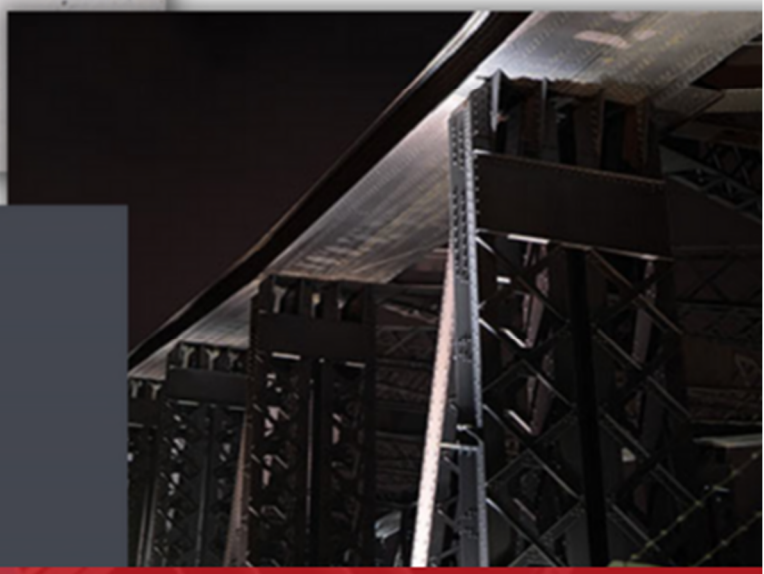
NSW: Unconscionable Conduct and Bank Guarantees

CRISP LAW



Newsletter

July 2024: Issue 1

In this Newsletter, we explore unconscionable conduct as defined by Common Law and section 20 of the Australian Consumer Law, focusing on its implications as an exception that may prevent a party from invoking a bank guarantee.

T +61 2 8042 8701 E admin@crisplaw.com.au

Introduction

Bank guarantees are becoming a more common form of security required in large-scale construction contracts. As such, key parties in the construction industry must be aware of the legal implications of issuing a Bank Guarantee and the potential consequences should they seek to have it recalled.

This newsletter will explore unconscionable conduct as one of the three exceptions where a court will interfere and seek to prevent a beneficiary from drawing upon a bank guarantee. Unconscionable conduct is prohibited under section 20 of the Australian Consumer Law ('ACL') which will be discussed below with a focus on general law principles and how these have been applied in case law. It concerns conduct, which is unfair or oppressive and within the meaning of the unwritten law from time to time.

The unconscionable conduct exception was set out in the case of *Clough Engineering Limited v Oil & Natural Gas Corporation Limited* [2008] FCAFC 136 ('Clough') and has subsequently been applied many cases which will be discussed below.

Relevance of this Newsletter

This newsletter is relevant for key parties in the Construction Industry who use bank guarantees as a form of security and seek to mitigate potential financial liability associated with construction contracts.

It must be noted that there are limited exceptions whereby a court will prevent a beneficiary from calling upon a performance guarantee in whose favour the guarantee is given. This newsletter will provide guidance of the unconscionable conduct exception to allow parties to be aware of the position at law should they seek to recall or challenge a bank guarantee.

It will also highlight the difficulties in making an unconscionable conduct argument when it comes to bank guarantees, due to the high standard to establish with the court.

Bank Guarantees

Bank guarantees have been described in case law to be "as good as cash" awaiting only a demand to the bank before it materialises.[1] As such, courts are reluctant to restrain a beneficiary from calling upon an unconditional bank guarantee. This is because the

[1] Wood Hall v Pipeline Authority (1979) 141 CLR 443.

 T +61 2 8042 8701 E admin@crisplaw.com.au

bank guarantee contract exists between the bank and the beneficiary, and where the beneficiary wishes to call upon the bank guarantee, the bank has the autonomy to pay it out.

Bank guarantees are beneficial in the construction industry as an unconditional bank guarantee will allow Contractors to reduce excessive pressure on their working capital.

The general principle is outlined in the following case:

Simic v NSW Land and Housing Corporation (2016) 260 CLR 85 ('Simic')

Pursuant to the case of Simic, the court stated at [88] that:

- "Such securities 'create a type of currency' and are ... essential to international commerce and, in the absence of fraud, should be allowed to be honoured free from interference by the courts".[2]

This is relevant as it shows that the courts will be reluctant to interfere with bank guarantees, but will allow them to be honoured unless fraud, or any of the other exceptions are present. The case of Clough sets out the three exceptions whereby the court may prevent a beneficiary from calling upon a bank guarantee. These are in cases of fraud, unconscionable conduct and contractual promises not to call upon the guarantee in particular circumstances.

This newsletter will focus on the unconscionable conduct exception.

Unconscionable Conduct

To provide a brief overview of unconscionable conduct, this is conduct that is prohibited under section 20 of the Australian Consumer Law.[3] Section 20 is as follows:

> (1) A person must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law from time to time.
> (2) This section does not apply to conduct that is prohibited by section 21.

To note, the term 'unwritten law' is intended to refer to the equitable doctrine of unconscionable conduct in case law. The unconscionable conduct doctrine has been

[2] Simic v NSW Land and Housing Corporation (2016) 260 CLR 85.
[3] Competition and Consumer Act 2010 (Cth) sch 2 s 20 ('Australian Consumer Law').

 T +61 2 8042 8701 E admin@crisplaw.com.au

applied and discussed in many cases concerning bank guarantees. The following cases are of relevance:

Clough Engineering Limited v Oil & Natural Gas Corporation Limited [2008] FCAFC 136

Clough Engineering Limited entered into a contract with Oil & Natural Gas Corp ('ONGC') to construct infrastructure for an oil and gas field off the Indian coast. Clough provided ONGC with an unconditional and irrevocable performance bank guarantee equal to 10% of the contract price. Under the contract, ONGC could invoke the performance guarantee if Clough failed to perform any of its contractual obligations. The guarantees were to be paid out immediately whereby a breach occurred by the Contractor.

Disputes arose over matters regarding extensions of time and performance of the contract. ONGC terminated the contract and made a demand to seek recourse to the performance guarantee. Clough successfully sought an injunction restraining payment. ONGC later filed to have the injunction discharged. Clough appealed to seek a stay of the injunction while the matter is being determined. However, the discharge of the injunction was stayed.

The issues of concern were as follows:

- Whether in those circumstances, upon the proper construction of the Contract, ONGC was entitled to invoke the performance guarantees;
- Whether a call on the performance guarantees contravened s 51AA of the Trade Practices Act 1974 (Cth) (now s20 of the Australian Consumer Law) on the ground that it was unconscionable within the meaning of the unwritten law of Australia.

Clough failed to get an injunction and the court held that ONGC did not act unconscionably as they had a bona fide claim on calling the performance guarantees. Based on the proper construction of the terms of the performance guarantee and the contract, ONCG was entitled to call upon the bank guarantee and this right was 'unconditioned on any actual breach' by Clough.

Exceptions:

At paragraph [77], the court reiterated three recognised principles to the rule that a court will not enjoin the issuer of a performance guarantee, or bond, from performing its unconditional obligation to make payment. These exceptions are:

 T +61 2 8042 8701 E admin@crisplaw.com.au

1) The Court will enjoin the party in whose favour the performance guarantee has been given from acting fraudulently.
2) The party in whose favour the performance bank guarantee has been given may be enjoined from acting unconscionably in contravention of s 51AA of the TPA (now s20 of the ACL).
3) The Court will restrain such a party where they have made a contractual promise not to call upon the guarantee in particular circumstances.

Discussion on Unconscionable Conduct:

The court noted that none of the categories of unconscionable conduct stated in Australian Competition and Consumer Commission v Samton Holdings Pty Ltd (2002) 117 FCR 301 at [48] apply in this case. That case recognises that under the rubric of unconscionable conduct, equity will:

(i) Set aside a contract or disposition resulting from the knowing exploitation by one party of the special disadvantage of another. The special disadvantage may be constitutional, deriving from age, illness, poverty, inexperience or lack of education - Commercial Bank of Australia Ltd v Amadio. Or it may be situational, deriving from particular features of a relationship between actors in the transaction such as the emotional dependence of one on the other - Louth v Diprose; Bridgewater v Leahy (1998) 194 CLR 457.

(ii) Set aside as against third parties a transaction entered into as the result of the defective comprehension by a party to the transaction, the influence of another and the want of any independent explanation to the complaining party - Garcia v National Australia Bank Ltd (1988) 194 CLR 395.

(iii) Prevent a party from exercising a legal right in a way that involves unconscionable departure from a representation relied upon by another to his or her detriment - Waltons Stores (Interstate) Limited v Maher; The Commonwealth v Verwayen.

(iv) Relieve against forfeiture and penalty - Legione v Hateley (1983) 152 CLR 406; Stern v McArthur.

(v) Rescind contracts entered into under the influence of unilateral mistake - Taylor v Johnson.

 T +61 2 8042 8701 E admin@crisplaw.com.au

The court further stated at [130] that a party alleging unconscionable conduct must be able to identify conduct that is unconscionable in a sense known to the unwritten law.

Under the unwritten law, this will be conduct that would support the grant of relief on principles set out in specific equitable doctrines. However, Equity does not provide a remedy for conduct which in the opinion of the judge is unfair.

While ONGC's actions did not constitute unconscionable conduct, the court recognised:

- Equity would generally intervene to ameliorate the application of a legal right if employed capriciously or unreasonably or harshly or oppressively such as to be unconscionable.[4]

Additional Cases of Relevance

The Clough exception has been applied and discussed in many subsequent cases. Some noteworthy cases which may provide a greater understanding of the application of the unconscionable conduct doctrine with regards to bank guarantees are as follows:

Fabtech Australia Pty Ltd v Laing O'Rourke Australia Constructions Pty Ltd [2015] FCA 1371

The case considered Clough Engineering in determining if the circumstances were such that the respondent would be acting unconscionably in having recourse to a bank guarantee. Unconscionable conduct was not found, however, the court stated at [42] that:

- 'Clough Engineering indicates the difficulties of an unconscionability argument in the case of a performance guarantee designed to operate as a risk allocation device. The unconscionable conduct would need to be extreme and almost merge into bad faith exercises of the power'.[5]

Uber Builders and Developers Pty Ltd v MIFA Pty Ltd [2020] VSC 596

In this case, the court made the following observations on statutory unconscionability and its relationship with the principles otherwise governing performance bonds:

[4] *Clough Engineering Limited v Oil & Natural Gas Corporation Limited* [2008] FCAFC 136, [77].
[5] *Fabtech Australia Pty Ltd v Laing O'Rourke Australia Constructions Pty Ltd* [2015] FCA 1371.

 T +61 2 8042 8701 E admin@crisplaw.com.au

- [125] Although much has been written on the subject of statutory unconscionability since the decision of Batt J in Olex Focas, the analysis in that case remains relevant. There, his Honour considered statutory unconscionability in circumstances in which the beneficiary of bank guarantees attempted to call on them, it was said, without a belief that it had any entitlement or right to do so, or in the positive belief that it had no entitlement or right to do so. In substance, Batt J accepted that the unconscionability provisions of the Australian Consumer Law may found relief in the form of an injunction restraining recourse to a performance bond notwithstanding the accepted commercial purpose of such a bond, but in construing the standard of conduct required to establish unconscionability, reference must be had to the factual context, which includes a historical purpose of the use of such bonds, which is taken to be understood by the parties contracting for a risk allocation regime.[6]

Good Living Company Pty v Kingsmede Pty Ltd [2021] FCAFC 33

The case concerned an appeal relating to unconscionable conduct. The full court considered unconscionable conduct under s20 and 21 of the ACL but stated that the claim could not succeed on that basis while referring to the reasoning of the primary judge as:

- [88] the nature of a bank guarantee means that there is only very limited scope for a finding of unconscionable conduct pursuant to s 20 of the ACL in a case involving such an instrument. In addition, and as I have already found, there was no inequality in bargaining power, and it could not be said that TGLC and Kimana were in a position of special disadvantage as the cases recognise... The parties involved were all businesspeople "concerned to advance or protect their own financial interests".

The court stated that the respondents in the case had a very good commercial bargain in being able to claim $500,000.00 under the deed of settlement and release as well the $100,000.00 subject of the bank guarantee.

However, without any other elements to trigger the courts equitable jurisdiction such as secrecy, trickery, unfair dealing, lack of good faith or misleading conduct, the ability to

[6] *Uber Builders and Developers Pty Ltd v MIFA Pty Ltd* [2020] VSC 596.

 T +61 2 8042 8701 E admin@crisplaw.com.au

benefit from a good commercial bargain did not render their conduct unconscionable.[7]

Conclusion and Implications

In conclusion, there are many potential consequences of entering into a bank guarantee that parties to a construction contract must be aware of. As noted above, while bank guarantees can be beneficial in allowing parties to mitigate potential financial liability, it may have challenges if the party who provided the guarantee seeks to have it recalled.

As such, parties must be aware of the instances in which a court may prevent a beneficiary from calling upon a guarantee and the difficulties in doing so. This is due to the high standard established by the court and the very limited scope for a finding of unconscionable conduct when it comes to bank guarantees, particularly where the agreements were made by businesspeople concerned with protecting their own financial interests.

[7] *Good Living Company Pty v Kingsmede Pty Ltd* [2021] FCAFC 33.

T +61 2 8042 8701 E admin@crisplaw.com.au