

“Performance Bonds”

8 March 2016

Performance Bonds

- To guarantee /secure the contractor's performance
- Recourse to meet losses suffered as a result of the contractor's breach
 - Usually corresponds to 10% value of the contract price
 - Usually valid till 6-12 months after expiry of Defects Liability Period

Calling The Bond

- Conditional?

Or

- Unconditional?

Or

- Hybrid?

Matter of construction of the bond itself

Unconditional Bonds

On demand bond

“upon first written demand”

“to forthwith pay”

“notwithstanding any contestation or
protest by the contractor”

Virtual promissory note – *Edward Owen* case

Conditional Bonds

- Triggered by proof of conditions stated in the bond
- Must prove breach of the underlying construction contract
- Proof of loss

Hybrid

- The Teknik Cekap type bond
 - *Teknik Cekap S/B v Public Bank Bhd [1995] 4 CLJ 697 CA*

“The banks are in fact not required to be told the nature of the breach or who is to be blamed for the breach. That is not the concern of the bank but it must be asserted that the demand is made as a result of a breach by the sub-contractor.”

- No need to prove or specify the nature of breach
- But must assert the breach

Unconditional Bonds - Prerequisites

A written demand

Bank's obligation to pay is immediate &
unconditional

- *Esso Petroleum M'sia Inc v Kago Petroleum S/B*
[1995] 1 CLJ 283 Supreme Court – locus classicus

Restraining a Call on Bond

- Injunction
- Checklist to succeed:-
 - Do you have clear evidence of fraud or unconscionability
 - Conditions of bond fulfilled & stated in demand?
 - Demand – does it assert the breach?
 - Clean hands, all material facts disclosed
 - “Balance of convenience”

Restraining a Call

- On demand bond

Traditionally:

Restrainable only in cases of fraud “brought to the bank’s notice”

- *LEC Contractors (M) S/B v Castle Inn S/B [2000] 3 CLJ 473 CA*

- A mere allegation of fraud is not sufficient. Fraud must be specifically pleaded and proved. Clear evidence of fraud (which has come to the knowledge of the bank) is needed.
- Instances of dispute between the parties do not amount to fraud.
- Unconscionable conduct or bad faith by itself is not fraud.

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- Allegations of *mala fide* conduct and oppressiveness in calling on the performance bond are insufficient to establish the element of fraud
 - ***HSH Engineering & Construction Sdn Bhd v Belton Properties Sdn Bhd & Anor [2001] 2 CLJ 186***
 - The fraud alleged must be a fraud that is apparent on the face of the performance bond itself
 - ***Patel Holdings Sdn Bhd v Estet Pekebun Kecil & Anor [1989] 1 MLJ 190***

Evidential burden

- Fraud – only realistic inference is that the beneficiary could not have honestly believed in the validity of the demand
 - “Ackner standard” in *United Trading Corp v Allied Arab Bank* [1985] 2 Lloyds Rep 554

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- Unconscionability - ok in Singapore (*Bocotra* case) but previously, not sufficient in Malaysia – *LEC Contractors*
 - But beware, unconscionability now good enough in Malaysia:-

Kejuruteraan Bintai Kindenko v Nam Fatt Const S/B & Anor [2011] 7 CLJ 442

Singapore test

- *Unconscionability sufficient.*
- *“Conduct so reprehensible or lacking in good faith that a court of conscience would either restrain the party or refuse to assist.” – Min Thai Holdings P/L v Sunlabel P/L & Anor [1992] 2 SLR 368*
- *Clear case of unconscionability required – Bocotra v AG [1995] 2 SLR (Rep) 262*
- *Strong prima facie standard to be met. Mere allegations insufficient – GHL v Unitrack [1999] 3 SLR (Rep) 44*

Change of Position

- *Kejuruteraan Bintai Kindenka v Nam Fatt Const S/B & Anor [2011] 7 CLJ 442*
- *“Unconscionability makes good commercial sense & is a sound principle. LEC Contractors principle (i.e., fraud) applicable to injunct the bank/issuer of bond. Unconscionability sufficient if injuncting beneficiary from making a demand.”*
- *“Manifest or strong evidence of some degree of conduct complained of – not a bare statement.”*
- *“Must consider on a case-by-case basis.”*
- **Sumatec case [2012] 4 MLJ 1 (FC)**

Issues

- Contractor's insolvency – is that a default that justifies a call on the bond?
- Damage to reputation – is that enough to restrain a call on the bond?
- Recourse to performance bond for what sort of losses? LAD? Defects? Retention?
