

On Demand Performance Guarantee: Unconscionability and Breach of the Underlying Principle Contract

OXLEY RISING SDN. BHD. V SSYANGYONG ENGINEERING & CONSTRUCTION CO. LTD. AND ANOR APPEAL [W-02(C)(A)-274-02/2022 & W-02(IM)(C)-273-02/2022]

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ISSUES

It is a commonplace in the construction industry for the employer to require the contractor to provide a performance guarantee in the form of a bank guarantee.

Often time, the employer will require such bank guarantee to be an “on-demand” guarantee. Can the bank or the contractor attach conditions to such “on-demand” guarantee?

If the bank guarantee is to guarantee performance, must the employer first establish that there is non-performance, or breach, before making a demand on the bank guarantee? Will the failure to prove breach be deemed as an unconscionable act warranting a restrain on the employer to receive the proceeds under the guarantee?

These questions were answered in the recent Court of Appeal decision in **Oxley Rising Sdn. Bhd. v Ssyangyong Engineering & Construction Co. Ltd. And Anor Appeal [W-02(C)(A)-274-02/2022 & W-02(IM)(C)-273-02/2022]**.

BRIEF FACTS

The brief facts of the case are as follows:-

- (a) The Defendant as the developer and the Plaintiff as the Main Contractor executed a construction contract.
- (b) The Plaintiff provided a bank guarantee (“**BG**”) pursuant to the construction works to be carried out.
- (c) According to the Defendant, there was a delay in the project leading to the termination of

the construction contract by the Defendant.

- (d) The Defendant contended that the delays caused losses to the Defendant and hence, made a demand on the BG.
- (e) The Plaintiff objected to the call and filed an application in the High Court (“OS”) applying, amongst others, for:-
 - i. Declarations that the Defendant is not entitled to make any demand for payment on any sum under the BG and that the demand made is wrong in law;
 - ii. Orders to restrain the Defendant (as well as representatives) from demanding and/or receiving any payment under the BG pending final determination of the parties’ rights in arbitration or until such further order; and
 - iii. Interim preservation of the BG from fraudulent and unconscionable demand by the Defendant in aid of arbitration.
- (f) At the outset, the High Court granted an injunction to restrain the Defendant from calling on the BG or receiving proceeds thereof pending the disposal of the OS (“**Interim Injunction**”);
- (g) After hearing arguments from both parties on the OS, the High Court allowed the OS and granted, amongst others, the following:-
 - i. Declarations that the Defendant’s demand is wrong in law and that the Defendant is not entitled to make any demand for payment on any sum under the BG pending final determination of the parties’ rights in arbitration or until such further order;
 - ii. Orders to restrain the Defendant (as well as representatives) from receiving any payment under the BG pending final determination of the parties’ rights in arbitration or until such further order; and
 - iii. Order to restrain the Defendant from utilising the payment from the BG and for the same to be refunded to the Plaintiff in the event the said proceeds have been received.
- (h) Dissatisfied with the High Court’s decision, the Defendant appealed against both the decision to the grant of the Interim Injunction as well as the OS (“**Appeals**”).

THE HIGH COURT'S FINDINGS

The Court of Appeal observed that the High Court granted the OS on the following grounds:-

*"[10] The learned HC judge found that the defendant is not entitled to call on the BG as it is **over-securitized** and therefore it is unconscionable for the call to be made.*

[11] The learned HC judge decided that the BG is an unconditional on-demand bond and there is no dispute regarding this.

*[12] The HC concluded that the **BG could only be called by the defendant based only on the reasons stipulated in the contract** executed between the plaintiff and defendant.*

*[13] The **defendant must prove** that at the date of the call, the estimated amount recoverable from the plaintiff is around RM 309 million."*

[Emphasis added]

SUBMISSIONS BEFORE THE COURT OF APPEAL

The Plaintiff's grounds to restrain payment of the BG proceeds are premised on the primary ground that *"the defendant did not satisfy the conditions laid mainly in the contract between the parties"* as the Contract provide that the BG may be called if there is any breach of the Contract.

In rebuttal, the Defendant submitted that both parties as well as the Learned High Court Judge accepted that, the BG in question is an on-demand BG and as such, *"there are no conditions attached to the same and once it is demanded, there is no option for the plaintiff but to agree to the release of the sum in the BG."*

DECISION OF THE COURT OF APPEAL

The Court of Appeal allowed the Appeals and overturned the High Court's decision in granting the Injunction on the following grounds:-

- (1) The BG is an on-demand BG and hence it is an unconditional guarantee;
- (2) Corollary to the above, the BG is not contingent on the Contract or any breach thereunder;
- (3) As such, there is no unconscionability in the demand on the BG.

On-Demand = Unconditional



Relying on the Supreme Court decision of **Esso Petroleum Malaysia Inc v Kargo Petroleum Sdn Bhd [1995] 1 CLJ 283**, the Court of Appeal found that an on-demand bank guarantee is without condition and can be triggered by a simple demand:-

*“[20] It should also be strongly borne in mind if the plaintiff says the BG is subject to the contract, why did the same agree that this is an on-demand BG? With respect, it is, to say the least, quite odd for the plaintiff to maintain there are conditions that must be satisfied by the defendant as stated in the contract before the BG could be effective. If this is to be sustained by the plaintiff, it should be obvious that it should not in the first place, have agreed to the fact this is an on-demand BG. **Especially when the case law above, unequivocally pointed out an on-demand BG is without conditions and can effectively be triggered when there is a simple demand for the same.**”*

*“[21] Based on the apex court decision above, it is high time that where a BG is available, **parties therein should be advised that they need to be extremely cautious in admitting the same to be an on-demand BG.** Agreeing the same to be an on-demand BG as shown by the case law above, entails great repercussions that may be beyond repair.”*

[Emphasis added]

On-Demand / Unconditional Bank Guarantee is not contingent on the Contract or any breach thereunder

Relying on the Federal Court case of **Karya Lagenda Sdn Bhd v Kejuruteraan Bintai Kindendo Sdn Bhd [2008] 6 MLJ 636**, the Court of Appeal also found that an on-demand guarantee is a separate and independent guarantee and not contingent on the terms of the principle contract between the Plaintiff and the Defendant, or any breach thereof:-

*“[23] **The on-demand BG should not be contingent on the contract executed between the plaintiff and defendant.** It is a separate document entitling the defendant to rely on its terms independent of and aside from the formal contract.*

...

*“[25] Hence, following the apex court case above, the BG in our present case does not depend on the terms of the written contract between the plaintiff and defendant. **Whether there was any breach of the terms of the written contract by the defendant (although denied), is no bar for the same to rightly call on the BG.** The terms of the on-demand BG could be relied on by the defendant separately and independently of the contract between the parties and the plaintiff had no option but to accede to the demand made by the defendant. The latter should not be estopped in any manner to call and benefit from*

the BG.

[26] In calling the on-demand BG, the defendant referred to the written contract. This reference is of no effect and consequence. It does not mean the terms of the contract are incorporated into the BG and the same is subjected to the terms of the said contract.”

[Emphasis added]

No Unconscionability

By reference to the Singaporean Court of Appeal’s case of **BS Mount Sophia Pte Ltf v Join-Aim Pte Ltd [2012] SGCA 28; [2012] 3 SLR 352**, the Court of Appeal also affirmed the position that unconscionability requires a high standard of proof, especially considering that it is commonplace in the construction industry for a bank guarantee to be provided:-

“[36] The on-demand BG as said is unconditional and effective once there is a demand by the defendant. It is provided under normal circumstances in the construction industry. We find no reason to say there was indeed unconscionable conduct on the part of the defendant in demanding the BG. The defendant is perfectly entitled and has the legal right to call the on-demand BG under the circumstances of this case.

...

[38] Likewise, in the present appeals before us, proving unconscionability by the plaintiff against the defendant should be on a higher level. Otherwise, the defendant would unjustifiably be deprived of the on-demand BG, which it is entitled to enforce.

[39] We totally agree that the plaintiff had not met this high standard. The unconscionable conduct alleged against the defendant remains unproven considering the effect of the on-demand BG to the benefit of the defendant.”

[Emphasis added]

The Court of Appeal also found that Clause 37.5 of the Contract, which provides that the BG may be called where there is a breach, does not necessitate the Plaintiff to prove breach before calling upon the BG. The BG is independent of the underlying principle Contract between the Plaintiff and the Defendant:-

[33] The above clause states as follows:



"In the event the Employer determines the employment of the contractor in accordance with Clause 25.0, or if there is any breach of the Contract, the Employer may call on the Performance bond and utilise and make payments out of or deduction from the Performance Bond for the completion of and/or rectification of the Works and reimbursement of loss and/or expense suffered by the Employer. [...]"

[34] The above suggests that the call on the BG must be premised on the breach of the written contract. Thus, the plaintiff contended that the defendant could not simply call on the BG without proving the breach of the contract by the plaintiff. While the learned HC judge relied on Bauer to find although it is an on-demand BG, the above clause qualified the said BG, restraining the defendant to call on the same.

[35] In respect of the above contention of the plaintiff and the finding of the learned HC judge, as stated earlier, the BG is unconditional and would effectively apply on-demand. It is independent of the terms of the contract and most importantly, even the plaintiff did not at any stage dispute that this is an on-demand BG, devoid of any conditions. Therefore, it could not be said that the BG is conditional on the above clause of the contract."

KEY TAKE AWAY

Following the decision, it is important to note that:-

- (a) An on-demand guarantee is an unconditional guarantee. Parties should be cautious of the consequences of providing such a bond as it only requires a simple demand to trigger payment.
- (b) An on-demand guarantee is not contingent on the terms of the underlying principle contract. The party demanding the guarantee need not prove breach of the underlying principle contract.
- (c) Proving unconscionability requires a high standard of proof.

If you have any questions or comments on this article, please contact:-



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