Supreme Court of Victoria finds that a builder has an implied right to pay out a bank guarantee, instead of the principal encashing it — L.U. Simon Builders Pty Ltd v Cardigan Commercial Pty Ltd (No 2) [2026] VSC 33

Executive Summary

The Court implied a term allowing the Contractor to substitute cash for the bank guarantee and require its release, despite the contract being silent. It held that bank guarantees are commercially equivalent to cash and that the term satisfied established implication principles. The decision may assist contractors in avoiding the consequences of encashment, though caution is warranted where liability is disputed or in other jurisdictions.

.

Facts

This case arose out of a design and construct contract between Cardigan Commercial Pty Ltd (**Principal**) and L.U. Simon Builders Pty Ltd (**Contractor**) for a mixed-use development in Carlton, Melbourne (**Contract**).

The Contractor provided security to the Principal in the form of two bank guarantees – the first was to be returned to the Contractor upon practical completion of the works, and the second was to be returned to the Contractor after the defects liability period.

The Principal released the first bank guarantee to the Contractor upon practical completion, but retained the second bank guarantee because it alleged there were unrectified defects in the works.

The Contractor offered unconditionally to pay cash to the Principal the amount of the second bank guarantee in exchange for its release to the Contractor. This was to avoid the Principal encashing (i.e cashing it in) it which it argued would cause reputational damage.

The Principal declined to release the second bank guarantee because it wished to retain it for "leverage" or "pressure" on the Contractor.

Issues to be Determined

The key issue before the Court was whether, in the absence of an express right in the Contract, there was a term implied into the Contract which entitled the Contractor to pay out the amount of the second bank guarantee to the Principal, instead of the Principal encashing it.

Victorian Supreme Court Decision

The Court found in the Contractor's favour that the following term was implied into the Contract:

"The Contractor may pay out the Security at any time without being required to do so by paying to the Principal the amount of the Security in cash, less any part or parts that previously have been paid following which the Principal is to release the Bank Guarantee/s to the Contractor and the Contractor shall have no obligation to provide replacement or other security."

The Court found that this term satisfied the well-established criteria for implying a term into a contract, specifically that:

1. It must be reasonable and equitable,
2. It must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it,
3. It must be so obvious that it 'goes without saying',
4. It must be capable of clear expression, and
5. It must not contradict any express term of the contract.

The Court reasoned that bank guarantees are treated in commerce as "as good as cash" and that it would be no different to the bank exercising its right under the terms of the bank guarantee to extinguish its liability.

Takeaways

This decision has potential significance across the contracting chain wherever security is provided by way of bank guarantees – including by contractors, subcontractors and suppliers of materials – and may also apply where insurance bonds are provided as security.

While the reputational damage of a bank guarantee being encashed is often the primary concern, there are broader commercial and financial risks that must be considered. The encashment of a bank guarantee may have flow-on consequences under the facility through which the guarantee was issued – for instance, triggering increased bank exposure and scrutiny, additional security requirements, or cross-collateralisation of other assets or entities.

Accordingly, a person who provides a bank guarantee (i.e. a contractor) may seek to avoid those consequences by paying to their counterparty (i.e. a principal) the cash equivalent of the guarantee, rather than allowing the guarantee to be encashed.

However, parties should exercise caution before doing so for two key reasons. First, where they do not agree with the underlying liability for which the guarantee is being encashed is disputed, payment of the cash equivalent may be seen as undermining that position. Second, the decision has not yet been widely adopted, and it remains to be seen whether courts in other jurisdictions would imply a similar term – particularly in contracts that already contain detailed security provisions. That said, at least in New South Wales, the Court's reasoning is consistent with emerging judicial recognition – including Rees J's comments in *Martinus Rail Pty Ltd v Qube RE Services (No 2) Pty Ltd* – of the commercial equivalence between cash payments and bank guarantees.

More information

For further details on construction law insights and legal case notes, visit Construction Legal Insights.

1. *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266; *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337.
2. *Martinus Rail Pty Ltd v Qube RE Services (No 2) Pty Ltd* [2023] NSWSC 1550, [127].

CONSTRUCTION LEGAL

admin@constructionlegal.com.au
+61 (02) 8591 9132
www.constructionlegal.com.au