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AUSTRALIA CLOUGH ENGINEERING LTD v. OIL & NATURAL GAS CORPORATION LTD

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Introduction

The recent case of *Clough Engineering Ltd* v. *Oil & Natural Gas Corporation Ltd*,[1](#ICL:20090135.374) is the last of a long line of Australian decisions relating to the circumstances in which injunctive relief may be available to prevent a call on a bank guarantee or standby letter of credit (banker's undertaking), issued to the owner of a construction project. The case is also tangentially relevant to the effect of an international arbitration clause in circumstances where an interim preservation order is being sought.

This case is an appeal from a single judge of the Australian Federal Court to the Full Court of the Federal Court of Australia. The presiding judges were French, Jacobson and Graham JJ. It is one of the last decisions delivered by French J before he assumed the position of Chief Justice of the High Court of Australia on 1 September 2008.

The case relates to a dispute which arose between Clough Engineering Ltd (Clough), an Australian company, and Oil & Natural Gas Corporation Ltd (ONGC), an Indian corporation. Pursuant to the relevant contract Clough undertook to construct infrastructure for an oil and gas field off the

1 [2008] FCAFC 136.

coast of India for US$215m. By way of security, Clough was required to provide ONGC an unconditional and irrevocable banker's undertaking equal to 10% of the contract price. However, the banker's undertakings were limited temporally. Accordingly, the contract provided for the extension of the guarantees in the event of the completion of the works being delayed. Importantly, clause 3.3.3. gave ONGC the right to invoke the performance guarantees and claim the amounts thereunder if Clough "failed to honour any of the commitments entered into under the contract".

The proper law of the contract was Indian. The arbitration clause had a relatively wide scope and related to "any dispute, difference, question or disagreement" which might arise between the parties or their respective representatives "... at any time in connection with the construction, meaning, operation, effect, interpretation arising out of the contract or breach thereof ..."

The project suffered from significant delays. Clough made claims for extensions of time. Some extensions of time had been granted, but not sufficient to excuse all of the delays which had been suffered. ONGC sought confirmation that insurance and the banker's undertakings would be extended so that both were current during the extended contract period.
On 4 June 2007 ONGC forwarded a facsimile to Clough purporting to terminate the contract. On the same date ONGC made demands pursuant to the banker's undertakings. On 5 June 2007 Clough commenced proceedings in the Federal Court of Australia naming ONGC and the three banks as respondents. The relief sought by Clough was in the form of declarations, injunctions and damages arising from the conduct of ONGC. An *ex parte* interlocutory injunction was granted on 5 June 2007. The effect of the injunctions granted was to prevent the banks from making payment to ONGC, in accordance with the demand made. On 7 June 2007 an *ex parte* injunction was granted against ONGC restraining it from taking further steps to demand or obtain payment or renew such claims or demands, from the banks under the performance bonds. Further orders were made on 7 June 2007 for leave to serve ONGC out of the jurisdiction. The question as to whether the injunctions against the banks should continue was considered by the court on 12 and 19 June 2007. Following further hearings an application by the banks to discharge the injunction was dismissed.
On 20 July 2007 ONGC made application to set aside service of the amended application, the order granting leave to serve the amended application out of the jurisdiction and that the interlocutory injunctions either be set aside or discharged. Further affidavit material was exchanged and the matter determined at first instance on 21 December 2007. The court at first instance granted the relief sought by ONGC resulting in orders discharging the injunctions previously made. Clough made an application for leave to appeal, which was granted on 29 February 2008. The Full Court of the Federal Court of Australia (the appellate court) dismissed the appeal and handed down its decision on 22 July 2008.
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Restraining payment pursuant to standby letter of credit or bank guarantee

Australian law recognises the commercial importance of banker's undertakings.2 (#ICL:20090135.375) The courts recognise that they should not interfere with the rights and obligations created by banker's undertakings, except in extreme circumstances, such as where there is fraud.3 (#ICL:20090135.376)
However, in limited circumstances the Australian courts have been prepared to grant injunctions restraining the beneficiary from making a call on the bond. These cases do not seek to injunct banks or adversely affect the undertakings given in the banker's undertakings.
In the usual case the injunctions are directed to preventing the occur-rence of the precondition to the bank having to pay in accordance with the banker's undertaking. That is they are directed to preventing the beneficiary from making a demand pursuant to the

banker's undertaking. Once the demand has been made and payment secured, the room for injunctive relief narrows considerably. Notwithstanding, in a number of cases Australian courts have been prepared to order the repayment of money already paid pursuant to a bond in exchange for a fresh bond issued by the contractor together with an injunction preventing a further call on the fresh bond.4 (#ICL:20090135.377) Thus, the *status quo* prior to the demand is re-created. Even in these cases, no action or orders are made against the bank. Accordingly, in principle the obligation of the bank remains unaffected. It is merely the beneficiary who is unable to enliven the obligation of the bank pursuant to the undertaking by making a demand. In so far as the court at first instance in the *Clough* case granted *ex parte* injunctions against the banks, this was not in accordance with principle established by previous cases.
Before a court will grant an injunction against a beneficiary, it is necessary for the beneficiary to establish that there is a serious issue to be tried. There are three possible arguments:

- (a) the beneficiary is acting fraudulently;
- (b) the beneficiary has (in the underlying contract regulating the transaction between the beneficiary and the contractor) promised not to make a call unless certain circumstances are satisfied (i.e., there is a negative stipulation or covenant, limiting the circumstances in which the beneficiary may make a call) and those circumstances have not been satisfied;
- (c) the beneficiary is in breach of section 51AA of the Trade Practices Act 1974 (Cth).

2 *Woodhall Ltd* v. *The Pipeline Authority* (1979) 141 CLR 443.
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3 *Washington Constructions Co Pty Ltd* v. *Westpac Banking Corporation* [1983] 1 Qd R 179.
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4 E.g., see *Sabemo Pty Ltd* v. *Malaysia Hotels (Australia) Pty Ltd*, Supreme Court of New South Wales, Hodgson J, 5 July 1990, unreported, and *Abigroup* v. *River Street Development* [2006] VSC 80.
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(a) Fraud

No allegations of fraud were made by Clough against ONGC or the banks. An injunction could not be justified on this basis.

(b) Negative covenant

The principal argument advanced for Clough was that the construction contract contained a negative covenant that ONGC would not call on the banker's undertaking unless it had an entitlement to be paid money by the contractor. The contractor disputed that there was any entitlement in the principal to be paid money and that therefore it was entitled to an interlocutory

injunction preventing a call, pending the resolution of the underlying dispute as to whether the contractor was indebted to the principal. Clause 3.3.3 of the contract provided as follows:

"The Company (ONGC) shall have the right under the guarantee to invoke the Bankers Guarantee and claim the amount thereunder [*sic*] in the event of the Contractor failing to honour any of the commitments entered into under the Contract. In case Contractor fails to furnish the requisite bank guarantee as stipulated above, then the Company shall have the option to terminate the Contract and forfeit the Bid security amount and no compensation for the Works performed shall be payable upon such termination. Upon completion of the Works the above said guarantee shall be considered to constitute the Contractor's warranty for the work done by him or for the Works supplied and their performance as per the specification and any other conditions against this Contract. The warranty shall be in force for 12 months, from the completion date as provided in clauses 5.10.2 & 5.10.3 ..."

At first instance, the judge concluded that, on a proper reading of the contract as a whole, there was no negative covenant. This conclusion was heavily influenced by the wording of the draft unconditional banker's undertaking attached as an annexure to the contract. Further (going further than he needed to do) the judge concluded that there was an actual breach of contract which would have justified the call, even had there been a negative covenant. Finally, the judge concluded that even if there had been a serious issue to be tried, he was of the view that the balance of convenience would not have justified an injunction in the circumstances. In reaching that conclusion, he was not persuaded that Clough's financial position, meant that irreparable harm to Clough would be suffered if the injunction was not granted and was not convinced that damage to Clough's reputation as a consequence of the call on the banker's guarantees would justify an alternative conclusion. To the contrary he concluded[5 (#ICL:20090135.378)]:

"125. If anything the maintenance of the injunctions will impair Clough's position. In Mr Simon's second affidavit, he has said that the Banks have each advised him that they will not extend any further facilities to Clough until such time as the injunctions against them are dissolved or otherwise dispensed with.

5 See [125].

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126. I would in these new circumstances not accord any significant weight, in considering the balance of convenience, to Clough's concerns as to its reputation."

The Full Court also concluded that on a proper construction of the underlying contract between Clough and ONGC there was no negative covenant. At paragraphs 83 and 109 the court commented as follows:

"[83] It follows that clear words will be required to support a construction which inhibits a beneficiary from calling on a performance bond where a breach is alleged in good faith, i.e., non-fraudulently ...

[109] In our opinion the approach taken by Brooking JA in *Bachmann* [1999] 1 VR 420, which in large measure reflects and follows that of *Fletcher Constructions* [1998] 3 VR 812 supports the view that a *bona fide* dispute as to whether Clough had failed to honour its commitments under the Contract, did not preclude ONGC from invoking the performance guarantees."

The Clough case together with the cases referred to by the Full Court of *Bachman Pty Ltd* v. *BHP Power New Zealand Ltd*,6 (#ICL:20090135.379) *Fletcher Construction* v. *Varnsdorf* 7 (#ICL:20090135.380) and another decision of the Victorian Court of Appeal, *Anaconda Operations Pty Ltd* v. *Fluor Daniel Pty Ltd*,8 (#ICL:20090135.381) mark a significant change in judicial attitude to that found in some earlier cases at first instance.9 (#ICL:20090135.382) It is now apparent that obtaining an injunction preventing the beneficiary from making a call on a banker's undertaking will be much more difficult to obtain, than it was in the 80s and 90s.

However, where the language is clear so that the owner has undertaken not to call upon a bond unless there is an absolute right to the money, an injunction may be available in a suitable case (i.e., where the applicant establishes that the discretion of the court should be exercised including satisfying the court that there is a serious matter to be tried and the balance of convenience otherwise favours the granting of an injunction). These clauses will generally be construed as clauses allocating the risk of who is to be out of pocket, pending the outcome of any dispute resolution process pursuant to the main contract.

(c) Claim under the Trade Practices Act

Clough also contended that it was entitled to an injunction pursuant to section 51AA of the Trade Practices Act.

Section 51AA of the Trade Practices Act 1974 (Cth) provides:

"(i) a corporation must not in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law, from time to time, of the States and Territories;

6 [1999] 1 VR 420.

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7 [1998] 3 VR 812.

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8 [1999] VCA 214.

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9 See, e.g., *Pearson Bridge (NSW) Pty Ltd* v. *State Rail Authority of New South Wales* (1982) 1 ACLR 81 (Sup Ct NSW); *Barclay Mowlem Construction Ltd* v. *Simon Engineering (Australia) Pty Ltd* (1991) 23 NSWLR 451.

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(ii) this section does not apply to conduct that is prohibited by Sections 51AB and 51AC."

If there is a breach of this section, then the court has a wide power to grant an injunction pursuant to section 80 of the Trade Practices Act.

Gilmore J, at first instance, concluded10 (#ICL:20090135.383) :

"In particular, Clough contends that the delay in its providing the 'Christmas Trees' was caused by breach on the part of ONGC relating to the 'DHPTT Cards'. It also asserts that ONGC was in breach in other respects, such as failing to effect well completion in relation to the deep water work and that ONGC lost the first 'Christmas Tree' and certain tools, all of which contributed to delays to the Project. The failure to undertake shallow water works, likewise, Clough says, was occasioned by breaches on the part of ONGC. It is not possible to resolve these factual questions and whether

those asserted breaches were occasioned by ONGC's own breaches. *This in turn gives rise to a* prima facie *case of a serious issue to be tried, whether based on those asserted breaches, ONGC acted unconscionably, contrary to s. 51AA of the TPA in calling up the performance guarantees* ..." (Emphasis added.)

However, the judge then went on to consider the evidence. He concluded that, on the basis of the material, that there were proven breaches of contract by Clough, namely, the failure to provide a replacement performance guarantee and take out necessary insurance during the extended period of the contract. He, therefore, in refusing to grant injunctive relief, concluded: "It follows that, in calling up the performance guarantees in respect of those breaches, ONGC was acting according to a legal entitlement under clause 3.3.3 untainted by conduct which could even arguably be characterised as unconscionable in contravention of the TPA ..."[11 (#ICL:20090135.384)]

While the trial judge was prepared to entertain the possibility of there being a serious issue to be tried arising from the allegation of breach of section 51AA of the Trade Practices Act, the Full Court was less impressed. At paragraph 138 of the judgment, the Full Court summarised its view:

"As already pointed out, on their proper construction, the performance bonds were unconditional on any actual breach and did entitle ONGC to call upon them for their full amount. Given the commercial purpose of such guarantees, recognised in *Woodhall Ltd*, 141 CLR 443, assuming the absence of fraud, there would seem to be very little, if any, scope for the application of equitable doctrines of unconscionable conduct to restrain the exercise by a party of its legal rights under such guarantees. There may be extreme cases which would merge into the area of bad faith exercise of the powers. However that may be, the present case is not a case which, on the material before His Honour, justified any finding of a serious question to be tried of a contravention of s. 51AA. The wide purpose of the performance bond of guarantees and their character as reflecting an allocation of risk in a provision of security to their holder militated against any argument as to disproportion in their exercise".

Accordingly, going forward, only very special cases could possibly justify the grant of an interlocutory injunction pursuant to section 51AA of the

10 *Clough Engineering Ltd* v. *Oil and Natural Gas Corporation Ltd (No 3)* [2007] FCA 2082 at [59].

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11 *Ibid*. at [95].

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Trade Practices Act. To date no injunction has been granted on this basis. However, the possibility has been considered in two cases.[12 (#ICL:20090135.385)]

The role of the court given the international arbitration clause

The contract contained an arbitration clause. Pursuant to Australian law, the arbitration clause is characterised as international. It is therefore regulated under the International Arbitration Act 1974 (Cth), not the legislation which regulates domestic arbitration. Subject to minor amendments, the International Arbitration Act incorporates the UNCITRAL Model Law. Accordingly, on application by either party, the court *must* stay its own processes. However, pursuant to Article 9 of the Model Law, the existence of an arbitration agreement does not prevent a court from granting interlocutory relief, including by way of injunction. Article 9 of the Model Law provides as follows: "It is not incompatible with an arbitration agreement for a party to request, before or during arbitral proceedings, from a court an interim measure of protection and for the court to grant such measure."

Accordingly, notwithstanding the arbitration clause, the application before the Federal Court was permissible in accordance with Australian law. However, it was inappropriate for the court to reach any final or binding determinations in relation to the subject-matter of the interlocutory hearing. As discussed above, the court did so, finding that Clough had actually breached the contract and that therefore ONGC was entitled to make the call on the banker's undertaking, notwithstanding any argument about unconscionable conduct or negative covenants.

It is appropriate that the court retain the power to grant interlocutory relief as, in accordance with Australian authority,13 (#ICL:20090135.386) it has been determined that any interlocutory determination by an arbitrator is *not* an award for the purposes of the New York Convention or the Model Law and that therefore the courts will not enforce such orders.

However, it is unfortunate that in this case the court at first instance has inadvertently trespassed into the area reserved for arbitration. That arbitration is now proceeding and no doubt ONGC will argue that the findings of the court, in its favour, bind the arbitrators.

12 The *Clough* case and *Olex Focas Pty Ltd* v. *Skodaexport Co Ltd* [1998] 3 VR 380. The logic in *Olex Focas* has been overtaken by subsequent authority which has significantly narrowed the operation of s. 51AA of the Trade Practices Act from that which was considered arguable in that case.

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13 *Resort Condominiums International Inc* v. *Ray Bolwell and Resort Condominiums (Australasia) Pty Ltd* [1995] 1 Qd R 406.

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