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Construction Matters

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To Call or Not To Call – The Purpose of Bank Guarantees Pending Final Resolution of a Dispute

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The decision of *Daewoo Shipbuilding & Marine Engineering Co Ltd v INPEX Operations Australia Pty Ltd* [2022] NSWSC 1125 considered whether the principles that courts adopt to an application seeking the grant of an interim injunction prohibiting a call on a bank guarantee also apply where the parties have agreed to arbitrate the underlying dispute, and whether the court's decision should await the (international) arbitral tribunal's final determination of the parties' rights and obligations.

Background

Daewoo and INPEX entered into a contract to construct a floating production storage offloading facility (FPSO). The contract contained a detailed provision requiring Daewoo to provide a bank guarantee to the approximate value of AU$467 million (Guarantee). Despite the FPSO being built and delivered, INPEX claimed it had suffered loss and damage (in excess of the value of the Guarantee) because of defects and delays.

In July 2022, INPEX commenced an arbitration in Singapore with the International Court of Arbitration. Daewoo subsequently applied to the New South Wales Supreme Court on an *ex parte* basis for an urgent interlocutory injunction to prevent INPEX from calling on the Guarantee.

While an interim injunction was initially granted restraining INPEX, the present case considered whether Daewoo was able to extend the interim injunction until the arbitral tribunal issued its award.

The Cases for and Against

Daewoo's case was based on three contentions:

1. That the warranty period during which the Guarantee could be called had expired
2. INPEX was in breach of a negative covenant preventing it from calling upon the Guarantee during a period when it was contractually intended to be released
3. An alleged contractual waiver to seek injunctive relief was a breach of public policy and thus unenforceable

Daewoo also argued that a call on the Guarantee could cause it to be unable to meet its financial obligations under other contracts, which could lead to irreparable harm to its business and reputation. Daewoo contended that the balance of convenience favoured an injunction because damages would be an inadequate remedy for these "profound financial and reputational consequences" if it was successful in the arbitration proceedings.

INPEX disputed Daewoo's contentions on the basis that the Guarantee acted as a risk allocation device. INPEX also argued that Daewoo's financial problem was a factor to be considered against an injunction. In particular, there was a risk to INPEX that Daewoo would be unable to extend the Guarantee and that Daewoo would not be able to satisfy any judgement if INPEX was successful on the substantive dispute.

Decision

The court found that a party's right to make a call on a bank guarantee will turn on the particular terms of their contract. In this case, the court held that while the three contentions advanced by Daewoo were arguable (or even strongly arguable), Daewoo had failed to establish that it had a sufficiently strong or serious *prima facie* case to justify an injunction preventing INPEX from calling on the Guarantee.

Critically, the court found that the Guarantee was not just security – it was also a risk allocation device, creating a "pay now, argue later" regime that is exercisable at any time. In essence, the contractual bargain of the parties was that, while the parties' disputes are resolved before an arbitral tribunal, INPEX gets to hold the money.

Although Daewoo could not have foreseen matters causing its own financial distress including, the impact of the COVID-19 pandemic and the Russia/Ukraine conflict, the court found that INPEX would not have agreed to take on a risk that it would lose its right to rely on a bank guarantee for protection due to Daewoo's financial circumstances and potential future insolvency.

In arriving at its decision, the court made clear that its examination and construction of contractual provisions should not be taken as binding on the arbitral tribunal, but rather that it is what the court is required to do in order to satisfy itself whether to preserve the status quo until the arbitral tribunal finally determines the matter.

The court noted that the application for relief in this case was made in the context of international arbitration. In that context, the court considered that its approach in construing the contract was consistent with Article 17J of the UNCITRAL Model Law (dealing with the court's power to order interim measures in an arbitration) and section 7(3) of the *International Arbitration Act 1974* (Cth).

The court reconciled the decisions in *CPB Contractors Pty Ltd v JKC Australia LNG Pty Ltd (No 2)* [2017] WASCA 123 and *Kawasaki Heavy Industries Ltd v Laing O'Rourke Australia Construction Pty Ltd* (2017) 96 NSWLR 329.

In passing, the court considered that the concession by INPEX that the provision of the contract waiving any right of Daewoo to seek to obtain an injunction in respect to recourse to the Guarantee was *prima facie* void, was rightly made. However, this provision did shed light on the issue whether the Guarantee was also a risk allocation device.

Key Takeaways

This decision strengthens the position in Australia that a bank guarantee may be called upon before the final award of an arbitral tribunal.

Parties should carefully consider the purpose of the security under their contracts and the wording of the security provisions, and remain mindful of those matters when making a call on a bank guarantee.

Further, parties whose contracts fall within the remit of the *Building and Construction (Security of Payment) Act 2021* (WA) should take note that this legislation requires a party to provide notice of their intention to call on a bank guarantee five business days prior to having recourse.

If you would like further information on managing risk and security under construction contracts, please reach out to a member of our team.

Concurrent Delays – Common Sense Prevails

Authors – Greg Steinepreis, Melissa Koo and Joseph Perkins

The recent decision of the UK's High Court in *Thomas Barnes & Sons PLC v Blackburn with Darwen Borough Council* [2022] EWHC 2598 (TCC) (*Thomas Barnes*) highlights courts' continuing shift towards a common sense approach to assessing concurrent delays.

Background

Blackburn with Darwen Borough Council (the Council) entered a contract with Thomas Barnes & Sons PLC (TB) for the construction of a new bus station. The project was significantly impacted by delays and increased costs.

As a result of the delays, the Council terminated the contract and engaged a replacement contractor to complete the works. TB subsequently entered administration.

Administrators for TB commenced proceedings and claimed that TB was entitled to an extension of time (EOT) of 172 days and associated costs of approximately £1.79 million. The Council disputed this, and further asserted their own entitlement to recover approximately £1.87 million for the costs of employing replacement contractors.

Central to the parties' dispute were two competing causes of delay:

- First, TB alleged works on the critical path were delayed due to deflection issues with the structural steelwork for which the Council was responsible
- Second, the Council claimed there were critical delays relating to TB's roof covering works, which were concurrent with the structural steelwork delays

Both TB and the Council relied on expert delay evidence in support of their cases. TB's expert adopted an as-planned versus as-built windows analysis, whereas the Council's expert adopted a hybrid of time-slice windows and time impact analyses.

In considering the parties' expert evidence, the court found that, **"irrespective of which method of delay analysis is deployed, there is an overriding objective of ensuring that conclusions derived from those analyses are sound from a common-sense perspective"**. Further, to properly assess the impact of any delay, the court determined that it must come to its own conclusions based on the entirety of evidence presented.

Ultimately, the court found that both delays caused delay to the critical path. In so finding, the court determined that it was not enough for TB to claim its delays were irrelevant due to the remedial works to the structural steelwork continuing before and after that period of delay. Conversely, it was not open for the Council to claim the remedial works were irrelevant because the roof coverings were on the critical path.

To this end, the court found that TB were entitled to an EOT of 119 days. However, TB were only entitled to recover prolongation costs for 27 days (being the period the steelwork delays were not concurrent with roof covering delays).

Key Takeaways

The court's reasoning represents a further departure from the "first in time" principle and industry guidelines in favour of an "effective cause test" in assessing concurrent delays.

Relevantly to Australian contracting entities, the decision in *Thomas Barnes* aligns with the recent decision of the New South Wales Supreme Court in *White Constructions Pty Ltd v PBS Holdings Pty Ltd* [2019] NSWSC 1166 (*White Constructions*).

In *White Constructions*, the court similarly departed from the expert analyses proffered and instead adopted a "common sense" approach in assessing the alleged delay. The court also made clear **"the importance of paying close attention to actual facts rather than opinions about what the evidence establishes".**

Construction litigants should be mindful of the growing authority in support of a pragmatic approach to delay, which may come at the expense of the often-complicated views of opposing expert delay analyses.

Western Australia Supreme Court Severs Part of an Adjudication Determination Beyond the Adjudicator's Jurisdiction

Authors – Greg Steinepreis, Melissa Koo and Joseph Perkins

Downer EDI Works Pty Ltd v Steensma [2022] WASC 396

This case concerns a judicial review of an adjudicator's determination under the *Construction Contracts (Former Provisions) Act 2004* (WA) (Act), in which the adjudicator wrongly found he had jurisdiction to determine that the adjudication applicant (RCA) was entitled to an amount set off by the adjudication respondent (Downer) before the relevant payment claim was made, where the set-off was not part of the payment dispute taken to adjudication.

Relevant Facts

On 25 March 2022, RCA submitted a payment claim to Downer for AU$148,973. The payment claim was divided into four subclaims – 6 September 2021, 7 October 2021, 8 October 2021 and 9 December 2021.

Also on 25 March 2022, but before RCA submitted its payment claim, Downer sent a letter to RCA headed "Notice of Overclaim and Set-Off". The letter stated that Downer had reconciled amounts claimed between September and December 2021, and determined that RCA had been overpaid.

Downer claimed that RCA owed it an amount of AU$116,975 and that it had set that sum off against two identified invoices for payment, leaving a debt due from RCA to Downer of AU$21,817.96.

On 1 April 2022, Downer rejected RCA's payment claim dated 25 March 2022 on the basis that RCA had not provided any new evidence.

On 20 May 2022, RCA applied for adjudication claiming AU$265,948.40, being the amount of its payment claim and the amount of Downer's overpayment claim.

The adjudicator found that there was insufficient evidence to substantiate RCA's payment claim and dismissed RCA's four subclaims. However, in respect of Downer's overpayment claim, the adjudicator considered that the claim had been raised by way of defence to RCA's payment claim, requiring him to take into account the merits of that alleged set-off in his determination. The reasons for this conclusion were that Downer had issued a formal notice of claim (not a casual letter) and because it claimed a set-off against monies due "on any account".

Ultimately, the adjudicator noted that Downer had provided no evidence of the set-off and determined that RCA was due the amount of AU$116,975 plus interest.

Judicial Review Proceedings

Downer applied for judicial review of the adjudicator's determination, on the basis that the adjudicator's consideration of the set-off amount fell outside the scope of the adjudicator's jurisdiction because it did not form part of the payment claim or payment dispute.

On review, the court found that the adjudicator had misconceived the function that he was to perform (being the determination of a payment dispute as defined in s 6 of the Act) and that the part of the adjudicator's determination that Downer pay RCA the set-off amount was outside the adjudicator's jurisdiction. The payment dispute giving rise to the adjudication was constituted by RCA's payment claim of 25 March 2022 and Downer's rejection of that payment claim on 1 April 2022. Relevantly, the set-off amount was not a component of the payment dispute because it was not part of RCA's payment claim, nor was it raised in Downer's assessment of RCA's payment claims or in its response in the adjudication.

Notwithstanding the court's primary finding, His Honour held that the jurisdictional error was confined to a severable part of the determination and that there was no reason to disturb the adjudicator's determination on the payment dispute, being that RCA was not entitled to any sum in respect of its payment claim.

Toolbox Topics

Retention Money Trust Scheme Now Applies to AU$1 million+ Construction Contracts in Western Australia

From 1 February 2023 to 31 January 2024, construction contracts valued at over AU$1million will be subject to the retention trust scheme under the Building and Construction Industry (Security of Payment) Act 2021 (save for minor exclusions).

During this time, if your construction contract is valued at less than AU$1 million at the time it is entered into, but the contract value is later varied to exceed AU$1 million, the statutory trust scheme for retention money will apply to retention money retained after the contract value exceeds AU$1 million.

This AU$1 million contract value threshold will apply until 1 February 2024, when the threshold will be lowered and the retention trust scheme will apply to construction contracts valued at over AU$20,000.

Australian Insolvency Regimes Rapidly Evolving

Australia's restructuring regimes are changing. In our latest insight, we cover some of the pending and most recent developments.

Continuous Disclosure Breaches Attract $450,000 Penalty for Mining and Exploration Company

On 13 January 2023, the Federal Court of Australia handed down a AU$450,000 fine to Australian Mines Limited (AML) for breaching its continuous disclosure obligations on three occasions. Federal Court justice, Craig Colvin, noted that AML had breached disclosure laws on matters of considerable significance to its affairs and on matters that were of major importance for its shareholders. This comes as a timely reminder, to companies and managing directors alike, of the importance of complying with continuous disclosure obligations.

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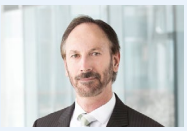

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