

Bank Guarantees – Risk Allocation vs Security?

FACTS

The case of *Martinus Rail Pty Ltd v Qube Re Services (No 2) Pty Ltd [2023] NSWSC 1550* involved a dispute over an interlocutory order restraining the use of a Bank Guarantee by a Principal (**Qube RE**).

In 2015, Qube RE entered into an AS4000-1997 contract for a sum of some \$140 million with the contractor (**Martinus**), to perform construction works for a national transport infrastructure project.

The contractor was obliged to provide security for 5% of the contract sum and in August 2022, the bank issued four unconditional undertakings to pay a total of \$7,029,849 on demand by the principal.

ISSUE

Whether the Court should prevent the principal from withdrawing sums of money for alleged breaches of contract using unconditional undertakings (or Bank Guarantees) provided by the Contractor?

FINDING

The court dismissed the case, refusing to prevent the principal from drawing on the bank guarantees, with Her Honour Rees J explaining the basic principles around the entitlement of principals to use Bank Guarantees:

“8. ... on an interlocutory application to injunct a call on a bank guarantee, the Courts commonly examine the contractual provisions and the terms of the bank guarantee, to ascertain whether the contractual regime is intended to provide security or a ‘risk allocation device’, or both. Where the contractual purpose of a bank guarantee is to provide security, this protects against the situation where a contracting party has a valid claim but there are difficulties in recovering from the party in default, in which case, recourse may be had against the bank. In that event, the principal has no authority to call on the bank guarantee pending resolution of the dispute. Where a bank guarantee security is a ‘risk allocation device’, the contract establishes a ‘pay now, argue later’ regime, where the beneficiary is able to call on the guarantee even if it turns out, in the end, that the other party was not in default; the clause identifies which party is to be ‘out of pocket’ pending resolution of a dispute: *Daewoo* at [5]-[10]...”

42 *Having regard to the terms of the Unconditional Undertakings and the contractual provisions, I consider that the contractual regime is intended to provide a ‘risk allocation device’, establishing a ‘pay now, argue later’ regime where the principal is entitled to call on the guarantee at an early stage in the dispute, even if it turns out at the conclusion of an arbitral proceeding that the contractor was not in default”.*

IMPACT

This decision shows the significance of the contractual wording around Bank Guarantees, and the importance of identifying whether the purpose of a bank guarantee is to provide a ‘risk allocation device’ or merely security.

Contractors and Subcontractors should be aware that where contractual Bank Guarantees are a ‘risk allocation device’, they may have to sue to recover a principal’s deductions; even when if the fault for an alleged breach does not actually lie with them!

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