CONSTRUCTION LAW FOCUS

ISSUE No. 4 of 1999
OCTOBER-NOVEMBER 1999

CHAN TAN & PARTNERS
ADVOCATES AND SOLICITORS

Performance bond – revision of contract sum – interim injunction to restrain receipt of payment under the bond – whether conduct of beneficiary unconscionable.

GHL Pte Ltd vs Unitrack Building Construction Pte Ltd and Anor (Unreported) Civil Appeal No. 20 of 1999

Unitrack Building Construction Pte. Ltd. ("Unitrack") were GHL Pte Ltd's ("GHL") main contractors for the construction of a five storey boarding house at Lorong 17 Geylang, Singapore ("The Project"). The contract sum was $5,781,400.00. The building contract incorporated the Singapore Institute of Architects' Articles and Conditions of Contract. Pursuant to the terms of the contract Unitrack arranged for AGF Insurance (Singapore) Pte Ltd ("AGF") to issue a performance bond in favour of GHL in the amount of $578,140.00 equivalent to 10% of the contract sum. On or about 30 April 1998, the parties varied the terms of the contract. The contract sum was revised downwards by about 65% to $1,961,400.00 through the exclusion of $3,820,000.00 for the sub-contract works of the various sub-contractors. GHL then made direct contracts with these sub-contractors and dealt directly with them. A dispute subsequently arose between Unitrack and GHL. On 6 October 1998, GHL wrote to AGF demanding payment of $578,140.00 under the performance bond.

On 23 October 1998, Unitrack commenced court proceedings against GHL and AGF, claiming inter alia the following:

(a) an injunction to restrain GHL from seeking or claiming payment from AGF on the performance bond, and

(b) an injunction to restrain AGF from making any payment to GHL on the performance bond.

On 6 November 1998, GHL terminated the contract. On 13 November 1998 GHL commenced proceedings in Suit No. 2080 of 1998 against AGF for payment of the sum of $578,140.00 under the performance bond.

On 13 January 1999, Unitrack applied for and were granted an interim injunction against GHL and AGF by Lim Teong Qwee JC. Rubin J subsequently confirmed this order at a special hearing date. Rubin J found that there was no evidence of fraud but found that in all the circumstances it was unconscionable on the part of GHL to call on the bond. GHL appealed against the decision.

The issue which the Court of Appeal had to determine was whether unconscionability alone without fraud constitutes a ground for restraining a beneficiary from enforcing his rights to call upon the performance bond.

The Court of Appeal dismissed GHL's appeal and held that there existed a separate ground of 'unconscionability' apart from fraud for restraining a beneficiary of a performance bond from enforcing it. Considering the facts, it held that GHL's call on the performance bond was unconscionable having regard to the drastic revision of the contract sum downwards by about 65%, and that after revision the sub-contracts works were taken out of Unitrack's contract. Since there were no sub-contracts entered into between Unitrack and the sub-contractors, Unitrack did not have the benefit of similar performance bonds from the sub contractors to support their performance bond to the extent as originally contemplated. As a result of the reduction of the contract sum, Unitrack's commitment was considerably reduced. Under the terms of the Contract, GHL was only entitled to a performance bond of an amount equal to 10% of the contract sum. Since 10% of the contract sum as revised amounted to $196,140.00 only, GHL by calling on the performance bond for the full amount of $578,140.00 was in effect seeking to obtain a sum which represented about 30% of the revised contract sum. This was unconscionable conduct.

EDITORIAL COMMENT

This decision is important as it makes clear once and for all the position of the Singapore Courts in relation to calls on performance bonds. After the decision of the Court of Appeal in *Bocotra Construction Pte Ltd v A-G (No. 2)* [1995] 2 SLR 733, it was thought that the Courts followed the position under English law that fraud was the only ground upon which an injunction to restrain a call on a on demand performance bond would be granted. This was due to the fact that there was dicta in *Bocatra* where the Court of Appeal held that the sole exception permitting injunctive relief was fraud and that there was no difference between the principles to be applied in dealing with attempts to restrain banks from paying and beneficiaries from calling for or receiving payment under the bond. As banks cannot be restrained other than for fraud it was thought that the same position would apply in respect of applications to restrain the beneficiary. Indeed the Singapore Courts in various decisions including the case of *New Civilbuild Pte Ltd v Guobena Sdn Bhd & Anor* adopted this approach when dealing with applications for injunctions to restrain calls on performance bonds.

The Court of Appeal in coming to its decision that 'unconscionability' was a separate ground to grant the injunctive relief, clarified its position in *Bocotra* and held that there was nothing in that judgment which can be said to indicate or suggest that the Court did not decide that 'unconscionability' alone was not a separate ground as distinct from fraud.

It expressly disapproved the dicta in *New Civilbuild Pte Ltd v Guobena Sdn Bhd & Anor* where the Court held that the Court of Appeal in *Bocotra* had used the term 'unconscionability' interchangeably with "fraud" and that it did not decide that 'unconscionability' was a separate exception permitting injunctive relief.

The following extract from the Court of Appeal's judgement in sets out the rationale for its position in holding that 'unconscionability' is a separate ground for the grant of injunctive relief:

". ……. We are concerned with abusive calls on the bonds. It should not be forgotten that a performance bond can operate as an oppressive instrument, and in the event that a beneficiary calls on the bond in circumstances, where there is prima facie evidence of fraud or unconscionability, the court should step in to intervene at the interlocutory stage until the whole of the circumstances of the case has been investigated. It should also not be forgotten that a performance bond is basically a security for the performance of the main contract, and as such we see no reason, in principle, why it should be so sacrosanct and inviolate as not to be subject to the court's intervention except on the ground of fraud. We agree that a beneficiary under a performance bond should be protected as to the integrity of the security he has in case of non-performance by the party on whose account the performance bond was issued, but a temporary restraining order does not prejudice or adversely affect the security; it merely postpones the realisation of the security until the party concerned is given an opportunity to prove his case (per Chan J in Chartered Electronic at p 31 of the transcript)."

In explaining the concept of 'unconscionability', the Court of Appeal referred to the dicta in the earlier unreported decision of Lai J in the case of *Raymond Construction Pte Ltd v Low Yang Tong and AGF Insurance (Singapore) Pte Ltd*, where the Court held that *:*

"The concept of 'unconscionability' to me involves unfairness, as distinct from dishonesty or fraud, or conduct of a kind so reprehensible or lacking in good faith that a court of conscience would either restrain the party or refuse to assist the party. Mere breaches of contract by the party in question (in this case, the first defendant) would not by themselves be unconscionable"

It is submitted that with the above interpretation of 'unconscionability' for the purpose of obtaining injunctive relief on the call of an on demand bond, the Court of Appeal has in a sense thrown the door wide open for applicants to argue whether the conduct of the beneficiary calling upon the bond in any particular case is unconscionable. To determine whether or not there is unconscionability, the Court would have to consider all circumstances of the case. As such the outcome of each case will therefore depend very much on its own special facts.

While it may be equitable or right for the Courts to intervene in a case where the conduct of the beneficiary is prima facie "reprehensible", the danger of this approach is that the Court will have to make an assessment on the basis of affidavit evidence before it as to whether the unconscionable conduct of the party complained of has been borne out. It is sometimes not easy for the court to ascertain on the basis of the affidavit evidence and in the absence of corroborative evidence which of the conflicting versions in the Affidavit it ought to believe. On the other hand, if the Courts were to conduct a full inquiry which would require time, this would defeat one of purposes of the performance bond which is to enable the beneficiary to immediately realise the monies secured under the bond immediately without having to await the outcome of the trial or arbitration of the dispute. Further, it is not clear if the Courts have to consider the "balance of convenience" test in deciding whether to grant the injunction.

The editor's view is that unless the alleged prima facie reprehensible conduct based upon the documentary evidence is very clear, the Courts ought not to grant the injunctive relief.

The Singapore position is a clear departure from the English law on performance bonds. It should be noted that the above decision would have implications beyond the call on performance bonds in the construction industry. They would apply to performance bonds or guarantees issued for international trade and finance as well.

It is submitted that the greatest effect of the above decision is that it can no longer be said with absolute certainty that payment in respect of on-demand unconditional performance bonds or guarantees will be made upon a demand by the beneficiary notwithstanding the clear language of the bond or guarantee itself.