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Securing your securities?

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In November 2015, we updated readers on the decision of *Laing O'Rourke Australia Construction Pty Ltd v Samsung C & T Corporation*¹ which provided insight into the willingness of the courts to quash determinations of adjudicators made under the *Construction Contracts Act 2004* (WA) (**Act**).

Those parties have recently been back before the court to dispute the entitlement of Samsung C & T Corporation (**Samsung**) to call on a security provided by Laing O'Rourke Australia Construction Pty Ltd (**LORAC**), worth \$7.5 million.

Facts

In February 2014, Samsung and LORAC entered into a contract whereby LORAC agreed to undertake construction work at the Roy Hill Iron Ore Project in Pilbara

(**contract**). Under the terms of the contract, LORAC was required to provide security equal to 10% of the contract value.

In February 2015, Samsung terminated the subcontract for convenience, and subsequently both parties entered into a Deed. Under the Deed LORAC provided Samsung with a security in substantially the same form as that provided under the contract (**Replacement Security**).

On 1 September 2015, Samsung merged with Cheil Industries Inc. (**Cheil**). Cheil is a company registered in accordance with the laws of the Republic of Korea. Later that month Samsung was dissolved, and a short time thereafter Cheil was renamed Samsung C & T Corporation (**New Samsung**). Despite taking its name, New Samsung did not retain the company registration number of Samsung, but asserted that it had assumed

the rights and obligations of both a private and public nature, assets, liabilities, contracts, employment agreements, etc. of Samsung.

The contract and Deed were ultimately terminated in the midst of LORAC claiming that Samsung owed it over \$90 million, and New Samsung claiming that LORAC owed it approximately \$55 million.

On 22 January 2016, New Samsung gave notice of its intention to call upon the Replacement Security under the Deed. On 25 January 2016 LORAC applied for an interlocutory injunction restraining New Samsung from demanding or receiving payment pursuant to the Replacement Security.

Determination

LORAC was tasked with persuading the court that the matter exhibited the three characteristics which must be present in order for injunctive relief to be granted:

- There is a serious question to be tried as to its entitlement to relief at trial. The requisite strength of the probability of ultimate success depends on the nature of the rights asserted and the practical consequences likely to flow from the interlocutory relief sought;²
- That damages would not be an adequate remedy; and
- That the balance of convenience favours the grant of an interlocutory injunction.

Quite separate from the above criteria, the general rule is that an injunction restraining the conversion of a performance bond will not be granted unless it can be established that the party in whose favour the security has been given has acted fraudulently or unconscionably, or has otherwise promised not to call on the security.³ It was not asserted that the facts of this case gave rise to any of the exceptions to the general rule.

LORAC raised the following points in an attempt to establish that there existed a serious question to be tried.

a. New Samsung is not the beneficiary of the Replacement Security, as the Replacement Security was provided for the benefit of Samsung

In determining this issue, his Honour considered the succession by New Samsung to the rights of Samsung was intimately connected with the merger from which New Samsung emerged. Both the existence and the rights and liabilities of the merged entity are therefore issues as to its *'status'*, which must be determined by reference to the law of New Samsung's domicile, the law of Korea. The Korean Commercial Code provides (in relation to a partnership of companies) that:

'A surviving company or a company newly incorporated in consequence of a merger shall succeed to the rights and obligations of the company which disappeared.'

Accordingly, his Honour found that New Samsung was the beneficiary for the purposes of the Replacement Security.

b. The conditions of the Replacement Security that must be met before it can be realised have not been satisfied

LORAC contended that the Replacement Security defines the *'contractor'* as Samsung, and that because New Samsung is not entitled to use Samsung's ABN (as it has a different Korean registration number) it does not meet the definition of the Contractor under the terms of the Replacement Security.

Accordingly, his Honour considered whether the definition of contractor in the Replacement Security should be construed so as to refer only to Samsung, or whether the proper construction is broad enough to capture New Samsung. In rejecting LORAC's submission, his Honour found that giving the Deed a sensible commercial interpretation, New Samsung has, for all intents and purposes, stepped into Samsung's shoes. The definition of *'contractor'* in the Replacement Security should be construed as including Samsung's successor, New Samsung.

c. The conditions of the contract and the Deed which govern the right to realise the Replacement Security have not been satisfied

This argument was predicated on his Honour first making a finding that there was a condition on the right to call on the Replacement Security that Samsung consider, acting bona fide, that it is or will be entitled to recover more than \$7.5 million from LORAC. This finding was in fact made despite such a condition not expressly forming part of the Deed.

His Honour went on to find that LORAC had not established to the requisite standard that New Samsung had not acted bona fide in considering it is entitled to recover \$7.5 million from LORAC. In coming to this view his Honour made two general observations:

*'A party that tries to establish, within the context of, and subject to the procedural limitations of, an interlocutory application, that its opponent acted without bona fides faces significant forensic difficulties. In assessing the allegation of a breach of bona fides, a court will look for undisputed facts and facts not surrounded by controversy from which to draw inferences. In this case, many of the matters relied upon by LORAC are so bound up in the controversies involved in the underlying dispute that it is difficult to draw the inference of a lack of bona fides for which LORAC contends;'*⁴

and

'The effect of granting the relief sought by LORAC will be to deprive Samsung of the benefit of the bargain for which it contracted, being the right to realise cash for its cash flow purposes by calling on the Replacement Security...The injunction will not preserve the status quo but will change it. In those circumstances, LORAC must demonstrate a prima facie case of sufficient strength to engender confidence that it would succeed if the matter went to trial. LORAC has raised a

*serious question but its prima facie case is not sufficiently strong to justify the grant of an injunction.'*⁵

Finally LORAC asserted that the following factors supported its position that the balance of convenience favoured the grant of an injunction:

- LORAC would suffer reputational damage as a result of the Replacement Security being called upon, and thus the value of the business would be affected;
- LORAC agreed to extend the life of the Replacement Security to enable a hearing of the dispute to take place lessening the significance of the injunction; and
- That Samsung had little or no real estate in Australia against which LORAC could enforce a judgment for \$7.5 million.

His Honour, in finding that the balance of convenience did not favour the granting of the injunction, held that while LORAC may suffer some reputational damage, potential buyers interested in LORAC's Australian operation would possess a level of sophistication which enables them to put the calling of the Replacement Security in its proper context, namely, that it is a risk of doing business in the commercially aggressive world of international construction contracting.

Further, his Honour found that any delay in New Samsung's right to call upon the Replacement Security erodes the benefit of the bargain it struck with LORAC, and for that reason LORAC's willingness to extend the life of the Replacement Security did not assist it in the assessment of where the balance of convenience lies.

Finally, his Honour was also convinced that Samsung would be able to satisfy any judgment which required that it return the \$7.5 million.

What does this mean?

The Supreme Court of Western Australia has reaffirmed the general rule that an injunction restraining the conversion of a

performance bond will not be granted unless one of the exceptions in *Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd*⁶ is established, that is, that the party in whose favour the security has been given has acted fraudulently or unconscionably, or has otherwise promised not to call on the security.

The court also indicated that in considering whether the balance of convenience favours granting the injunction the fact that a party may suffer some reputational damage as a result of the security being pulled will carry little weight particularly in circumstances where commercially sophisticated entities that may have an interest in contracting with/purchasing the affected contractor should appreciate that such risk is simply part of the commercially aggressive world of international construction contracting.

When considering the drafting of security clauses, contractors should consider including a number of protective measures. Firstly, contractors should not agree to clauses which preclude the bringing of an injunction (it is strongly arguable in most circumstances that such a clause would not be enforceable in any event where it fetters the discretion of the court but contractors should avoid the implication that they had willingly agreed not to bring an injunction, giving further strength to arguments for the party making the call on security). Secondly, contractors should limit calls on security to where there is actually a debt due or at a very minimum include the words that there must be a bona fide claim for a debt due under the

contract. This will both limit the opportunity to call on the security and also enshrine the implied term noted earlier. Contractors should also insist on being given notice of a call on security and an opportunity to rectify the breach or loss giving rise to the call on security. In this way there will at least be an opportunity to negotiate the outcome or prepare for an injunction understanding the apparent basis for the call on security. Lastly, an opportunity to call on security should not apply. Where the principal itself has not strictly complied with contractual requirement, particularly where there is a strong basis to dispute entitlement to the amount claimed by the principal.

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¹ [2015] WASC 237.

² *Australian Broadcasting Corporation v O'Neill* [2006] HCA 46; (2006) 227 CLR 57 [71].

³ *Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd* (1999) 15 BCL 158.

⁴ [2016] WASC 49 [134].

⁵ [2016] WASC 49 [135].

⁶ (1999) 15 BCL 158.

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