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# INJUNCTIONS AND PERFORMANCE BONDS – A RETURN TO ENGLISH ORTHODOXY

*Bocotra Construction Pte Ltd* v *Attorney-General (No 2)*[1]

## *Introduction*

IT is common for a party awarding a construction contract to extract from the builder a performance bond which he can call upon as security in case the builder fails to perform according to contractual stipulation. The bond will be issued by a bank on the instructions of the builder. In the event that a dispute arises between the parties regarding the responsibility for a faulty performance and the counter-party attempts to call on the performance bond, the builder would want to prevent payment on the performance bond. In what circumstances can the builder apply for an interim interlocutory injunction against the bank or the counter-party pending the resolution of the dispute at trial? Does the court adopt different principles in considering whether to grant such an injunction against each of the parties?

There was some uncertainty in Singapore over the resolution of the above questions because of two High Court decisions[2] which adopted a more liberal attitude in the issue of an injunction against the beneficiary under the performance bond than one against the bank. The two High Court decisions consciously departed from the English position which allows the injunction only under very stringent conditions and which takes the position that the 'fraud exception' is the only basis for an injunction against payment of a performance bond, whether the injunction is sought against the bank or the beneficiary.[3] The Court of Appeal in *Bocotra Construction Pte Ltd* v

1 [1995] 2 SLR 733.

2 *Royal Design Studio Pte Ltd* v *Chang Development Pte Ltd* [1991] 2 MLJ 229; *Kvaerner Singapore Pte Ltd* v *UDL Shipbuilding (Pte) Ltd* [1993] 3 SLR 350.

3 *Edward Owen Engineering Ltd* v *Barclays Bank International Ltd* [1978] QB 159; *RD Harbottle (Mercantile) Ltd* v *National Westminster Bank Ltd* [1978] QB 146; *Howe Richardson Scale Co Ltd* v *Polimex-Cekop* [1978] 1 Lloyd's Rep 161; *Intraco Ltd* v *Notis Shipping Corp of Liberia, 'The Bhoja Trader'* [1981] 2 Lloyd's Rep 256; *State Trading Corp of India*

*Attorney-General (No 2)* (hereinafter *Bocotra No 2*) put to rest the initiative taken in the two High Court decisions and restores the Singapore position to one congruent with the English position.

In *Bocotra No 2*, the appellants were contractors commissioned by the Public Works Department (PWD) to undertake certain engineering works involving the Central Expressway. A performance guarantee was issued to the PWD by a bank on the instructions of the appellants. The appellants failed to complete the works according to schedule and a dispute ensued between the parties. The appellants claimed that the delay was due two factors: first, errors contained in the respondent's drawings and specifications; and second, maladministration on the part of the respondent. The respondent counterclaimed for cost of remedial works necessary to rectify defects in the construction of the tunnels. Both matters were referred to arbitration in accordance with the arbitration clause in the construction contract. Before determination of the dispute by the arbitrator, the respondent notified the appellants and the bank of its intention to call for payment on the guarantee. The appellants then sought and obtained from the arbitrator a restraining order requiring the respondent to desist from making a call on the performance bond. The respondent contested the jurisdiction of the arbitrator to make the order and the Court of Appeal in *Bocotra Construction Pte Ltd* v *Attorney-General*[4] held that the arbitrator had no jurisdiction to make the order. The appellants subsequently commenced proceedings in the High Court to seek an order on similar terms from the High Court.[5] Goh Joon Seng J dismissed the application. The appellants then appealed to the Court of Appeal which upheld the decision of Goh Joon Seng J. The principal issues before the Court of Appeal in *Bocotra No 2* were (a) whether the establishment of fault was a pre-condition to a call on the bond and (b) the principles to be applied in determining whether an injunction should issue against the beneficiary under a performance bond.

### *Pre-conditions to a Call on the Performance Bond*

The appellants sought to argue that proof of default was a precondition for a call under the performance bond by relying on certain clauses within the performance guarantee as well as certain references in the performance guarantee to the underlying contract. These were: (a) Clause 1 of the recital

*Ltd* v *ED & F Man (Sugar) Ltd* [1981] Com LR 235; *Deustche Ruckversicherung* v *Walbrook Insurance Co Ltd* [1994] 4 All ER 181.

4 [1995] 2 SLR 523.

5 As the suit was against the Government, Bocotra Construction Pte Ltd could only seek a declaration as to the rights of the parties and not an injunction: s 27(1)(b) Government Proceedings Act (Cap 121). See *Bocotra No 2*, *supra*, note 1, at 742.

to the guarantee which referred to clause 9 of the underlying contract obliging the contractor to provide a bank guarantee for a sum equal to 10% of the contract sum 'for the due performance of the contract'; (b) Clause 5 of the guarantee which required a claim on the bank to be made 'within six (6) months from the expiry of [the] guarantee'; (c) Clause 4 of the guarantee which specified that the guarantee was valid up to the date the engineer issues the maintenance certificate 'in accordance with clause 55 of the conditions of contract'; and (d) Clause 2 of the guarantee which obliged the beneficiary to refund the balance of the sum paid under the performance bond after applying the amount paid to satisfy such liability of the contractor as determined by the PWD.[6]

After making the observation that the guarantee was 'in substance' a performance bond, Karthigesu JA stated what he perceived to be the approach taken by the English courts in the construction of performance bonds:

> The tendency of the English courts has been to treat performance bonds as unconditional provided that there is a clear statement that the amount guaranteed is payable by the bank simply upon a written demand being made, even though there may be some indications to the contrary elsewhere in the document.[7]

Applying this presumption to the construction of the guarantee, Karthigesu JA held that the terms of the guarantee did not disclose a requirement for proof of fault before the beneficiary could call on the guarantee.

Such an approach is pragmatic. Where performance bonds are stated to be unconditional and payable upon demand, banks should be entitled to treat the bond as one payable upon a plain demand unless there are clearly stipulated conditions to payment. Banks deal in documents. They are not equipped to ascertain substantive issues arising from the underlying contract. The disinclination against a construction to the effect that the bank needs satisfy itself as to the existence of a breach in the underlying contract would be reflective of commercial expectations that banks do not involve themselves in substantive issues.[8]

It would be an extremely rare case for the parties negotiating a performance bond transaction to expect the bank to involve itself in

6 *Supra*, note 1, at 737.

7 *Supra*, note 1, at 738B-C.

8 The *dictum* of Neill LJ in *Esal (Commodities) Ltd* v *Oriental Credit Ltd* [1985] 2 Lloyd's Rep 546 at 554 is reflective of such an attitude:

> In the absence of any requirement in the performance bond itself for some document to support the demand, I would be reluctant to introduce into this field any rule which provided scope for an argument that the qualifying event had not been sufficiently identified.

a substantive question. After all, the purpose of a performance bond is the assured payment of a sum in the nature of liquidated damages if something goes wrong in the underlying contract plus the avoidance of troublesome formal court processes otherwise necessary in order to determine and then enforce the right to damages.

Indeed it would be surprising to find a bank willing to issue a performance bond containing conditions for payment which cannot be readily ascertained by the bank. Imagine a performance bond issued on the express condition that the sum is payable to the beneficiary only if the counter-party to the underlying contract has committed a breach of certain obligations in the underlying contract. When a demand is made, the bank will be hard-put to ascertain whether there has been a breach with the stipulated consequences. The beneficiary will claim that the breach has the required effect. The counter-party will predictably demur. However the demand having been made, the bank has no choice but to make a determination – a determination which may later be found to be erroneous by the courts. It is not difficult to see why a prudent bank would not accept applications for issue of such bonds: the exposure involved is not one that the bank would ordinarily be willing to undertake.

Apart from its congruence with commercial expectations, the presumption is also sound in legal principle. It may be viewed as an instance of the rigorous application of the *contra proferentem* rule. As the terms of the bond will invariably reflect the terms contained in the application submitted by the applicant, the applicant is in a position to specify the conditions precedent to payment under the bond. Any ambiguity should therefore be resolved against the applicant who drafts and defines the risk he assumes. Therefore he should not be allowed to shelter behind vague clauses to the prejudice of the beneficiary and the bank.

Karthigesu JA's judgment underscores the need for applicants to prescribe the conditions precedent in no uncertain terms. The *dictum* quoted above indicates that where the bond is *ex facie* one payable simply upon written demand, the bond will be interpreted as an unconditional one notwithstanding the existence of some clauses containing "indications to the contrary". One should not interpret the *dictum* as signalling a disregard of other clauses in the document even if these clauses point clearly to requirements to be satisfied before payment is to be made. To do so would be a departure from the basic tenet that documents must be construed as a whole.[9] What Karthigesu JA must surely have meant in the *dictum* is that the presumption

[9] See *Siporex Trade SA* v *Banque Indosuez* [1986] 2 Lloyd's Rep 146 at 158. Also *IE Contractors* v *Ltd Lloyd's Bank plc* [1990] 2 Lloyd's Rep 496 at 503.

stated will only be rebutted if the conditions precedent are clearly stipulated.[10]

Such an approach has desirable consequences. It forces the applicant to make clear express stipulations as to the conditions precedent to payment under the bond. It encourages transparency on the pain of nullification of vague conditions. Consequently any risks involved are clearly disclosed to the bank. Banks will thus be given due notice of the duties expected of them and will be in a position to appreciate fully the nature of the exposure they assume. From the perspective of the beneficiary, he rests comforted knowing that he will not be met with an allegation of a condition precedent based on some vague and obscure reference to the underlying contract.

While there are some English cases like *United Trading Corporation* v *Allied Arab Bank*[11] which hint at sharp practice on the part of beneficiaries, it is difficult to feel much sympathy for the applicants who tend to be sophisticated commercial parties. As banks issue performance bonds on the instructions of applicants, these applicants are in a position to control the risk they assume by specifying the terms of payment under the bond. If doubts exist regarding the integrity of the beneficiary, the applicant may refuse to instruct the issue of an unconditional performance bond. He may negotiate for certification by a third party as a condition precedent, *viz,* the beneficiary will only have a right to call on the bond if he is able to obtain a certification from the third party stating the existence of a particular state of affairs. Such a condition precedent will give the parties the assurance they desire since the third party will normally be an expert who will not risk his reputation by the careless certification. Alternatively if the applicant chooses to assume the risk that the beneficiary will unjustifiably call on the bond, the applicant can charge a premium on the price as compensation for the moral hazard risk assumed.[12]

If the Court of Appeal's decision in *Bocotra No 2* appears harsh on the applicants, it also sends a clear message to all future applicants of performance bonds that they assume the risk of ambiguous drafting. Future applicants would do well to take heed and plan the terms of the performance bond carefully.

### *The Performance Bond as a Separate and Distinct Transaction from the Underlying Contract*

In performance bonds, the bond issued by the bank is separate and distinct from the underlying contract and the banks are not concerned with the terms

[10] See *Esal (Commodities) Ltd* v *Oriental Credit Ltd supra*, note 8.
[11] [1985] 2 Lloyd's Rep 554.
[12] See *Edward Owen Ltd* v *Barclays Bank supra*, note 3, at 170F.

of the underlying contract. Karthigesu JA affirmed this rule in *Bocotra No 2*:

> Of the various propositions of law suggested by the respondent, four principles may be extracted ... (a) The 'autonomy principle' – the guarantee constitutes a separate contract from the underlying transaction. The [applicants] are not privy to the guarantee ... The weight of authority suggests that [the autonomy principle is] well entrenched.[13]

To appreciate fully the 'autonomy principle', one should be mindful that the performance bond is one of three sets of relationships involving the two parties to the underlying agreement and the bank:

(1) the underlying contract between the applicant and the beneficiary. This usually takes the form of the applicant agreeing to perform certain obligations in return for payment from the beneficiary.

(2) the contract between the applicant and the bank under which the bank promises to pay to the beneficiary a specified sum of money on the terms set out in the application. In return the applicant promises to reimburse the bank and to pay the customary charges.

(3) the contract of guarantee between the bank and the beneficiary.[14]

To the contract of guarantee, the applicant is an outsider. He has no rights under this contract. Even if the bank pays in circumstances beyond its mandate, the applicant's rights derive from the contract for issue of the guarantee,[15] not from the contract of guarantee between the bank and the beneficiary. This explains why courts would dismiss an application for an injunction against the bank on the basis that there has been a breach of the underlying contract.[16] In the absence of clear statements to the contrary, the bank's mandate is not affected by a breach of the underlying contract.

[13] The other three principles are (i) the 'cash in hand' principle (ii) the 'fraud' exception and (iii) the absence of distinction between cases where an injunction is sought against the bank and where it is sought against the beneficiary. See *Bocotra No 2*, *supra,* note 1, at 744.

[14] To avoid problems arising from the doctrine of past consideration, the guarantee is – as a matter of prudence – issued in the form of a deed.

[15] The applicant is protected by the doctrine of strict compliance. See judgment of Ackner LJ in *Esal (Commodities)* v *OCL supra*, note 8, particularly p 550.

[16] See *Hamzeh Malas & Sons* v *British Imex Industries Ltd* [1958] 2 QB 128.

Since performance bonds are regarded as operating on the same principles as documentary credit transactions,[17] an illustration taken from the typical documentary credit transaction will be instructive. A documentary credit transaction invariably gives the bank the mandate to pay against specified documents. In order to ascertain whether its obligation to pay has arisen, the bank need only concern itself with the terms of the documentary credit.[18] The bank is legally not obliged to consider the due performance of obligations arising from the underlying contract.[19] Similarly the bank issuing a performance bond should in principle concern itself only with the terms of its mandate contained in the application and which should be reflected in the performance bond.

This does not, however, mean that the underlying transaction is always irrelevant to the construction of the mandate.[20] As a matter of general law, it is entirely possible for provisions of the underlying contract to be incorporated by reference. This was the finding of Rolf J in *Barclay Mowlem Construction Ltd* v *Simon Engineering (Australia) Pty Ltd*.[21] Indeed in *Bocotra No 2*, Karthigesu JA did not preclude the possibility of such an technique being used. In distinguishing *Barclay Mowlem*, he appeared to be troubled not so much by Rolf J's espousal of the principle, but more the applicability of that principle to the facts of *Barclay Mowlem.* And certainly on the facts of *Barclay Mowlem*, one could not help but get the impression that Rolf J may have been somewhat too generous in coming to the conclusion that the mere statement that the contract was incorporated as a part of the performance bond sufficed to introduce proof of default as a condition of the performance bond.[22]

[17] See *dictum* of Lord Denning in *Edward Owen Engineering Ltd* v *Barclays Bank International Ltd supra*, note 3, at 171A-C.

[18] See Art 4 and 14 of ICC Uniform Customs and Practice for Documentary Credit (ICC Publication No 500) (Commonly referred to as UCP 500).

[19] Art 3(a) UCP 500.

[20] This possibility is apparently excluded in documentary credits by the terms of UCP 500 Art 3(a):

> Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), *even if any reference whatsoever to such contract(s) is included in the Credit*. (emphasis mine)

[21] (1991) 23 NSWLR 451.

[22] In *Barclay Mowlem*, the bank's undertaking was expressed to be an obligation to pay upon demand. Nonetheless the court held that the following clause had the effect of incorporating the due performance of one of the underlying obligations as condition precedent to the right to call on the bond:

> Whereas the principal, Simon Engineering (Australia) Pty Ltd has entered into a written agreement with Barclay Bros Ltd ... for the performance of contract No 301 (Principal 5407/28) for Allied Mills which contract is by reference made a part hereof and is hereinafter called 'the said contract'. (*supra*, note 21, at 454D-E)

Commercial parties perceive performance bonds as valuable because of the assurance that the sums guaranteed will be paid by the bank notwithstanding any disputes regarding liability on the underlying contract. The efficacy of the performance bond would be much diminished – and the commercial parties would be very much taken by surprise – if a passing statement that the underlying contract is incorporated is held to be sufficient to introduce into the guarantee all the conditions which avoidance was the very purpose for which the guarantee was requested. A mere statement that the underlying contract is incorporated should not *per se* introduce as conditions the due performance of the beneficiary's obligations in the underlying contract. Application of the *contra proferentem* rule would require all conditions precedents to be clearly stated in the guarantee. This applies *a fortiori* where the terms of the conditions precedent are contained in another document. Mere references to the underlying contract should not suffice. There should be a reference to the conditions with sufficient particularity to enable one's attention to be drawn to them. Such sentiments were articulated by Karthigesu JA:

> We are quite unable to see how the passing reference to [the main contract] in the recital [of the guarantee] could support the appellants' arguments that the contract itself had qualified the right of the respondent to make a demand on the guarantee. Even if the contract had been incorporated into the guarantee, the appellants could not point to any provision within the contract (and indeed there was none) which might expressly exclude the respondent from making a call.[23]

Nonetheless it remains theoretically possible for the applicant to incorporate by reference provisions in the underlying contract and mandate the bank to pay the bond only upon the satisfaction of provisions in the underlying contract. Parties should however take care to state any conditions with utmost clarity. They should also be mindful that the judicial policy to promote the security of the performance bond would probably prompt the court to allow a bank to carry out its mandate as long as it acts according to what it reasonably interprets as the terms of its mandate.

### *Injunctions Against Banks and Injunctions Against Beneficiaries*

Do different principles apply to a case where an injunction is sought against the beneficiary than one where the injunction is sought against bank? Is the 'fraud exception' the only basis on which an injunction can be issued

[23] *Supra*, note 1, at 740E-F.

whether against the beneficiary or the bank? Karthigesu JA, following a long and distinguished line of English cases, held that the 'fraud exception' is the sole basis for an injunction whether the injunction is sought against the beneficiary or the bank. He stated categorically:

> ... there is no distinction between the principles to be applied in cases dealing with attempts to restrain banks from making payment or those dealing with restraint of callers from calling for payment.[24]

In so doing, Karthigesu JA put to rest the idea suggested by Eveleigh LJ in *Potton Homes* v *Coleman Contractors (Overseas)* that the beneficiary could be restrained from making a demand for payment on grounds other than fraud.[25] Interestingly it was in Singapore that the idea took root and found its application.

In *Royal Design Studio Pte Ltd* v *Chang Development Pte Ltd*,[26] the beneficiary who sought to call on the performance bond was a builder who complained that he could not carry on the construction because the land-owner had refused to make certain interim payments. Thean J (as he then was)[27] refused to discharge the injunction granted against the beneficiary because he was of the view that the beneficiary already had sufficient security for the due performance of the land-owner's obligations and that it would be inequitable for the builder to call on the performance bond. It is difficult for one to feel comfortable with the final result in this case – the land-owner could not point to any legal right on which to base the injunction. Thean J merely resorted to the notion that it would be inequitable in the circumstances of the case to allow the builder to call on the bond. However, while one may disagree with Thean J as to whether the injunction was justified on the facts of the case, the basis on he proceeded is consistent with the basic principles of contract law:

[24] *Supra*, note 1, at 744D.

[25] "As between buyer and seller the underlying contract cannot be disregarded so readily. If the seller has lawfully avoided the contract *prima facie*, it seems to me he should be entitled to restrain the buyer from making use of the performance bond. Moreover, in principle I do not think it possible to say that in no circumstances whatsoever, apart from fraud, will the court restrain the buyer. The facts of each case must be considered. If the contract is avoided or if there is a failure of consideration between buyer and seller for which the seller undertook to procure the issue of the performance bond. I do not see why, as between the seller and buyer, the seller should not be able to prevent a call upon the bond by the mere assertion that the bond is to be treated as cash in hand." (1984) 28 Build LR 19 at 28.

[26] *Supra*, note 2.

[27] Interestingly Thean JA was one of the members of the Court of Appeal hearing *Bocotra No 2*. By his concurrence with Karthigesu JA, he seems to have recanted of his views expressed in *Royal Design Studio* v *Chang*.

> We are not concerned with the 'irrevocable nature of the obligation assumed by the relevant bank'; we are concerned with the relationship between the parties under the main or underlying contract they made and the dispute arising from such relationship. In the present case, the plaintiff is not restraining the insurance company from paying on the bond, and therefore the question of the insurance company not being able to honour its obligations does not arise. The dispute is only between the plaintiff and the defendant and relates solely to the main or underlying contract made them.[28]

In strict legal principle, it is very difficult to disagree with Thean J. The basis for an injunction against a beneficiary is found in the underlying contract and rests on different premises from an injunction against the bank.

If the injunction is sought against the bank, the only ground upon which the applicant can proceed is probably the 'fraud exception'. The bank would have been given a mandate to pay upon the satisfaction of certain conditions. Very often the bond is stated to be unconditional. If the terms of the bond issued to the beneficiary are stated in such terms, the bank will be obliged to pay simply upon a demand by the beneficiary. Indeed it is doubtful whether an injunction will issue even if the bank seeks to pay beyond its mandate; after all, if the bank does not strictly comply with the terms of its mandate, the customer would not be expected to pay the bank. It is thus difficult to see what prejudice the customer is subject to in such a circumstance. Truly, the performance bond is *res inter alios acta* with respect to the applicant. The 'fraud exception' is therefore an exceptional circumstance. In the opinion of Lord Diplock, it is justified only because the conscience of the court will be shocked if it renders its assistance in the enforcement of the bond:

> The exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim *ex turpi causa non oritur actio* or, if plain English is to be preferred, "fraud unravels all". The courts will not allow their process to be used by a dishonest person to carry out a fraud.[29]

It is submitted that there is an intermediate step which was omitted in the above rationalization of the 'fraud exception'. In circumstances of manifest fraud and which fraud is known to the bank, the bank's conscience is

[28] *Supra*, note 2, at 234.

[29] *United City Merchants (Investments) Ltd* v *Royal Bank of Canada* [1983] 1 AC 168 at 184, [1982] 2 All ER 720 at 725.

impugned. In such instances, even if the bank acts lawfully within the terms of its mandate, the circumstances of fraud being so convincingly demonstrated, the bank would be assisting in the perpetration of fraud – and this the court cannot countenance.

However where an injunction is sought against the beneficiary, the injunction will be based on breach of the terms in the underlying contract.[30] In other words, the applicant is merely seeking the enforcement of the terms of the underlying contract. It is not difficult to imagine an agreement in which the beneficiary agrees with the applicant not to draw on the performance bond unless certain conditions have been satisfied. It may be that the bank would not accept an application for a issue of a bond which payment terms require the proof of certain pre-conditions. The applicant will have little choice but to instruct the issue of an unconditional bond. The best alternative in such circumstances is to incorporate the condition precedent into the underlying agreement by extracting an undertaking from the beneficiary that the guarantee – though *ex facie* unconditional – will only be drawn on if the agreed conditions have been satisfied. In such a case, the ground on which the action proceeds is a request for the enforcement of the promise given in the underlying contract – a ground which is conceptually distinct from fraud.

It is unfortunate that the Court of Appeal in *Bocotra No 2*, apart from pointing out that there was a conscious departure from the established English authorities, did not elaborate on how Thean J had erred in *Royal Design Studio* v *Chang*.

There is little doubt that the position taken by the Court of Appeal was motivated by the policy to ensure that banks can honour the obligations they have assumed free from the interference by the courts. The desire to promote the efficacy and certainty of banking transactions recurs like a *leitmotif* throughout the cases on performance bonds and letters of credit. In the words of Kerr J (as he then was):

[30] A distinction should be drawn between a case where an injunction is sought on the ground that there is a failure to provide due performance of contractual obligations and one based on the non-entitlement due to the non-satisfaction of conditions precedent. In the first class of breach, the ordinary remedy is damages and in appropriate circumstances, rescission and restitution of benefit conferred. These are judicial remedies which are properly available only after a full and proper trial of the issues. More importantly there is no connection between the breach and the entitlement to call on the bond. *Hamzeh Malas & Sons* v *British Imex Industries Ltd,* (*supra,* note 16) is clear authority for the proposition that the mere breach of the underlying contract does not entitle the innocent party to restrain the party in default from exercising his rights *vis-à-vis* the bank. In the second class of breach, the condition is tied in to the right to exercise one's rights against the bank.

> It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain.[31]

Although Chan Sek Keong J in *Chartered Electronics Industries Pte Ltd* v *Development Bank of Singapore*[32] pointed out that a "performance bond is as good as cash as between the buyer and the seller only because that is the effect of the English decisions and not because it is the cause of such decisions,"[33] it is suggested that the policy inclination toward promoting the security of banking transactions and rendering them immune from interference has in turn shaped and moulded the manner in which traditional principles are worked out in this area of law.

The injunction is one of the orders a court makes under its equitable jurisdiction. It is a discretionary remedy and will be granted only in circumstances in which the court deems fit. Policy considerations have changed the principles on which a court is to proceed in considering an application for an injunction. The principles ordinarily applicable in determining whether to grant an application for an injunction are found in *American Cynamid Co* v *Ethicon Ltd,*[34] *viz,* first, whether there is 'a serious question to be tried' and second, whether on a balance of convenience it is just and equitable for the court to issue the injunction. The balance of convenience test seeks to weigh the potential prejudice to each of the parties should the court incline either way.[35] Later cases have termed the

[31] *RD Harbottle (Mercantile) Ltd* v *National Westminster Bank Ltd, supra,* note 3, at 155. See also *Edward Owen Ltd* v *Barclays Bank, supra,* note 3, at 171; *The Bhoja Trader supra*, note 3, at 257.

[32] Suit No 485/1990. Judgment delivered on 30 April 1992.

[33] *Ibid,* at 32.

[34] [1975] AC 396.

[35] Lord Diplock prescribed the following as the approach the court should take in deciding whether to grant an interim interlocutory injunction:

> "[T]he governing principle is that the court should first consider whether, if the plaintiff were to succeed at the trial in establishing his right to a permanent injunction, he would be adequately compensated by an award of damages for the loss he would have sustained as a result of the defendants continuing to do what was sought to be enjoined between the time of the application and the time of the trial. If damages in the measure recoverable at common law would be an adequate remedy and the defendant would be in a financial position to pay them, no interlocutory injunction should normally be granted, however strong the plaintiff's claim appeared to be at that stage.
>
> If, on the other hand, damages would not provide an adequate remedy for the plaintiff in the event of his succeeding at the trial, the court should then consider whether,

process as 'the balance of the risk of doing an injustice'.[36]

In the context of performance bonds and documentary credit transactions, the paramount consideration of promoting the certainty of such banking transactions has apparently translated into a displacement of the *American Cynamid* approach and its replacement by a test based on proof of a 'clear case of fraud'.[37]

The grounds for such displacement are especially persuasive in a case where the injunction is sought against the bank. The object of inquiry at the first stage of the *American Cynamid* test is whether there exists a 'real prospect of succeeding in his claim for permanent injunction at the trial'.[38] The focus at this stage is not on the strength of the evidence to prove the case nor on the probability of success at trial;[39] rather it is "whether the evidence reveals issues which enable the plaintiff to succeed".[40] What underpins the displacement of the *American Cynamid* test is probably a perception that the test will be too lenient and that the bank stands at great risk of being prejudiced without a sufficiently strong cause. The bank is ordinarily in the dark as to the goings-on between the applicant and the beneficiary and any information regarding the proof of fraud would come from the applicant. The informational imbalance means that the bank is normally in no position to contradict the allegations contained in the affidavit supporting the application for an injunction; it simply does not possess the facts to affirm or rebut the allegations. As such it is pragmatic for the court to raise the threshold of persuasion to that incorporating an examination of the strength of the evidence – 'clear proof of fraud' – before it will grant the injunction. To enhance the efficacy of the higher threshold, the English authorities also indicate that the

> on the contrary hypothesis that if the defendant were to succeed at the trial in establishing his right to do that which was sought to be enjoined, he would be adequately compensated under the plaintiff's undertaking as to damages for the loss he would have sustained by being prevented from doing so between the time of the application and the time of the trial. If damages in the measure recoverable under such an undertaking would be an adequate remedy and the plaintiff would be in a financial position to pay them, there would be no reason upon this ground to refuse an interlocutory injunction."

*American Cynamid Co* v *Ethicon Ltd, ibid,* at 408.

36 *Cayne* v *Global Natural Resources plc* [1984] 1 All ER 225 at 237; *Films Rover International Ltd* v *Cannon Film Sales Ltd* [1987] 1 WLR 672 at 680.

37 See *Brody White & Co* v *Chemet Handel Trading (S)Pte Ltd* [1993] 1 SLR 65 at 70; also *Bocotra No 2, supra,* note 1, at 746.

38 *Supra*, note 34, at 408.

39 See Browne LJ's judgment in *Alfred Dunhill Ltd* v *Sunoptic SA* [1979] FSR 337 at 373.

40 Pinsler, *Civil Procedure* (1994) p 445. See also *Hong Kong Vegetable Oil Co* v *Malin Sirinaga Wicker & Ors* [1978] 2 MLJ 13; *Cayne* v *Global Natural Resources plc* [1984] 1 All ER 225.

beneficiary must provide strong corroborative evidence of the allegations and give the beneficiary an opportunity to answer the allegations made.[41]

The *American Cynamid* test – with its emphasis on weighing the potential prejudice to each of the parties – is also inappropriate to the performance bond context for another reason. If protection of the bank's reputation and commercial standing is the underlying policy rationale for the more substantive examination of the evidence supporting the allegations, satisfaction of the higher threshold of persuasion would mean that the potential prejudice to the bank has been considered (since it has been built into the test) and overriden by the *ex turpi causa* principle. The balance of convenience test is thus quite superfluous.

Should a similar standard be applied to a case where an injunction is sought against the beneficiary on the grounds of fraud? Here the arguments raised above do not apply with equal force. The informational imbalance no longer exists since the fraud is allegedly committed by the beneficiary himself and he would *ex hypothesi* be in a position to answer the allegations. However as performance bonds are commercially regarded as collateral, it is perhaps pragmatic to refrain from imposing too onerous a burden on the beneficiary in the conduct of the interlocutory proceedings.[42] Given the absence of a substantive inquiry into the evidence under the *American Cynamid* test and the paramount interest of the legal system in protecting the security of performance bonds as collateral, there is probably sufficient justification for replacing the *American Cynamid* test with the test requiring clear evidence of fraud.

But how conceptually does 'clear proof of fraud' feature in a case where the injunction is sought on the ground that the beneficiary is not entitled to call the bond by the terms of the underlying contract? It is suggested that what the courts actually mean when they state that the 'fraud exception' is the only basis for issue of an injunction is the consequence of a similar displacement of the *American Cynamid* test which would ordinarily be applicable to such a case involving a threatened breach of contract. The policy considerations are similar to that earlier raised. The desire on the part of the courts not to interfere with the security of financial transactions results in a higher threshold of persuasion incorporating a more substantive examination of the evidence. Although the application for the injunction

[41] See *dictum* of Ackner LJ in *United Trading* v *Allied Arab Bank*, *supra*, note 11, at 561.

[42] A very good illustration of this attitude is seen in *United Trading* v *Allied Arab Bank* (*supra,* note 11). Although the plaintiffs in this case provided evidence sufficient to support a 'seriously arguable case' that the demands on the bonds had not been honestly made, the court was prepared not to require the foreign beneficiary to answer the allegations because each of the contracts was stipulated to be governed by Iraqi law and contained an Iraqi jurisdiction clause.

is based on a contract to which the bank is not a party, a restraining order will nonetheless have the *practical effect* of interfering with obligations assumed by banks.[43] If the *American Cynamid* test were applied to a threatened breach of the underlying contract, the efficacy of the performance bond as a collateral would be much reduced. The following *dictum* of Philips J in *Deustche Ruckversicherung* v *Walbrook Insurance Co Ltd* regarding the suitability of the *American Cynamid* test applies *mutatis mutandis* to performance bonds:

> If a beneficiary is to be held to be fraudulent if he draws on a letter of credit in circumstances where he is uncertain as to the validity of his right to payment under the underlying contract, the plaintiff seeking to enjoin him will have to do no more than persuade the court that there is a seriously arguable case that the claim under the underlying contract is invalid. This will rob the beneficiary of much of the benefit which a letter of credit is intended to bestow. When a letter of credit is issued by way of conditional payment under an underlying contract, I do not consider that it is correct to imply a term into the underlying contract that the beneficiary will not draw on the letter of credit unless payment under the underlying contract is due.[44]

What the Court of Appeal in *Bocotra No 2* appears to have done is to dispense with the application of the *American Cynamid* test in this particular type of contract because of its impact on the security of the performance bond. Instead the Court increased the threshold of persuasion on the applicant in such a manner as to require him to prove not only that there is a seriously arguable case of a non-entitlement to call on the bond, but such a clear and convincing case of non-entitlement so as to make it unconscionable for the beneficiary to make a call on the bond – that is, – the beneficiary must be shown to be acting fraudulently. In other words, the beneficiary will be entitled to call on the performance bond as long as he has a *bona fide* claim to payment under the underlying contract.[45]

Karthigesu JA's ruling that the 'fraud exception' constitutes the only scenario in which the court will consider an injunction thus represents the elevation of the threshold of persuasion and the conflation of a case involving fraud with a case involving breach of contract for non-entitlement to call on the bond. So explained the court is not disregarding the conditions precedents to a call which may be found in the underlying contract, it is

[43] In *Bolivinter Oil SA* v *Chase Manhattan Bank* [1984] 1 All ER 351 it was the bank which applied, and was granted, the discharge of the injunction.

[44] *Supra*, note 3, at 196.

[45] *Ibid*. See also *United Trading Corporation* v *Allied Arab Bank, supra*, note 11, at 559.

merely suspending the application of the *American Cynamid* principles in favour of a stricter test because of the paramount policy consideration of protecting the bank's reputation and commercial standing.[46] Indeed the security accorded to the performance bonds by the legal system will have the ancillary effect of promoting the jurisdiction as a desirable place to enter into such banking transactions. The approach adopted by the courts is also revealing of the value judgment by the legal system of what it deems to be more worthy of protection.

Viewed in this light, Thean J's premise in *Royal Design Studio* v *Chang* was not wrong in basic principle. He erred only because he had failed to anticipate that the balance of judicial opinion in Singapore would desire a policy orientation similar to that of the English courts and that there should be a concomitant change to the principles applicable to such banking transactions. A similar comment may be made of the other case which approved Eveleigh LJ's *dictum* in *Potton Homes – Kvaerner Singapore Ltd* v *UDL Shipbuilding (Singapore) Ltd*.[47]

### *Emasculation of the Fraud Exception in Demand Guarantees?*

Although the Court of Appeal in *Bocotra No 2* stated that the 'fraud exception' will support an injunction against the bank, it is questionable whether the exception can ever be established when the bond in question is an unconditional performance bond.

In *Brody, White & Co Inc* v *Chemet Handel Trading (S) Pte Ltd*, Lai Kew Chai J cited Lord Diplock in *United City Merchants (Investments) Ltd* v *Royal Bank of Canada*[48] to say that in the context of a documentary credit, the fraud that needs to be established is fraud in the presentation of the required documents to the bank.[49] That is, the documents themselves must contain expressly or by implication, "material representations of fact that to his knowledge are untrue."[50] Fraud in the underlying transaction which does not impact on the documents presented is irrelevant when the 'fraud exception' is argued against the bank.

46 Although there is a diminution of the remedies that normally attach to a breach of contract, the applicant's rights under the contract are not nullified. It is still open for him to sue for damages at common law.

47 [1993] 3 SLR 350. Interestingly the principle *applied* by Selvam JC (as he then was) appears to be consistent with the orthodox position since he concentrated on the lack of *bona fides* of the beneficiary. Whether a court with the policy orientation of the Court of Appeal in *Bocotra No 2* would similarly find that the evidence adduced was sufficient to support the finding that there was a lack of *bona fides* remains an open question.

48 *Supra*, note 29.

49 *Supra*, note 37, at 70-71.

50 *Ibid,* at 71B.

The 'fraud exception' is a possibility in documentary credit transactions because the presentation of the bill of lading and the commercial invoice would contain representation (if only impliedly) that the goods stated in the bill of lading and the invoice have been shipped. If what is shipped is rubbish, there would be a fraud contained in the documents. However in the context of unconditional performance bonds, the only document that will be handed to the bank is the demand for payment. It is difficult to see how any representation, whether express or implied, is contained in such an instrument. The applicant will have to establish linkage between the bond and the underlying document. As the bank has no knowledge of and is indeed indifferent to any conditions precedent agreed between the parties, it is difficult to see how there can even be any implied assertion that the beneficiary has become entitled, under the terms of the underlying contract, to call on the bond.

The 'fraud exception' is thus a theoretical *impossibility* when one seeks to restrain a bank from paying on an unconditional performance bond.

However where the injunction is sought against the beneficiary, the assertion is not that there is a fraudulent statement in the demand issued to the bank. Rather the assertion will be that there is either fraudulent conduct in the underlying transaction so as to disentitle the beneficiary from calling on the bond, or fraudulent conduct in attempting to call on the bond when his right to call has clearly not arisen under the terms of the underlying contract. As such the particulars of fraud to be contained in the affidavit accompanying the application for injunction against the beneficiary would be substantially different from that which are to be contained in an affidavit supporting an application for injunction against the bank. Proof of the 'fraud exception' remains a possibility in an injunction sought against the beneficiary.

### *Whether a Challenge to the Validity of the Guarantee is a Ground for an Injunction*

In the course of argument, the appellants cited *Bolivinter Oil SA* v *Chase Manhattan Bank*[51] to argue that a 'substantial challenge' to the validity of the guarantee is a ground for an injunction. On this issue, Karthigesu JA said:

> ...we do not think that the mere fact that the validity of the guarantee was substantially challenged in other proceedings will automatically provide a basis for an injunction to be obtained restraining an intended

[51] *Supra*, note 43.

> call for payment. It will still be in the 'wholly exceptional case' of fraud that an injunction can be granted.[52]

Donaldson MR's *dictum* in *Bolivinter* indicates that what he had in mind when he considered a challenge to the validity of the guarantee was a demand for a payment already made. As Karthigesu JA correctly pointed out, this is merely an instance of the 'fraud exception' and does not constitute a separate ground for granting an injunction against a call for payment.

Indeed it is difficult to see how the applicant can challenge the validity of the guarantee in the first place. The validity of the guarantee is a matter between the beneficiary and the bank. As to the applicant, it is *res inter alios acta.* If there is a problem with the validity of the guarantee, it is for the bank to say so. The applicant has no *locus standi* to challenge the validity of the guarantee.

If what is alleged is unconscionable conduct (whether duress or fraud) on the part of the beneficiary in extracting the guarantee, the challenge should be one based on tort or rescission of contract. The action would be one against the beneficiary on those grounds – not on the validity of the guarantee.

## *Endnote*

As the law presently stands, a demand guarantee or unconditional performance bond is impregnable to attacks by the applicant. The applicant cannot obtain an injunction against the bank unless the 'fraud exception' is established. However, as it appears that the fraud that needs to be established is fraud in the presentment of the documents, there is theoretically no instance where an injunction can be sought against the bank in a demand guarantee.

Theoretically, it remains open to the applicant to stipulate conditions precedent either in the guarantee or incorporate by reference conditions precedent found in the underlying document. *Bocotra No 2* indicates that a Singapore court should be most reluctant to find that the performance bond is a conditional one in the absence of clear and explicit reference to the conditions. This is especially so in a guarantee which contains a term stating that the guaranteed amount will be payable upon demand. The message to the draftsman is clear: take pains in the drafting of the conditions or suffer a nullification of the conditions.

The most important contribution of *Bocotra No 2* is to set the record straight with regard to whether different principles apply where an injunction

[52] *Supra*, note 1, at 745B.

is sought against the bank than where an injunction is sought against the beneficiary. The answer is a clear no. At first blush it may be difficult to understand why the 'fraud exception' is said to be the only basis for an injunction even when it is sought against a beneficiary for breach of his undertaking not to call on the bond except upon the satisfaction of certain conditions. Nonetheless an examination of the *American Cynamid* test reveals that it may not be very appropriate to the context of performance bonds because of the policy to preserve the certainty and efficacy of performance bonds. In this area of the law, it is important to recognize that this policy has been the driving force behind the re-shaping of the principles for considering the injunction.

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