

# Construction Law Focus

CHAN TAN & PARTNERS

ISSUE 4 OF 1995

NO.1 COLOMBO COURT #09-26/27 SINGAPORE 179742

**Performance Bonds -whether proof of default in performance of contract required before call for payment under bond -interim injunction to restrain call - whether Court should examine disputes relating to the underlying contract-whether balance of convenience test relevant**

*Bocotra Construction Pte Ltd & Ors v Attorney General (No 2) 1995 2 SLR 733*

The facts of this case have been set out in the previous issue of Construction Law Focus No 3 of 1995. Essentially, the appellants were appointed as contractors by the Public works Department (PWD) for the design, construction and maintenance of Phase II of the Central Expressway (CTE). They furnished a bank guarantee as security for the due performance of their works. Disputes arose between the parties and these were referred to arbitration. The contractors claimed for *inter alia* loss and expenses incurred in the prolongation of the works while the PWD counter claimed for liquidated damages for delay in completion and the costs of remedial works. The PWD on 5.2.94 (after the completion of the works) notified the bank and the contractors of their intention to call upon the guarantee. The contractors sought and obtained an interim order from the arbitrator to restrain the PWD from calling upon the guarantee. Upon the PWD's application, the interim order of the arbitrator was set aside by the High Court. The contractors appealed against this decision to the Court of Appeal.

**Held:** On the issue of whether the Court could grant an interim injunction to restrain the PWD from calling upon the bank guarantee (which was in effect an on demand performance bond) the Court of Appeal held as follows:

It accepted the principles established in the English authorities that performance bonds stand on a similar footing as irrevocable letters of credit and that an injunction restraining a call or payment upon the bond will not be granted unless fraud is involved. There was no distinction between the principles to be applied in the cases dealing with attempts to restrain banks from making payment from those dealing with restraint of beneficiaries from calling upon the bond.

The sole consideration in the application for an

injunction was whether there is fraud or unconscionability.

The Court need not consider the disputes relating to the underlying transaction. It need not apply the balance of convenience test propounded in the *American Cyanamid* case when deciding whether to grant the injunction. Accordingly, the possibility that the call upon the bond may cause irreparable damage to the reputation of the contractors was not a factor to be considered as this would negate the purpose of performance bond.

In the present case there was no allegation that the Government had acted without honest belief of its entitlement to call upon the guarantee. Further even if the Arbitrator ultimately decided the dispute in favour of the contractors and awarded damages, there was no doubt that the Government would be able to satisfy such an award. The Court of Appeal accordingly dismissed the appeal.

## EDITORIAL COMMENT

This decision of the Court of Appeal effectively reverses a number of High Court decisions starting with the *Royal Design* case which held that an injunction may be granted against the beneficiary from calling upon the bond if it was inequitable in the circumstances for the bond to be called for instance in the case of total failure of consideration of the underlying contract. The sole criteria now to be considered by the Court is whether fraud is involved. However the burden of proving fraud is not easy to be discharged. It is clear the Court should now not have any regard to the dispute in the underlying contract. The Court of Appeal's decision no doubt reaffirms the rule of non interference by the Court when a call is made upon an on demand bond unless in the case of fraud. It also boosts confidence in the system of unhindered payment under unconditional bonds.

Nevertheless it may be argued that the Court ought to retain for itself some degree of discretion to grant an injunction to restrain a call if the circumstances of the case warrants it even when fraud is not alleged. One can envisage for instance a situation where the contractor has completed his works under the building contract and there are more than sufficient retention monies to offset any claim for the costs of rectification works or liquidated damages. In such a scenario, surely the employer ought to be restrained from making a call upon the bond even though there is no fraud involved in the underlying transaction.

There is also the case as may be common now where the employer is a company specifically incorporated for the purpose of the project concerned and has no other assets. In such a case even in the event that the arbitrator or the Court decides the dispute in favour of the contractor, there may not be any or any sufficient assets to satisfy the judgement or the award let alone recover the bond monies paid out on the call under the bond. In the light of the above decision, contractors should be more careful in agreeing to provide on demand performance bonds since the bonds are really equivalent to a cash deposit in the hands of the employer in terms of ease in which the employers may seize these monies. Perhaps contractors ought to consider furnishing conditional bonds, that bonds in which the employer must show some evidence of default on the contractor's part before the bond can be called. One way to do this would be to require the architect to certify default or breach of contract by the contractor or for the employer or caller to affirm a statutory declaration on the alleged default before a call upon the bond can be made.

Alternatively, the contractor may negotiate for the amount of the bond to be reduced from the present 10% of the contract sum to a lower sum. Another way is to allow a gradual reduction of the amount guaranteed from 10 % to 0 % in accordance with the actual progress of the works at the site as certified by the architect. The disadvantage of this as far as the employer is concerned is that there may not be any security left to satisfy a claim for liquidated damages for delay in completion even though the works may be completed if the completion of the works were delayed.

#### **Technical Publications**

We have received an e-mail from Institute for Research in Construction, National Research Council Canada drawing our attention to the availability of the following papers. Copies are available from IRC Publication Sales (email: [lecuyer@irc.lan.nrc.ca](mailto:lecuyer@irc.lan.nrc.ca)).

#### **Published Documents:**

- "Building consensus : Canada's model construction codes" Consensus 22 (2), 1995 pp. 20-24.
- Energy-Efficient Lighting (Newcastle, U.K., 1995) pp. 59-66, 1995 v. 1 (NRCC-38939).
- Materials and Manufacturing Processes 10(3), 1995 pp. 593-595. (NRCC-37931) (IRC-P-3778)
- Ramachandran, V.S.; Wise, T. "The Effect of phosphonic acid on the slump loss in superplasticized mortar" Il Cemento 92(1), 1995 pp. 3-14. (NRCC-36935) (IRC-P-3481)
- Swartz, J. "Code National du Batiment 1995 des changements benefiques pour l'industrie de la construction" Construire 10(3), 1995 pp. 48-50. (NRCC-39267)
- Swartz, J. "Fire safety through the national model codes" Consensus 22(2), 1995 pp. 27-28. (NRCC-39269)
- Swartz, J. "Major changes to the 1995 codes" Consensus 22(2), 1995 pp. 25. (NRCC-39268)
- Tumidajski, P.J.; Blander, M. "Solubility of CoCl<sub>2</sub> in molten NaCl-AlCl<sub>3</sub>" Journal of Physical Chemistry 99(24), 1995 pp. 9992-9995. (NRCC-38737) (IRC-P-4018)
- Tumidajski, P.J.; Turc, I. "A rapid test for sulfate ingress into concrete" Cement and Concrete Research 25(5), 1995 pp. 924-928. (NRCC-38937)
- Vanier, D.J.; Turk, Ziga "Internet and the construction industry" CAD Systems 13(3), 1995 pp. 1,14-15. (NRCC-39282)
- Veitch, J.A.; Finn, D. "L'eclairage en spectre complet: est-ce que cela vaut le cout?" Eclairage Plus 6(1), 1995 pp. 14-15. (Also available in English: Is full-spectrum lighting worth it?) (NRCC-38753) (IRC-P-4034)
- Veitch, J.; Newsham, G.R. "Quantifying lighting quality based on experimental investigations of end user performance and preference" Right Light Three:3rd European Conference on Energy-Efficient Lighting (Newcastle, U.K., 1995) pp. 119-127, 1995 v. 1 (NRCC-38940)

Readers with any questions or comments on the contents of this issue are welcomed to write to us or send us an e-mail to our internet address at [chantan@singnet.com.sg](mailto:chantan@singnet.com.sg)