## Case Note

# THE PRINCIPLE OF GOOD FAITH IN THE ENFORCEMENT OF PERFORMANCE GUARANTEES

*BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd*
**[2012] 3 SLR 352**

This case note analyses the Singapore Court of Appeal's decision in *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 and its implications for Singapore's jurisprudence on performance guarantees payable on-demand.

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## I. The facts, litigation and decision

1 BS Mount Sophia Pte Ltd ("Mount Sophia") (a property developer) employed Join-Aim Pte Ltd ("Join-Aim") (a builder) to construct a residential condominium in Singapore. As security for the performance obligations under the contract Join-Aim provided a performance bond payable on demand. A dispute arose between the parties relating to the time for completion of the construction works. Mount Sophia made a call on the bond alleging that it was entitled to liquidated damages from Join-Aim for delay in the completion of the works allegedly caused by Join-Aim. Join-Aim argued that Mount Sophia was not entitled to any liquidated damages because the delay certificate was not issued in accordance with the contract and that any delays were caused by Mount Sophia or its consultants. One of the preconditions that had to be fulfilled before the architect would certify that the works were complete and issue a completion certificate was that the electrical portions of the works had to pass certain tests. In order for the tests to be carried out the proper electrical connections and cables were necessary. Join-Aim argued that there had been indecision as to the necessary power specifications on the part of Mount Sophia and its consultants. The approved electrical working load under the contract was 276kVA; however, following various inspections and recommendations from Mount Sophia's consultants, this was subsequently varied to 138kVA. As a result of the time taken for this variation there was a delay in the installation of the particular electrical cables necessary to carry the specified electrical load. This in turn led to a delay in the subsequent testing of the power grid unit. It also argued that the demand under the guarantee was made in bad faith and for a

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collateral purpose because it was made in retaliation to the request for arbitration. It further argued that it was unfair for Mount Sophia to call under the guarantee when a progress claim remained due and outstanding.

2 The High Court judge ordered the interim injunction restraining Mount Sophia from calling under the guarantee to stand. The order was made on the ground of unconscionable conduct on the part of Mount Sophia calling under the guarantee. Referring to an e-mail on 4 October 2010 regarding the backdating of the completion date which resulted in Join-Aim incurring liquidated damages which formed the substantial basis of the call on the performance guarantee the High Court stated that:[1]

> This exhibited a strong *prima facie* case of unconscionability and I was concerned that this was an abusive call on the bond. As I stated above (in [27]–[29]), the cross allegations of breaches of contract fell to be dealt with in the arbitration proceedings and so I did not consider them in coming to the conclusion that the 1st defendant acted unconscionably … I also kept in mind the oft repeated warning that the courts should guard against unnecessarily interfering with contractual arrangements freely entered into by the parties … Having considered this, I was of the view that the parties did not enter into a contract where the completion date could be, without good reason, unexpectedly pushed back by the Architect after having been previously confirmed by him.

It follows that the courts should be slow to intervene with contractual arrangements between commercial parties, and hence should respect the freedom of contract between the applicant and the beneficiary who are parties to the underlying contract. However, in circumstances where the conduct of the beneficiary calling under the guarantee evidenced unconscionability[2] the court may look into the nature of the underlying contractual arrangement and/or breaches of contract between the applicant and the beneficiary. Thus, the High Court affirmed the Singapore position that judicial intervention is necessary to restrain abusive calls amounting to unconscionability.

3 Mount Sophia appealed to the Court of Appeal. Dismissing the appeal, the Court of Appeal was of the view that there was a strong *prima facie* case of unconscionability justifying the continuance of the

1 *Join-Aim Pte Ltd v BS Mount Sophia Pte Ltd* [2012] SGHC 3 at [37], *per* Tay Yong Kwang J.

2 See discussion at paras 6–10 below of the meaning of unconscionability in the context of performance guarantees.

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injunction restraining the call under the guarantee. Andrew Phang Boon Leong JA, delivering the grounds of decision, stated that:[3]

> … it is settled law that unconscionability, as distinct from fraud, is a ground upon which the court can grant an injunction restraining a beneficiary of a performance bond from calling on the bond.

4 However, the Court of Appeal came to a finding of unconscionable conduct on the part of the beneficiary calling under the guarantee after taking into account a far broader set of facts than the High Court. The reasoning of the Court of Appeal states as follows:[4]

> The 4 October 2010 e-mail *per se*, no matter how robust a peg it was, was not, in our view, sufficient to establish a finding of unconscionability. It was far more important to read the 4 October 2010 e-mail in the *context* of the sequence of events at the time as well as in relation to the exchange of correspondence between the parties in order to ascertain whether a strong *prima facie* case of unconscionability existed in the context of the present appeal.

Thus the Court of Appeal's reasoning indicate that the presence of unconscionability cannot be decided on a single piece of evidence read without the benefit of the entire context surrounding the demand under the guarantee – "the entire chronology of the case, viewed in relation to all the relevant factors (set in their context)",[5] that established a strong *prima facie* case of unconscionability on the part of the beneficiary calling under the guarantee. With reference to the events relating to the power grid unit testing the Court of Appeal noted that "these events cast a shadow over the appellant's *bona fides* in so far as its call on the Bond was concerned".[6] In taking into account these events leading to the call under the guarantee the Court of Appeal was careful not to make any findings as to the merits of these matters relating to the underlying contract between the parties, but emphasised its role "to be alive to the lack of bona fides" in those matters.[7]

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3 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [18], *per* Andrew Phang Boon Leong JA. For a discussion of the case law development of the concept of unconscionability as a separate ground as distinct from fraud for challenging a demand on a performance bond, see generally L P Thean, "The Enforcement of a Performance Bond: The Perspective of the Underlying Contract" (1998) 19 Sing L Rev 389 and Low Kee Yang, Eugene Ooi & Elizabeth Wong, "Unconscionable Calls on Performance Bonds: A Bold New Exception" in *Singapore Academy of Law Conference 2006: Developments in Singapore Law between 2001 and 2005* (Teo Keang Sood gen ed) (Singapore Academy of Law, 2006) ch 21.

4 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [40].

5 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [54].

6 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [51].

7 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [52].

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## II. Analysis of the decision

### *A. An unconscionable call – A call made in bad faith*

5 The Court of Appeal's decision is to be welcomed, not only in its affirmation of unconscionability as a separate ground from that of fraud for restraining the beneficiary calling under the guarantee, but also in providing some clarity on the substantive content of the concept of unconscionability in the context of performance guarantees payable on demand.[8]

6 The meaning of unconscionability in the context of performance guarantees can be distinguished from the general contract law doctrine of unconscionable conduct which vitiates the consent to enter into a contract.[9] In a contractual setting exploitation of a person's special vulnerability amounts to unconscionable conduct; hence, there are two key components that underpin this notion – "power" and "vulnerability". In the context of performance guarantees it simply means lack of *bona fides* on the part of the beneficiary calling under the guarantee. The Court of Appeal noted this fundamental difference and provided a detailed discussion of the meaning of unconscionability in the context of performance guarantees.[10]

7 By way of comparison, it is to be noted that the previous case law has indicated the types of behaviour of the beneficiary that would be caught by the concept of unconscionability rather than an account of its constituent elements. For example, in *Min Thai Holdings Pte Ltd v Sunlabel Pte Ltd*,[11] it was held that a demand under a guarantee stemming from non-delivery of goods due to natural disasters despite a *force majeure* clause in the underlying contract amounts to unconscionable conduct; in *GHL Pte Ltd v Unitrack Building Construction Pte Ltd*[12] ("*GHL*"), it was held that in the light of the revision of the value of the contract, demand under the performance guarantee for the *full amount* amounts to unconscionable conduct; and in *JBE Properties Pte Ltd v Gammon Pte Ltd*[13] ("*JBE Properties*"), it was

8 The need for emerging Singapore case law to clarify the core substantive content of unconscionability in the context of performance guarantees has been discussed in academic literature; See, *eg*, Kelry Loi, "Two Decades of Restraining Unconscionable Calls on Performance Guarantees – From *Royal Design* to *JBE Properties*" (2011) 23 SAcLJ 504.

9 For a discussion of the general contract law doctrine of unconscionable conduct, see generally Nelson Enongchong, *Duress, Undue Influence and Unconscionable Dealing* (London: Sweet & Maxwell, 1st Ed, 2006) Part III.

10 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352. See generally [23]–[37].

11 [1999] 3 SLR(R) 961.

12 [1999] 3 SLR(R) 44.

13 [2011] 2 SLR 47.

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held that *prima facie* gross exaggeration of the costs of rectification in support of the beneficiary's call under the guarantee amounts to unconscionable conduct. The judicial pronouncements in *Dauphin Offshore Engineering & Trading Pte Ltd v The Private Office of HRH Sheikh Sultan bin Khalifa bin Zayed Al Nahyan*[14] ("*Dauphin Offshore*") and *Eltraco International Pte Ltd v CGH Development Pte Ltd*[15] provide some guidance in understanding the defining elements of unconscionable conduct in the context of demand guarantees. These cases indicate that in the context of performance guarantees unconscionability is just one type of unfairness. These cases also suggest that a beneficiary's conduct in calling under a performance guarantee that is so reprehensible or lacking in good faith would constitute unconscionable conduct on his part and that the existence of unconscionability depends largely on the facts of each case.

8 In relation to the elements that constitute unconscionability in the context of demand performance guarantees Phang JA in the present appeal observed as follows:[16]

> Unconscionability is a distinct and separate ground from fraud, and as stated earlier (at [19]), includes conduct such as unfairness and abuse that are broader than the conduct that would constitute fraud. In other words, the availability of unconscionability acknowledges that conduct exhibited by the beneficiary other than fraud might be sufficiently reprehensible to justify relief on the part of the obligor. For example, unfairness is an element of unconscionability, but it would not make logical sense to say that a beneficiary had thereby acted in such an egregiously unfair manner as to amount to fraud. This is because the concept of unfairness admits of other dimensions beyond the fraudulent dimension, and is assessed on different parameters from those with which we assess fraud. The most we can say is that such conduct does not necessarily constitute fraud.

14 [2000] 1 SLR(R) 117 at [42]. The Court of Appeal noted that:

> We do not think it is possible to define 'unconscionability' other than to give some very broad indications such as lack of *bona fides*. What kind of situations would constitute unconscionability would have to depend on the facts of each case. This is a question which the court has to consider on each occasion where its jurisdiction is invoked. There is no pre-determined categorisation.

15 [2000] 3 SLR(R) 198 at [29]–[30]. The Court of Appeal noted that:

> … the appellants would appear to suggest that based on this opinion, unfairness, *per se*, could constitute 'unconscionability'. We do not think it necessarily follows. Lai Kew Chai J said the concept of 'unconscionability' involves unfairness. We agree. That would be so. In every instance of unconscionability there would be an element of unfairness. But the reverse is not necessarily true. It does not mean that in every instance where there is unfairness it would amount to 'unconscionability'.

16 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [23].

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It follows that conduct such as "unfairness" and "abuse" on the part of the beneficiary calling under a guarantee amounts to unconscionable conduct on his part. This is the case, for example, where the beneficiary procures a guarantee for a certain percentage of the contract price and after the issue of the guarantee the contract price is revised downwards.[17] In such a case the beneficiary's call on the full amount of the guarantee is unfair or abusive. In this context it is to be understood that unconscionability is a type of unfair conduct that does not amount to fraud. In the context of performance guarantees, fraud or fraudulent conduct denotes lack of honest belief on the part of the beneficiary calling under the guarantee.[18] Hence, unconscionability is a type of unfair conduct that falls short of fraud.

9 The Court of Appeal went on to emphasise that:[19]

> … broadly speaking, unconscionability is a label applied to describe unsatisfactory conduct tainted by bad faith. A precise definition of the concept would not be useful because the value of unconscionability is that it can capture a wide range of conduct demonstrating a lack of *bona fides*.

This statement suggests that non-compliance with principles of good faith is the defining indicator of unconscionability in the context of demand performance guarantees under Singapore law, and that a definition of the concept of unconscionability is unlikely to be forthcoming because the value of the current indicator of unconscionability – "the lack of *bona fides*" – is that it can capture a wide range of call scenarios.

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17 See, *eg*, *GHL Pte Ltd v Unitrack Building Construction Pte Ltd* [1999] 3 SLR(R) 44.

18 See, *eg*, *Edward Owen Engineering Ltd v Barclays International Bank Ltd* [1978] QB 159 at 170–171; [1977] 3 WLR 764 at 773; (1978) 1 All ER 976 at 983, wherein Lord Denning stated that:

> So long as the [beneficiaries] make an honest demand, the banks are bound to pay: and the banks will rarely, if ever, be in a position to know whether the demand is honest or not. At any rate they will not be able to prove it to be dishonest. So they will have to pay.

19 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [36]. See also [45] wherein the Court of Appeal stated that:

> … a finding of unconscionability is a conclusion applied to conduct which the court finds to be so lacking in *bona fides* such that an injunction restraining the beneficiary's substantive rights is warranted. Sufficient reasons must be given to the court to enable it to come to such a conclusion, and it is necessary that these reasons are drawn from a thorough consideration of the relevant facts as viewed in the entire context of the case, taking into account the parties' conduct leading up to the call on the bond.

*Contra* Australian law, that is, Australian courts have powers under s 22(2) of the Australian Consumer Law (set out in Sch 2 of the Competition and Consumer Act 2010 (Act No 51 of 1974)) to apply notions of good faith and fair dealing in a variety of commercial transactions (in trade and commerce) to determine whether the alleged conduct is unconscionable.

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10 It should be noted that the principle of *bona fide* or good faith comprises standards of fair dealing in the performance and enforcement of contracts.[20] In the performance guarantee context it becomes relevant to consider whether the beneficiary has acted in good faith and complied with concepts of fair play and fair dealing in the insistence of their strict right to payment under the guarantee. Hence, the main issue in the case was whether Mount Sophia had acted in good faith in calling under the guarantee.

11 In the context of performance guarantees, it can be said that there exists an implied duty on the part of the applicant to exercise good faith and fairness in the performance of the underlying contractual duties for which the guarantee was procured. Similarly, there exists an implied corresponding duty on the part of the beneficiary to exercise good faith and fairness in seeking to enforce the guarantee. Hence, the beneficiary insisting on their right to payment under the guarantee in circumstances in which their conduct is lacking in *bona fides* can be construed as a violation of the fair standards of conduct the beneficiary should have adhered to in the guarantee market.

12 The Court of Appeal's above statement that the significance of the current indicator of unconscionability is that it can capture a wide range of call scenarios can create uncertainty in identifying the type of conduct that may be captured by a "lack of *bona fides*". From a theoretical perspective it is argued that a particular category of unconscionability in equity can provide a useful link for defining unconscionability and its application in the context of performance guarantees – insistence upon strict legal rights in circumstances it amounts to an unfair advantage taking of vulnerability.[21] In the context

20 According to one commentator, good faith embraces three notions: first, an obligation on the parties to co-operate in achieving the contractual objects (loyalty to the promise itself); secondly, compliance with honest standards of conduct; and thirdly, compliance with standards of conduct which are reasonable having regard to the interests of the parties: Elisabeth Peden, "The Meaning of Contractual Good Faith" (2002) 22 *Australian Bar Review* 235, citing Anthony Mason, "Contract, Good Faith and Equitable standards in Fair Dealing" (2000) 116 LQR 66. Good faith doctrine comprises standards or obligations or considerations that seek to temper the deliberate pursuit of self-interest in situations where the conscience is bound. See Jane Stapleton, "Good Faith in Private Law" (1999) 52(1) *Current Legal Problems* 1 at 7. See generally *Good Faith in Contract: Concept and Context* (Roger Brownsword, Norma Hird & Geraint Howells eds) (Ashgate Publishing, 1999).

21 See generally Patrick Parkinson, *The Principles of Equity* (Australia: Thomson Reuters, 2nd Ed, 2003) at pp 39–42. See also Philip H Clarke *et al*, "Notion of Unconscionability" in, *Unconscionable Conduct, The Laws of Australia* (Paul Vout ed) (Australia: Lawbook Co, 2nd Ed, 2009) at p 121, para 35.5.10: this scholarly writing identifies five distinct categories in which unconscionable conduct can be found in equity: (a) Exploitation of vulnerability or weakness; (b) abuse of positions of trust or confidence; (c) insistence upon rights in circumstances which make that

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of performance guarantees payable on-demand there can be situations where the competition in the market compels the applicant of the guarantee to agree to procure this type of security in favour of the beneficiary. Thus, the beneficiary becomes the power possessor who could avert or refrain from inflicting economic harm on the applicant. Therefore, the beneficiary who insists upon his strict legal right to payment on the guarantee in circumstances inconsistent with the "spirit" of the demand guarantee (that the guarantee is payable only in the event of non-performance, defective performance or late performance of the underlying contract but without having to prove the default) falls within this type of unconscionable conduct. In other words, in the performance guarantee's context, unconscionability lies in the insistence of the beneficiary's right under the guarantee to demand payment in circumstances where it amounts to an abuse of that right.

13 Given that the scope of unconscionability as a ground for restraining the enforcement of performance guarantees has been subjected to criticism in the past,[22] the Court of Appeal could have provided some justification for allowing the current indicator to capture a wide range of call scenarios. The Court of Appeal could have placed the invocation of this concept in narrow scope; hence, the judicial intervention in commercial disputes would be limited to only certain types of call scenarios. Arguably, such an approach could be useful in fostering confidence in the performance guarantees as security instruments – by limited interventions via unconscionability exception to the autonomy of performance guarantees, the courts would be in a better position to ensure that recognition of unconscionability will not lead to easy availability of injunctions restraining beneficiaries calling under performance guarantees.

### *B. Standard of proof*

14 As for the requisite standard of proof of an unconscionable call under a performance guarantee previously in *Bocotra Construction Pte Ltd v Attorney-General*[23] ("*Bocotra Construction*"), the Court of Appeal dispensed with the application of the balance of convenience test

insistence harsh or oppressive; (d) inequitable denial of legal obligations; and (e) unjust retention of property.

22 Academic literature suggests that the scope of unconscionability needs to be narrowly circumscribed. See, *eg*, Nelson Enongchong, "The Problem of Abusive Calls on Demand Guarantees" [2007] LMCLQ 83 at 105; Arvin Lee, "Injuncting Calls on Performance Bonds: Reconstructing Unconscionability' (2003) 15 SAcLJ 30; and Quentin Loh & Tang Hang Wu, "Injunctions Restraining Calls on Performance Bonds – Is Fraud the Only Ground in Singapore?" [2000] LMCLQ 348. *Cf* Ji Lian Yap, "Unconscionability and Performance Bonds" (2013) 6(3) IJPL 279.

23 [1995] 2 SLR(R) 262.

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propounded in the *American Cyanamid Co v Ethicon Ltd*,[24] but stated that dispensing with consideration of the balance of convenience test does not make an injunction easier to obtain. It stated that:[25]

> 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' … we need only note that dispensing with consideration of the balance of convenience does not make an injunction any easier to obtain. Indeed, a higher degree of strictness applies, as the applicant will be required to establish a clear case of fraud or unconscionability in the interlocutory proceedings. It is clear that mere allegations are insufficient.

Thus, the standard of proof of unconscionability propounded and adopted in *Bocotra Construction* is "an established case of unconscionability". However, there is nothing in that statement or elsewhere in that judgement that explains the "higher degree of strictness" that applies to this criterion. By reference to "fraud or unconscionability" the Court of Appeal appears to have suggested that the standard of proof that applies to fraud (that is, a strong *prima facie* case) has a similar application where unconscionability is invoked as a ground for restraining a call under a performance guarantee.

15 There is reference to this similarity in subsequent judicial pronouncements. For example, in *GHL* the Court of Appeal endorsed

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24 [1975] AC 396 at 406 ("*American Cyanamid*"). The House of Lords stated that:

> … the object of the interlocutory injunction is to protect the plaintiff against injury by violation of his right for which he could not be adequately compensated in damages recoverable in the action if the uncertainty were resolved in his favour at the trial. But the plaintiff's need for such protection must be weighed against the corresponding need of the defendant to be protected against injury resulting from his having been prevented from exercising his own legal rights for which he could not be adequately compensated under the plaintiff's undertaking in damages if the uncertainty were resolved in the defendant's favour at the trial. The court must weigh one need against another and determine where 'the balance of convenience lies'.

Thus, the balance of convenience test seeks to weigh the potential prejudice to each of the parties should the court incline either way. Note that Singapore Court of Appeal in *Reed Exhibitions Pte Ltd v Khoo Yak Chuan Thomas* [1995] 3 SLR(R) 383 stated that the approach in the *American Cyanamid* case was to be followed in granting interlocutory injunctions. See generally *Singapore Civil Procedure 2003* (G P Selvam ed) (Sweet & Maxwell Asia, 2003) at pp 547–548.

25 *Bocotra Construction Pte Ltd v Attorney-General* [1995] 2 SLR(R) 262 ("*Bocotra Construction*") at [47]. Alexander Loke, commenting on this aspect found in *Bocotra Construction*, states that "the American Cyanamid Test with its emphasis on weighing the potential prejudice to each of the parties is inappropriate to the performance bond context" and that the "balance of convenience test is thus quite superfluous": see Alexander Loke Fay Hoong, "Injunctions and Performance Bonds: A Return to English Orthodoxy?" [1995] Sing JLS 682 at 695.

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the strong *prima facie* standard propounded by the High Court in *Chartered Electronics Industries v Development Bank of Singapore Ltd*,[26] where "fraud" was invoked. Chan Sek Keong J (as he then was) who heard the High Court application continued the injunction until trial on the ground of a "strong *prima facie* case of fraud on the part of the buyer".[27] The Court of Appeal in *GHL* adopted a similar burden of proof in requiring the applicant to prove unconscionability on the part of the beneficiary, stating that:[28]

> … 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.

In *Dauphin Offshore*, the Court of Appeal was mindful of the test adopted in *Bocotra* and *GHL*. The Court of Appeal reiterated that what must be shown is a strong *prima facie* case of unconscionability and ruled that that standard has not been satisfied in the instant case.[29]

16 The Court of Appeal in the present case noted that the law with regard to the standard of proof of unconscionability is settled, and examined the contours of the standard of proof that rests on the applicant to establish a case of unconscionability on the part of the beneficiary calling under the guarantee:[30]

> … Simply put, the threshold is a high one, and the burden that the applicant has to discharge is to demonstrate a strong *prima facie* case of unconscionability (see, for example, *Dauphin* at [57]). The question in this appeal is really a question of defining the contours of that burden, having regard to the relevant facts.
>
> When determining if a strong *prima facie* case has been made out, the entire context of the case must be thoroughly considered, and it is only if the entire context of the case is particularly malodorous that such an injunction should be granted. We must emphasise that the courts' discretion to grant such injunctions must be sparingly exercised and it should not be an easy thing for an applicant to establish a strong *prima facie* case.

On this statement, mere allegations of unconscionability would not suffice and it is incumbent on the applicant to satisfy the threshold of strong *prima facie* case of unconscionability on the part of the

26 [1999] 2 SLR(R) 20.

27 *Chartered Electronics Industries v Development Bank of Singapore Ltd* [1999] 2 SLR(R) 20 at [45].

28 *GHL Pte Ltd v Unitrack Building Construction Pte Ltd* [1999] 3 SLR(R) 44 at [24].

29 *Dauphin Offshore Engineering & Trading Pte Ltd v The Private Office of HRH Sheikh Sultan bin Khalifa bin Zayed Al Nahyan* [2000] 1 SLR(R) 117 at [57].

30 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [20]–[21], *per* Andrew Phang Boon Leong JA.

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beneficiary calling under the guarantee. If the applicant is successful in establishing that the entire context of the case leading to the call on the guarantee is "malodorous", he may be entitled to interlocutory relief.

17 Thus the Court of Appeal whilst granting the injunction based on a strong *prima facie* case of unconscionability on the part of the beneficiary calling under the guarantee has dispensed with the balance of convenience test.[31] Whilst it would be desirable to advocate the adoption of the test of a "strong *prima facie* case" of unconscionability for restraining the beneficiary calling under the guarantee, it would not be logical to dispense with the balance of convenience test. By considering whether the balance of convenience favours the grant of the injunction, the court would be able to strike a balance between the interests of the applicant on the one hand and the beneficiary on the other. For example, in cases where damages will not be an adequate remedy or where the applicant will suffer irreparable harm if the beneficiary is allowed to draw upon the guarantee because it is likely that the beneficiary will be insolvent in the immediate future, the balance of convenience may clearly favour the grant of an injunction. However, in cases where the beneficiary is a reputable large company with substantial assets in Singapore and would be in a position to meet any damages which might have been awarded against them if the call was wrongful, the balance of convenience may clearly be against the grant of an injunction. This approach will also be useful in ensuring that unconscionability as a separate ground from that of fraud for restraining the enforcement of demand guarantees will not make injunctions a readily available device although the Court of Appeal in the present case stated that the "courts' discretion to grant such injunctions must be sparingly exercised".[32] According to the Court of Appeal, a "strong *prima facie* case" of unconscionability is a high

31 *Contra*, note that the Australian courts have applied the balance of convenience test in granting injunctions restraining the beneficiary calling under a performance guarantee in circumstances where it was unconscionable. See, *eg*, *Olex Focas Pty Ltd v Skodaexport Co Ltd* [1998] 3 VR 380 at 404, in which the court noted that having regard to the consequences for the plaintiffs and their parent company, and having regard to the lack of need, on the evidence as it stands before court, of the first defendant to get its hands on all the moneys covered by the mobilisation guarantees, that the balance of convenience strongly favours the granting of an interlocutory injunction. See also *Boral Formwork v Action Makers* [2003] NSWSC 713 at [12]–[14]. Note that the Malaysian courts also have applied the balance of convenience test in applications for injunctions restraining unconscionable conduct on the part of the beneficiary calling under a performance guarantee: see, *eg*, *Kejuruteraan Bintai Kindenko Sdn Bhd v Nam Fatt Construction Sdn Bhd* [2011] 7 CLJ 442 and *Malaysian Refining Company Sdn Bhd v Sumatec Engineering and Construction Sdn Bhd* [2012] 3 CLJ 401.

32 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [20] and [21], *per* Andrew Phang Boon Leong JA. See also H N Bennett, "Autonomous Guarantees" in *Benjamin's Sale of Goods* (Michael Bridge Ed) (Sweet & Maxwell, 8th Ed, 2010) ch 24 at p 2165.

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threshold. This high threshold would enable the court to strike the appropriate balance between the conflicting positions of the applicant and the beneficiary of a performance bond and hence preserve the efficacy of performance guarantees as security instruments.[33]

### *C. Functional and commercial justifications*

18 Drawing upon a previous judicial pronouncement of the Court of Appeal in *JBE Properties* which explained the functional and commercial reasons for the Singapore courts' recognition of unconscionability as a separate ground from that of fraud for restraining the enforcement of demand performance bonds, the Court of Appeal decision noted that:[34]

> The Singapore courts' rationale in applying unconscionability as a separate and independent ground for restraining a call on a performance bond (especially one given by the contractor-obligor in a building contract) is that a performance bond serves a different function from a letter of credit. The latter performs the role of payment by the obligor for goods shipped to it by the beneficiary (typically via sea or air from another country), and 'has been the lifeblood of commerce in international trade for hundreds of years' … Interfering with payment under a letter of credit is tantamount to interfering with the primary obligation of the obligor … In contrast, a performance bond is not the lifeblood of commerce, whether generally or in the context of the construction industry specifically. …
>
> … yet another relevant consideration is that an excessive or abusive call can cause unwarranted economic harm to the obligor. This is particularly relevant in the construction industry, where liquidity is frequently of the essence to contractors. …
>
> [emphasis in original omitted]

On this view, the functional and commercial reasons behind the Singapore courts' recognition of unconscionability as a separate and independent ground from that of fraud for restraining the beneficiary calling under a performance guarantee are twofold. Firstly, when a distinction is drawn between the functions of letters of credit and performance bonds, it can be said that whilst letters of credit are a primary obligation of the applicant of the credit and therefore have "been the lifeblood of international trade",[35] the performance bonds are

33 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [24], *per* Andrew Phang Boon Leong JA.

34 *JBE Properties Pte Ltd v Gammon Pte Ltd* [2011] 2 SLR 47 at [10]–[11], *per* Chan Sek Keong CJ.

35 *JBE Properties Pte Ltd v Gammon Pte Ltd* [2011] 2 SLR 47 at [8]. Note that Chan Sek Keong CJ, by reference to the English position on demand performance bonds first laid down by the English Court of Appeal in *Edward Owen Engineering Ltd v*

(*cont'd on the next page*)

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a secondary obligation of the applicant which arises in the event they default in the performance of the underlying contract. Accordingly such security instruments do not serve the function of "the lifeblood of commerce". Secondly, if the beneficiary is allowed to make a demand under the performance bond for a sum in excess of their loss or a demand that amounts to an abuse of the security instrument, they will gain more than what they bargained for. Moreover, if such demands are allowed it would result in economic harm to the applicants, especially to those in the construction industry if they are deprived of their liquidity.

19 Again later in the judgement, the Court of Appeal reiterated that:[36]

> … if an unconscionable call on a performance bond is made pending the resolution of the substantive dispute between the parties, ostensibly to provide the beneficiary with cash in hand in the meantime, that call itself might suffice to leave the obligor high and dry, and cripple its ability to defend itself in the resolution of that substantive dispute.

The decision also raises the beneficiary's perspectives, in particular the beneficiary's right to call on the performance guarantee and the importance of liquidity or cash flow for his business.[37] Whilst the decision recognises the need to strike a balance between the competing interests of the applicant and the beneficiary, it illustrates that an injunction restraining the performance of the guarantee may not result in adverse consequences for the beneficiary:[38]

> It might be thought that since such an injunction is only meant to subsist until resolution of the substantive issues by a court or arbitral tribunal, that the harshness of the remedy can be mitigated by its reversibility, should the merits of the case shift in favour of the beneficiary at the substantive hearing. In any event, it would appear that the beneficiary is not bereft of a substantive remedy and, if he has a good claim to relief, he would receive it eventually.

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*Barclays Bank International Ltd* [1978] QB 159; [1977] 3 WLR 764; (1978) 1 All ER 976, stated (at [7]–[8]) that:

> … Lord Denning MR, delivering the leading judgment, held that an on-demand performance bond '[stood] on a similar footing to a letter of credit' (at 171) …
>
> In setting out the above principles, Lord Denning was obviously influenced by the well-established autonomy principle applicable to letters of credit, which he acknowledged to be the lifeblood of international trade …

36 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [34], *per* Andrew Phang Boon Leong JA. For similar comments in academic literature, see, *eg*, Quentin Loh & Tang Hang Wu, "Injunctions Restraining Calls on Performance Bonds – Is Fraud the Only Ground in Singapore?" [2000] LMCLQ 348 at 353.

37 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [29].

38 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [28].

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20 It follows that the commercial objectives of a performance guarantee will not be defeated if the courts are to restrain an unconscionable call on the guarantee. As regards the guarantee operating as a security device and its ability to be converted into cash, the Court of Appeal seems to suggest that a preliminary injunction will result in the beneficiary merely losing the immediate opportunity to turn the guarantee into cash in hand. If the court decides to lift the preliminary injunction the damage will simply be the loss of use of the guarantee for a short period and he will be entitled to relief "eventually". If the injunction is maintained and in effect its issue is justified, the beneficiary has no ground to complain. Arguably, the above statement fails to appreciate the beneficiary's position that the nature of the guarantee he bargained was payable upon demand and that the intention of the parties was to provide relief to the beneficiary "immediately", not "eventually", upon resolution of disputes between the parties. The decision could have considered this fundamental characteristic of performance guarantees payable on demand,[39] rather than speculate whether or not the bid price or other terms of the contract between the parties may have been influenced by the mode of the performance guarantee as opposed to a cash deposit.[40]

## III. Concluding remarks

21 The decision in *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd*[41] marks a significant legal development of unconscionability as a separate ground from that of fraud for restraining the enforcement of performance guarantees. It not only affirms the legal position in Singapore, but also delves into important issues surrounding the defining indicator of unconscionability, standard of proof of unconscionability, and functional and commercial justifications for the recognition of unconscionability in the context of performance guarantees.

22 In clarifying the substantive content of unconscionable conduct, the Court of Appeal distinguished its meaning from the contractual

39 Note that these guarantees operate as instruments subject to prompt and inevitable payment if the beneficiary makes a demand on them. This inevitability and reliability is the reason for this instrument being referred to as equivalent to "cash in hand". See Charles Debattista, "Performance Bonds and Letters of Credit: A Cracked Mirror Image" [1997] JBL 289 at 289 wherein the author makes an opening remark that it has become a truism to say that a performance bond is the equivalent of cash in hand. See also Adrian Wong Soon Peng, "Restraining a Call on a Performance Bond: Should 'Fraud or Unconscionability' Be the New Orthodoxy?" (2000) 12 SAcLJ 132 at 193.

40 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [25], *per* Andrew Phang Boon Leong JA.

41 [2012] 3 SLR 352.

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doctrine of unconscionable conduct in equity and stated that in the performance guarantees' context a "lack of *bona fides*" on the part of the beneficiary calling under the guarantee indicates unconscionability on his part. Thus, the decision affirmed the application of the principle of good faith in the context of performance guarantees which could capture a wide range of call scenarios. It has been argued in this case note that the decision could have set a narrow scope of unconscionability in the performance guarantees' context. It has also been argued that reference to a strand of unconscionability in equity jurisprudence could serve the purpose of providing a more comprehensive doctrinal perspective of unconscionability which focuses on the similarities and linkages between the principle of good faith which applies to demand guarantees and other relevant principles in equity. Such an approach could also ensure that the principle of unconscionability in the context of performance guarantees develops in a more coherent manner.

23 In attempting to justify the adoption of a "strong *prima facie* case" as the required standard of unconscionability the decision fails to appreciate the significance of the "balance of convenience test" in the grant of interlocutory relief. It has been argued in this case note that an injunction on the ground of unconscionability should only be granted where the balance is distinctly in favour of the applicant of the guarantee. Finally, the decision strengthens the protection available to applicants who procure performance guarantees as security instruments. However, its over-emphasis on the significance of liquidity or cash-flow to the applicant seems to undermine the significance of liquidity or cash-flow to the beneficiary who is entitled to "pay first – argue later" on the guarantee.

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