preserve or vindicate rights which one person has against another.

6.13 What rights does the contractor have against a bank which pays a principal on an unlawful demand? If the payment by the bank to the principal triggers the liability of the contractor to pay the bank under the counter-indemnity, the triggering of that liability will also (by virtue of the bank's unlawful participation in the principal's unlawful demand) give rise to a cause of action in the contractor against the bank for the amount of the contractor's liability under the counter-indemnity.

6.14 Thus, if the principal makes a demand, the contractor may bring urgent proceedings seeking a declaration that the principal's demand was unlawful, a mandatory injunction requiring the principal to withdraw the demand, *and* it may seek a *quia timet* injunction against the bank to restrain it from making payment. By the time the matter reaches the hearing stage, if the bank was not already sufficiently aware of the unlawfulness of the principal's demand, it will be at that point (after the contractor has adduced evidence of that unlawfulness).[176] This is the basis upon which the contractor may seek injunctive relief against the bank, notwithstanding that the contractor is seeking to restrain the bank from performing its obligations under a contract between the bank and the principal[177] (i.e. a contract to which the contractor is not privy, notwithstanding that the contractor has an interest in the circumstances of its performance[178]).

---

[176] *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 397, per Batt J. However, if proceedings are commenced against a bank, and at the time the proceedings were commenced the bank did not possess sufficient knowledge of the unlawfulness of the principal's demand so as to disentitle the bank from meeting the demand, and if the bank, after becoming apprised of the unlawfulness of the principal's demand, refuses to pay the principal: the bank will obviously have acted quite properly, and it is suggested that the bank ought not to bear the legal costs of it being involved in the interlocutory proceedings.

[177] Cf *Bachmann Pty Ltd v BHP Power New Zealand Ltd* [1999] 1 VR 420 at 429-430, per Brooking JA; *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1998) 15 BCL 158 at 166, per Austin J [Sup Ct NSW]; *Reed Constructions Pty Ltd (Scheme Manager Appointed) v Redelman* (unreported, Sup Ct NSW, Giles CJ Comm D, 1 Sept 1995) pp9-10. See also Phillips, "Unconditional Performance Bonds - Or Are They?" (1991) 9 *Building and Construction Law* 81 at 84.

[178] *Howe Richardson Scale Co Ltd v Polimex-Cekop* [1978] 1 Lloyd's Rep 161 at 165, per Roskill LJ. Another avenue by which the contractor may potentially proceed is to seek to enjoin the principal from making pursuing a demand for payment, or appropriating the proceeds of an unconditional bank guarantee (if payment has already been made), on the basis that the principal has engaged in misleading or deceptive conduct by representing to the bank that the contractor is in default pursuant to the underlying contract: *Trade Practices Act* 1974 (Cth) ss52, 80. But it may be that the unconditional bank guarantee does not require the principal, in making a demand for payment, to represent to the bank that the contractor is in default, in which case it will be rather difficult for the contractor to assert that the principal has engaged in misleading or deceptive conduct.

6.15 A further point to be considered is that if the contractor is able, prior to the principal making a demand for payment, to obtain an injunction against the principal prohibiting it from a making demand: that will either have the actual effect of preventing a demand being made; or, if the principal, despite the injunction, goes ahead and makes a demand, it will render it most unlikely that the bank would make payment if the bank was aware of the injunction. For the bank to make payment, with knowledge of the injunction, would put the bank into contempt of court, together with the principal.[179]

7. Conclusion

7.1 The comment was made, at the commencement of this article, that unconditional bank guarantees are used less frequently in English building and engineering projects than they are in Australia. The perception in England seems to be that unconditional bank guarantees are open to abuse by principals. That is a perception which is held by many contractors.

7.2 There is also a different perception of unconditional bank guarantees. It is the perception of principals, and other participants in building and engineering projects who regularly require security, that unconditional bank guarantees are of limited value, because (it seems) every time the holder of an unconditional bank guarantee seeks to make a demand for payment, the principal is dragged along to court by the party who procured the security, and it then has a fight on its hands as to whether interlocutory relief should be granted. The view is taken: it is all very well for the security to be expressed to be unconditional, and that, in theory, I should be entitled to access readily a source of funds from a reliable paymaster. But the reality is that every time I try to make a demand on an unconditional bank guarantee, I get embroiled in litigation and it takes me some time to get the proceeds of the unconditional bank guarantee in my pocket.

7.3 In Australia, those perceptions have perhaps not ossified. Yet a considerable volume of case law has emerged – particularly over the last ten years or so – in which contractors have sought interlocutory injunctions against principals who have made demands, or attempted to make demands, on unconditional bank guarantees.

---

[179] See *Seaward v Paterson* [1897] 1 Ch 545 at 554, per Lindley LJ; *Attorney-General v Times Newspapers Ltd* [1992] 1 AC 191; *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 Lloyd's Rep 345 at 361, per Staughton LJ; *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 405, per Batt J; *Broadmoor Special Health Authority v Robinson* [1999] QB 957 at 964-965, per Poole J; *Cardile v LED Builders Pty Ltd* (1999) 198 CLR 380 at [30]; ***A-G (UK) v Punch Ltd* [2002] UKHL 50;** cf *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 Lloyd's Rep 251 at 257, per Sir John Donaldson MR.

7.4 It is suggested that much of the interlocutory litigation concerning the lawfulness of a principal's demand could be headed-off if underlying construction contracts were to specify clearly:

- When the principal is entitled to make a demand upon the unconditional bank guarantee; and
- What the consequences are of the principal making a demand.

7.5 There are many construction contracts which fail to do this. The result is that the parties do not always know where they stand when in relation to the encashing of the relevant unconditional bank guarantee which the contractor has procured. It is this, perhaps, which is a cause of so much of the litigation which both Australia and England have seen in relation to unconditional bank guarantees.

7.6 If unconditional bank guarantees are indeed to be a ready source of cash for a principal to access where it has a claim, *bona fide*, that the contractor is in default; it is suggested that underlying construction contracts could bring greater certainty as to the parties' respective rights and obligations – particularly in the context of where there has been no final determination of the lawfulness of the principal's claims – if they were to state to the effect of the following (as a minimum):

- If the principal makes a demand on the unconditional bank guarantee in respect of a default of the contractor, the principal shall be entitled to retain and utilise as it sees fit the proceeds of the unconditional bank guarantee, and the proceeds shall be a part of the principal's assets.
- If the contractor disputes the principal's entitlement to make a demand on the unconditional bank guarantee, and the contractor can establish at a final hearing that it was not in default, the contractor shall be entitled to recover the loss or damage which it has suffered as a result of the principal making a demand on the unconditional bank guarantee.
- The contractor will not seek to restrain the principal from making a demand on the unconditional bank guarantee, or if a demand has been made from utilising the proceeds of the unconditional bank guarantee, prior to the final determination of the contractor's claim that it was not in default.[180] The

[180] It is acknowledged that there could be an argument that such an agreement is void on the basis that it contrives to oust the jurisdiction of the courts. However, there are many agreements which do oust the jurisdiction of the courts

exception to this is where the contractor is able to establish that it is seriously arguable that the only realistic inference is that the principal's demand is fraudulent.

7.7 If underlying contracts were drafted to this effect, it ought to be clear to all parties that the bank guarantee is, in truth, a liquid security which the principal is entitled to realise "on demand". Of course, all of this might well be unpalatable to a contractor. If that is so, alternative forms of security may be more appropriate (e.g. money retentions held in a trust account).[181]

7.8 Since they gained currency in the 1970's, unconditional bank guarantees have been used quite successfully as a means of security in many construction projects. Whether they will continue to be used widely or in more limited circumstances depends, in part, on the approach which the courts take to applications to restrain their encashment. Certainly, the very fact that applications are made regularly to restrain principals from realising their security is a source of discouragement to the use of unconditional bank guarantees. But it remains to be seen whether unconditional bank guarantees are heading down the path of commercial extinction.

For further information, please contact Julian Bailey at julian.bailey@cmck.com or on +44 (0)20 7367 2057.

This article was first published in International Construction Law Review in April 2003.

(most notably, arbitration agreements and expert determination agreements), but which are nevertheless enforced on the basis that "a contract is a contract", and the parties should abide by it: *Badgin Nominees Pty Ltd v Oneida Ltd* (Unreported, Sup Ct Vic, Gillard J, 18 December 1998). See also *Amoco (UK) Exploration Co v Amerada Hess Ltd* [1994] 1 Lloyd's Rep 330.

[181] Or perhaps the problem can be overcome by the provision of a counter-guarantee by the principal in favour of the contractor: Marston, "Pre-Arbitral ADR Techniques and Conditional Letter of Credit Performance Guarantees" [2002] *International Construction LR* 526.