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CONSTRUCTION LAW: RESTRAINT ON THE CALL OF PERFORMANCE BONDS – UNCONSCIONABILITY

Tech-System Design & Contract (S) Pte Ltd v WYWY Investments Pte Ltd [2014] 2 SLR 1309

In Summary

In this Singapore High Court case relating to Performance Bond, the court stated its position on the calling of performance bonds, the elements of unconscionability and highlighted that any such issue about the unconscionability on the calling on performance bond should not have bearing on the merits of the main dispute between the parties.

Application made

The Plaintiff (the main contractor) applied for an injunction to restrain the Defendant's (the developer) call on the two performance bonds until determination of the arbitration proceedings between the parties over liquidated damages claimed by the Defendant for over a year's delay of completion and the extent of the Plaintiff's obligation under the contract to rectify defects that arose during the one year Defect Liability Period.

Issue before the Court

The Court had to deal with the sole issue of whether the Plaintiff was able to make out a strong *prima facie* case that there was unconscionable conduct on part of the Defendant such that an injunction on the call of performance bonds should be granted.

Unconscionability

In dealing with the matter of unconscionability, Edmund Leow Judicial Commissioner (JC) cited the court's decision in *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd [2012] 3 SLR 352* ('*BS Mount Sophia*') which held that in an application for equitable relief of injunction on the call of performance bond on the basis of unconscionability, the elements of abuse, unfairness and dishonesty had to be established – a high threshold of a strong *prima facie* case.

Leow JC held that there was no apparent evidence before the court, let alone to the level of a strong *prima facie* case, that the discrepancy in the sum claimed by the Defendants and the counterclaim by the Plaintiff was due to the Defendant being unconscionable. The Court was unable to make out any unconscionable conduct on the part of the Defendant including claiming over 500 defects to be rectified in the Defects Liability Period and for liquidated damages at a rate of S\$ 6,000.00 per day for the 351 days that the Architect failed to grant an extension of time against the Plaintiff, was not so obviously, abusive or dishonest as to be unconscionable.

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Leow JC emphasised that his comments on the issue of unconscionability should not have any bearing on the merits of the parties' respective cases.

Calling on the Performance Bond

The court also agreed with the then Chief Justice Chan Sek Keong in *JBE Properties Pte Ltd v Gammon Pte Ltd* [2011] 2 SLR 47 that a performance bond is "security for the secondary obligation of the obligor to pay damages if it breaches its primary contractual obligations to the beneficiary", providing the beneficiary of the performance bond security for its claim.

The court went on to observe that the beneficiary of a performance bond would generally be entitled, subject to the terms of the performance bond, to call on the bond to assure itself of the sum that it was claiming, and save for unconscionable conduct on the part of the beneficiary, the beneficiary's entitlement should generally be respected and enforced as the parties had contracted for that entitlement to be protected. When the dispute is finally determined in arbitration or litigation, the obligor of the bond might be entitled to compensation for its losses if it was found that in the result the beneficiary of the bond was not entitled to the amount that that it had received.

Leow JC observed that even if the beneficiary was mistaken in adopting the position that it was entitled to a certain sum thus justifying a call on a performance bond, the call would be legitimate as long as the position was genuinely adopted and the beneficiary honestly believed that the obligor was in breach of its obligations. Citing *BS Mount Sophia*, Leow JC opined that the court's role is not to appraise the merits of the parties' decisions, but rather, to be alive to the lack of *bona fides* in those occasions.

The court also agreed with the court in *BS Mount Sophia* that a beneficiary should not be prevented from calling on a bond simply because this resulted in hardship to the obligor. Hardship claimed by the obligor could not be used as a ground to prevent a beneficiary who was otherwise entitled to call on a performance from doing so. The court's inquiry focused on the beneficiary's alleged unconscionable conduct rather than the effect on the obligor.

Holding

Accordingly, the court found that the Defendant was entitled to call on the performance bonds and that the Plaintiff was not entitled to an injunction because it was unable to show that the Defendant's conduct was unconscionable.

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CONSTRUCTION LAW: ARCHITECT'S CERTIFICATE & STAY OF PROCEEDING IN FAVOUR OF ARBITRATION

H P Construction & Engineering Pte Ltd v Chin Ivan [2014] SGHC 137

In Summary

In this Singapore High Court case (an appeal against the decision of the Assistant Registrar to grant a stay of proceedings), the court reiterated the “*temporary finality*” of an architect's certificate and that such finality:

- a. cannot be disregarded in any attempt by a party to apply to stay court proceedings in favour of arbitration;
- b. can however be defeated if there is fraud, improper pressure or interference by parties to the contract as provided in *Clause 31(13)* of the *Singapore Institute of Architect's Condition of Contract* (“*SIA Conditions*”); and
- c. the standard of proof for fraud, improper pressure or interference by either party to the contract in such cases is *prima facie* a *bona fide* dispute as to whether the architect's certificate was affected by fraud, improper pressure or interference by parties to the contract.

Issues and holding of the lower court

The Plaintiff (Appellant - the main contractor), brought a suit against the Defendant (Respondent – the employer), claiming for outstanding sum certified by the Defendant's architect. In response, the Defendant applied for a stay of proceedings under *Section 6* of the *Arbitration Act* in favour of arbitration.

At the hearing, the issue that the architect's certificate was procured by the Plaintiff's fraudulent misrepresentation to the Defendant's architect was raised. As certificates issued by the architect under the *SIA Conditions* enjoy “*temporary finality*”, the Defendant had to show that the validity of the architect's certificate was in dispute for the stay of proceedings to be allowed.

The Assistant Registrar granted a stay of proceedings on the grounds that there appears to be a *bona fide* dispute as to whether any fraudulent misrepresentation was made to the architect, resulting in the issuance of the certificates.

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Issues on Appeal

The issue before the appeal Court was whether the party applying for a stay of proceedings in favour of arbitration on the basis that a certificate issued by the architect under the *SIA Conditions of Contract* is affected by fraud, has to establish that there was a *bona fide* dispute on a *prima facie* basis, or whether a higher standard of proof is required.

Fraud affecting temporary finality of architect's certificate and stay of proceedings

Edmund Leow Judicial Commissioner (JC) hearing the appeal held that while fraud is a serious allegation and in accepting the Defendant's counsel's citing of the case of *Anwar Siraj and another v Teo Hee Lai Building Construction Pte Ltd* [2007] 2 SLR(R) 500 ("*Anwar Siraj*") where it was held that a stay of proceedings in favour of arbitration would be granted if the Defendant could show that there was *prima facie* a *bona fide* dispute as to whether there was improper pressure or interference (these being the exceptions under *clause 31(13)* of the *SIA Conditions of Contract*), further held that such fraud does not necessarily require a different standard of proof for applying to obtain a stay of proceedings in favour of arbitration as compared to improper pressure or interference in the context of *clause 31(13)*.

Leow JC also agreed that the test in *Anwar Siraj* was essentially the same as the test in *Multiplex Construction Pty Ltd v Sintal Enterprise Pte Ltd* [2005] 2 SLR(R) 530, both citing the observation of the court in *Uni-Navigation Pte Ltd v Wei Loong Stepping Pte Ltd* [1992] 3 SLR(R) 595, that when one party makes out a *prima facie* case of dispute the court should not embark on an examination of the validity of the dispute as though it were an application for summary judgment but that there should be some credible evidence of fraud, not mere allegations of fraud.

The court was of the view that in interpreting *Clause 31(13)*, one should not disregard the objective and spirit of *clause 31(13)* itself, which is to ensure expedient cashflow within the construction industry.

Holding

On the issue of whether the court should stay the whole of the Plaintiff's claim or whether the Defendant should only be granted a partial stay of proceedings, Leow JC held that even though there was a dispute on fraud, such fraud, even if proven, only affects certain items on the certificate. Thus, these items could be severable from the items disputed by the parties as those have been clearly quantified. Accordingly, the court allowed the appeal in part and granted a stay of the part of the Plaintiff's claim that relate to the dispute on fraud, with no stay of proceedings for the remaining claimed sum.

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CHANGAROTH CHAMBERS LLC

If you would like more information on this or any other area of law, you may wish to contact our lawyers, Mr Anil Changaroth and Ms Tan Lee Jane.

ANIL CHANGAROTH

FCIArb FSIArb

Advocate and Solicitor of
Singapore and Solicitor of England
and Wales

anil@changarothchambers.com



TAN LEE JANE

Advocate and Solicitor of Singapore
tanleejane@changarothchambers.com

