CALLING UP BANK GUARANTEES

VOS CONSTRUCTION & JOINERY QLD PTY LTD v SANCTUARY PROPERTIES PTY LTD & ANOR [2007] QSC 332

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Recently, the Queensland Supreme Court considered an application to restrain an owner from calling on a bank guarantee provided as security under a construction contract.

In the case, the Queensland Supreme Court held that:

- The financier's obligation in such commercial instruments is independent of the underlying construction contract. This means that a security provided under a construction contract may prima facie be called up unless there is a breach of a negative stipulation in the underlying contract which conditions the right to call it up.
- Unless expressly so stated, the dispute resolution clauses of a contract do not affect an owner's right to draw on the contractor's security for a debt owed whether, disputed or not.
- The time within which to give notice of an intention to call on a security under s 67J of the *Queensland Building Services Authority Act 1991*, only begins to run in circumstances where the right to payment accrues to a party, but not before. Here, that did not occur until the issuance of the architect's final certificate confirming rejection of the applicant's dispute.
- It was also held that, on the facts, the circumstances that the applicant might suffer embarrassment and loss of reputation within the industry if the call was made did not justify the grant of an injunction.

BACKGROUND TO APPLICATION

In August 2005, the respondents, joint venturers Sanctuary Properties Pty Ltd and MIRVAC Developments Pty Ltd (Sanctuary), entered into a contract (contract) with Vos Construction & Joinery Qld Pty Ltd (Vos) for the performance of building work. The contract price was $7,010,606 and Vos provided security for its performance of the project in the form of a bank guarantee.

The architect extended the date for practical completion from 29 November 2005 to 17 January 2006. On 13 February 2006, Sanctuary notified Vos of its intention to claim liquidated damages for failure to complete the project by the adjusted date for practical completion. Vos reached practical completion on 21 March 2006. The architect issued the final certificate for the project on 8 June 2006. On 12 June 2006, Vos disputed the final certificate by notifying the architect in accordance with clause C8 of the contract. Clause C8 required the architect to assess the dispute and give a written decision to Sanctuary within 10 working days. Vos notified Sanctuary of same.

On 25 June 2006, the architect, rejecting Vos's submissions, concluded that the final certificate should stand. Sanctuary gave notice of its intention to draw on Vos' bank guarantee in the sum of $173,800 (the sum certified by the architect) on the same day.

THE APPLICATION

Sanctuary relied on clauses: clause C5, clause C6 and clause C9 of the contract as the basis of its right to call on Vos's security.

Clause C5 significantly provided that:

- C5 owner's right to draw on security—subject to clause C6, the owner may draw on the security provided by the contractor under clause C1 if:
    - a certificate issued by the architect in favour of the owner under any of clause N4, N11 or Q17 is not paid by the contractor within the period shown in item 4 of schedule 1, or
    - the contractors [sic] engagement is terminated by the owner under clause Q1 or Q2 and the architect has issued a certificate under clause A9 and the contractor has not disputed the owner's rights under clause A8.
- The owner may not draw on security in the form of unconditional guarantees under clause C1 or otherwise unless the owner has given the contractor:
    - Written notice ('the first notice') to the contractor, within 28 days after the owner becomes aware, or ought reasonably to have become aware, of its right under clause C5.1, advising of the proposed use and, if the amount due can be quantified when the first notice is given, of the amount due, and
    - If the amount due cannot be quantified when the first notice is given, a further notice ('the second notice') to the contractor within three business days after the owner becomes able to quantify the amount due, advising of the amount due.

• Vos submitted that:

  • Sanctuary had no right to draw the security since Vos had disputed Sanctuary's rights under clause A8. Vos argued that once a dispute arose, both parties were bound to follow dispute resolution procedures set out in the contract

  • Sanctuary had breached s 67J of the *Queensland Building Services Authority Act 1991* by not giving notice within 28 days of being aware of their rights to payment, and

  • its reputation in the construction industry would suffer if it became known that its security had been drawn down and this should be taken into account by the court.

HELD

In considering Vos's application the court dealt with the following issues:

• Financier's obligation independent of underlying contract—principle of autonomy.

The court acknowledged that the financier's obligation in commercial instruments such as bank guarantees is independent of the underlying contract. Generally, courts do not interfere with the financier's obligation to pay if called to (*Boral Formwork & Scaffolding Pty Ltd v Action Makers Ltd* [2003] NSWSC 713) because guarantees of this nature and in this context are considered 'as good as cash' (*Wood Hall Ltd v Pipeline Authority* (1979) 141 CLR 443). However, 'breach of a negative stipulation in the underlying contract which conditions the right to call up the guarantee' may provide grounds for an injunction to issue (*Austrak Pty Ltd v John Holland Pty Ltd* [2006] QSC 103).

• Rights to payment stand unless payment certificate negated.

In the court's view, the obvious commercial purpose of the proviso in clause C5.1 was to prevent recourse to the security where the contractor has disputed the owner's rights under clause A8 successfully, so as to negate the effect of the earlier certificate. Accordingly, the court held that an unsuccessful dispute could not stall the debt recovery process because that would flout 'business commonsense' (*Antios Compania Naviera SA v Salen Rederierna AB* [1985] AC 191).

• Right to payment is independent of obligation to follow dispute resolution procedures

Sanctuary's right to draw down the security for a debt owed was independent of its obligation to resolve its dispute with Vos in accordance with the dispute resolution clauses under the contract. The court held that Sanctuary had the right to draw on the security even if the dispute between the parties had not proceeded to final resolution.

• Notice

Under s 67J(2) of the *Queensland Building Services Authority Act 1991*, notice of a claim must be given within 28 days of a party becoming 'aware, or ought reasonably to have become aware, of the contracting party's right to obtain the amount owed'. Vos argued that since Sanctuary notified Vos of its intention to claim liquidated damages on 13 February 2006, it must have been aware of its right to payment on that date. It followed that Sanctuary's 25 June 2006 notice was out of time.

The court held that Sanctuary must have an accrued right to payment before it can be 'aware of its right'. That right accrues in circumstances where the architect issues the final certificate. It followed that Sanctuary was well within the time limits if one considered the dates of the architect's final certificate (8 June 2007) or the architect's determination relating to the disputed final certificate (25 June 2007).

• Vos's reputation did not constitute serious question to be tried.

The court found that the present application turned on questions of construction and not disputed factual matters. It did not consider the argument of industry reputation as constituting a serious question to be tried.

• Balance of convenience.

The court, for the above reasons, and in its discretion, found the balance of convenience to be in favour of not granting an interlocutory injunction.

Accordingly, Vos's application for an interlocutory injunction restraining Sanctuary's call on the contract security was dismissed.

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