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PERFORMANCE BONDS AND INJUNCTION: AN UNCONSCIONABLE CONDUCT

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Abstract

Performance bonds and guarantees have been the subject of considerable litigation either in Malaysia or other law jurisdiction. Performance bond and guarantees given are considered as a security to the beneficiary but there are triggering events which restrain a call or payment of the bond. Injunction will be granted if there are serious issues to be tried; fraudulent and unconscionable conduct by parties in trial; balance of convenience; and irretrievable damages. In the English courts, an injunction for restraining a call or payment upon the bond will be granted if there is an existence of fraud or unconscionable conduct. However, this research aims to identify either the English judgment is applied in Malaysian courts. Hence, the objective of this study is to determine the legal interpretation on the application of injunction to restrain a call of the bond and payment received in performance bond particularly on unconscionable conduct. In order to achieve the objective, the research is conducted through legal analysis of reported and unreported court decisions in Malaysia and South East Asian countries. From the analysis, the differences of circumstances of unconscionably conducts are identified as well as the reasons for not granting the injunction relief or any principles to be applied in the cases in order to prevent the banks from making payment and dealing with the calling of the bond.

Keywords: Performance Bond, Injunction, Unconscionable Conduct, Malaysia and South East Asian Construction Contracts.

1. Introduction

Claims under performance bonds or guarantees are frequently the subject of litigation in Malaysia where there is a growing body of case law on the topic (Powell-Smith, 1992). The main reason is because, in most of the local standard forms of building contract, the performance bond and / or bank guarantee required as a conditions upon the award of the contract (Ho Sook Chin, 2006). As per stated in Clause 37(a) of the *P.W.D. Form 203A (Rev. 10/83) Standard Form of Contract to be Used Where Bills of Quantities Form Part of the Contract* that the Contractor shall either deposit with the Government a performance bond in cash or alternatively by way of a Treasury's Deposit or Banker's Draft or approved Banker's or Insurance Guarantee equal to 5% of the Contract Sum as a condition precedent to the commencement of work (Azizan et al, 2009).

A performance bond and guarantees are intended to provide an assurance to the owner of a project that the project will be completed in the event of the contractor defaults or fails to perform as required by the construction contract (Bockrath, 2000). In the current state of the construction industry, performance bonds are here to stay, but there are possible pitfalls when the time comes to call on the bond. The call on the bond as set out in that bond itself with order to be entitled for payment (Micheal, 2003). If the parties are in dispute, before the dispute is resolved, whether or not the prime contractor has performed its obligations under the contract and the client makes a call off the bonds.

A demand or call for payment under the performance bond is almost predictable with preceeding for injunction relief if there are any objections or any contestation from contractor or subcontractor to restrain the employer or contractor from gaining the benefits in performance bond. In case *LEC Contractors (M) Sdn. Bhd. V. Castle Inn Sdn. Bhd.* [2000] 3 MLJ 339, a party may seek to conduct injunctive relief when there are legal suit to be brought forward to the court. The subject to injunctive relief on performance bond is a complex and controversial one. This is because, injunction in performance bond occurred wherein surety party in arrangement of bond calling and acquired

injunction order from the main purpose is to withhold the payment of performance bond to beneficiary (Abdul Aziz, 2001). Different approaches have been used by the courts to lessen the severe impact in any of misjudged cases (Low Kee Yang, 2003).

2. Availability of an Injunction to Restrain a Call or Payment in Performance Bond

The question as whether the performance bond is a conditional or on demand becomes an issue and ought to be determined first in the trial which will affect the availability of injunction relief to restrain any payment of the performance bond. In determining whether it is conditional or otherwise, the court is concerned with the contractual construction or interpretation of the bond or guarantee itself (*Suharta Development Sdn. Bhd. v. United Overseas Bank (M) Bhd. & Anor* [2005] 2 MLJ 762)

It has been recognized that performance bonds, particularly, those expressed in 'on demand', 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 or unconscionability is involved. These principles had been discussed in the following case such as *Edward Owen Engineering v Barclays Bank International* [1978] QB 159; [1978] 1 All ER 976, *RD Harbottle (Mercantile) v National Westminster Bank* [1978] 146 QB 146; [1977] 2 All ER 862 and *Howe Richardson Scale Co v Polimex-Cekop* [1978] 1 Lloyd's Rep 161, supplemented by the additional cases of 'The Bhoja Trader'; *Intraco v Notis Shipping Corp of Liberia* [1981] 2 Lloyd's Rep 256.

The disputes could arise in such situations as: (i) a failure by the beneficiary to provide an essential element of the underlying contract on which the bond is depended; (ii) a wrongly use by the beneficiary of the guarantee by failing to act in accordance with the purpose for which it had been given; (iii) a total failure of consideration in the underlying contract; (iv) a threatened call by the beneficiary for an unconscionable ulterior motive; or (v) a lack of an honest or bona fides belief by the beneficiary that the circumstances, such as poor performance, against which a performance bond had been provided, actually existed.

Even though the party may seek the injunctive relief in difference circumstances after the dispute arose, there is no distinction between the principles to be applied in the cases dealing with attempts to restrain banks from making the payment and from those dealing with restraint of beneficiaries from calling upon the bond (*Bocotra Construction Pte Ltd & Ors v. Attorney General (No 2)* [1995] 2 SLR 733)

2.1 Principal of granting the injunction in Performance Bond

The principles applicable on granting or refusing an application for an injunction to restrict a call on a performance bond by the beneficiary could be summarized as follows: (i) an injunction would only be granted in exceptional circumstances; (ii) the party making the application had to adduce compelling evidence to establish such exceptional circumstances in spite of the fact that only affidavit evidence could be allowed (given the interlocutory nature of the application); and (iii) the rules in *American Cyanamid Co v Ethicon* [1975] AC 396 that it was sufficient for a plaintiff to establish a good arguable claim to the right sought to enforce and because of that, the court could not decide on the claim on affidavit evidence, it was enough if the plaintiff showed that there was a serious question to be tried did not apply.

2.2 'Fraudulent' or 'Unconscionable' conduct in Performance Bond.

The sole consideration in the application for an injunction is whether there is a fraud or unconscionability. The party seeking the injunction would be required to establish a clear case of fraud or unconscionability in interlocutory proceedings. It is not enough to raise "mere allegations." An interlocutory injunction will not therefore be granted against a bank which has given a bond or guarantee to restrain its payment, since the bank must honour it according to its terms, unless it has clear notice or evidence of fraud; *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All E.R. 976. As regards to the standard of proof of fraud, the courts have accepted, for cases involving letters of credit, what is known as "the Ackner standard" in assessing allegations of fraud in applications for interlocutory injunctions.

The starting point is in this court's decision *Bocotra Construction Pte Ltd* (1995), Karthigesu JA delivered the judgment of the court, after referring to various authorities, he concluded thus:

"In our opinion, whether there is fraud or unconscionability is the sole consideration in applications for injunctions restraining payment or calls on bonds to be granted. Once this can be established, there is no necessity to expend energies in addressing the superfluous question of 'balance of convenience'. It does not lie in the mouth of the defendant to claim that damages would still somehow be an adequate remedy."

As affirmed before, in English courts approach that an injunction for restraining a call or payment upon the bond will be granted if there is existence of fraud or unconscionability. Therefore, in respect of an injunction which involves restraining the call of the performance bond it had been ruled by our Malaysian authorities that it

is only in 'exceptional circumstances' that the courts will interfere with the machinery of irrevocable obligations assumed by banks.

The "exceptional circumstances" will depend on the facts and circumstances of each of the cases. Fraud has been ruled to be an instance of such exceptional circumstances. In *Perkasa Duta Sdn. Bhd. v Perbadanan Kemajuan Negeri Selangor* [2002] 2 CLJ 307 it was also held that unconscionable conduct could also be regarded as an exceptional circumstances. The question also arose in *Olex Focas Pty Ltd v Skodaexport Co Ltd*. [1996] 70 ALJR 983 where Batt J considered that there were no grounds for granting the injunction at common law. He noted that there were only three circumstances in which a documentary credit would be restrained. These are (i) when there is a clear case of fraud of which the bank is aware at (probably) the time of payment; (ii) where the documents are forged; and (iii) possibly where the underlying contract is illegal. Batt J was of the view that the principles of restraining performance bonds were the same as those relating to letters of credit, noting that the case of forged documents is unlikely to be relevant to the performance bond.

2.2.1 Fraud

Fraud in the common law sense implies more than a mere absence of bona fides in the claim. It implies an element of dishonesty on the part of the beneficiary, that is to say, a case where the beneficiary presents a claim on the performance bond which he knows at the time to be invalid or false: *GNK Contractors Ltd v Lloyds Bank plc & Anor* [1985] 30 Build LR 48, 63. The usual requirement is that the beneficiary's fraudulent conduct must be clearly established, and that the bank must have knowledge of this fraud before making payment on the bond. In the matter of *United Trading Corporation SA and Murray Clayton Ltd v Allied Arab Bank* [1985] 2 Lloyd's Rep 554 at 56, it was stated that the mere allegation of fraud would not be sufficient. The court is expected to require strong corroboration of the allegation, usually in the form of contemporary documents.

2.2.2 Unconscionability as separate from fraud

The concept of 'unconscionability' 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. In *Dauphin Offshore Engineering & Trading Pte Ltd*, [2000] 1 SLR 657 the Court of Appeal stated that "what must be shown is a strong *prima facie* case of unconscionability". Fraud and unconscionability are separate grounds for restraining a beneficiary of a performance bond from enforcing it (*GHL Pte Ltd v Unitrack Building Construction Pte Ltd* [1999] 4 SLR 604). In *Four Seas Construction Pte Ltd v The Tai Ping Insurance Co Limited* [1998] SGHC 414 that a commercial dispute arising out of a building contract should not be unjustifiably elevated to the level of fraud or unconscionability. In this case, the plaintiffs' arguments showed a strong *prima facie* case of unconscionability on the part of the first defendants in calling on the two performance bonds in issue.

3. Methodology

By examining thoroughly the issues commonly arise in disputed analysis of reported and unreported decision, the objective of the study is to identify legal interpretation on the application of injunction to restrain a call of the bond and receiving the payment in performance bond which deliberate on an unconscionability conduct.

By using the words 'Performance Bond', 56 cases for the past 20 years were downloaded from the Malayan Law Journal to be analyzed further. From the first reading and screening of the above cases, the judge of 9 cases were identified which the judge discussed on the injunction relief to restrain the call of the Performance Bond will be further analyzed, as in summary in Table 1.

4. Legal Interpretation in Performance Bond on Application of Injunction to Restrain a Call or Payment of the Bond: An Unconscionable Conduct

Table 3.1 shows the Legal Interpretation in Performance Bond on Application of Injunction to restrain a call or demand of the bond

No	List of Selected Cases	Unconscionably conduct	Injunction be granted	Principles applied
1	<i>Nam Fatt Corp Bhd & Anor v. Petrodar Operating Co Ltd & Anor</i> [2011] 7 MLJ 305.	X	X	1. The allegations of fraud and unconscionability are more in the nature of disputes over interpretation of the contract and the material as adduced by affidavit evidence does not lend itself to the only reasonable inference of fraud.

				2. The judge found that the demand on the Performance Bond has been validly made and there was nothing forthcoming from the plaintiffs that they would be extending the Performance Bond pending negotiating. If the demand is not made the Performance Bond would have expired. Failure of the second plaintiff to renew the Performance Bond is a breach of its contractual obligations.
2	<i>LEC Contractors(M) Sdn Bhd v. Castle Inn Sdn. Bhd. & Anor [2000] 3 MLJ 33.</i>	X	X	Bad faith or unconscionable conduct by itself is not fraud. The fraud that claimed by the plaintiff were not fraud but the disputes that must be settled between the parties and they would not affect the performance bond. The court found that there was no evidence of fraud. What was more important was that the bank (second defendant) had no knowledge of any fraud or that fraud was ever given to their notice. As such the second defendant had no alternative but to honour the performance bond.
3	<i>Newtech Engineering Construction Pte Ltd v. BKB Engineering Constructions Pte Ltd & Others [2003] SGHC 141; [2003] 4 SLR 73.</i>	√	√	A strong <i>prima facie</i> case of unconscionability on the part of BKB in calling on the two performance bonds in issue: 1. BKB failed to explain the discrepancies in their final statements of account, were unable to produce any documents to support its contention and in particular, it failed to show how the costs of removal of surplus earth, to which they attributed the discrepancies in their statement of account. 2. Newtech had produced cogent evidence to support their contention that they were not in default of their contractual obligations and that there was therefore no reason to call on the bonds.
4	<i>Samwoh Asphalt Premix Pte Ltd v Sum Cheong Piling Pte Ltd [2002] 1 SLR 1.</i>	√	√	The doctrine that unconscionability is a separate ground from "fraud" was reiterated by the Court of Appeal.
5	<i>Liang Huat Aluminium Industries Pte Ltd v. Hi-Tek Construction Pte Ltd. [2001] SGHC 334.</i>	√	√	It has been suggested that the "current conception of the ground of unconscionability by the courts may be unreasonably wide in light of the causes that have led to it being introduced as a disjunctive ground for injuncting a call on a performance bond"
6	<i>Dauphin Offshore Engineering & Trading Pte Ltd, [2000] 1 SLR 657.</i>	√	√	The Court of Appeal stated that "what must be shown is a strong <i>prima facie</i> case of unconscionability". Fraud and unconscionability are separate grounds for restraining a beneficiary of a performance bond from enforcing it.
7	<i>New Civilbuild Pte Ltd v Guobena Sdn Bhd & Anor [1999] 1 SLR 374.</i>	√	√	The term 'unconscionability' first appeared after a discussion of the question whether the balance of convenience test applied in such applications, the court holding that once it is found that 'fraud or unconscionability' is established, there is no need to address the question of balance of convenience.
8	<i>GHL Pte Ltd v. Unitrack Building Construction Pte Ltd & Anor [1999] 4 SLR 604.</i>	√	√	It was clear from <i>Bocotra Construction Pte Ltd v A-G (No 2)</i> and other relevant Singapore authorities that there existed a separate ground of unconscionability (apart from fraud) for restraining a beneficiary of a performance bond from enforcing it.
9	<i>Four Seas Construction Pte Ltd v The Tai Ping Insurance Co Limited [1998] SGHC 414.</i>	√	√	A commercial dispute arising out of a building contract should not be unjustifiably elevated to the level of fraud or unconscionability.

5. Conclusion

After analysing the related cases under the law journals, there are several principles involved in interpretation on application of injunction relief in the performance bond. It could be interpreted that mostly the court considered the element of fraud or unconscionably conduct in the facts of the case which regards to making a call or receiving payment on performance bond. If fraud and unconscionably conduct are identified, there is no further testing needed for not granting the injunction relief.

The legal interpretation that identified in this study is the court has been inclined to depart from position of fraud being the sole of ground of challenge. The matter has been approached from two perspectives. First, it is argued that different considerations are applied if the injunction sought is not against the bank but against the beneficiary. The words taken from case *Themeleph* (supra) where Waite LJ stated that, it does not seem to me that the slightest is involved to the autonomy of the performance bond if the beneficiary is enjoined from enforcing it in proceedings to which the guarantor is not a party. Such view had been applied in Singaporean and Malaysian courts. The second approach is to consider and introduce new grounds of challenge. Both Singaporean and Malaysian courts have accepted unconscionability as additional ground for seeking an injunction against a call on a performance bond.

It should be clarified that, although the party may seek the injunction relief in difference circumstances after the dispute arose, there is no distinction between the principles to be applied in the cases dealing with challenge to prevent banks from making payment and dealing with the calling of the bond. Therefore, serious issues should be verified by the court on the stipulated disputes brought by both parties which seeking for the injunction. However, the court considered whether there are existence of fraud allegation and unconscionability conducted by the beneficiary of the principal. Besides that, the court clarified whether there is an alternative remedies that is more appropriate to grant to innocent party rather than allowing an application of injunction relief. This is because the performance bond is lifeblood of commerce policy applies whether the injunction sought against the bank or against the beneficiary.

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