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The Law of Guarantees: Balancing the Interests of the Parties

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THE LAW OF GUARANTEES: BALANCING THE INTERESTS OF THE PARTIES

1. First of all, I would like to thank both the SMU and Jones Day for inviting me to Singapore and making me so welcome. It is very much a pleasure and a privilege to be the Jones Day Professor of Commercial Law at the SMU not only because of the reputations of both institutions (and the fact everybody has been so hospitable), but also because I have always been a firm believer in the establishment of a very close relationships between academe, the legal profession and the judiciary, which I think benefits all sectors in terms of the exchange of ideas and the advancement of legal knowledge. Indeed the main focus of my work over many years has related to issues and problems arising in legal practice; it is the reason that I entered academe in the first place. I am so pleased to see that in Singapore the relationship is very strong (as illustrated by the Jones day Professorship itself and also the nature of research undertaken here). I emphasise the point because by contrast in the United Kingdom these links have become much weaker and sometimes research which is directed towards the needs of the profession and judiciary is now seen as unworthy – something that should not be undertaken in universities. It is so important that links between law schools, the legal profession and the judiciary should be maintained and developed, and I think institutions such as the Jones Day Professorship provide a vital role in doing so.

2. Turning to the topic, much of the modern law relating to guarantees over the past 15 years has concerned itself with protecting the legal status of guarantors, especially those perceived to be in a weak negotiating position. An increased obligation of disclosure has been imposed upon the lender. Additionally, in England (as held in *Royal Bank of Scotland Plc v Etridge No 2* (*Etridge* [2002] AC 773) where a wife guarantees her husband's debts (or the debts of a company controlled by her husband) the lender is put on inquiry by knowledge of that transaction alone that the guarantee may have been procured by the undue influence of her husband (thus enabling the wife to set aside the transaction vis-à-vis the bank if undue influence is shown to exist). The decision in *Etridge* may have been somewhat harsh on lenders,

and there is something to be said for a broader, fact- specific investigation of whether or not the lender is put on inquiry. Nevertheless it has meant that in this, and other situation involving 'non-commercial guarantors' procedures (most notably the provision of independent legal advice) have been put in place to ensure that the guarantor does not enter the guarantee without, as Lord Bingham put it in *Etridge*, fully understanding the nature and effect of the proposed transaction. It appears that the position of prospective guarantors has been significantly improved. Certainly there are far fewer cases these days where guarantors seek to avoid the guarantee on the basis of under undue influence, misrepresentation and unconscionability.

3. Over this period there has been little attention paid to the position of the lender. There is, of course, often little sympathy for banks these days whose activities are seen, at least in the United Kingdom, as putting our financial system at risk and where bankers are regarded as receiving excessive remuneration. But often those who make these points seem to have little knowledge of core banking activities, such as payment systems and, in the context of this paper, the bank's role as lender, which involve significant skill and significant risks. I do not suppose that I will reduce you to tears of sympathy for the banks, but I am going to discuss some of the legal problems which banks face when they lend money to business (which I might say governments - certainly the UK government - encourage banks to do). In particular, an analysis will be made of defences that may be raised by guarantors as a result of circumstances surrounding the execution of a guarantee or upon a restructuring arrangement.

4. In general terms - and this is the central theme of my talk - my view is that the law should not impede the enforcement of a guarantee based on technical defences which have no substantive merit, and only seek to protect the guarantor, especially the vulnerable guarantor, where the guarantor has been misled or there is evidence of undue influence or unconscionability. Let us turn first to circumstances related to the execution of the guarantee.

Execution

5. As I have mentioned, the law requires procedures prior to the execution of the guarantee to be undertaken by banks to ensure that a guarantor understands the nature of the transaction which is being undertaken (so that the guarantee may be set aside if they are not followed), but there are less worthy defences open to a guarantor in this context.

6. I refer in particular to the fact that sometimes the relevant documentation indicates that the guarantee is not supported by consideration. I suspect at this point some of you will be very concerned that I am going to take you back to your law school days with long dreary lectures on the doctrine of consideration (cases like *White v Bluett* (1853) 23 L.J. Ex 36 and *Lampleigh v Braithwaite* (1615) Hob 105 ; 80 E.R. 255 come to mind) which probably seemed to you to have no relevance at all for your future careers in legal practice. Fear not, I will spare you the details.

7. Nevertheless, consideration is not irrelevant to commercial practice, as the law of guarantees shows. Defences based on the absence of consideration are surprisingly common. The most usual is that consideration is past (you will remember from those dreary lectures that past consideration is no consideration), for example, because the guarantee expressly stipulates that the consideration for the guarantee is the execution of the principal loan facility, which has already been entered into before the guarantee is executed. As a result the guarantor's promise could not have induced the execution of the facility, since that event has already taken place. There is no contractual bargain-the consideration is past.

8. How have the courts dealt with this? In the main, in England, they have rejected defences based on the fact that consideration is past, achieving a sensible commercial result. But in doing so, in my view many of the English cases have sometimes distorted normal contractual rule. So, for example, guarantees expressed to be given in consideration of a loan *having been agreed* have often been interpreted as statements of future consideration despite the use of the past tense. In other cases, despite the guarantee clearly stating that its date of execution was

later than the date of the conclusion of the loan facility (the stipulated consideration for the guarantee), it is said the documents create an "inconsistency'' since the execution of the guarantee could not have been induced by the execution of the loan facility which was concluded at an earlier point in time. And this ''inconsistency'' (so–called) is somehow resolved in favour of the lender. In my view, however, in these cases the clear wording of the guarantee is ignored. Of course, we now sensibly accept a contextual approach to the interpretation of contracts (with the courts having regard to the overall commercial purpose of the transaction), but as Judge of Appeal Rajah said in *Master Marine AS v Labroy Offshore Ltd* [2012] SGCA 27 at para 42 "a contextual approach is not just a carte blanche for a creative interpretation", ignoring the plain meaning of the words in the document.

9. An additional problem is that a sensible, commercial result is only achieved (often at appellate level) after endless expensive litigation and the cases we read in the law reports are only the tip of the iceberg. Defences based on lack of consideration are often raised in summary judgment proceedings, delaying the enforcement of the guarantee .

10. I am pleased to say that in this jurisdiction the Courts have approached this difficulty on a more principled basis, relating well established (and ancient) rules of consideration to this modern commercial context. In *Rainforest Trading Ltd v State Bank of India Singapore* (*Rainforest Trading Ltd* [2012] SGCA 21), (a case of a security given by way of equitable mortgage but raising the same issue as presently under discussion in respect of guarantees), Judge of Appeal Andrew Phang , giving the judgment of the Court, emphasised that if there is a request to perform the prior act alleged to constitute the consideration (coupled with an understanding between the parties that the act is to be remunerated) the rule as to past consideration will not apply. (And by the way, students wishing to avoid dreary lectures on consideration should read this judgment as it tells you most of what you need to know about the subject).

11. So, in our context, if there is an express or implied request by the guarantor to establish the facility (together with an understanding that it was to be remunerated by the promise of guarantee) the provision of that facility can be good consideration for the guarantee, even though the facility agreement itself is executed prior to the date of execution of the guarantee. The law views this request and promise as a "single contemporaneous transaction" so that the strict chronology of the documentation is not decisive. For those that remember, this is in fact the essence of the decision in *Lampleigh v Braithwaite*.

12. The approach in *Rainforest Trading Ltd* may go a great deal of the way to providing a general answer to this technically unmeritorious defence: as the Court of Appeal emphasised, there will often be a prior request by the guarantors to provide the facility. This, however, will not always be the case. In *Rainforest Trading Ltd* itself, the relevant correspondence and documentation (which provided a clear indication that the security would be executed after the facility agreement was entered into) were regarded as important factors indicating the existence of a prior request. And in the case of non-director guarantees they will often not be closely involved in the negotiations leading to the grant of the facility, so making it more difficult to infer a prior request to provide the facility. On one view of the law in this area, however, a request should not be an essential element in determining the existence of consideration and therefore the enforceability of the guarantee. In their excellent article discussing *Rainforest Trading Ltd* Professors Yip Man of SMU and Yihan Goh of NUS review the authorities relating to past consideration and cogently argue that there should be a more general enquiry, namely, to ascertain whether the alleged consideration (the loan facility) is 'connected' to the promise of guarantee so that it can be said that the loan has been given in exchange for the promise. The existence of this request would be simply one factor amongst others pointing to the existence of the connection. If this analysis of the law is accepted (and I hope it is) it would further improve the lender's position since the absence of a request to grant the facility would not in itself be fatal to the enforceability of the guarantee. Yet sometimes even more general evidence of 'connectivity' will be thin. So, perhaps, there should be a more radical solution with the law being modified so that if there

is proof of the guarantor's intention to be legally bound and the guarantee is certain (identifying the loan facility guaranteed) the presumption should be that the guarantee is legally binding – despite the fact that the documentation indicates the consideration is past. Of course, a wider debate may be engaged in here, which questions the need for consideration at all, and what I am suggesting may be regarded by some as creating an unprincipled exception. But in my view it is better to do that than permit an unprincipled defence.

13. Another current problem for lenders (as illustrated by the recent English Court of Appeal decision in *Harvey v Dunbar Assets Plc* ([2013] EWCA Civ 952) arising in respect of execution of guarantees is where the guarantee contemplates that several guarantors will sign and, as it transpires, one does not, or the signature is a forgery, or, perhaps, one of the guarantees is unenforceable because it is tainted with undue influence. The lender can be quite vulnerable here because the reference in the usual standard form guarantee to the guarantors' liability being joint and several has been interpreted not merely as indicating that each guarantor will be liable for the whole debt (up to the limit of its liability), and can be sued either individually or collectively in conjunction with the others. This is, of course, the reason why the lender describes the guarantor's liability as being joint and several. The phrase has also been interpreted as having a secondary meaning, namely, as pointing to "the likely conclusion that the signatures of all the named guarantors is an essential precondition to the liability of each guarantor" (*Harvey v Dunbar Assets Plc).* In other words, all must execute it. One cannot say that this is an unreasonable interpretation, but in my view it is not a necessary one. Indeed the early cases concede that it is a secondary implied meaning. Another possible construction is that the phrase simply makes it clear that, in respect of the guarantors that **do sign**, each is liable for the whole debt and can be sued individually or jointly with the others.

14. The secondary meaning is, however, now well established but despite this many standard form guarantees do not cater appropriately for the not unusual occurrence that one of the named guarantors does not sign. The usual protective provisions do

not have a specific provision expressly negating this secondary implied meaning arising from the words “joint and several” and making it plain that if one guarantor *never* becomes liable for whatever reason, the others will nevertheless still be bound by the terms of the guarantee. Instead the usual general protective clauses (as in *Harvey v Dunbar Assets Plc)* are predicated on the assumption that each guarantor has come under an **initial** liability, and shall not be discharged by subsequent events. So a guarantor may be defined as “a person liable under this deed” with the clause then stating that:

> “neither the obligations of the guarantor herein contained, nor the rights powers and remedies conferred ----- upon the bank by this deed shall be discharged, impaired or otherwise affected by---- any obligations of any guarantor or principal debtor to the bank becoming illegal, invalid or enforceable”.

This clause does not embrace the situation where no liability ever arises in the first place because one of the named guarantors does not sign the guarantee, or the signature is a forgery (although it should cover the case where the guarantee is voidable as a result of, for example, misrepresentation).

15. My view here it that the early decisions have been wrong to interpret the words joint and several as leading to the ‘likely conclusion’ that all guarantors must sign, but I concede that it is now too late to reverse the tide of authority. So I have no firm proposal for reform here – just a plea that the courts should not be hesitant to rebut this ‘likely conclusion’ by reference to evidence of surrounding circumstances (*Overseas Union Bank v Lew Keh Lam* [1999] 3SLR 393 is an example of a flexible approach that I favour) and that lenders should carefully check their documentation. This is the salutary warning from *Harvey v Dunbar Assets* Plc. Let me turn now to further unmeritorious defences that may be raised in the context of restructuring arrangements and guarantees of debts by instalments.

Restructuring arrangements

16. Turning to restructuring, the problem facing lenders is not a complicated one but may have serious consequences for them. It is this. The guarantee which is initially executed is drafted (quite reasonably) so as to embrace liability "under or pursuant to a specified facility agreement" (or there is similar wording to like effect). On the face of it, this looks like sensible drafting – especially since the guarantee also invariably contains a clause stating that the guarantor will not be affected or discharged by a variation of the facility agreement, or by the lender giving the borrower additional time to pay. Usually another clause is added whereby the borrower "may be treated for all purposes as a principal debtor".

17. It may be remarked in passing that the first of these clauses ('the variation clause') is included to exclude the general equitable rule that **any** variation of the principal contract discharges the guarantor, with the rule not being limited only to variations which are detrimental to the interests of the guarantor. (The only exclusions are 'insubstantial variations' or those that are clearly to the benefit of the guarantor). Frankly this rule is absurdly prejudicial to the lender with a rationale which defies commercial logic. The case of the lender giving the borrower an additional period of credit is a case in point. When this happens the law prevents the guarantor paying off the debt on its due date because it would effectively undermine the whole arrangement from the borrower's point of view (since the borrower is now exposed to an action-not by the creditor- but by the guarantor exercising his right of indemnity). But it is then said that the guarantor must be discharged absolutely because he has lost the right of paying off the debt on its due date and immediately claiming reimbursement from the borrower by way of this indemnity. But, as one American judge has commented, such a result is based on a totally unrealistic assumption:

> "the law has shaped its judgments upon the fictitious assumption that a surety who has probably lain awake nights for fear that payment may someday be demanded has in fact been smarting under a repressed desire to force an unwelcome payment on a reluctant or capricious creditor."

18. No one presses for a reformulation or change in the principle that any variation discharges the guarantor because a well drafted guarantee will effectively exclude the rule. Nevertheless, as I discuss in detail in my book, care needs to be taken in drafting the clause if it is to be effective. For example, some standard form documents rely on a very general clause (not specifically referring to a variation) stating that the guarantor's liability shall continue not withstanding "any act or thing whereby the guarantor would otherwise be released". The danger here is that the clause can be restrictively interpreted so as to exclude variations from its ambit.

19. Anyway, back to our central topic. In these cases where the guarantee refers to a specific facility agreement, what may transpire is that the restructuring arrangements are found to be so extensive as to effectively discharge and replace the original facility agreement. The result is that the guarantor is not liable because the monies are not within the scope of the guarantee, that is, they are not owing "under or pursuant to" the original facility agreement. Furthermore, the lender is not protected by the variation clause, even a well drafted one, since in the events that have occurred there has not been a "variation" of the original agreement, but a new replacement agreement. As Longmore LJ stated in *Triodos Bank NV v Dobbs* [2005] EWCA Civ 630 at para 17-18:

> "it is apprehended that assent, whether previous or subsequent to a variation, only renders the surety liable for the contract as varied, where it remains a contract within the general purview of the original guarantee… If a new contract is to be secured there must be a new guarantee".

Additionally, the principal debtor clause will neither have the effect of embracing these additional liabilities, nor converting the guarantee into an indemnity.

20. In my view this is not a commercially sensible result. The drafting of the guarantee in *Triodos Bank v Dobbs* was not an unreasonable one but produced a result that the guarantor was not liable, despite the fact that the guarantor's liability never increased beyond the original limit of his liability, and that in the new loan

agreements it had been expressly stated that the security for the loan was to be the existing guarantee.

21. So how can this result be avoided? It is not an easy matter to distinguish a variation of a contract from a new replacement agreement but it would certainly be helpful if the courts adopted a more expansive meaning of the term "variation". Indeed, in *Triodos Bank v Dobbs*, it appears that a substantial increase in the amount of borrowing will result in a finding that there has been a replacement agreement rather than a variation, despite some much earlier authority indicating a more flexible approach to determining what amounts to a variation. In this context, the general rules for the construction of guarantees have sometimes not helped in arriving at a broad meaning of the term because, although the general approach is now to construe guarantees in the same way as any other commercial document, vestiges remain (at least in England) of the *contra proferentem* approach to construction in the context of exclusionary provisions (as with our variation clause excluding the general equitable rule). The issue of whether such an approach should continue to apply was specifically left open in *Harvey v Dunbar Assets Plc*, but in my view a modern contextual approach should be taken to all provisions in the guarantee – including the exclusionary provisions. This is especially so since (as I have explained) the rule of law which is being excluded, namely, that any variation of the principal contract discharges the guarantee, lacks substantive merit.

22. I should also say it is arguable that another interpretive norm may work unfairly against the interests of the creditor. The rather rigid rule in English law (sensibly not adopted with such rigidity in Singapore law) that evidence of prior negotiations are excluded for the purpose of drawing inferences about what the contract means has resulted in cases where the refusal to admit such evidence (quite properly in accordance with the rule) has resulted in the guarantor unjustifiably escaping liability. In *Dumford Trading AG v OAO Atlantrybflot,* where it was argued that the proper guarantor was the parent company of the named guarantor, the Court of Appeal, overturning the decision at first instance, refused to admit evidence of prior negotiations to provide evidence of this contention. This conclusion was reached

despite the fact that the address referred to in the guarantee was not the address of the named guarantor and some of the extrinsic evidence strongly pointed to the parent company being the guarantor. It is reasonably clear that if the evidence had been admitted a different conclusion would have been reached as to the meaning of the guarantee. The exclusion of prior negotiations is compounded by the fact that other doctrines (rectification and misnomer) which might potentially help the lender in this context are difficult to prove. As mentioned, in Singapore there has been a more flexible approach so this sort of result is likely to be avoided. (See Zurich Accident (Singapore) Ltd v B- Gold Interior Design and Construction [2008] 3 SLR (R) 1029 and I commend to you the excellent article ' Re-drawing the Boundaries of Contractual Interpretation--from Text to Context to Pre-text and Beyond' (2010) 22 SAcLJ 513 by VK Rajah)

23. Aside from hoping for a more commercial approach to construction, are there any drafting mechanisms that the lender can adopt? The answer is not obvious, and the matter is not made easier by the fact that the English Court of Appeal in *CIMC Raffles Offshore (Singapore) Ltd v Schahin Holding SA* ([2013] EWCA Civ 644 refers to the position taken in *Triodos* as the "purview doctrine" and considered (without finally deciding), that there was something to be said for the view that the issue was not simply a question of construction. I do not think that this is right and causes a concern because it is always more difficult to counteract legal doctrines through drafting alone.

24. One thing the lender can do is to take new guarantees, but this is inconvenient and involves increased cost. Alternatively, the creditor may obtain a separate written undertaking from the guarantor at the time of the restructuring that the existing guarantee extends to and encompasses the obligations pursuant to the new facility arrangement. There is some indication that this may be effective and the approach is to be welcomed as reflecting the reasonable commercial expectations of the lender, but it is not without potential technical difficulty.

25. The problem is that a written undertaking from the guarantor at the time of the restructuring can only be effective as a legally binding variation of the original guarantee, so that it must either be in the form of a deed or supported by consideration. The undertaking cannot be used simply as a tool of construction to extend the scope of the original guarantee since subsequent negotiations and conduct cannot be used to interpret a prior concluded agreement (unless and until the different New Zealand approach in *Gibbons Holdings v Wholesale* [2008] 1 NZLR 277). If the consideration is the entry into the new facility arrangements, the guarantor's undertaking that the guarantee will apply to it must be executed prior to (or at least at the date of) the execution of the facility agreements. Otherwise (as the law now stands) the consideration will fail as past consideration, and the variation will be ineffective. Additionally, even if the original variation is legally binding, there may be issues of construction as to the precise effect of the variation upon the scope of the original guarantee. A final protective mechanism is to draft the scope of liability of the original guarantee in such a way as to encompass future agreements on substantially different terms. The usual 'all moneys' clause is the obvious mechanism. Yet the lender may find considerable resistance from the guarantor to the use of the clause in this context since it is not really a proper description of his initial obligation, which is a guarantee of a specific facility. In any event an 'all moneys' guarantee is not all that it appears since (despite its wording), in certain contexts it will not be all encompassing, and, in particular, may not embrace liabilities not within the reasonable contemplation of the guarantor at the time of its initial execution.

Guarantees of Debts Payable by instalments

26. In the case of debts payable by instalments, the lender's enforcement of the guarantee may be affected by the precise form in which the guarantee is drafted. On general principles a distinction must be drawn between two types of guarantee. The first is where the guarantor undertakes that if the principal debtor fails to pay any instalment he (the guarantor) will pay it or, alternatively, where the guarantor undertakes that the principal debtor will carry out his contract. An example of the first type of guarantee (hereafter called type (1)) would be an undertaking that 'in case the debtor is in default of payment I will forthwith make the payment of behalf

of the debtor'. A guarantee of 'the performance of all the terms and conditions of the contract' would be an illustration of the second type (type (2)). Sometimes (and , as we will see, preferably from the lender's point of view) the two forms of guarantee are combined. Thus in *NRG Vision Ltd v Churchfield Ltd*, the guarantee was stated to be in respect of 'the payment by the customer of all sums due under the agreement … and the due performance of all the customer's obligations thereunder'.

27. If the guarantee is of type (1), the creditor's cause of action is in debt or for a money sum, the claim being for a liquidated amount. In respect of a guarantee of type (2), the cause of action will generally be in damages for breach of contract. All this appears somewhat technical (and it is) but the distinction between the types of guarantee becomes crucial when the principal contract is determined as a result of the principal's breach. As Lord Reid indicated in *Moschi v Lep Air Services* if the guarantee only amounts to an undertaking by the guarantor that he will pay any instalment not paid by the debtor (a guarantee of type (1) as described above), the guarantor is discharged in respect of subsequent instalments by a determination of the principal contract, even though the determination arises out of the lender's acceptance of the borrower's breach.

This result arises because the terms of the guarantee indicate that the guarantor has only promised to pay an instalment if the debtor fails to pay and that obligation to pay (arising as it does in the future) never matures because the contract has been determined. As a consequence, an action for a liquidated sum is not available because the payment has not yet been accrued. A claim in damages is also not possible vis-à-vis the guarantor because the terms of the guarantee contemplate merely a guarantee of the instalments and not a liability in respect of damages.

28. No doubt this reasoning has some technical merit. But, given that the central object of the guarantee is to protect the creditor against the contingency of the principal's breach, the result is perhaps unfortunate. The guarantor escapes all liability in respect of future obligations subsequent to termination because of

technical distinctions in drafting. The benefit of the guarantee is lost at the time it is most needed.

Some comments on unconscionability and performance bonds

29. Finally, I would like to say something about safeguards for guarantors. As I mentioned earlier in the talk, there needs to be proper mechanisms to ensure that guarantors (especially those in a potentially vulnerable position) understand the nature of the transaction. But what of protecting the interests of guarantors in a purely corporate context? I turn my attention to on demand performance bonds which are commonly used in the construction industry as a security for the performance of a contractor's or subcontractor's obligations under the building contract. Here, however, the obligations arise simply upon a demand being made; there is no need for a default. It has been generally accepted that fraud is a proper ground for restraining the beneficiary of the bond making a demand. But the Courts in Singapore have consistently held that unconscionability, as distinct from fraud, is a separate ground upon which the court may grant an injunction. And they seem to have come under attack from some commercial lawyers for doing so.

30. In my view the Singapore Courts have adopted the correct approach, although at the outset I should declare that I am something of a convert so far as doctrines based on unconscionability are concerned. When I practised law in Australia, it was in a period that the general doctrine of unconscionable bargains was developed, with many of the relevant authorities being decided in the context of guarantees. The doctrine operated to vitiate the guarantee as a result of events arising prior to its execution. Initially, I opposed the development of the doctrine on the basis that it made a guarantee a less valuable and more uncertain security. Yet I changed my mind, because I found that in time the courts delineated reasonably clearly those circumstances and patterns of behaviour that would lead to a finding that the agreement was an unconscionable bargain and those which did not. This refinement by judicial decision-making enabled the prediction of outcomes and consequently the giving of proper legal advice much easier. Indeed my enthusiasm is such that I have elsewhere proposed that unconscionability in the context of non-business

arrangements replace the separate doctrines of duress, undue influence and mistake.

31. Unconscionability in terms of a restriction on the enforcement of an on demand performance bond is of course different from the doctrine of unconscionable bargains, but I take the view here as well that it is a sensible development. Those who object to its application in this context do so on a variety of grounds. It is emphasised that the performance bond is a substitute for a cash deposit so that the beneficiary should be entitled as of right to call on the bond and effectively convert the bond to such a deposit pending the resolution of the dispute between the parties; that permitting such a restraint is contrary to the clear terms of the bond which specify that the beneficiary is entitled to call on the bond upon demand; that an assessment of whether or not the conduct is unconscionable will mean that the courts will inevitably become involved in the real dispute pursuant to the underlying transaction; that the application of the doctrine is vague and uncertain and will lead to endless litigation ('the floodgates will be opened'); and finally, more dramatically, that performance bonds (like letters of credit) are the lifeblood of commerce.

32. In *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* (*BS Mount Sophia Pte Ltd* [2012] SGCA 28) Judge of Appeal Andrew Phang has refuted these objections and convincingly so. There is no need to repeat them here and I content myself with making the following two points in support of the position taken by the Singapore Court of Appeal. First, and fundamentally, it is clear from the cases (and practice) that a call on a performance bond may cause severe liquidity problems for the contractor or subcontractor obligor under the bond. Calling up the bond where there has been no breach may result in the business failing simply because of that event alone. It is an injustice that needs to be prevented. Indeed, as pointed out in *BS Mount Sophia Pte Ltd,* in one sense an unwarranted call upon the bond may put the contractor in a worse position than if it had given a cash deposit. Providing a cash deposit means that the contractor is at the outset out of pocket, but at least it knows its position and does not face the insecurity of a call on the bond for no good reason at an unspecified time when it is least expecting it.

33. Secondly, the burden of proof to obtain an injunction is a high one – that is, a strong prima facie case of unconscionability must be made out. Unconscionability is narrowly defined in terms of a lack of bona fides. As stated in *BS Mount Sophia Pte Ltd* (at para. 45):

"a finding of unconscionability is a conclusion applied to conduct which the court finds to be **so lacking in bona fides** that an injunction restraining the beneficiaries' rights is warranted".

It may be remarked that this is a more rigorous test than is required for the more established doctrine of unconscionable bargains, which requires simply that the stronger party takes advantage of the weaker party.

34. Thus defined, I would say that unconscionability as a ground for restraining a call upon the bond sensibly introduces a little flexibility extending the court's jurisdiction only narrowly beyond the notion of fraud. Indeed, it seems to me that in many of the Singaporean cases where unconscionability has been held to be a ground of relief fraud might also have been a legitimate basis for relief. So in *BS Mount Sophia Pte Ltd* itself, it was held that there was unconscionability because "the [beneficiary] did not genuinely believe that the [contractor] was in breach". This approximates quite closely to the definition of fraud, at least in some of the cases – for instance in *Balfour Beatty Civil Engineering v Technical and General Guarantee Company Ltd*, the English Court of Appeal considered that a demand where the beneficiary does not honestly believe that the money is due is fraudulent. Similarly, another Singapore sensible decision where the conduct seems to approximate to fraud is *GHL v Unitrack Building Construction Pty Ltd* ([1999] 4 SLR 604*)* where calls on the bond were limited to 10% of the contract price, but the contract was subsequently reduced. The court restrained a call upon the bond when the beneficiary sought to demand 10% of the original, rather than the re-negotiated price.

35. So my view here in relation to on demand performance bonds fits in with the general message from this paper. The law should erect unreasonable barriers preventing the properly enforcement of the guarantee. Guarantors and others giving security should be precluded from relying on technical defences that lack substantive merit. But, at the same time, we should permit and refine defences which diminish the possibility of unfairness to guarantors.