

Bonds - Fraud Necessary to Restrain Calls in Singapore

Bocotra Construction Pte Ltd and Others v The Attorney-General (No2)
[1995] 2 Singapore Law Reports 733.

In a decision handed down in May this year the Singapore Court of Appeal has confirmed the principles applicable when a Singapore Court is asked to restrain either a bank from paying out, or a beneficiary from calling on, a performance bond.

In *Bocotra Construction Pte Ltd and Others v The Attorney General, Singapore* the plaintiffs were appointed by the Director General of Public Works, Singapore to be contractors for the design, construction and maintenance of Phase II of the Central Expressway, (CTE). The contract price was Singapore \$312.88 million. The Contractor was required to, and did, deliver the Public Works Department (PWD) a bank guarantee for Singapore \$31.28 million as security for their due performance of the works. The contract contained an arbitration clause.

The deadline for practical completion, 25 January 1991, was not met and a substantial portion of the work was completed only by September 1991. The Contractor contended that among other things, there were errors in PWD's drawings and specifications which caused delays in the work. The Contractor referred to arbitration its claims for the sum of Singapore \$138.45 million and for an extension of time totalling 384 days.

PWD contended that there were defects in the construction of tunnels forming part of the CTE and claimed the cost of remedial works and liquidated damages for delay amounting to Singapore \$87 million. PWD's claim had not yet been referred to arbitration. PWD notified the Contractor and the bank of its intention to call for payment on the guarantee.

The Contractor commenced proceedings in Court seeking declarations that:

1. the guaranteed sum was only payable upon proof of default under the contract with PWD; and
2. PWD was not entitled to call on the guarantee or to receive the guaranteed sum until after the final award in the arbitration had been made.

The Contractor's claim was dismissed at first instance and it appealed.

In relation to the question whether proof of default in performance was a pre-condition for a call, the Court of Appeal stated that the issue was one of contractual interpretation of the performance bond. After having considered the terms of the guarantee the Court held that no proof of default was required.

On the second claim the Court said that the issue could be seen as whether the Contractor had any right (legal or equitable) to an interim injunction restraining PWD from

their intended call on the guarantee. The Court accepted that performance bonds stood on a similar footing as irrevocable letters of credit and stated 4 principles to be applicable:

- (a) the "autonomy" principle - the guarantee constitutes a separate contract from the underlying transaction;
- (b) the "cash in hand" principle - the underlying purpose of bond is to provide security which is readily, promptly and assuredly realisable; "cash in hand" reflects the importance of promoting commercial efficiency and certainty in the use of letters, guarantees and bonds;
- (c) the "fraud" exception - the sole exception to the 2 principles above arises where the plaintiff can establish fraud in the circumstances of the call for payment. This permits injunctive relief; and
- (d) there is no distinction between cases where an injunction is sought to restrain a bank (from making payment) or the beneficiary (from calling for payment).

The Court expressly disapproved of Australian, English and previous Singapore authorities which suggested that the "fraud" exception was not the sole basis for granting an injunction. The Court took pains to emphasise that there was no room for the application of the "balance of convenience" test in cases involving performance bonds and irrevocable letters of credit. In this regard the Court emphatically rejected the Contractor's argument that it would be relevant to consider, first, the slur on its reputation which would arise if a call was made on the bond and, secondly, that damages would not adequately compensate them for any loss of reputation.

The Court noted that the Contractor had not alleged that PWD had acted without honest belief of its entitlement to make a call, and had indeed conceded that they could not show that fraud was present on the facts. The appeal was dismissed.

The Court of Appeal in Singapore has stated in no uncertain terms that to prevent a call on a performance bond, the Contractor will need to prove nothing short of fraud.

In Singapore at least, performance bonds are as close to "cash in hand" as one can get.

- **Alan Thambiyah, Mallesons Stephen Jaques, Solicitors, Perth. Reprinted with permission from Mallesons Stephen Jaques Construction Update.**