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ABSTRACT

The recent decision of Austin J in *Boral Formwork v Action Makers*¹ highlights significant statutory inroads into the autonomy principle, as it applies to bank guarantees and unconditional performance bonds. To explore whether these instruments should continue to be accepted in lieu of cash retentions, this paper examines the autonomy principle and its exceptions (both common law and statutory). The conclusion reached is that the uncertain, and potentially broadening, operation of both the common law and statutory exceptions to the autonomy principle may significantly curtail the use of bank guarantees and unconditional performance bonds as cash equivalents. For a bank guarantee or unconditional performance bond to function as a risk allocation device (as well as a security), an intended beneficiary will need to routinely implement certain safeguards. Placing blind faith in the autonomy principle will no longer suffice.

¹ [2003] NSWSC 713.
AS GOOD AS CASH?
THE DIMINUTION OF THE AUTONOMY PRINCIPLE

Bill Dixon*

1. INTRODUCTION

In *Wood Hall Limited v Pipeline Authority*² Stephen J observed (in relation to performance guarantees):

“Once a document of this character ceases to be the equivalent of a cash payment, being instantly and unconditionally convertible to cash, it necessarily loses acceptability. Only so long as it is ‘as good as cash’ can it fulfil its useful purpose of affording to those to whom it is issued the advantages of cash while involving for those who procure its issue neither the loss of use of an equivalent money sum nor the interest charges which would be incurred if such a sum were to be borrowed for the purpose. Being ‘as good as cash’ in the eyes of those to whom it is issued is essential to its function”.³

The issue of whether a performance guarantee was the functional equivalent of cash arose for consideration in *Olex Focas Pty Ltd v Skodaexport Co Ltd*⁴ (‘Olex Focas’). In this well-known decision, Batt J was required to consider the conduct of a beneficiary in attempting to call up (in full) guarantees that secured mobilisation/procurement advances which had been substantially repaid. Batt J held that this conduct, where a partial call only was available, was unconscionable within the meaning of the unwritten law and proscribed by s 51 AA of the *Trade Practices Act 1974* (Cth). In reaching this conclusion, Batt J made the observation that the

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* B Econ, LLB (Hons) (Qld), LLM (QUT); Solicitor, Queensland; Lecturer, Faculty of Law, Queensland University of Technology. I am grateful for the insights of an anonymous referee.

² (1979) 141 CLR 443. In *Boral Formwork v Action Makers* [2003] NSWSC 713 it was judicially recognised ([37]) that *Wood Hall Limited v Pipeline Authority* (1979) 141 CLR 443 remains the leading statement of the autonomy principle in Australian law.

³ *Wood Hall Limited v Pipeline Authority* (1979) 141 CLR 443, 457.

effect of the statutory provision worked ‘a substantial inroad into the well-established common law autonomy of letters of credit and performance bonds and other bank guarantees’.  

Justice Batt’s decision attracted considerable controversy and promoted substantial academic debate. One commentator suggested the need for statutory amendment so that the autonomy principle should not be imperilled. However, despite pleas to the contrary, the approach adopted by Batt J in *Olex Focas* has recently received the tacit approval of the New South Wales Supreme Court (Austin J) in *Boral Formwork v Action Makers*.

Given this development it is timely to examine the autonomy principle, and the full extent and operation of all exceptions (both common law and statutory), in its application to bank guarantees and unconditional performance bonds. To the extent that there has been a diminution in the autonomy principle, such that instruments of this ilk may no longer be considered the functional equivalent of cash, the paper will examine the implications for beneficiaries.

2. AUTONOMY PRINCIPLE

Bank guarantees and unconditional performance bonds are historically relatively new creatures. The autonomy principle was first associated with a commercial instrument of significantly longer duration, the letter of credit or documentary credit, and the principle must first be examined in this context.

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5 *Olex Focas* [1998] 3 VR 380, 404.
10 [2003] NSWSC 713.
11 *Boral Formwork v Action Makers* [2003] NSWSC 713, [32]. In *Edward Owen Engineering v Barclays Bank International* [1978] QB 159, Lord Denning described a performance bond as being a new creature as far as the courts were concerned (164).
12 An outline of the history of the autonomy principle is provided by Young J in *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545.
2.1 Letters of credit

Under a letter of credit arrangement the issuing bank makes a commitment, on behalf of the account party, to pay a certain sum to the beneficiary, provided documents are presented which strictly comply with the terms of the credit. The promise that is made by the issuing bank under the letter of credit is to the beneficiary. This is a separate contract under which the issuing bank is to pay provided the beneficiary can provide those documents required under the terms of the credit. In addition to the contract between the account party and the beneficiary ('the underlying contract') and the contract between the issuing bank and the beneficiary there is usually at least one further contract, namely that between the issuing bank and the account party.

The independence of the contract between the issuing bank and the beneficiary and the underlying contract is described as the 'autonomy principle'. The operation of this principle has been repeatedly confirmed. Due to the autonomy principle, provided the beneficiary presents documents which comply with the credit, the beneficiary will be paid regardless of whether or not the actual goods in question conform with the terms of the underlying contract and regardless of any dispute under the underlying contract. It is this independence from the performance of the underlying contract which gives documentary letters of credit 'their international commercial utility and efficacy'.

Part of the attraction of the operation of the letter of credit, from a beneficiary's viewpoint, is the primary obligation owed by the issuing bank. Considerations of set-off and counterclaim will not often arise and these instruments are unlikely to be nullified by attachment orders. Due to the

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14 For example: Urquhart Lindsay & Co Ltd v Eastern Bank Ltd [1922] 1 KB 318; Hamzehi Malas & Sons v British Imex Industries Ltd [1958] 2 QB 127.
15 The rule being that the banks concerned deal in documents and not in goods: Montrod Ltd v Grundkotter Fleischvertriebs GmbH [2002] 3 ALL ER 697, [37].
16 The operation of the autonomy principle was clearly brought into focus as a result of the Islamic revolution in 1978 in Iran, when, for political reasons, demands were being made under letters of credit and first demand bonds by Iranian beneficiaries. These demands were allegedly fraudulent, being made for reasons unrelated to default in the underlying contract.
international reliance placed upon commercial documentary credits, the practice relating to these instruments has been subject to a body of rules formulated by the International Chamber of Commerce (‘ICC’). The *Uniform Customs and Practice for Commercial Documentary Credits* (‘UCP’) is an attempt to standardise the terms and conditions on which bankers will issue and act on commercial credits.19 These UCP provisions are incorporated by reference into virtually every documentary letter of credit. While the provisions are not themselves law, they are nevertheless binding on the parties as contractual terms. The autonomy principle is well enshrined by the UCP provisions.20

To a large extent the operation of the autonomy principle means that from a beneficiary’s viewpoint, such instruments are the equivalent of cash in hand. This is important given the reliance21 placed on such letters of credit.22 As well as being ‘regarded by merchants the world over as equivalent to cash’23 the autonomy principle is also of relevance to the issuing bank or financier. Banks who charge a service for the provision of such facilities did not wish to be drawn into disputes arising from the performance or otherwise of the underlying contract.24 Financiers must consider their reputation. As noted in *Tukan Timber Ltd v Barclays Bank PLC*:25

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20 Articles 3, 4 and 13(c) *Uniform Customs and Practice for Commercial Documentary Credits* (UCP 500). (A new version (UCP 600) of the *Uniform Customs and Practice for Commercial Documentary Credits* is expected to be released by autumn 2005 according to an interview with a member of the relevant drafting group of the International Chamber of Commerce: http://www.iccbooks.com/frame_dciart4.asp). UCP 500 also applies to standby letters of credit. As noted by Everett and McCracken, although the ICC adopted the International Standby Practice Rules (ISP 98) and endorsed the *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* in 1999, anecdotal evidence suggests that Australian parties continue to have their standby letters of credit governed by UCP 500: S McCracken and A Everett, *Banking & Financial Institutions Law*, 6th ed, Lawbook Co, Sydney, 2004, 490-491. The autonomy principle is accorded similar recognition in the *Uniform Commercial Code*.
21 These instruments have been described as the ‘crankshaft of modern commerce’: Chorley, *Law of Banking*, 6th ed, Sweet & Maxwell, London, 225 as referred to by A L Tyree, above n19, 482. In *Intraco Ltd v Notis Shipping Corporation* (The “Bhoja Trader”) [1981] 2 Lloyd’s Rep 256, such instruments were described as the lifeblood of commerce. In *Discount Records Ltd v Barclays Bank Ltd* [1975] 1 ALL ER 1071 Megarry J said that banker’s credits should only be interfered with in ‘grave’ circumstances as there was a need to maintain commercial confidence. It was these considerations of commercial confidence and commercial certainty that lead the House of Lords to observe in *United City Merchants (Investments) Ltd v Royal Bank of Canada* [1983] 1 AC 168 that the autonomy of the documentary credit was its raison d’etre [183].
23 Further, as a party to a separate contract, independent of the underlying contract, the issuing bank is not usually in a position to have time to consider and is not obliged to make enquiries in relation to matters which may arise under the underlying contract.
"The reputation of Barclays depends on strict compliance with its obligations ... the machinery of irrevocable obligations assumed by banks is essential to international commerce. Unless such commitments by banks can be honoured, trust in international commerce could be irreparably damaged".26

The autonomy principle allows financiers to meet their obligations promptly so as to ensure that there is no effect on their ‘reputation for financial and contractual probity’.27

The operation of the autonomy principle must be further examined in relation to bank guarantees and unconditional performance bonds.

2.2 BANK GUARANTEES AND UNCONDITIONAL PERFORMANCE BONDS

The essential parties to a bank guarantee or an unconditional performance bond are the same as the parties to a letter of credit transaction, namely the ‘issuing bank’ (or ‘issuer’), the ‘account party’ and the ‘beneficiary’. Before considering these instruments themselves further, it is necessary to briefly examine certain terminology.

Standby letters of credit, unconditional performance bonds, bank guarantees, banker’s undertakings and independent or first demand guarantees are terms that are commonly intermingled. Although differently described, these terms commonly describe the same type of obligation serving the same commercial purpose.28 The differences of form can largely be ascribed to the different jurisdictional nexus. Standby letters of credit are essentially the American equivalent of a performance guarantee.29 A standby letter of credit differs from a traditional documentary credit in that a traditional letter of credit ‘is intended to secure payment to the beneficiary in respect of his performance of the underlying contract, whereas the latter [standby credit] is intended to secure the beneficiary against non performance by the

29 Standby letters of credit originated in the United States in the 1940’s. At that time, United States’ banks were forbidden from issuing third party guarantees. The banks overcame this restriction by the adaptation of the traditional letter of credit to function as the equivalent of a performance guarantee: S McCracken and A Everett, Banking & Financial Institutions Law, 6th ed, Lawbook Co, Sydney, 2004, 477-478. See, also, M Coleman, ‘Performance Guarantees’, Lloyd’s Maritime and Commercial Law Quarterly (1990), 223, 225.
applicant”. Whilst standby letters of credit are a byproduct of the American system, performance bonds are essentially a product of the English legal system. Bank guarantees and banker’s undertakings are, in turn, a product of the European system. These documents are traditionally not under seal.

This paper will focus on bank guarantees and those types of performance bonds which have been described as ‘unconditional’ or ‘first demand’ bonds. The distinction is important, as performance bonds, in particular, are available in many varieties and hybrids. Having said this, bank guarantees or unconditional performance bonds will be the instruments most commonly sought by intended beneficiaries. Whilst an unconditional or first demand guarantee or bond traditionally is called for by the terms of an underlying contract, the guarantee or bond itself typically does not make reference to the underlying contract and certainly, from a beneficiary’s viewpoint, does not seek to incorporate its terms by reference.

For the purposes of this paper it is assumed that a payment obligation is triggered by a simple demand by the beneficiary. As such these unconditional documents are commonly used and represent an instrument which is ‘readily, promptly and assuredly realisable’. The utilisation and purpose of these documents is very similar to the utilisation and purpose of documentary letters of credit as previously discussed. These documents are commonly used for trade and project finance, in building or construction contracts, in property transactions (in lieu of deposits) and as security for service contracts. Some of the advantages of these documents were

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31 As English lawyers remain ‘burdened with the problems of the doctrine of consideration’ (C M Chinkin, P J Davidson, and W J M Riquier (Eds), Current Problems of International Trade Financing, Malaya Law Review and Butterworth & Co, Singapore, 1983, 267) a bond, taking the form of a deed, overcomes these issues.
32 As observed in IE Contractors Ltd v Lloyds Bank PLC and Rafidain Bank [1989] 2 Lloyd’s Rep 205 ‘it is important to determine whether the bond is payable on first simple demand or on first demand in a specified form, or on first demand supported by a specified document.’ (207)
33 As the commercial function of these instruments is to protect the beneficiary from carrying credit risk during the course of a dispute with the account party as to money due under the underlying contract: Boral Formwork v Action Makers [2003] NSWSC 713, [36].
34 In this context the term ‘guarantee’ is a misnomer: Wood Hall Limited v Pipeline Authority (1979) 141 CLR 443, 445 (Barwick CJ) (Similarly, Young J in Hortico (Aust) Pty Ltd v Energy Equipment Co (Aust) Pty Ltd [1985] 1 NSWLR 545, 550 and Callaway JA in Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd [1998] 3 VR 812, 826). These instruments typically impose primary obligations expressed to be unconditional once a demand is made in accordance with the instrument: Boral Formwork v Action Makers [2003] NSWSC 713, [35].
35 A considerable body of case law has developed in relation to ‘statement’ guarantees or ‘conditional’ bonds that will not be considered within the scope of this paper.
36 Siporex Trade SA v Banque Indosuez [1986] 2 Lloyd’s Rep 146, 158.
identified by Stephen J in *Wood Hall Limited v Pipeline Authority*[^37] in the passage quoted at the start of this paper; namely that they have the advantages of cash whilst not involving the loss of use of the actual cash sum, nor exposing the account party to the interest charges applicable if the sum referred to in the document were actually borrowed. In addition to lowering costs for an account party, there are a number of advantages for a beneficiary. The beneficiary knows that the unconditional bank guarantee or performance bond provides a means of immediate compensation without the need to go through arbitration, negotiation or litigation. Further, being able to make demand on such a document may well provide the beneficiary with a strengthened position of negotiation. Finally, to the extent that there is an element of the underlying contract price that may reflect the cost of the security, this will be reduced ‘because the bank is not required to expend time and resources in investigating the validity of a claim’.[^38]

In the considerable case law treatment of bank guarantees and unconditional performance bonds, these instruments have been equated with letters of credit.[^39] Although each individual instrument must be separately considered to decide its effect and blind categorisations should not be adopted,[^40] the observation is commonly made that such instruments are very similar to irrevocable letters of credit.[^41] Consistent with these observations, the autonomy principle is also regarded as being applicable to these types of documents[^42] such that there are again a number of separate contracts that arise. Particularly, there is a separation of the issuing bank's contract to pay the beneficiary and the underlying contract. Barwick CJ noted in *Wood Hall Limited v Pipeline Authority*[^43]:

‘... there is no basis whatever upon which the unconditional nature of the Bank’s promise to pay on demand can be qualified by reference to the terms of the contract between the contractor and the owner. Equally, there is no basis on which the owner’s unqualified

[^37]: (1979) 141 CLR 443.
[^38]: M Coleman, above n 29, 230.
[^39]: Consistent with the observation made by Batt J in *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380, 397.
[^40]: *GKN Contractors Ltd v Lloyds Bank* (1986) 30 BLR 53.
[^43]: (1979) 141 CLR 443.
right at any time to demand payment by the Bank can be qualified by reference to the terms or purpose of that contract.”

This decision was cited with approval by a Full Court of the Supreme Court of Queensland in *Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd* as being authority for the principle that ‘unconditional promises of this kind by a bank are not to be qualified by reference to the underlying contract which led to the creation of the bank’s instrument’. This conclusion is again consistent with a perceived and real commercial desirability for such instruments to be ‘as good as cash’.

Whilst the strict application of the autonomy principle promotes the objects of commercial utility and efficacy, as noted previously it does operate to reallocate the risk to the account party. This risk is accentuated in cases of fraud. While the account party may be left with an action under the underlying contract against the beneficiary, this action may be illusory or alternatively not capable of enforcement (particularly in relation to certain foreign beneficiaries). The judiciary has had to face the difficult task of balancing the risk between the various parties concerned.

The operation of both common law and statutory exceptions to the autonomy principle are reflective of a judicial balancing exercise. As will be demonstrated, the practical upshot of the operation of these exceptions is a diminution in the functionality of a bank guarantee or an unconditional performance bond as a cash equivalent.

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44 **Wood Hall Limited v Pipeline Authority** (1979) 141 CLR 443, 445.
47 This policy reason, underlying the court’s refusal to tamper with the unconditional nature of these instruments, was expressly recognised: *Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd* [1992] 2 Qd R 54, 57.
48 *Bache & Co (London) Ltd v Banque Vernes et Commerciale de Paris* [1973] 2 Lloyd’s Rep 437
49 Policy considerations must also be considered: *Montrod Ltd v Grundkotter Fleischvertriebs GmbH* [2002] 3 ALL ER 697 [58].
3. THE FRAUD EXCEPTION

3.1 LETTERS OF CREDIT

The fraud exception describes circumstances where, due to the operation of fraud, the autonomy principle must yield.\(^{50}\) In this paper, the fraud exception, as applying to letters of credit, will only be examined relatively briefly in order to provide the framework to consider whether this exception has application in relation to bank guarantees and unconditional performance bonds.

The fraud exception may operate to enable an issuing bank to elect to not make payment under a documentary letter of credit or alternatively may enable an account party to seek to restrain the issuing bank making payment or to restrain the beneficiary from seeking payment. The actual scope and availability of the fraud exception in practice turns on several questions and appears to be very much dependent upon the relevant jurisdiction.

It seems to be accepted that the fraud exception, to the autonomy of documentary credits, was first recognised by American courts.\(^{51}\) The leading case is *Sztejn v J Henry Schroder Banking Corporation*.\(^{52}\) (‘*Sztejn*’). There the fraud alleged was that the beneficiary seller shipped worthless material and rubbish rather than the goods ordered. Shientag J after referring to the principle of autonomy as being 'necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade'\(^{53}\) went on to consider the situation where for the purposes of this case it had to be assumed that the seller intentionally failed to ship the required goods. Shientag J observed:

"In such a situation, where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of the

\(^{50}\) The basis for the fraud exception, at least as between the issuing bank and its customer, may well be an implied contractual term: Czarnikow-Rionda Sugar Trading Inc v Standard Chartered Bank London Ltd[1999] 1 ALL ER 890, 914 (Rix J).

\(^{51}\) An observation confirmed by Young J in Inflatable Toy Company Pty Ltd v State Bank of New South Wales (1994) 34 NSWLR 243, 249.

\(^{52}\) (1941), 31 NY Supp 2d 631.

\(^{53}\) Ibid 634."
independence of the bank’s obligation under the letter of credit should not be extended to protect the unscrupulous seller.”

In other words, a fraudulent beneficiary should not be unjustly enriched. A difficulty arising from this case is that it is not clear whether this was a case of false documents or rather a case of fraud in the underlying transaction. This distinction will assume greater significance in subsequent discussions. For present purposes the writer prefers the view that the case should be characterised as a case of fraud in the underlying transaction. Certainly, the general trend of subsequent American decisions (arising from the operation of the Uniform Commercial Code) seems to be that the fraud exception is not limited to fraud as it relates to payment documents but will apply in relation to fraud in the underlying commercial transaction. It is useful to briefly consider some other jurisdictional approaches.

Canadian decisions also recognise the operation of the fraud exception. The Canadian approach has been to not confine the operation of the exception to cases of fraud in the tendered document but to include ‘fraud in the underlying transaction of such a character as to make the demand for payment under the credit a fraudulent one’. In the same context, it was observed that ‘the fraud exception to the autonomy of a documentary credit should extend to any act of the beneficiary of a credit the effect of which would be to permit the beneficiary to obtain the benefit of the credit as a result of fraud’.

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54 Id.
59 Ibid, 177.
Contrary to the approach of the American and Canadian judiciary, English courts have adopted a fairly strict view of the fraud exception. The leading decision remains the House of Lords decision in United City Merchants (Investments) Ltd v Royal Bank of Canada. This case defines the parameters of the fraud exception in English courts. In that case, a shipment of goods was made one day after the time specified in the letter of credit but the loading brokers, who were not associated with the beneficiary, fraudulently entered the earlier date on the bill of lading. In a judgment given by Lord Diplock, with the concurrence of the other four Law Lords, it was held that the fraud exception did not extend to fraud to which the beneficiary was not a party. More importantly, although the House of Lords observed that ‘fraud unravels all’, the nature of the fraud in this case was a fraud in the tendered documents rather than fraud in the underlying transaction. In taking such a strict view, the House of Lords was attaching paramount importance to the autonomy principle.

This approach can be contrasted with the earlier approach of Lord Denning MR in Edward Owen Engineering Ltd v Barclays Bank International Ltd where the fraud exception was characterised by Lord Denning MR as follows:

“... the bank ought not to pay under the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances where there is no right to payment.” (Underlining added).

The second half of Lord Denning’s formulation would seem to be wide enough to encompass the concept of fraud in the underlying transaction.

Unfortunately, there is a dearth of Australian authority in relation to the operation of the fraud exception. Whilst Sztejn, as accepted by the English Court of Appeal in Edward Owen

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61 An observation made in Montrod Ltd v Grundkotter Fleischvertriebs GmbH [2002] 3 ALL ER 697 [44].
63 This proposition was recently affirmed in Montrod Ltd v Grundkotter Fleischvertriebs GmbH [2002] 3 ALL ER 697, where the Court of Appeal held that the fraud exception did not embrace a nullity exception based upon the concept of a document being fraudulent in itself or devoid of commercial value.
64 [1978] QB 159.
Engineering Ltd v Barclays Bank International Ltd, has been accepted as being the law in Australia, the parameters of the exception have not been clearly defined. Particularly, the question remains open whether the fraud exception extends to fraud in the transaction rather than merely to fraud in the tendered documents. Whilst there is a suggestion that the judgment of Young J. in Inflatable Toy Company Pty Ltd v State Bank of New South Wales may have adopted a slightly wider test in relation to the fraud exception, as exemplified by the American and Canadian decisions, the question remains open whether the fraud exception extends to other cases of unconscionable conduct, or cases of non-performance of the underlying contract. Until such time as there is a decision by a higher appellate court or the High Court, there remains considerable uncertainty as to the actual operation of the fraud exception. All that can be said with certainty at the present time is that the exception is recognised as being part of Australian law.

3.1.1. GENERAL OBSERVATIONS

As well as the bounds of the fraud exception differing, differing standards of proof seem to be applied in different jurisdictions and there are consequential differences as to the prospects of relief being obtained. There are also differences in approach depending upon whether the issuing bank seeks to avoid payment or alternatively whether the account party seeks relief either against the issuing bank or the beneficiary.

However, there are some unifying trends. Generally it is unlikely that issuing banks will seek to avoid their payment obligations. In circumstances where banks may wish to dishonour their payment obligations, due to the operation of the fraud exception, they will require strong evidence. It would seem the issuing bank, in these circumstances, would need to establish at least that the relevant facts are indicative of ‘fraud’ (as the term is understood in the individual jurisdiction) and the relevant fraud must be ‘established’ before the issuing bank may dishonour

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66 (1941) 31 N.Y.S. 2d 631 (S.C).
67 [1978] 1 All ER 976.
70 These issues were expressly left open by Young J in Inflatable Toy Company Pty Ltd v State Bank of New South Wales (1994) 34 NSWLR 243, 251.
71 The English standard of clearly established fraud (Edward Owen Engineering Ltd v Barclays Bank International Ltd [1978] 1 All ER 976, 984) appears again to be most stringent.
its payment obligations. In practical terms, these circumstances are unlikely to arise. As noted previously, the issuing bank is regulated by a contract which is separate from the underlying contract and usually the bank has no duty of inquiry.73 Given that the bank has no duty of inquiry and generally wishes to preserve its reputation by making payment promptly, it is unlikely that fraud to the requisite standard of proof would be ‘established’ before the bank’s payment obligation arose.

Where the account party seeks relief, due to the operation of the fraud exception, different considerations will arise. Again, in general terms, it can be observed that the possibility of relief is far greater where relief is sought against a beneficiary rather than the issuing bank. This aspect will be considered in greater detail as it applies in relation to bank guarantees and unconditional performance bonds.

3.2 BANK GUARANTEES AND UNCONDITIONAL PERFORMANCE BONDS

The typical form of a bank guarantee or unconditional performance bond is such that the issuing bank's liability is triggered by a demand for payment, rather than the production of documents as is the case in a letter of credit transaction. Undoubtedly, this produces a greater scope for abuse of these instruments and therefore greater possibilities of fraud. Ackner L.J. refers, for instance, to the ‘many abuses of the performance bond procedure’.74 There is also a greater likelihood that these documents may be called up with a view to resolving a quite separate dispute that may have arisen between the contractual parties,75 to enhance a negotiating position (as part of a ‘strategy’ to seek to resolve a dispute)76 or for purely political reasons.77

Given the possibilities for fraudulent abuse of these documents, it is necessary to consider the application of the ‘fraud exception’ in relation to the generally autonomous nature of these transactions. Particularly, is the case law that has developed in relation to letters of credit

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73 As noted by the Court of Appeal in Montrod Ltd v Grundkotter Fleischvertriebs GmbH [2002] 3 ALL ER 697 it is not for a bank to make its own inquiries about allegations of fraud. [58].
74 Esal Commodities Ltd v Oriental Credit Ltd [1985] 2 Lloyd’s Rep 546, 550.
75 As with the ‘Billion Egg Contract’ in United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank Ltd [1985] 2 Lloyd’s Rep 554.
76 As in Wood Hall Limited v Pipeline Authority (1979) 141 CLR 443.
77 The judgment of the Court of Appeal in R D Harbottle (Mercantile) Ltd v National Westminster Bank Ltd [1978] QB 146 highlights the risks for account parties of the unconditional wording associated with such documentation.
directly applicable to bank guarantees and unconditional performance bonds? At the outset, it must be observed that the documentary letter of credit cases are less likely to be applicable\textsuperscript{78} given an issuing bank’s obligations under a documentary letter of credit to ensure that there is strict compliance in terms of documentation and the investigation made necessary by this requirement. In bank guarantee and unconditional performance bond cases, there is less emphasis on ‘strict compliance’ and accordingly less scope for investigations by the issuing bank to discover or be aware of fraud. There is a further potential impediment to the application of the ‘fraud exception’ to bank guarantees and unconditional performance bonds. As previously mentioned, the approach of the House of Lords in \textit{United City Merchants (Investments) Ltd v Royal Bank of Canada}\textsuperscript{79} seems to limit the fraud exception in that jurisdiction to ‘fraud in the documents’ rather than ‘fraud in the underlying transaction’.

As demand may be made under bank guarantees or unconditional performance bonds without the production of documents, the strict approach of the House of Lords may make the fraud exception of no application. This approach is not without criticism.\textsuperscript{80} It may be argued that the flexible standard, as to what will fall within the fraud exception, advocated by Stephenson J in the Court of Appeal decision in \textit{United City Merchants (Investments) Ltd v Royal Bank of Canada}\textsuperscript{81} is preferable. Consistent with the approach of Lord Denning MR in \textit{Edward Owen Engineering Ltd v Barclays Bank International Ltd},\textsuperscript{83} when applying the fraud exception to bank guarantees and unconditional performance bonds, it may be argued that it is sufficient if a request for payment is made fraudulently. In other words, fraud sufficient to invoke the fraud exception should not be required to relate directly back to the documents ‘but may simply taint the demand made under the instrument’.\textsuperscript{84}

Notwithstanding the possibility that the House of Lords' decision in \textit{United City Merchants (Investments) Ltd v Royal Bank of Canada},\textsuperscript{85} if strictly followed, seems to leave no room for the application of the fraud exception in relation to unconditional performance bonds and bank

\textsuperscript{79} [1983] 1 AC 168.
\textsuperscript{80} Fellinger suggests that a technical distinction between ‘fraud in the documents’ and ‘fraud in the underlying transaction’ is specious: G A Fellinger, above n 56, 23.
\textsuperscript{81} [1981] 1 Lloyd’s Rep 604.
\textsuperscript{82} A flexible standard could accommodate the American/Canadian approach where the fraud exception is generally accepted to be wider in its operation.
\textsuperscript{83} [1978] 1 QB 159.
\textsuperscript{84} G A Fellinger, above n 56, 18.
guarantees, subsequent English and Australian cases recognise the possibility of a fraud exception arising in relation to these documents. Inconsistent approaches to the standard of proof and discretionary considerations associated with the grant of equitable relief mean that the bounds of the fraud exception in Australian jurisdictions have not been clearly delineated. The only thing that can be said with certainty is that if common law fraud is established, to the appropriate standard of proof, then relief may be available. Will anything else, apart from common law fraud, invoke the operation of the fraud exception?

In the English and Australian jurisdictions, contrary to the American and Canadian approach, there seems to have been a reluctance to widen the theoretical bounds of the fraud exception. However there have been statements made at various times to indicate that the exception may not be theoretically limited to common law fraud. In an early English decision, *Elian & Rabbath v Matsas & Matsas*, the Court of Appeal, in what it regarded as being a special case, granted an injunction to prevent what might be irretrievable injustice. The result in this case was perhaps legally justified due to a total failure of consideration and/or the invalidity of the underlying contract.

In *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd*, arguments based on equitable, rather than common law, fraud were raised as justifying the application of the fraud exception. Although the equitable concept of ‘fraud of a power’ was not considered to invoke

87 It has been judicially noted that English interlocutory injunction decisions must be approached with a degree of caution concerning the standard of proof for fraud: *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812, 830 (Callaway JA).
88 Together with the absence of a High Court authority.
89 The generally accepted view in Australia being that the standard of proof for fraud at trial is proof on the balance of probabilities taking into account the nature and seriousness of the allegation: *Helton v Allen* (1940) 63 CLR; *Rejek v McElroy* (1965) 112 CLR 517; *Neat Holdings Pty Ltd v Karajan Holdings Pty Ltd* (1992) 67 ALJR 179 referred to in *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812, 830.
90 [1966] 2 Lloyd’s Rep 495.
91 (1985) 1 NSWLR 545.
the exception,92 Young J indicated that equitable relief could be given where there was either fraud or gross unconscionable conduct.93 In Hughes Bros Pty Ltd v Telede Pty Ltd,94 the possibility of relief was mooted where a claim for payment was made which could be regarded as specious or fanciful or far fetched. In GKN Contractors Ltd v Lloyds Bank,95 it was suggested that the ambit of the fraud exception might be extended to a case where the demand did not tally with the terms of the document itself in that it was made by a beneficiary not named. Finally, by way of illustration, in Potton Homes Ltd v Coleman Contractors Ltd,96 Eveleigh J suggested that there may be an exception, wider than the fraud exception, operative if there was a total failure of consideration in the underlying contract or if this contract was avoided. These decisions simply serve to illustrate that the scope of the fraud exception is by no means clearly delineated and may potentially be broader than previously recognised.

3.2.1 INJUNCTIVE RELIEF

Where it is alleged that a beneficiary has committed fraud an account party will seek court assistance. The assistance sought would usually be in the form of an injunction or other equitable relief discretionary in nature.97 One of the more instructive cases in relation to the type of equitable considerations that apply is Hortico (Australia) Pty Ltd v Energy Equipment Co. (Australia) Pty Ltd.98 Young J stressed that in the exercise of discretion as to the grant of equitable relief, the Court must have regard to the commercial character, and exigencies, of the transaction, noting that:

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92 Young J noted that although equity may intervene where there is an unconscionable use of a contractual (or statutory) power for an improper purpose, (Logue v Shoalhaven Shire Council [1979] 1 NSWLR 537, 553-554), the exercise of this discretionary power was not warranted given the commercial nature of the transaction.
93 By way of contrast, Batt J had grave reservations concerning whether gross unconscionability, falling short of actual fraud, would be grounds for an injunction: Olex Focas [1998] 3 VR 380, 400.
94 (1989) 8 ACLR 22.
95 (1986) 30 BLR 53.
97 It is trite law that the grant of an injunction will require the applicant to establish both that there is a serious issue to be tried and that the balance of convenience favours the grant of an injunction. However, in the context of the fraud exception it is noted by Paget that ‘the circumstances in which both propositions can be established will be exceedingly rare.’ Paget, in turn, refers to numerous reported instances where applications for injunctions have failed: Paget, above n 30, 651.
98 [1985] 1 NSWLR 545.
"there is a time to interfere in commercial activities, but that more often than not, commercial life is better served by a 'hands off' policy on behalf of the courts".  

Young J cautioned against the Court readily interfering in dealings between ‘experienced commercial men’. Young J went on to note that ‘equitable doctrines which were invented to protect the gullible and uneducated from predators are not necessarily to be applied in transactions between merchants or members of the commercial community in their ordinary trading’. In this regard, the potential insolvency of the beneficiary of the bank guarantee or unconditional performance bond was irrelevant.

A court will be reluctant to grant equitable relief unless it can be shown that without relief being provided that there will be irreparable damage for which damages would not represent adequate compensation. Also where a beneficiary is based overseas a Court may be unwilling to grant an injunction where the question of foreign enforcement arises. A further issue that arises is the requisite standard of proof to establish fraud. Once again, there is no uniformity of approach in relation to the standard of proof required. Fellinger refers to the need for ‘obvious fraud’ or ‘clear fraud’. Earlier cases, particularly English cases, have once again adopted a fairly rigorous test, namely the requirement for clearly established fraud or circumstances where ‘the only realistic inference to draw is that of fraud’. A slightly different later English formulation in GKN Contractors Ltd v Lloyds Bank was that the test should be whether fraud was the only reasonable inference to be drawn in the circumstances.

Once again, although there may be different jurisdictional approaches, there are certain similar trends. An uncorroborated statement of the account party alleging fraud will not constitute

99 Ibid 553.
100 Id.
101 [1985] 1 NSWLR 545, 553-554.
102 GKN Contractors Ltd v Lloyds Bank (1986) 30 BLR 53.
103 United Trading Corporation SA & Murray Clayton Ltd v Allied Arab Bank Ltd [1985] 2 Lloyd’s Rep 554.
104 G A Fellinger, above n 56, 17.
106 (1986) 30 BLR 53.
107 Once again, American and Canadian decisions seem to have adopted a less onerous standard, namely a ‘strong prima facie case’ of fraud, particularly with respect to applications for interlocutory injunctions.
sufficient evidence for the fraud exception to apply. A mere failure by a beneficiary, particularly a foreign beneficiary, to answer an allegation of fraud will not necessarily be enough for an adverse inference to be drawn to enable the fraud exception to be established. Despite this, it seems that an opportunity must be given to the beneficiary to answer fraud allegations.

The suggestion has been made (in relation to letters of credit) that there may be a variable approach depending upon who it is that is seeking to apply the fraud exception. More particularly, Fellinger suggests that should the issuing bank dishonour its obligations on the basis of an alleged or perceived fraud in the absence of a court injunction (known as ‘elective dishonour’—see 3.2.1.1 below), this may involve a higher standard of proof than injunctive dishonour cases where wider considerations and different standards of proof may apply to determine whether there is fraud in the ‘transaction as a whole’. These comments would appear equally applicable to cases involving bank guarantees and unconditional performance bonds. In the absence of a High Court determination, the differing standards of proof and different jurisdictional approaches make the availability of injunctive relief uncertain. The different types of relief and differing circumstances in which relief may be sought are further considered in 3.2.1.1 to 3.2.1.3 inclusive.

3.2.1.1 Mandatory injunction or declaration or other relief sought by a beneficiary to get an issuing bank to pay when the issuing bank is trying to resist payment (on the grounds of fraud)

Due to the operation of the autonomy principle, coupled with the desire of an issuing bank to preserve its own reputation, cases of this type have been relatively rare until recent times. Often characterised as ‘elective dishonour’ cases, commentators have suggested that issuing banks should not be encouraged to resist payment. A situation like this arose in Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd where the issuer of unconditional bonds sought to refuse to pay by asserting that the beneficiary’s right to payment was qualified by the provisions of the building contract which the bonds in question secured.

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109 G A Fellinger, above n 56, 22.

110 ‘Fraud is a legal matter and, as such, issuing banks should not be permitted to make judgments on the evidence.’: G A Fellinger, above n 56, 22.

This argument was rejected by the Full Court of the Queensland Supreme Court. Applying the unanimous decision of the High Court in *Wood Hall Limited v Pipeline Authority*¹¹², it was held that the issuing bank had ‘the burden to pay, with no burden of enquiry, or duty to third parties’.¹¹³

Without the clearest possible evidence of fraud, which in the absence of a duty to inquire the issuing bank is not likely to have, it is likely that an action for a mandatory injunction or declaration or other relief to require payment by an issuing bank would have reasonable prospects of success.

### 3.2.1.2 Injunction sought by an account party seeking to restrain an issuing bank making payment to a beneficiary

An action of this type would generally have extremely limited prospects of success. ‘The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the fact of fraud and as to the bank’s knowledge’.¹¹⁴ (Underlining added) Given that the issuing bank will usually have no documents to examine and is under no duty to make enquiries it will be very difficult in practice for this evidential standard of proof as to fraud to be satisfied. There have been innumerable cases where such injunctions have been sought without success.¹¹⁵ Apart from the almost insurmountable problems of proof that will arise in seeking such injunctions against the issuing bank, a further problem was identified in *R.D. Harbottle (Mercantile) Ltd v National Westminster Bank Ltd*.¹¹⁶ The issuing bank only has two options; it can pay or it can refuse to pay. If the bank pays when it should have paid, no complaint can be made. If the bank pays when it should not have paid, due to fraud, then the account party may pursue a remedy in damages against the bank¹¹⁷ or against the beneficiary. In these circumstances, the balance of convenience does not favour the issue of an injunction.¹¹⁸

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¹¹² (1979) 141 CLR 443.
¹¹⁴ *Bolivinter Oil SA v Chase Manhattan Bank NA* [1984] 1 All ER 351.
¹¹⁵ In *Washington Constructions Company Pty Ltd v Westpac Banking Corporation* [1983] Qd R 179, Thomas J described such a claim against the issuing bank as being ‘misconceived’; [180].
3.2.1.3 Injunction (mandatory or otherwise) against a beneficiary to withdraw a demand or to stop a future demand

This type of action may have some prospects of success and is separately considered as the second recognised exception to the autonomy principle.

4. THE SECOND EXCEPTION TO THE AUTONOMY PRINCIPLE

4.1 RESTRICTIONS ARISING FROM THE TERMS OF THE UNDERLYING CONTRACT

Even though the terms of the bank guarantee or unconditional performance bond appear to be 'unconditional', it is open for the account party to allege that the terms of the underlying contract regulate the circumstances under which the beneficiary is entitled to demand payment under the bank guarantee or unconditional performance bond. Typically, the account party will seek an injunction to restrain the breach, by the beneficiary, of an express, implicit or implied negative stipulation in the underlying contract. The account party will allege that the effect of the stipulation is that the beneficiary may not call upon the instrument where a dispute exists between the account party and the beneficiary. While the court is not required to interfere

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118 There can be no irretrievable injustice of the type contemplated in *Potton Homes Ltd v Coleman Contractors Ltd* (1984) 28 BLR 19.

119 The operation of this exception to the autonomy principle has been the subject of a number of existing articles and is only considered briefly in this paper. Reference may be made to the following: William Mark Jones, 'Injunctions Restraining Contractor’s Bank Guarantees', (1999) 15 *Building and Construction Law* 229; The Honourable Justice David Byrne, 'Rights of the Grantor under a Performance Bond', (2001) *Building and Construction Law* 4.

120 Contractual terms will not readily be implied in bank guarantees or unconditional performance bonds: *Wood Hall Ltd v Pipeline Authority* (1979) 141 CLR 443, 451; *BI (Aust) Pty Ltd v Cigna Insurance Australia Ltd* (1990) 11 BCL 64.

121 The account party will bear the onus of proof: *ADI Ltd v State Electricity Commission of Victoria* (Unreported, Vic Sup Ct, Brooking J, 12 August 1997).

122 To adopt the language of Callaway JA in *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812,826.

123 The account party will frequently be concerned that any demand that is successfully made under a bank guarantee or unconditional performance bond will adversely affect their commercial reputation. Refer, for example, to *Pearson Bridge v State Rail Authority of New South Wales* (1982) 1 ACLR 81, [20]; *Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451, 461-462.
directly with financier’s autonomy, the beneficiary is precluded from invoking the financier’s autonomous obligation.124

‘The origin of the mischief’125 arose from an obiter comment by Stephen J in Wood Hall Limited v Pipeline Authority.126 In that case, a submission that the Authority was in breach of its contract with the contractor, in making demand for payment before its entitlement to damages had been established, was rejected. In doing so, His Honour said:

"Had the construction contract itself contained some qualification upon the Authority's power to make a demand under a performance guarantee, the position might well have been different".127

Although the contract in that case was silent on the point, it will be appreciated that most underlying contracts will not be silent. Although English courts have been reluctant to grant injunctive relief of this type,128 this reluctance is not reflected in a substantial line of Australian authority where beneficiaries have been successfully enjoined in the absence of an entitlement under the underlying contract to make the demand for payment.129 Unfortunately, Australian authority is itself divided with a number of cases upholding a beneficiary’s recourse to a security provided the claimed entitlement was neither fanciful nor specious.130 The fact that these two lines of Australian authority have been judicially recognised to be irreconcilable131 merely serves

124 Boral Formwork v Action Makers [2003] NSWSC 713, [40].
126 (1979) 141 CLR 443.
127 Wood Hall Limited v Pipeline Authority (1979) 141 CLR 443, 459.
129 Pearson Bridge v State Rail Authority of New South Wales (1982) 1 ACLR 81; Tenore Pty Ltd v Roleystone Pty Ltd (Unreported, NSW Sup Ct, Giles J, 14 September 1990); Hughes Bros Pty Ltd v Teledyne Pty Ltd (1989) 7 BCL 210; Selvas Pty Ltd v Hanson Yuncken Pty Ltd and State Bank of Australia (1987) 6 ACLR 36; Barclay Mowlem Construction Ltd v Simon Engineering (Australia) Pty Ltd (1991) 23 NSWLR 451 and Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd (1999) 15 BCL 158 are illustrative of a strong line of authority.
130 Hughes Bros Pty Ltd v Teledyne Pty Ltd (1992) 7 BCL 210; Phillips Pty Ltd v Boulderstone Hornibrook Pty Ltd (Unreported, NSW Sup Ct, Giles J, 26 October 1994); Ultra Refurbishing and Construction Pty Ltd v John Goubran & Associates Pty Ltd (Unreported, NSW Sup Ct, Young J, 24 April 1997); Coby Constructions Pty Ltd v Melbourne Glass Pty Ltd (Unreported, Vic Sup Ct, Gillard J, 7 April 1998) and Kennedy Taylor (Vic) Pty Ltd v Boulderstone Hornibrook Pty Ltd (2000) 16 BCL 374 are equally illustrative of a strong divergent line of authority (as referred to by The Honourable Justice David Byrne, ‘Rights of the Grantor under a Performance Bond’, (2001) Building and Construction Law 4,10).
to heighten the importance that will be attached to an individual construction of the particular contract\(^{132}\) between the account party and the beneficiary.\(^{133}\) Given the lack of any unifying trend in the numerous Australian decisions on this particular issue, it is perhaps not surprising that one commentator has suggested that an appropriate response to the question ‘Are performance bonds as good as money?’ may be:

"Yes, if the judge says so, but it depends upon which judge is allocated to make the decision and on subtleties of language in the underlying contract and whether the judge thinks the beneficiary is acting unfairly."\(^{134}\)

The one thing that is clear is that ‘the duty of the bank to pay and the right of a beneficiary to claim are not simply opposite sides of the same coin’\(^{135}\) and there may be reasonable prospects of an account party being successful in this type of action.\(^{136}\) Further, ‘injunctive dishonour’ cases of this type are not usually associated with the exacting standard of proof associated with elective dishonour cases leading to a greater likelihood of curial relief. In combination with the inherent uncertainty associated with judicial interpretation of individual contracts in circumstances of clearly divergent lines of authority, these factors alone indicate that any equation, by beneficiaries, of a bank guarantee or unconditional performance bond with cash may be dangerous. It remains now to examine the third exception to the autonomy principle.

\(^{132}\) In delivering judgment in *Malaysia Hotel (Australia) Pty Ltd v Sabemo Pty Ltd* (1993) 11 BCL 50, Mahoney JA expressly restricted his decision to the particular contractual documents and the context in which they were made.

\(^{133}\) The decisions are also reflective of the evolution of certain standard contractual provisions. For a useful history of both this evolution and the particular importance that may be attached to contractual language (such as ‘may be entitled’, ‘shall be entitled’, or ‘becomes entitled’) refer to: The Honourable Justice David Byrne, ‘Rights of the Grantor under a Performance Bond’, (2001) *Building and Construction Law* 4. By way of illustration only, the distinction between the words ‘shall be entitled’ and ‘may be entitled’ were regarded as critical by Austin J in *Reed Construction Services Pty Ltd v Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158.

\(^{134}\) R Chesterman, above n 125, 173, 179.

\(^{135}\) M Coleman, above n 29, 224. At a judicial level, a similar observation was made by Callaway JA in *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* [1998] 3 VR 812, 826.

\(^{136}\) Although at least one commentator is of the view that the prospects of being granted an injunction may diminish where the form of security involved is a standby letter of credit, on the basis that courts view applications for an injunction more critically in these circumstances: William Mark Jones, above n 119, 237.
5. THE THIRD EXCEPTION TO THE AUTONOMY PRINCIPLE

5.1 STATUTORY UNCONSCIONABILITY

In the introductory comments reference was made to the controversy\textsuperscript{137} generated by the judgment of Batt J in \textit{Olex Focas}\textsuperscript{138} and the potential impact of statutory unconscionability on the autonomy principle. The full extent of the impact has recently been demonstrated in the judgment of Austin J in \textit{Boral Formwork v Action Makers}.\textsuperscript{139}

Boral and Action Makers entered into an agreement under which Action Makers was to manufacture and deliver to Boral scaffolding equipment. After inspecting certain equipment as delivered, Boral determined that the product was defective in that it did not meet the supply specifications. Boral wrote a letter to Action Makers providing details of the defects and subsequently incurred expenditure in carrying out rectification work on the goods.

Under the terms of its supply agreement, Action Makers was the beneficiary of an irrevocable standby letter of credit issued by the second defendant bank on behalf of its client, Boral. Administrative receivers were appointed to Action Makers. The receivers, as agents for Action Makers, made a demand on the bank for payment of the sum representing the full amount of the invoices rendered by Action Makers for scaffolding equipment supplied. The bank paid that part which Boral admitted to be owing (‘the undisputed amount’) but the balance of the amount claimed was alleged by Boral to be the cost of the rectification work (‘the disputed amount’), which Boral claimed to be entitled to deduct from the sum owing.

The issue for determination by the court was whether Boral was entitled to prevent the Bank from meeting the receivers’ demand on the letter of credit for the disputed amount. To succeed, Boral needed to overcome the operation of the autonomy principle. Boral claimed to be entitled to relief on the basis of an implied negative stipulation in the supply agreement; or alternatively pursuant to s 51 AA or s 51 AC of the \textit{Trade Practices Act 1974} (Cth). Austin J was not

\textsuperscript{137} Prior to this decision, unconscionability was considered unlikely to arise in the commercial arena: R Baxt and J Mahemoff, ‘Unconscionable Conduct Under the \textit{Trade Practices Act}-An Unfair Response by the Government: A Preliminary View’ (1998) 26 \textit{ABLR} 5, 11.

\textsuperscript{138} [1998] 3 VR 380.

\textsuperscript{139} [2003] NSWSC 713.
persuaded that there was an implied negative stipulation in the underlying supply agreement such as to ground an entitlement to an injunction restraining a call being made under the standby letter of credit for the disputed amount. Was Boral entitled to relief on the basis that Action Makers, by its administrative receivers, had engaged in unconscionable conduct for the purposes of s 51 AA or s 51 AC of the Trade Practices Act 1974 (Cth) when they made a call on the letter of credit for amounts more than due, for reasons known to the receivers, and certified incorrectly for that purpose?

Austin J was satisfied that it would be appropriate to make declarations and orders under s 51 AA of the Trade Practices Act 1974 (Cth). In addition, the specified conduct of the administrative receivers was held to be unconscionable within the words of s 51 AC of the Trade Practices Act 1974 (Cth). As to the presumption of autonomy, Austin J opined:

“… the presumption of autonomy does not provide an adequate discretionary reason for declining declaratory and injunctive relief on the basis of contravention of s 51 AC. The position might have been different if this was simply a case of making a call on the irrevocable instruments to apply pressure to resolve the dispute. But here, the dispute was effectively over and the Disputed Amount was no longer owing, and it was unconscionable for Action Makers to use its rights under the letter of credit by certifying for payment of the whole Invoice Amount in those circumstances.”

Having regard to the provisions of s 51 AA(2) of the Trade Practices Act 1974 (Cth), Austin J ultimately granted relief under s 51 AC, to the exclusion of s 51 AA. In the result, Action Makers was required to countermand the demand for payment of the disputed amount under the letter of credit, and restrained from making any further demands under the instrument. While the judgment makes it clear that the autonomy principle does not override the statute, the principle has a clear role to play:

“Even if the conduct is unconscionable, the principle of autonomy is relevant to the exercise of the Court’s discretion to grant injunctive relief or leave the plaintiff to other remedies. Here the circumstances, involving as they do a call on the letter of credit on a false basis, are sufficiently

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140 Boral Formwork v Action Makers [2003] NSWSC 713, [87].
141 Boral Formwork v Action Makers [2003] NSWSC 713, [91].
142 Boral Formwork v Action Makers [2003] NSWSC 713, [74].
special to overcome the hesitation which the principle of autonomy generates.\textsuperscript{143} (Underlining added)

With great respect to Austin J, the description of circumstances as being 'sufficiently special' to justify interference with the autonomy principle seems to merely provide further ammunition for those who argue\textsuperscript{144} that statutory unconscionability should have no role to play in commercial transactions of this ilk.\textsuperscript{145} Apart from the general concern that 'sand is not thrown in the wheels of commerce',\textsuperscript{146} it would seem reasonable to suggest that the behaviour of the receivers in this particular instance was merely an example of the commercially driven morality that was impliedly sanctioned by the High Court in \textit{Wood Hall Ltd v Pipeline Authority}.\textsuperscript{147} Undoubtedly, intended beneficiaries will have genuine concerns about the consistent future implementation of a judicial standard of 'sufficiently special' circumstances justifying interference with the autonomy principle. Further, beneficiaries may be concerned that allegations of unconscionable conduct may be used as a bargaining chip by account parties in a post hoc attempt to reallocate risk.

6. PRACTICAL REMEDIES FOR BENEFICIARIES

Beneficiaries have a legitimate concern to ensure that bank guarantees and unconditional performance bonds are as ‘good as cash’. The advantages of these instruments, as compared to a usual guarantee, are clear.\textsuperscript{148} Although it is not possible to exclude the operation of the

\begin{itemize}
\item \textsuperscript{143} \textit{Boral Formwork v Action Makers} [2003] NSWSC 713, [94].
\item \textsuperscript{145} Austin J expressly acknowledged the dangers associated with any judicial intervention with the performance of unconditional commercial obligations: \textit{Boral Formwork v Action Makers} [2003] NSWSC 713, [94].
\item \textsuperscript{146} The colourful phrase used by Callaway JA in \textit{Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd} [1998] VR 812, 831, as subsequently adopted as an article subtitle by The Honourable Justice David Byrne, ‘Rights of the Grantor under a Performance Bond’, (2001) \textit{Building and Construction Law} 4.
\item \textsuperscript{147} (1979) 141 CLR 443. In \textit{Olex Focas}, Batt J observed that the High Court in \textit{Wood Hall Ltd v Pipeline Authority} (1979) 141 CLR 443 noted with ‘apparent equanimity’ that, in making its demands, the beneficiary was pursuing a strategy of applying pressure on the account party with a view to achieving an advantageous settlement of their dispute.
\end{itemize}
‘fraud exception’, 149 a beneficiary’s protection will be maximised if the bank guarantee or unconditional performance bond operates not only as a security but also as a risk allocation device. 150 To achieve these objectives a number of safeguards can be adopted.

As regards the security instrument itself, the beneficiary should ensure that it operates as a primary undertaking to pay rather than as a guarantee151 or a contract of surety. The issuing bank’s obligation to pay should be specified in the instrument to be unconditional152 and the terms of the underlying contract should not be incorporated by reference.153 Beneficiaries should also ensure that the nominated issuing bank is unlikely to have a liquidated claim which may be set off as against the beneficiary.154

In addition, a beneficiary should require that the underlying contract contain certain provisions. The account party should be required to expressly acknowledge that:

- the bank guarantee or unconditional performance bond, in addition to being a security, is a risk allocation device, it being the intention of the parties that the risk of litigation (particularly who is to be out of pocket pending resolution of a dispute)155 or insolvency156 be borne by the account party; and

- the terms of the underlying contract do not (and are not intended to) contain any restriction upon the beneficiary’s right to make demand157 and further that the beneficiary is entitled to make demand under the bank guarantee or unconditional performance

149 For public policy reasons.
150 In Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd [1998] 3 VR 812 the Supreme Court of Victoria expressly recognised the potential use of these securities as risk allocation devices (albeit that this conclusion was reached as a matter of construction of the commercial purpose of the agreement). Jones also refers to the importance that must be attached to the parties’ intentions concerning the allocation of risk: William Mark Jones, above n 119, 229.
151 As previously noted, the term ‘guarantee’ is a misnomer.
152 In order that the form of the document is seen to represent the intention of the parties: Malaysia Hotel (Australia) Pty Ltd v Sabemo Pty Ltd (1993) 11 BCL 50.
153 To avoid the type of result that flowed in Barclay Mowlem Construction Co. v Simon Engineering (1991) 23 NSWLR 451.
154 To avoid the consequences of the decision in Hong Kong & Shanghai Banking Corporation v Kloeckner & Co AG [1990] 2 QB 514 (a letter of credit case that may apply by analogy).
155 Often a key issue that would otherwise arise as a matter of construction of the underlying contract see, for example, Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd [1998] 3 VR 812.
156 In the same way (as previously noted) that a letter of credit arrangement usually operates to reallocate the risks of litigation, insolvency and dishonesty: M Shaw, above n 13, 253.
bond notwithstanding any dispute under the underlying contract\textsuperscript{158} provided that the demand is not fraudulent at common law.\textsuperscript{159}

If these suggestions were followed, the bank guarantee or unconditional performance bond would operate to substantially allocate the risk in the transaction to the account party. Express provisions in the underlying contract would circumscribe argument based on implied restrictions\textsuperscript{160} and also militate against any interference with the autonomy principle based on statutory unconscionability.\textsuperscript{161} The inclusion of the suggested provisions in the underlying contract would undoubtedly strengthen the bargaining position of a beneficiary during any subsequent settlement negotiations,\textsuperscript{162} and allow a beneficiary to act in what may be otherwise interpreted as a commercially driven manner.\textsuperscript{163}

7. CONCLUSION

Even though bank guarantees and unconditional performance bonds may be unconditional in their wording, they are not necessarily as ‘good as cash’ due to the exceptions to the autonomy principle outlined in this paper. Unfortunately, the true boundaries of all three exceptions have not been clearly delineated by the courts.

The operation of the fraud exception remains clouded in mystery. Is fraud restricted to common law fraud\textsuperscript{164} or, adopting a more flexible approach,\textsuperscript{165} does it extend to equitable fraud or gross unconscionable conduct\textsuperscript{166} or circumstances where there has been a total failure of consideration in the underlying contract or the underlying contract has either not been

\begin{itemize}
  \item[157] No implied restriction can arise if it is inconsistent with an expressly agreed allocation of risk: \textit{Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd} [1998] 3 VR 812, 827 (Callaway JA).
  \item[158] Adopting the words of Murphy J, this will help prevent a situation where all the ‘legal and factual complexities of a … dispute would be injected into an otherwise straightforward unconditional undertaking’: \textit{Wood Hall Ltd v Pipeline Authority} (1979) 141 CLR 443, 461.
  \item[159] Contractual exclusion of the common law fraud exception to the autonomy principle being impermissible.
  \item[160] The second exception to the autonomy principle as described in this paper.
  \item[161] The basis for relief in \textit{Boral Formwork v Action Makers} [2003] NSWSC 713.
  \item[162] A ‘strategy’ that was previously unquestioned based on the High Court decision in \textit{Wood Hall Limited v Pipeline Authority} (1979) 141 CLR 443.
  \item[163] Being one possible characterisation of the conduct of the administrative receivers in \textit{Boral Formwork v Action Makers} [2003] NSWSC 713.
  \item[164] The restrictive English approach.
  \item[165] Consistent with the more expansive approach adopted in American and Canadian decisions.
  \item[166] As suggested by Young J in \textit{Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd} (1985) 1 NSWLR 545
\end{itemize}
performed or avoided? In addition to these unresolved fundamental theoretical questions, contradictory dicta in relation to the standard of proof, the inherent uncertainties usually associated with any application for equitable relief and differing curial approaches, in part reflective of the significance of the identity of the party seeking relief, combine to provide a legal landscape which is undoubtedly challenging for those who are called upon to provide commercial advice.

The second exception, restrictions arising from the terms of the underlying contract, is no less problematic. Faced with irreconcilable lines of authority, judicial interpretation of individual contractual wording has become paramount. Unfortunately, such a demonstrably ad hoc approach provides little certainty for either beneficiaries or account parties.

The final exception, statutory unconscionability, is also troublesome in its application. Whilst the argument is undoubtedly open that a judicial characterisation of individual circumstances as ‘sufficiently special’ may justify interference with the autonomy principle, this approach may not sit comfortably with the intention that the bank guarantee or unconditional performance bond operate as a risk allocation device (as well as a security). If the risk of a beneficiary acting in what may be characterised as a commercially driven manner is to be borne by the account party this will need to be made patently clear in the underlying contract.

If the safeguards suggested in this paper are not routinely implemented, the intended beneficiary of a bank guarantee or unconditional performance bond may well rue the day that such an instrument was accepted in lieu of a cash retention.

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168 Part 3.2.1 of this paper.
169 Part 4.1 of this paper.
170 *Boral Formwork v Action Makers* [2003] NSWSC 713, [94].
171 At a macro level, a wholesale return to the use of cash retentions would also reduce the funds available in certain industry sectors, such as the construction sector: William Mark Jones, above n 119, 238.