

In its recent decision in *CPB Contractors Pty Ltd v JKC Australia LNG Pty Ltd [No 2]* [2017] WASCA 123, the Western Australian Court of Appeal unanimously dismissed CPB's appeal from the decision of the Supreme Court which refused to injunct JKC Australia LNG Pty Ltd from calling on performance bonds issued under the security provisions of the parties' Subcontract. In doing so, the Court of Appeal confirmed that whilst the unconditional nature of performance bonds are a factor to be taken into account, the bonds' terms do not "control the question of construction of the Subcontract".¹

Key Findings

- The Court of Appeal noted the way in which the WA Supreme Court followed the *Clough Engineering*² and *Sugar Australia*³ cases' approach without objection from CPB.
- Upon the proper construction of the Subcontract, JKC has a right of recourse to the performance bonds where, in the circumstances, it had an honest, bona fide claim to immediate payment under the Subcontract.
- The purpose of the performance bonds, and the provisions of the Subcontract relating to them, would be defeated if JKC was restrained from calling on the performance bonds until the dispute concerning extensions of time and liquidated damages had been resolved by arbitration.

Background

The appellant, CPB Contractors Pty Ltd (CPB), are contractors employed to perform engineering procurement, construction and commissioning works relating to the on-shore buildings associated with the Ichthys LNG Project pursuant to a subcontract (the "Subcontract") entered into with the head contractor and respondent in this case, JKC Australia LNG Pty Ltd (JKC).

Under the terms of the Subcontract, CPB were required to procure unconditional performance bonds⁴ totalling AU\$26.1 million, being 10% of the Subcontract price, in favour of JKC. Despite rejecting the majority of the extensions of times claims (EOT claims) made by CPB between April 2015 and February 2017, JKC asserted that the completion dates incorporating those EOT claims that were granted had not been achieved and that CPB was liable to pay liquidated damages in the contractual maximum amount of AU\$39.225 million.

JKC demanded payment of this sum and, based on this entitlement, gave notice that it intended to have recourse to the performance bonds.

On 10 March 2017, CPB wrote to JKC, giving notice, pursuant to the Subcontract's dispute resolution provision GC 57(a), and asserting that JKC had no present entitlement to liquidated damages. That letter also demanded that JKC either withdraw its demand for payment of liquidated damages or provide an undertaking that it would not pursue payment of liquidated damages by way of relief by making demand for payment under the bonds.

JKC responded, stating that it would not withdraw its demand nor provide any undertakings, leading to CPB commencing proceedings claiming an injunction. Accordingly, CPB sought to restrain JKC from demanding or receiving any payment pursuant to the performance bonds until after the determination of the validity and extent of the EOT claims made by CPB or, alternatively, to require JKC to strictly comply with the dispute resolution process in respect of the Bond Dispute Notice in GC 57, thus preventing it from taking certain steps, including calling upon the performance bonds.

Justice Le Miere's subsequent decision of 20 April 2017 in *CPB Contractors Pty Ltd v JKC Australia LNG Pty Ltd* [2017] WASCA 112 was significant as it re-confirmed the conventional position in Australia that an unconditional performance bond provided to secure performance of a contract operates autonomously – that is, a principal may make a call upon it unless: (1) the recourse is fraudulent; (2) the recourse is unconscionable; or (3) the recourse would breach an express or implied restriction in the contract.⁵

Decision of the WA Supreme Court

The dispute heard by the Supreme Court of Western Australia in *CPB Contractors Pty Ltd v JKC Australia LNG Pty Ltd*⁶ concerned the proper construction of GC 35.3 of the Subcontract, which provides:

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

¹ *CPB Contractors Pty Ltd v JKC Australia LNG Pty Ltd [No 2]* [2017] WASCA 123.

² *Clough Engineering Ltd v Oil & Natural Gas Corp Ltd* (2008) 249 ALR 458.

³ *Sugar Australia Pty Ltd v Lend Lease Services Pty Ltd* [2015] VSCA 98.

⁴ The Court of Appeal noted, citing *Simic v New South Wales Land and Housing Corporation* [2016] HCA 47; (2016) 91 ALJR 108 [2], that performance bonds are sometimes misleadingly referred to as bank guarantees (as was the case in the Subcontract between JKC and CPB).

⁵ *Clough Engineering Ltd v Oil & Natural Gas Corp Ltd* (2008) 249 ALR 458.

⁶ [2017] WASCA 112.

In contemplation of the proper construction of this clause, Justice Le Miere found that the requirements for a grant of injunction were not satisfied; CPB had not made out a prima facie case that JKC was not entitled to call on the performance bonds, and the balance of convenience did not favour the grant of an injunction. His Honour concluded that the text and structure of GC 35, in the context of the Subcontract as a whole, revealed that the purpose of the provisions relating to performance bonds was not only to protect JKC from the insolvency of CPB but to also ensure that the JKC would have the funds during the dispute between parties. In fact, the purpose of the performance bonds, and the provisions of the Subcontract relating to them, would be defeated if JKC was restrained from calling on the performance bonds until the dispute concerning extensions of time and liquidated damages had been resolved by arbitration. To this end, the performance bond provision also serve as an important tool in allocating risk where a dispute is on foot.

This decision re-confirmed the conventional position and dismissed CPB's application for an interlocutory injunction aimed at restraining JKC from demanding payment by the bank under the performance bonds.

Subsequently, the main ground of CPB's appeal of this decision was that the primary judge had misconstrued the provision in entitling JKC to have recourse to the performance bonds.

Decision of the WA Court of Appeal

The Court of Appeal unanimously dismissed CPB's appeal, addressing each of the appeal grounds submitted, as outlined below.

Ground 1: The Effect of the Bond Dispute Notice

As a notice of a dispute relating to the performance bonds had already been issued on 10 March 2017, prior to the commencement of proceedings in the Supreme Court, CPB contended that the primary judge had erred in failing to grant an injunction to restrain JKC from calling upon the performance bonds whilst this dispute was subject to the dispute resolution process under GC 57 of the Subcontract. CPB submitted that, because JKC's threat to call upon the performance bonds had activated GC 57, JKC was bound under the terms of the Subcontract to do all things necessary to enable CPB to have the benefit of the Subcontract's dispute resolution process. However, the Court of Appeal held that the implied duty to cooperate does not sustain these contentions and does not rise above the promises of performance made by the parties to a contract.⁷ Further, a duty to cooperate cannot be imposed on a party so as to compel that party to bring about a circumstance or result that the contract does not require,⁸ nor can it be extended so as to substantially impair JKC's express contractual right under GC 35.3(a).

7 *Alcatel Australia Ltd v Scarcella* [1998] NSWSC 483; (1998) 44 NSWLR 349, 368; *Servcorp WA Pty Ltd v Perron Investments Pty Ltd* [2016] WASCA 7; (2016) 50 WAR 226 [82].

8 *Australis Media Holdings Pty Ltd v Telstra Corporation Ltd* (1998) 43 NSWLR 104, 124- 125; *Servcorp WA Pty Ltd v Perron Investments Pty Ltd* [2016] WASCA 7; (2016) 50 WAR 226 [82].

In addressing the second aspect of CPB's submissions, the Court of Appeal adopted Le Miere's primary reasons at [61] and held that, on a proper construction of the Subcontract, the fact that a party had invoked the contractual dispute resolution procedure does not mean that the status quo must be preserved pending resolution of the dispute. Therefore, no part of the Subcontract, or any implied duty, restrains JKC from exercising any right under the Subcontract merely because CPB gave notice of a dispute in which it asserted that JKC was not entitled to exercise the right.

Ground 2: Construction of GC 35.3

In its submissions, CPB asserted that the primary judge erred in his construction of the wording in GC 35.3(a), stating that an amount is "payable" within the meaning of that clause only if, objectively and indisputably, CPB had a contractual obligation under the Subcontract to pay the amount. On this construction, where a subcontractor disputes its liability to pay an amount, no amount would be payable within the meaning of GC 35.3(a) unless and until it is so determined after arbitration under the dispute resolution procedure. To this end, CPB asserted that GC 35.3(a) ought to have been construed as serving the sole purpose of protecting JKC against the risk of insolvency of CPB.

The Court of Appeal addressed this submission by considering each of the GC 35.3 subclauses in turn.

The Proper Construction of GC 35.3(a)

According to the Court of Appeal at [83], performance bonds take the form of a promise by the grantor that it will pay to the beneficiary named in the bond an amount up to the limit set out in the bond unconditionally or on specified conditions, without reference to the terms of the contract between the parties. In the context of a construction contract, a performance bond will generally be intended to serve either or both of two purposes:

- a. To provide security against the risk of insolvency of the contractor
- b. To allocate the risk between the parties as to who is to be out of pocket pending the resolution of a dispute between them

This unconditional promise to pay on demand has the essential characteristics of cash,⁹ with it being a question of construction as to when and in what circumstances the other party is entitled to have recourse to the performance bond.¹⁰

9 *Wood Hall Ltd v Pipeline Authority* [1979] HCA 21; (1979) 141 CLR 443, (445, 453, 457 - 458); *Clough Engineering Ltd v Oil & Natural Gas Corporation Ltd* [2008] FCAFC 136; (2008) 249 ALR 458 [76].

10 *Wood Hall Ltd v Pipeline Authority* [1979] HCA 21; (1979) 141 CLR 443 (459); *Clough Engineering Ltd v Oil & Natural Gas Corporation Ltd* [2008] FCAFC 136; (2008) 249 ALR 458 [77], [85]; *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812, 826; *Marcon Pty Ltd v Kerman Contracting Pty Ltd* [2015] WASCA 7 [59].

Whilst noting (at [87] and [88]) the divergence of some recent decisions (such as that of *Laing O'Rourke Australia Constructions Pty Ltd v Kawasaki Heavy Industries Ltd* [2017] NSWSC 541 [80]-[81]) away from the *Clough* position, which provides authority for the proposition that the unconditional terms of the bond itself ought to influence the interpretation of the contract's terms for the call on the bonds, the Court of Appeal noted but declined to follow the CPB's submission that there was an important matter of principle distinguishing the *Clough* approach from CPB's submission that the terms of the unconditional bond are of limited relevance to interpreting the overall contract.

The Significance of GC 35.3(b)

As to GC 35.3(b), the Court of Appeal stated at [90] that whilst there have been some differences in approach in recent appellate decisions, the resolution of the appeal lies in the proper construction of the Subcontract conditions.

In arriving at what a "proper construction" of GC 35.3 ought to be, the court followed Justice Le Miere's earlier interpretation that, if JKC has an honest claim that an amount is payable to it by CPB, JKC may have recourse to the performance bond in order to recover that amount. This construction of GC 35.3(b) reinforces the construction of para (a) by providing that CPB waives any right to obtain an injunction to prevent JKC exercising its right under para (a) to have recourse to the performance bonds. That waiver advances the risk allocation purpose cited earlier in this note and refutes CPB's argument that the purpose of performance bonds is merely to provide security against the risk of insolvency.

The Contractual Terms As to "Bank Guarantees"

Finally, and in reference to other considerations had in mind whilst coming to its decision, the Court of Appeal highlighted the duration of the performance bonds (referred to as "Bank Guarantees") as being an important feature that was inconsistent with CPB's contention that the bonds were provided for the *sole* purpose of providing security to JKC against the risk of CPB's insolvency. The Court of Appeal noted that if it were to follow CPB's construction of GC 35.3(a), then there would be a substantial risk that the Initial Bank Guarantee might expire before any dispute about liquidated damages was resolved. There was also a similar risk in relation to the Warranty Bank Guarantee (which expires 30 days after the expiry of the last Warranty Period).

By contrast, the stipulated duration of the Bank Guarantees, as interpreted by the Court, is consistent with the purpose of GC 35.3, being for JKC to be in the money, to the extent of the Bank Guarantees, pending resolution of any dispute.

Accordingly, CPB's appeal was unanimously dismissed.

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