



expert talk

# INJUNCTIONS ON THE INVOCATION OF BANK GUARANTEES: A GLOBAL PERSPECTIVE

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## I. INTRODUCTION

### A. The construction industry

1. For decades, the construction industry has been a crucial factor for measuring the growth of world economies. In 2018, the Global Construction Intelligence Center forecasted that global construction output would rise to US\$ 12.9 trillion by 2022, up from US\$ 10.8 trillion in 2017.<sup>1</sup>
2. The construction industry is a horizontal industry and serves almost all other industries, since creation of economic value across sectors occurs mainly by means of building or other constructed assets. It is difficult to provide a definition which would encompass all aspects of the construction industry. There is even some debate regarding whether the construction industry is an industry, or a sector that comprises many industries.<sup>2</sup>
3. Professor David Pearce's report titled "*The Economic and Social Value of Construction*"<sup>3</sup> provides valuable input for defining the construction industry, and provides a "narrow" and a "broad" definition. The narrow sector consists solely of on-site assembly including repair work, which encompasses the site preparation, construction of buildings and infrastructure, building installation, and building completion (decoration). The broad definition consists of much more, including the supply chain for construction related products, including the mining of construction materials, and the manufacture of construction products. It also includes professional services such as management, architecture, design, and facilities management.<sup>4</sup>

### B. Elements of a Construction Project

4. The different types of construction projects include residential, building, commercial, industrial, highway construction, heavy construction, rig conversions, etc.
5. A typical construction project involves the following key players:
  - (a) the employer (alternatively called the client, owner, or developer);
  - (b) the consultant; and
  - (c) the contractor.
6. The employer initiates the process by conceiving a business plan for the project and taking the decision to build, after analysing commercial and financial prerequisites.<sup>5</sup> Once the decision to build is made, the employer then has to decide the structure in which it wants the construction project to be executed. Some of the common structures are as follows:



- (a) Traditional build model, in which the employer prepares all the designs, drawings, and specifications, on the basis of which it invites contractors to build the project;
  - (b) Design and build model, in which the contractor prepares the designs, drawings, and specifications, and then builds the project;
  - (c) Hybrid model, in which the employer prepares basic designs, drawings, and specifications, on the basis which contractors have to conduct detailed engineering and designing, before starting construction.
7. After choosing an appropriate model, the employer prepares a project brief, which may either be provided to a consultant, or directly used for preparation of tender documents. On the basis of the tender documents, the employer calls for bids for the project, for the works to be executed through one of the various models,<sup>6</sup> including:
- (a) Lump sum contracting;
  - (b) Unit rate contracting;
  - (c) Reimbursable cost contracts;
  - (d) Cost plus model;
  - (e) Cost plus percentage model;
  - (f) Start cost reimbursable with later conversion to lump sum;
  - (g) Provisional contract price arrangement;
  - (h) Target cost (shared overrun and underrun); and
  - (i) Incentive plans.
8. Considering the significant amounts of investment involved in the execution of construction projects, it is frequently seen that several corporations globally join hands to work together and bid for particular projects. The need for tailor relationships in response to the requirements of projects has led to the formation of the following structures amongst the contractors including:<sup>7</sup>
- (a) Consortium, which is an arrangement between several companies, in which each company contributes an equity stake in the form of risk capital or payment in kind in order to qualify as a member. In such cases, the remuneration of the members of the consortium is generally calculated as a share of net profits.
  - (b) Joint Venture, which is a type of arrangement characterised by a number of companies collaborating on a project, or a number of distinct projects, with a



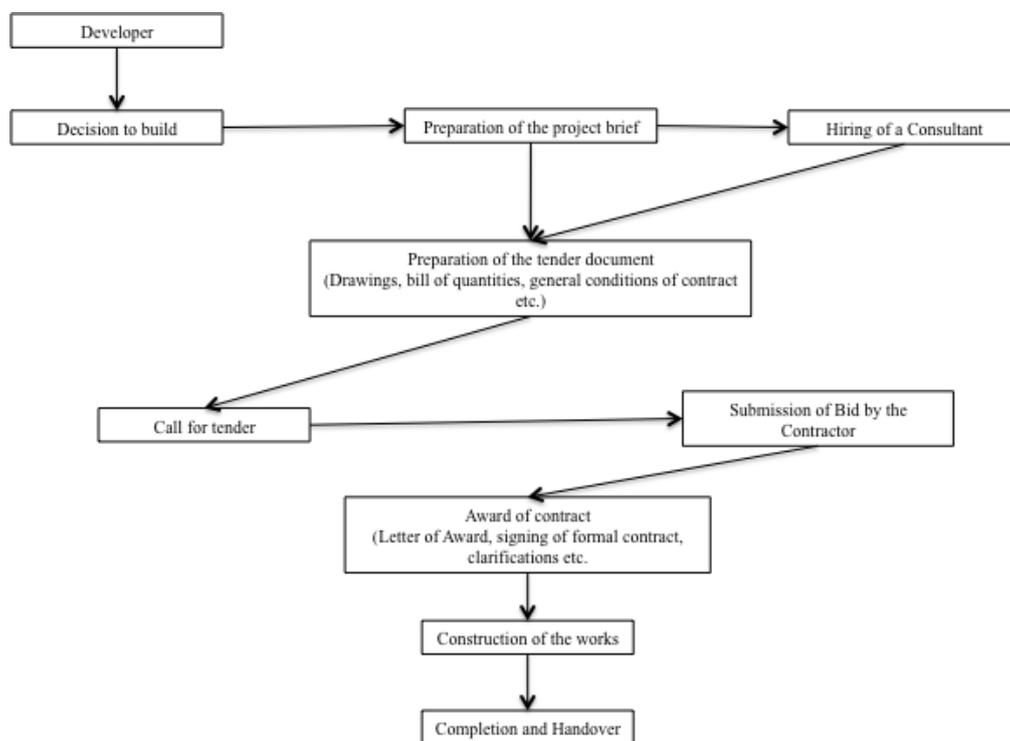
view to sharing profits, each company being paid on the basis of its agreed contribution in kind or in financial terms.

(c) Partnering agreement, which involves a number of companies, usually including the employer, working co-operatively to achieve a given output over one or a number of projects. In such arrangements, the remuneration is generally based on contract terms and contribution of work.

(d) Special Purpose Vehicle, which is a formal accounting and contractual arrangement set up by one or more companies to undertake a project separate from the accounts of the companies comprising the special purpose vehicle.

9. In practice, it is commonly seen that variants and hybrid structures are formed by contractors, to meet the requirements of projects. These structures also sometimes involve partnership arrangements with institutional financiers as well.

10. Once the bids are received from various contractors, the employer and the consultant evaluate the same. Post agreement on the terms of the contract, the contract is awarded. The principal stages of a typical construction project may be summarised as follows:



### C. Risks associated with projects and the role of bank guarantees

11. The high risks and disputes associated with the construction industry are not uncommon. The industry is vulnerable to the numerous technical and business risks, which often represent high exposure for investors. Risks such as economic crises, labour issues, credit risks, engineering and material related issues, etc. sometimes lead to not only the failure of a project, but even its abandonment.
12. All stakeholders involved in a project including investors, partners, financiers, etc. have always sought to minimise risks and protect their interests. An effective mode of mitigating risks is the execution of bank guarantees (hereinafter referred to as “BG” in singular, or as “BGs” in plural).
13. There are a variety of situations in which a BG may be sought by the stakeholders involved in a project:
  - (a) employers may seek BGs from contractors, in relation to particular features of, or all of, a given project;
  - (b) contractors may seek BGs from their consortium partners or sub-contractors, for due performance of their obligations; and
  - (c) financiers and investors may seek BGs from contractors as a security for their investments.
14. BGs play a vital role with respect to:
  - (a) Liquidity - by facilitating release of cash and saving costs for financing;
  - (b) Safety - by limiting risk arising out of a contract and to secure the risk of non-payment; and
  - (c) Construction - by facilitating bidding in tenders and the subsequent construction of projects.<sup>8</sup>

### D. Concept of Guarantee

15. Chitty on Contracts<sup>9</sup> defines a contract of guarantee as follows:

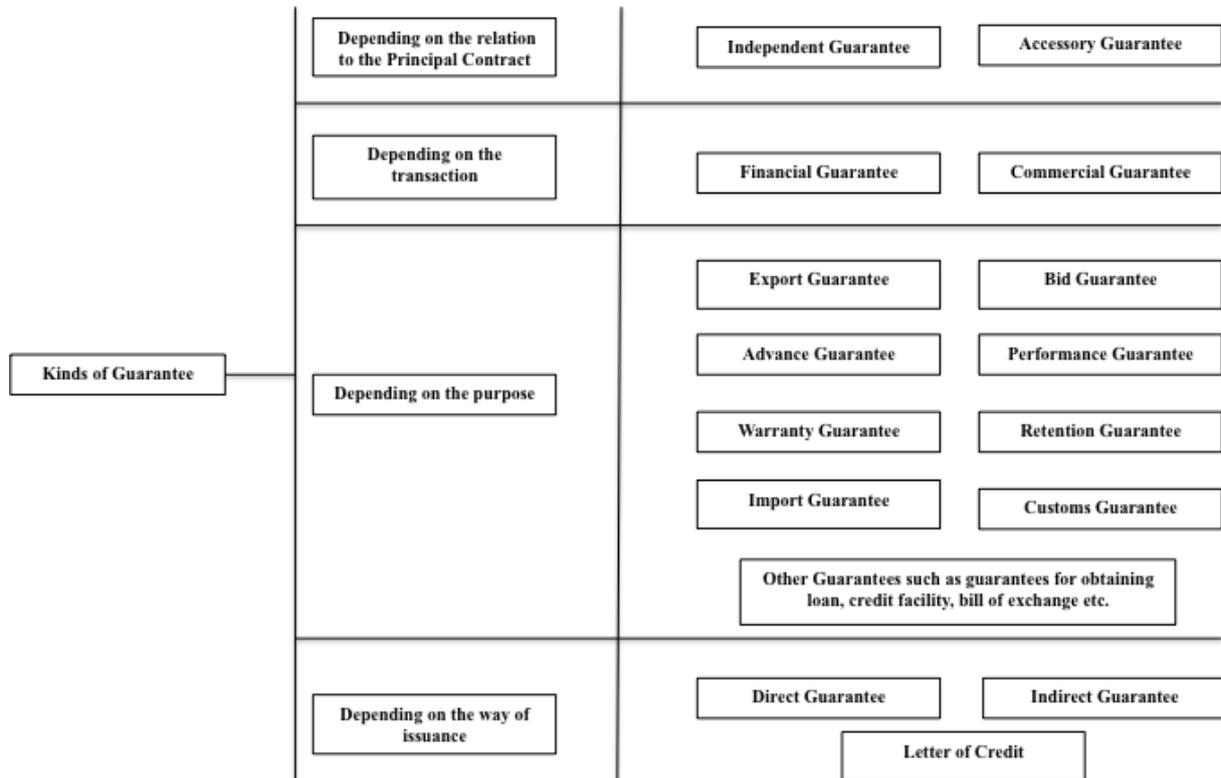
*“In a contract of guarantee, the guarantor promises to be responsible with the principal for the performance of the principal’s obligation to the beneficiary so that the guarantor will be personally liable if the principal fails to perform its obligations to the beneficiary to the same extent as the principal.”*

16. A contract of guarantee is a tripartite arrangement and involves:
  - (a) the principal obligor;
  - (b) the creditor; and



(c) the guarantor.

17. The following table summarises the different kinds of guarantees:



18. This article limits its discussion to BGs only. A BG is a financial guarantee created with an undertaking by the bank that it will satisfy creditors based on the guarantee up to a specified amount of money if the debtor fails to fulfil a specific debt to the creditor, or if the other conditions of the guarantee are met.

19. The various types of guarantees involved in construction projects are:

- (a) Bid Bond/ Bid Security/ Earnest Money (generally 2 - 5% of the total contract price), which is a fund or bond submitted with a bid, as a guarantee to the recipient of the bid that the contractor will not modify its bid during the period of bid validity and if awarded, will execute the contract and supply the guarantees necessary upon signing.
- (b) Performance BG (generally 10 - 20% of the total contract price), which is a security which covers the obligation of the contractor to complete the project within the agreed time, and liabilities for damages in case of delays, or in case the contractor discontinues its work.
- (c) Advance/ Mobilization BG, which is a BG submitted by the contractor to meet its capital deficit by way of obtaining a mobilization advance on the payment



due to it from the employer.

(d) Warranty/ Retention BG, which is a security warranting the quality/ life of the project.

20. Thus, it can be seen that BGs are an effective mode of mitigating the risks involved in the industry. However, the misuse of BGs is not uncommon. Often, the beneficiary invokes BGs wrongfully, thereby causing huge losses and expenses to contractors. It is important for the party furnishing a BG to understand the grounds on which it can obtain a stay on the invocation of BGs from courts or tribunals.

21. The laws governing the invocation of BGs differ from jurisdiction to jurisdiction, and the law governing the BG becomes essential in determining the grounds for obtaining an injunction on the invocation of the BGs. This article analyses case laws from multiple jurisdictions, to understand the grounds on which an injunction can be obtained in such jurisdictions.

## II. DEMAND GAURANTEES

### A. Definition

22. Performance bonds and bank guarantees (demand guarantees) are common features of international sales and construction contracts.<sup>10</sup>
23. A demand guarantee is a guarantee that imposes a primary obligation on the issuer to pay the beneficiary on its first demand for payment if the primary obligor fails to perform the contract. The issuer's obligations are not affected by disputes arising from the underlying contract between the beneficiary and the primary obligor. There are various types of demand guarantee including tender, performance, and advance payment.<sup>11</sup>
24. The widely accepted principle of determining whether a guarantee issued could be regarded as a demand guarantee is the Paget's presumption principle laid down in the case of *Wuhan Guoyo Logistics Group v. Emporiki Bank of Greece*,<sup>12</sup> which provides that if the following elements are present in a guarantee, there is a presumption that it will be construed to be a demand guarantee:
- (a) It relates to an underlying transaction between the parties in different jurisdictions;
  - (b) It is issued by a bank;
  - (c) It contains an undertaking to pay "on demand" (with or without the words "first" and/or "written"); and
  - (d) It does not contain clauses excluding or limiting the defences available to a guarantor.
25. A demand guarantee is independent of and detached from the underlying contract to which it relates, and operates strictly in accordance with its own terms. This concept is generally referred to as the autonomy of the demand guarantee and is the longest standing principle in the operation of the law of documentary credits. The autonomy principle also provides that the payment obligations embodied in the demand guarantee are independent of both the performance of the underlying contract between the applicant of the credit and the beneficiary, and the relationship between the applicant and the issuing bank.<sup>13</sup>

### B. Structure of a bank guarantee

#### *(i) Preamble*

26. This part of a BG generally makes a reference to the underlying transaction in light of which the BG is being issued. However, mentioning the underlying transaction does not in any way affect the independence of the instrument. The purpose is to



ensure that the beneficiary does not take recourse to the BG for any other risk than originally envisioned.

27. A typical mention of the purpose and the risk the BG is supposed to cover does not make this language a part of the payment clause.<sup>14</sup> However, this also depends on the language used in the preamble. One has to ensure that the preamble has no a relation to the payment clause of the guarantee. The law governing the BG plays a major role in determining this.

28. A typical preamble in a BG will read as follows:

*"In consideration of the [Contractor] entering into a contract with [Owner] bearing [reference number] for the construction of [details of the project] and upon the request of the [Contractor], we hereby provide this guarantee for the faithful performance of the entire contract."*

*(ii) Payment clause*

29. This is the most important clause in a BG, as it provides the payment obligation of the issuing bank.

30. This clause generally provides the following:

- (a) amount, interest, and currency;
- (b) extent of liability of the guarantor;
- (c) formal mode in which a demand is to be made;
- (d) requirement of formalised additional documents/ declarations with the demand; and
- (e) formal requirement of avilment (for instance, whether the demand is to be made in writing).

31. The construction of this clause determines whether the guarantee is conditional or unconditional. Courts throughout the world take recourse to various tools of interpretation to determine the times when the beneficiary can have recourse to the said guarantee.

32. Conditional BGs contain no express provision outlining the time of release, and in most cases, require the beneficiary to prove to the guarantor that the principal obligor has failed to perform its obligations under the contract, entitling the beneficiary to encash the guarantee.

33. On the other hand, unconditional BGs contain express provisions outlining the time of release, and do not require the beneficiary to prove to the guarantor that the principal obligor has failed to perform its obligations under the contract. In



order to invoke an unconditional BG, a mere statement that the contractor has defaulted is, depending upon the terms of the guarantee, sufficient for the bank to release the monies.

34. This article limits its discussion to unconditional guarantees only. The universal approach to drafting an unconditional BG generally includes the use of words such as *“without any demur, reservation, contest or protest and/ or without any reference to the contractor”*.
35. With regard to the demand, the most frequently used wording is the obligation to pay on *“first demand”*. However, courts throughout the world read the guarantee as a whole to determine its true nature, irrespective of the words used.
36. In order to protect their position, banks may require presentation of additional documents/ declarations that the contractor is in default. In such cases, the bank does not become the judge as to whether there is a breach by the contractor or not. This requirement is merely to protect the bank’s interest with regard to the BG.
37. A typical payment clause would read as follows:

*“We [guarantor] do hereby guarantee and undertake to pay immediately and upon receiving the first demand in writing and any/ all monies to the extent of [amount] without any demur, reservation, contest or protest and/ or without any reference to the [contractor]. Any such demand made shall be conclusive and binding without the requirement of any proof with regard to the money due and payable notwithstanding any disputes pending before any courts, tribunals or any other authority.”*

*(iii) Expiry and return of the guarantee document*

38. This clause provides the time until which the BG remains in force. Additionally, this clause further provides whether the guarantee is revocable or not, and whether the obligations under the guarantee would be affected on account of insolvency of the principal obligor.
39. This clause also contemplates whether the guarantee document is to be returned to the guarantor after all the obligations under the same have been discharged.
40. A typical clause would read as follows:

*“Notwithstanding anything contained herein above, our [guarantor] liability under the guarantee shall remain in force till [date]. Any claim under this guarantee must be received before the expiry of such guarantee and if no such claim is received by us by the said date, the rights under the guarantee will cease to exist.”*

*(iv) Miscellaneous clause*



41. This clause generally provides the choice of law which would govern the guarantee. The choice of law governs the construction of the guarantee and determines the rights and obligations under the same.

42. A typical clause would read as follows:

*“the [guarantor] agrees that the said guarantee will be governed by [law of the country]”*

43. Further, in order to protect the position of the beneficiary, the guarantor often provides a declaration to the effect that the said guarantee has been issued in compliance with the laws of the country where the BG is issued.

### C. ICC Rules for Contract Guarantees

44. Historically, there weren't any rules governing the operation of the guarantees, and employers had leverage over contractors, often leading to severe financial difficulties for them.

45. In efforts to reduce the exploitation of guarantees, the International Chamber of Commerce (“ICC”) framed various rules governing these instruments. This article briefly discusses the following:

(a) ICC Publication 325 - Uniform Rules for Contract Guarantees (“URCG”);

(b) ICC Publication 458/1 - Uniform Rules for Demand Guarantees (“URDG 458”)

(c) ICC Publication 590 - International Standby Practices (“ISP98”); and

(d) ICC Publication 758 - Uniform Rules for Demand Guarantees (“URDG 758”)

46. ICC published the URDG in 1978 to propose a set of universally acceptable rules for certain types of contract guarantees. The main aim for publishing these rules was to encourage equitable practices in the area of BGs by reducing opportunities for abuse by employers. The URDG though was useful, but faced severe backlash from employers throughout the world on account of its central and rigid requirement that the guarantee be payable only against a third-party certificate of default.

47. The ICC tried again in 1992 with URDG 458 which, although more successful than URDG, failed to gain popularity like the universal adoption that the Uniform Customs & Practice for Documentary Credits (UCP) Rules achieved in the letter of credit industry. This failure was largely attributable to obstacles the rules put in the way of employers in obtaining prompt payment or extension of the guarantee and to the reluctance of banks to perform some of the obligations which the rules could impose on them.<sup>15</sup>



48. The URDG 458 provided a framework for harmonizing international trading practices and established agreed upon rules for independent guarantees and counter-guarantees among trading partners. Most importantly, URDG 458 removed the requirement of the third-party certificate and provided that the payment could be made by a written demand subject to certain conditions.
49. The American Institute of International Banking Law and Practice adopted a set of standard rules for standby letters of credit, known as ISP98. This was intended to be incorporated in standby letters of credit in the same way that the UCP is usually incorporated in commercial letters of credit.
50. The current version of the URDG is URDG 758 which came into effect on 1 July 2010 and superseded the previous versions. The key features of URDG 758 are:
- (a) provides a more legalised approach than the earlier instruments;
  - (b) for the first time, it extends the scope of the rules to counter-guarantees;
  - (c) provides special provisions for the authentication of the electronic documents;
  - (d) retains the simple on-demand payment undertaking as brought in through URDG 458;
  - (e) requires the guarantor to allow the commercial parties a maximum of 30 days to resolve the dispute between them under the underlying contract, by agreeing to extend the term of the guarantee, before making payment of the demand;
  - (f) provides that the guarantee will be extended for 30 days in case of a *force majeure*;
  - (g) expressly provides for the process of paying as opposed to merely processing of the demand; and
  - (h) provides a standard form of guarantee and counter-guarantee and certain optional clauses for potential inclusion in the guarantee.
51. It is pertinent to note that these are merely rules and not law, and have to be expressly agreed between parties to the instrument in order to be applicable.







### III. LEGAL ANALYSIS

#### A. India

52. There are two principal grounds for restraining the invocation of BGs in India:

- (a) fraud on invocation of the BG; and
- (b) special equities in the form of preventing irretrievable injustice to the parties.

53. The law relating to the grant of injunctions was first laid down in the Indian Supreme Court decision in *U.P. Cooperative Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.*<sup>16</sup> ("**U.P. Cooperative Case**"). The court held that:

*"In order to restrain the operation either of irrevocable letter of credit or of confirmed letter of credit or of bank guarantee there should be a serious dispute and there should be good prima facie case of fraud and special equities in the form of preventing irretrievable injustice between the parties. Otherwise the very purpose of bank guarantees would be negative and the fabric of trading operation will get jeopardized."* (emphasis added)

54. In the UP Cooperative Case, the Supreme Court relied on the decision of the UK Court of Appeal in *Bolivinter Oil S.A. v. Chase Manhattan Bank N.A and Others.*<sup>17</sup> While deciding whether to issue an injunction restraining the payment of a BG by a bank, the UK Court of Appeal held that *"the wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the facts of the fraud and as to the bank's knowledge."*

(i) *Fraud exception*

55. Under Indian law, courts follow the following principles to adjudge fraud on invocation:

- (a) a case of fraud cannot be orally made and must find a foundation in the pleadings;
- (b) the evidence must be clear, and a mere assertion without strong corroborative evidence is not enough;
- (c) fraud is where the person in whose favour the bank has issued a guarantee fraudulently represents to the bank expressly or by implication of a fact untrue to its knowledge;
- (d) the fraud should be "egregious" so as to vitiate the entire transaction;
- (e) the word "egregious" means extraordinary, noticeable, conspicuous, glaring,





flagrant bad conduct.<sup>18</sup>

56. While certain authorities confuse this issue by noting that fraud has to be on the formation of the BG, the Supreme Court's decision is clear on this point, that:

*"a demand by the beneficiary under the bank guarantee may become fraudulent not because of any fraud committed by the beneficiary while executing the underlying contract but it may become so because of subsequent events or circumstances. We see no good reason why the courts should not restrain a person from making such a fraudulent demand from enforcing a bank guarantee."*<sup>17</sup>

57. The enquiry into the existence of fraud is a factual enquiry of the pleadings. An illustration of what would amount to a fraud can be seen from the Delhi High Court's decision in the case of *Su-Kam Power Systems Ltd. v. Yog Systems India Ltd.*

58. The facts of this case are as follows:

- (a) Su-kam Power Systems Ltd. ("**Su-kam**") had raised a purchase order on Yog Systems India Ltd. ("**Yog**") for the supply of 5,000 transformers, to be supplied in 10 lots of 500 transformers each.
- (b) The payment for the same was to be made within 10 days of lorry receipt and this was secured by a BG;
- (c) Yog sought to invoke the BG on the basis that it had supplied 600 transformers to Su-kam, the payment for which was not made within 10 days of the receipt.

59. Su-kam approached the Delhi High Court seeking an injunction on the invocation of the BG on the ground of fraud as:

- (a) Yog had only supplied 382 transformers for which it was already paid; and
- (b) even after being aware that 600 transformers were not delivered to Su-kam but were lying with the transporter, Yog went ahead and sought to invoke the BG for non-payment of the monies for 600 transformers.

60. The Delhi High Court found that there was fraud on the invocation of the BG, and granted an injunction. The division bench of the Delhi High Court upheld this decision.<sup>21</sup>

(ii) *Special equities exception*

61. The second exception under Indian law is on the ground of special equities in the form of irretrievable injustice or irretrievable injury.

62. In the case of *UP State Sugar Corporation v. Sumac International Ltd.*,<sup>22</sup> the Supreme Court noted that the standard required to establish special equities is the same kind as that noted in the famous American case of *Itek Corporation v. First*





*National Bank of Boston.*<sup>23</sup> ("Itek Corporation Case")

63. In the Itek Corporation Case:

- (a) an exporter in USA entered into an agreement with the Imperial Government of Iran and sought an order terminating the letter of credit issued by an American bank in favour of an Iranian bank in terms of the contract;
- (b) this relief was sought on account of the situation created after the Iranian revolution, when the American government had cancelled exporters' licenses on account of the Iranian government holding 52 American citizens as hostages, blocked all Iranian assets, and cancelled the contract;
- (c) the court upheld the contention of the exporter that any claim for damages against the purchaser, if decreed by the American Court, would not be executable in Iran, and the realisation of the letter of credit would lead to irretrievable injustice to the exporter.

64. Though this standard is considered high, it has been followed by courts in India,<sup>24</sup> and the attempts to narrow down this standard have been looked down upon by the Supreme Court<sup>25</sup> and other High Courts.

*(iii) Other exceptions*

65. While it is a clear position of Indian law that there are only two scenarios under which an injunction on the invocation of a BG may be granted, this standard does not necessarily apply to a non-performance bank guarantee (like an advance guarantee) issued by a company which is under insolvency resolution process.<sup>26</sup>

66. The insolvency regime under Indian law is governed by the Insolvency and Bankruptcy Code, 2016 ("IBC").

- (a) Section 14(1)(c) of the IBC provides that in the event that a company is admitted into corporate insolvency resolution process, a moratorium shall be declared on any action to recover or enforce of any security interest created by that company in respect of its property; and
- (b) The term "security interest" is in turn defined in Section 3(31) of the IBC and states that security interest means right, title or interest or a claim to property created in favour of, or provided for a secured creditor by a transaction, which secures payment or performance of an obligation. However, the proviso to this section notes that the definition does not include a performance guarantee.

67. Hence, a guarantee which is not a performance guarantee is covered by moratorium, and it is likely that courts will grant an injunction from invocation of





such guarantees. Several tribunals have considered this distinction, and have granted injunctions against the invocation of non-performance bank guarantees.<sup>27</sup>





## B. Australia

68. Under Australian law, the grounds on which an injunction on the invocation of a BG may be granted are:

- (a) fraud;
- (b) unconscionable contravention of Section 51AA of the Trade Practices Act, 1974; and
- (c) breach of an express or implied restriction in the underlying contract.<sup>28</sup>

69. In the recent authorities, it is seen that the autonomy principle i.e., the principle that the court cannot look into the underlying contract, has been diluted, and the courts have looked into the wordings of the relevant contract to determine the right of a party to call upon the security.

70. In order to obtain an injunction in Australia, the following two conditions have to be established:

- (a) there is a serious question to be tried as to a party's entitlement to have recourse to the security;<sup>29</sup> and
- (b) the balance of convenience favours the granting of an injunction.

(i) *Fraud exception*

71. Fraud under Australian law means conduct which vitiates every transaction known to the law, and is an insidious disease and if clearly proved spreads and infects the whole transaction.<sup>30</sup>

72. Australian courts have also considered the application of "intentional fraud" in restraining the invocation of BGs. This may be seen in the case of *Contronic Distributors Pty. Ltd. v. Bank of New South Wales*,<sup>31</sup> where the court held that:

*"It seems to me that the case could be decided on a simple basis of fraud. I think it is sufficient to enable Balfour in any event to get relief in these proceedings, to establish an intention to obtain money by deceit on the part of GEC at the time that the letter of credit is to be presented by it for payment. GEC would then be obtaining money by the use of documents it knew to be false and which were brought into being by it and with its connivance."* (emphasis added)

73. The application of the fraud exception was elucidated in the case of *Olex Focas Pty. Ltd. v. Skodaexport Co. Ltd.*<sup>32</sup> ("**Olex Focas Case**"). The facts of this case are as follows:

- (a) The plaintiff was an Australian company that specialized in the design and provision of communication systems, and the defendant was a Czech





company that was awarded a contract for construction of an oil pipeline in India.

- (b) The plaintiff and the defendant entered into a contract for providing communication services for the pipeline. As a part of the contract, the plaintiff furnished mobilization and performance BGs.
- (c) Disputes arose between the parties, and the matter was referred to arbitration.
- (d) The plaintiff alleged that the defendant had threatened to invoke the BG in an attempt to force a reasonable settlement which was alleged to be the fraud.

74. While analysing the fraud exception, it was held that:

*“The principle is clearly established that payment by a bank and a demand therefor by a beneficiary under an unconditional performance bond or guarantee, as under a confirmed irrevocable letter of credit, will not be restrained except in a clear case of fraud, of which the bank is clearly aware at the time of, probably, the proposed payment, or in the case of forgery of documents (which is probably applicable only to letters of credit) or, perhaps, in the case of illegality of the underlying contract.”*

75. The courts in Australia have also stated that the judgment of Justice Shientag in *Sztejn* is accepted as “being the law in Australia”.<sup>33</sup> The inquiry that the courts undertake in order to determine the existence of fraud is not merely a mechanical exercise of checking whether the words in the documents are completely true or completely untrue to the knowledge of the seller. The question is really of considering whether in all the circumstances the uttering of the documents involves actual fraud.<sup>34</sup>

(ii) *Unconscionability exception*

76. The unconscionability exception has its foundations laid down in the case of *Hortico (Aust) Pty. Ltd. v. Energy Equipment Co. (Aust) Pty. Ltd.*<sup>35</sup> and the *Olex Focas Case*. The statutory law on this exception is found in Section 51AA of the Trade Practices Act, 1974 which states that:

*“A corporation must not, in trade or commerce, engage in conduct that is unconscionable within the meaning of unwritten law, from time to time of the States and Territories.”*

77. The meaning of “unconscionable” for the purposes of the Trade Practices Act, 1974 has been interpreted to include conduct in respect of which a judge in equity would have been prepared to grant relief, and the “unwritten law” is equated to the common law of Australia.

(iii) *Breach of an express or implied restriction in the underlying contract exception*





78. The third exception, i.e., the breach of an express or implied restriction in the underlying contract, is the most common exception that is used by parties to restrain the invocation of BGs.

79. An example of this exception may be seen from the case of *RCR O'Donnell Griffin Pty Ltd. v. Forge Group Power Pty Ltd.*<sup>38</sup> The facts of this case are as follows:

- (a) The defendant engaged the appellant as an electronic sub-contractor under the terms of which the appellant provided two unconditional BGs of US\$ 5 million;
- (b) Clause 5.2 of the subcontract entitled the defendant to have recourse to the guarantees where it remained “*unpaid after the time for payment*”;
- (c) During the course of the works, the defendant became insolvent and receivers were appointed. The principal, the defendant, and the appellant entered into a deed of novation, pursuant to which the appellant entered into a new contract with the principal, for performance of the remainder of the subcontract works;
- (d) The receivers of the defendant appointed a new superintendent, who certified liquidated damages in the amount of US\$ 2.5 million, and asked the appellant to make the payment, failing which the BGs would be invoked.

80. The court of appeal held that on the correct interpretation of Clause 5.2, the defendant was entitled to recourse *only* where, as a matter of objective fact, there was an outstanding debt owed to it by the appellant. The court opined that:

*“[T]he precondition to recourse to the security was the fact of money being unpaid to [Forge]. Clause 5.2 was not in terms which referred to a belief, or grounds for a belief, that money remained unpaid...”*

*The implication that a security could be called upon merely where there was a claim in good faith could have no operation once the absence of merit in that claim was established.”*

81. The principal of this case has been reiterated in the recent case of *Dedert Corporation v. United Dalby Biorefinery Pty Ltd.*<sup>39</sup> where the court, while restraining the invocation of bank guarantee, referred to the recourse provision in the construction contract and held that:

*“...it was an implied negative stipulation in the contract that the respondent would not invoke recourse to the security in the absence of there being an account ‘unpaid’ by the applicant to the respondent ‘after the time for payment’.”*





### C. Singapore

82. It is a settled position in Singapore that a bond is in essence a separate contract from the underlying building contract in respect of which it was issued. Thus, in the absence of any express terms incorporating the provisions of the construction contract, the operation of the bond is not affected by the terms of the contract.<sup>40</sup>

83. Under Singapore law, whether the bond is conditional or on-demand, turns on the construction of the terms of the bond.<sup>41</sup> The wording of the bond itself is therefore paramount, and a court would be restrained in its examination of the external context and extrinsic evidence.<sup>42</sup>

84. The courts will hold that a bond is an on-demand bond (unconditional) if on a true construction of the words used in the bond, the guarantor is liable to pay the beneficiary the bonded sum when the demand is made in the manner provided for in the bond, without the need for the beneficiary to prove breach of the underlying building contract or both.<sup>43</sup>

85. Under Singapore law, the injunction on the invocation of an on-demand bond is granted upon the following grounds:

(a) fraud on invocation of bank guarantee; and

(b) unconscionability.

(i) *Fraud exception*

86. The recent case of *Sunrise Industries (India) Ltd. v. PT Oki Pulp and Paper Mills*<sup>44</sup> discussed the applicability of the fraud exception and noted that:

*"Fraud involves dishonesty and preventing a call on a performance bond on the ground of fraud on the party making the call is an application of the maxim "fraud unravels all". It is intended to shield the party who arranged for the guarantee from dishonest demands by the beneficiary of the bond. A party seeking to restrain a call on the performance bond on the ground of fraud has to show that the beneficiary knew at the time of the call was made that it is false or that the call was made recklessly, that is to say, indifferent to whether or not it is a valid demand."*

87. The Singapore courts have departed from English position in the standard of proof required to establish fraud. The earliest case of this departure is seen in the case of *Chartered Electronics Industries Ltd. v. Development Bank of Singapore*<sup>45</sup> ("**Chartered Electronics Case**") where the court, while analyzing the standard of proof required to establish fraud, held that:

*"In my view, unlike in cases concerning the letter of credit, the reasons for applying the Ackner standard to performance guarantee are not compelling. On the*





contrary, the application of that standard tends to cause more injustice to the performer than it achieves justice to the beneficiary...

In my view, there is no reason why the less onerous test of a "strong prima [facie] case" should not suffice for instruments given purely to secure the performance of the contracts."

88. More recently, in *Arab Banking Corporation v. Boustead Singapore Ltd.*,<sup>46</sup> the Singapore Court of Appeal expressed the view that the standard of proof required is that it must be shown that the "only realistic inference" on the available evidence is fraud. Further, the court went on to state that it was not necessary for every possibility of an innocent explanation to be excluded before the fraud exception is made out, as that would pitch the standards of proof to high and render the principle "fraud unravels all" meaningless. This position is consistent with the Chartered Electronics Case.

(ii) *Unconscionability exception*

89. The concept of unconscionability involves "unfairness, as distinct from dishonesty or fraud, or conduct of a kind so reprehensible or lacking in good faith that a court of conscience would either restrain the party or refuse to assist the party".<sup>47</sup>

90. In the case of *Raymond Construction Pte. Ltd. v. Low Yang Tong*<sup>48</sup> ("Raymond Case"):

- (a) The building contract required the submission of a performance guarantee to be issued for a sum of \$40,419.05 which was to be "payable unconditionally on demand";
- (b) The construction of the building was completed, but shortly after the defendants moved into the house, they began to complain of the defects, which were valued at \$26,158.70;
- (c) In addition, the plaintiffs alleged that the defendants prevented the architect from issuing interim payment certificate with the result that the defendants owed the plaintiffs \$229,417.

91. The High Court held that the conduct of the defendants was in the circumstances unconscionable, and the plaintiffs were entitled to an injunction to restrain any payment under the guarantee.

92. The case of *Royal Designs Studio v. Chang Development*<sup>48</sup> presented a similar factual scenario, where the court had held that the party was entitled to injunction on the ground of unconscionability.

93. Another example of courts restraining invocation of BGs on the ground of unconscionability is in *Kvaerner Singapore Ltd. v. UDL Shipbuilding*,<sup>50</sup> where the





beneficiary made a call on a bond based on a breach induced by its own default. In this case, an injunction was granted to prevent the beneficiary from doing so.

94. Under the unconscionability exception, Singapore courts have also considered the application of partial restraint on the performance guarantee claim. In the case of *Eltraco International Pte Ltd v. CGH Development Ltd.*,<sup>51</sup> the plaintiff was the contractor of a building project. Pursuant to the contract, the contractor procured the issuance of a performance bond for the sum of S\$2.438 million. While noting its equitable jurisdiction on this subject, the court held that:

*“It must be borne in mind that the court in restraining a beneficiary from calling on a bond on the ground of unconscionability is exercising an equitable jurisdiction. We are unable to see why in the exercise of this jurisdiction the court may not limit the restraint to only that part which was clearly excessive and allow the other part which would not be unconscionable to remain, bearing in mind that under the terms of the bond, the beneficiary is entitled to make calls from time to time and for such sums as may be appropriate. To restrain the entire call when part of it is clearly not unconscionable, would be inconsistent with the object of the jurisdiction which is to ensure that there is no injustice or abuse. To say that the restraint must be on the entire call would surely cause injustice to the beneficiary. The object of this jurisdiction is not to punish the beneficiary from making an excessive call but to achieve equity and justice.”*

95. Consequently, the Singapore Court of Appeal decided that the respondent should only be entitled to call a sum of \$600,000. Multiple courts in Singapore have followed this principle.<sup>52</sup>





## D. Malaysia

96. Under Malaysian law, an injunction restraining the invocation of a BG can be obtained on the following grounds:<sup>53</sup>

- (a) fraud;
- (b) unconscionable conduct; and
- (c) other exceptions.

(i) *Fraud exception*

97. The decision of the Kuala Lumpur High Court in the case of *Focal Asia Sdn Bhd & Anr v. Raja Noraini Raja Datuk Nong Chik and Anr.*<sup>54</sup> (“**Focal Asia Case**”) throws light on the fraud exception to the invocation of BGs. The court stated that the judicial and extra judicial views in Singapore accord with good commercial sense, and should be adopted and followed in Malaysia.

98. The court also relied on Justice LP Thean’s article “*The Enforcement of a Performance Bond: The perspective of the underlying contract*”<sup>55</sup> to note that the fraud exception is defined in relation to the call on the document. The court further analysed various Singaporean and Malaysian decisions to define the threshold of fraud to be “a seriously arguable case”.

99. In the case of *Nafas Abadi Holdings Sdn Bhd v. Putrajaya Holdings Sdn Bhd and Anr.*,<sup>56</sup> the court, provided the following standard of proof:

*“I consider the correct contractual inference that should normally be drawn is that the beneficiary will be entitled to draw on the letter of credit provided that he has a bona fide claim to payment under the underlying contract”*

100. The court rejected the application of the higher threshold adopted by Lord Ackner in *United Trading SA v. Allied Banking Corporation.*<sup>57</sup>

(ii) *Unconscionability exception*

101. The principle of unconscionable conduct has been discussed by the Court of Appeal of Malaysia in the case of *Malaysian Refining Company Sdn. Bhd. v. Sumatec Engineering and Construction Sdn. Bhd.*<sup>58</sup> The court summarised the position of law on unconscionability in Malaysia, holding that:

*“[24][...] to establish “unconscionability” there must be placed before the court manifest or strong evidence of source degree in respect of alleged unconscionable conduct complained of, not a bare assertion. Hence the Respondent has to satisfy the threshold of a seriously arguable case that the only realistic inference is the existence of “Unconscionability” which would basically mean a strong prima facie case...The additional ground of Unconscionability*





should only be allowed with circumspect where events or conduct are of such degree such as to prick the conscience of a reasonable and sensible man.

[25] The principle concerning “unconscionability” was initially propounded by Lord Denning in the case of *Lloyds Bank v. Bundy* [1975] QB 326 where it was held that unconscionable transaction between parties may be set aside by the court of equity. This “unconscionable” category is said to extend to all cases where unfair advantage has been gained by an unconscientious use of power by a stronger party against a weaker (see also: *Halsbury’s Law of England*, 3rd ed. Vol. 17 [1956] at p. 682).

[26] On an application for relief against unconscionable conduct, the court looks to the conduct of the party attempting to enforce, or retain benefit of, a dealing with a person under a special disability in circumstances where it is not consistent with equity or good conscience that he should do so. (see: *Commercial Bank of Australia Ltd v. Amadio and Another* [1983] 46 ALR 402).”

102. The principle underlying the doctrine of unconscionability is the prevention of oppression and unfair conduct, and its determination is always fact specific. Hence, while making such a determination, courts must consider such a claim on a case-by-case basis, and assess the totality of the circumstances.<sup>59</sup>
103. Malaysian courts have *inter alia* found the following conduct to be unconscionable:<sup>60</sup>
  - (a) Where the beneficiary failed to fulfil a major obligation as stated in the contract, such as to open a letter of credit;<sup>61</sup>
  - (b) Where the beneficiary threatened to make a call on the performance bond unless the obligor paid the lower tier sub-contractor which had a financial connection to the beneficiary, but for which there is no contractual provision allowing the beneficiary to make such a direction;<sup>62</sup>
  - (c) Where the beneficiary and/ or its consultants failed to work with the obligor unless they paid a bribe, and upon the obligor refusing to pay the bribe, issued a notice to terminate the contract, and commenced a course of conduct which afforded the beneficiary an excuse to call on the performance bond;<sup>63</sup>
  - (d) Where the obligor's non-performance of the contract was induced by the beneficiary's own actions, and where the non-performance was due to the beneficiary's refusal to pay the interim payments;<sup>64</sup>
  - (e) Where the beneficiary had repeatedly obstructed the obligor from carrying on the works;<sup>65</sup>





- (f) Where the beneficiary owed a substantial sum of money to the obligor and had issued bounced cheques, and yet called on the performance bond;<sup>66</sup>
- (g) Where the beneficiary was aware that the obligor was entitled to the benefit of a force majeure clause for not fulfilling its contractual obligations due to severe floods, but proceeded to call on the performance bond anyway;<sup>67</sup>
- (h) Where the beneficiary called for the full amount of the performance bond when the contractual amount had been reduced by 65%;<sup>68</sup>
- (i) Where the obligor had completed 95% of the works and the amount called was more than the value of the remaining works and value for repairs;<sup>69</sup> and
- (j) Where the beneficiary had called on the full amount of the performance bond, the greater part of which had already been repaid.<sup>70</sup>

(iii) *Other exceptions*

104. Another exception, which has not been discussed much by the Malaysian courts, is the Australian concept of the presence of an express restriction in the underlying contract. This was seen in the case of *Daewoo Engineering & Construction Co Ltd v. The Titular Roman Catholic Archbishop of Kuala Lumpur*.<sup>71</sup> In this case:

- (a) The claimant furnished a guarantee in favour of the defendant for the purpose of getting his consent in order to install a ground anchor on his land;
- (b) In terms of the underlying contract, the defendant's right to draw on the guarantee was "subject to" informing the claimant of his intention to claim against the guarantee 14 days before the date of the demand;
- (c) Post expiry of the underlying contract, the parties agreed to renew the same, but the respondent insisted upon removal of the express term in the contract. However, this was rejected by the claimants, and the contract was never renewed;
- (d) The defendant invoked the bank guarantee stating that the restriction in the underlying contract was not applicable to the autonomous contract of guarantee.

105. Though the court granted an injunction on the ground that there are "serious issues to be tried", some authors have stated that this approach concludes that existence of express contractual restrictions is recognised as a possible exception to the principle of autonomy by Malaysian courts.<sup>72</sup>





## E. England

106. The grounds for injunction on invocation of BGs under English law are:

- (a) fraud on invocation of the BG; and
- (b) irretrievable injury.

107. The very first case related to the invocation of BGs (also referred to as the locus classicus of the law relating to BGs) was that of *Edward Owen Ltd. v. Barclays Bank International Limited*,<sup>73</sup> where Lord Denning noted as follows:

*"A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer, nor with the question whether the supplier has performed his contractual obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand, if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice."*<sup>74</sup>

- (i) *Fraud exception*

108. The test of fraud under English law was well explained in the case of *United Trading Corporation SA v. Allied Arab Bank Limited*.<sup>75</sup> The facts of this case are as follows:

- (a) United Trading Corporation SA ("**United Trading**") entered into 19 contracts for the sale of foodstuff by a group of English traders to an Iraqi government concern, Agromark;
- (b) In terms of the contract, Agromark required United Trading to establish performance bonds through Rafidain, an Iraqi state bank;
- (c) the Iran-Iraq war delayed the performance of the contract and disputes arose between the parties;
- (d) When Agromark began to call in the performance bonds, the English sellers claimed the demands were fraudulent and sought injunctions restraining their English bankers from paying out to Rafidain.

109. Though the court did not find fraud on the ground that Agromark did not wish to submit to English courts on its lack of jurisdiction, Lord Ackner J. laid down the test required to establish fraud in such cases as the "only realistic inference" test, noting that:

*"The corroborated evidence of a plaintiff and the unexplained failure of a beneficiary to respond to the attack, although given a fair and proper opportunity, may well make the only realistic inference that of fraud, although the possibility*





*that he may ultimately come forward with an explanation cannot be ruled out.”*

110. Several courts have followed the test laid down by Ackner J.<sup>76</sup>

(ii) *Irretrievable injury*

111. Though the only established exception under English law is fraud, in practice, courts have also granted injunctions on the invocation of BGs on the ground of irretrievable injury.

112. The applicability of irretrievable injury as a possible exception may be elucidated on from the case of *Elian and Rabbath v. Matsas and Matsas*.<sup>77</sup> The facts of this case are as follows:

- (a) various goods were being shipped to Yugoslavia and were consigned to buyers in Hungary;
- (b) when the goods arrived at Yugoslavia, there were delays in unloading, on account of which the ship owners claimed lien on the goods on account of demurrage;
- (c) in terms of the charter party arrangement, the shippers were not liable to pay demurrage but they agreed to submit a BG against the release of lien;
- (d) upon submission of the BG, the lien was lifted. However, the master asserted a new lien on account of fresh delays;
- (e) in light of the fresh lien, the shipowners tried to invoke the BG, and the shippers approached the court for an injunction.

113. The Court of Appeal granted an injunction and noted as follows:

*“Lord Justice Denning: I think this is a special case in which an injunction should be granted. There is prima facie ground for saying that, on the telex messages which passed, the shipowners promised that, if the bank guarantee was given, they would release the goods. I know that the only lien they had in mind at that time was the lien for demurrage. But would anyone suppose that the goods would be held for another lien? It can well be argued that the guarantee was given on the understanding that the lien was raised and no further lien imposed: and that when the shipowners, in breach of that understanding, imposed a further lien, they were disabled from acting on the guarantee.*

*Lord Justice Danckwerts: It seems to me that if the shipowners were entitled immediately after obtaining the undertaking to claim a fresh lien and use it for the purpose of the undertaking, it would amount at least to a breach of faith in regard to the arrangement between the parties. Whatever may be the final result of the case, it seems to me this is an instance where the Court should interfere and*





prevent what might be an irretrievable injustice being done to the plaintiffs in the circumstances.”

(iii) *Other grounds*

114. While strictly not an additional ground for granting an injunction on the invocation of BGs, it is a general principle under English law that a guarantee which is contrary to law, good morals or public policy is illegal and void.
115. It is also recognised that where the demand guarantee itself constitutes an infringement of international obligations, this will be an acceptable ground for the bank to refuse payment.<sup>78</sup>
116. This principle can be understood from the famous case of *United City Merchants (Investments) Ltd. v. Royal Bank of Canada*,<sup>79</sup> in which the demand guarantee was held to be unenforceable on the ground that it was in breach of Peruvian exchange control regulations and was therefore unenforceable in England under Article VIII (2)(b) of the Bretton Woods Agreement.





## F. Turkey

117. Under Turkish law, an injunction on the bank guarantee can be sought on the following grounds:

- (a) enforcement of the guarantee would violate the terms and conditions of the underlying contract between the principal and the beneficiary; or
- (b) enforcement of the guarantee would constitute an abuse of rights.<sup>80</sup>

118. The Turkish Code of Civil Procedure (“CCP”) provides guidance for the test to be applied in case of a request for interim injunctions. Article 389(1) of the CCP states that:

*“In order for a court to grant an interim injunction regarding the disputed matter, the court must be concerned that, due to a change in the current state of affairs, there is a serious risk that obtaining an entitlement will be substantially more difficult or completely impossible or that inconvenience or serious loss or damage will be sustained due to delay.”*

119. Article 2/II of the CCP provides guidance on the meaning of “abuse of rights”. This Article provides that it is necessary for a right to have been used contrary to the purpose of the regulation in order to conclude that it has been abused, and is also known as the objective opinion under Turkish doctrine.

120. This concept appears to be quite similar to the concept of good faith under common law. Article 2/I of the CCP provides that *“every one must act in good faith while using his rights and carrying out his debts”*.

121. A recent decision of the Istanbul Court of First Instance throws light on the standard followed by the Turkish courts in granting an injunction. In this case:

- (a) a turnkey contract was entered into between an Indian contractor and a Turkish owner, for the installment and application of integrated software systems. A BG was provided by the contractor to the owner;
- (b) when the contractor claimed its receivables due under the contract, the owner attempted to unlawfully terminate the contract, instead of honouring the payment;
- (c) the contractor approached the Istanbul Court seeking an injunction on the invocation of the BG;
- (d) the Istanbul Court granted an injunction acknowledging the risk that the contractor might suffer from a loss of right hard to recover.<sup>81</sup>





## G. South Africa

122. Based on the long-standing tradition in South African courts of following English precedents relating to letters of credit, it is generally assumed that South Africa follows the English approach of applying strict documentary compliance to the letters of credit.<sup>82</sup>
123. The grounds for injunction of BGs under South African law are:
- (a) unfair or fraudulent calls on the bank guarantee; and
  - (b) illegality.
124. In order to obtain an interim injunction in South Africa, the following must be established:<sup>83</sup>
- (a) *prima facie* right;
  - (b) well-grounded apprehension of irreparable harm if the interim relief is not granted and the ultimate relief is eventually granted;
  - (c) balance of convenience in favour of the granting of the interim interdict; and
  - (d) absence of any other satisfactory remedy.
- (i) *Unfair or fraudulent calls on BGs*
125. This ground has been referred to in only a few South African cases.<sup>84</sup> Courts in South Africa have drawn a clear distinction between breach of contract and fraud. A landmark case on the fraud exception is that of *Phillips v. Standard Bank*<sup>85</sup>. The facts of this case are as follows:
- (a) Phillips imported shoes from an Italian manufacturer, the payment for which was secured by a letter of credit issued by Standard bank;
  - (b) in terms of the letter of credit, the payment was deferred to some days upon submission of the requisite documents;
  - (c) on receipt of the goods, Phillips discovered that the goods were materially defective. While Phillips raised its complaint, the manufacturer was unwilling to postpone the date for the payment;
  - (d) Phillips approached the courts seeking an injunction against the bank from honouring the letter of credit.
126. The court relied on various judgments under English law and did not grant an injunction, holding that on the facts of the case, this could merely be considered an innocent breach of contract, in the absence of any allegation of fraud in the injunction request. Though the court did not embark on the standard required to establish fraud, it opened up the possibility of using fraud as an exception to





injunction of letters of credit.

127. Other cases following *Phillips v. Standard Bank* have noted the standard applicable to establish the fraud exception:

- (a) fraud must be established clearly, and that the burden of proof is the ordinary civil one that has to be discharged on a balance of probabilities;
- (b) as in any other case, where fraud is alleged, it will not be inferred lightly<sup>86</sup> and mere error, misunderstanding or oversight will not amount to fraud.

(ii) *Illegality of the guarantee*

128. There exists no case law granting an injunction on the invocation of BGs on the basis of illegality of the guarantee. However, similar to the English law, it is a settled position that a contract which is contrary to the law, good morals or public policy, is illegal and consequently void.<sup>87</sup> Authors have stated that once faced with this challenge, it is likely that courts would consider this exception as a ground for granting an injunction on the invocation of BGs.<sup>88</sup>





## H. Germany

129. German courts may grant an injunction on the invocation of BGs only in case of “manifest abuse”, which can be only established if the absence of any entitlement on the basis of the underlying contract is irrefutably proven.<sup>89</sup> This objection of improper exercise of right is based on a violation of equity in terms of Section 242 of the German Civil Code.

130. The ground of “manifest abuse” is comparable to the ground of fraud in other jurisdictions. German authors have summarised the German decisional law on fraudulent invocations as follows:

*“The bank is entitled to refuse payment whenever it has knowledge that a demand is fraudulent. The source of such knowledge is irrelevant, it may come from the principal or from elsewhere. It can be expected, however, that a well advised bank will exercise its right to payment only when it is in possession of sufficient evidence to establish that a demand for payment is in fact fraudulent.”<sup>90</sup>*

131. Under German law, banks also have a positive obligation to examine whether there is manifest abuse of the call of the guarantee, and courts have held that the banks can refuse payments on this ground.<sup>91</sup>

132. Authors have noted the general practice in case of establishing “manifest abuse” in German courts as follows:<sup>92</sup>

- (a) proof of manifest abuse cannot be made only on the basis of interpretation of contract;
- (b) the proof has to be shown through documentary evidence.

133. An example of what could be a “manifest abuse” is a situation where a BG is invoked for the failure to complete work on time, but the documentary evidence (e.g., the certificate of completion) clearly shows that the work was completed on time. In such a case, it is likely that German courts would grant an injunction.

134. Under German law, the elements of this abuse include:

- (a) inadmissible abuse of a formal legal position;
- (b) ascertaining the purpose of the guarantee; and
- (c) guarantor having the burden of proof to establish abuse.

135. There are mixed decisions as to whether a party has to prove specific mens rea while seeking an injunction. While in terms of Section 242 of the German Civil Code it is sufficient to show that the demand for payment is objectively improper, certain court decisions note that an abuse will only be recognised if the beneficiary obviously demanded payment arbitrarily, fraudulently or maliciously.<sup>93</sup>





## I. China

136. Unlike other jurisdictions, Chinese law provides for a quasi-statue specifically dealing with instruments such as BGs, viz., the judicial interpretation adopted by the judicial committee of the Supreme People's Court titled "Provisions of the Supreme People's Court on several issues concerning trial of disputes over independent guarantees" dated 8 November 2016 ("SPC Provisions").<sup>94</sup>
137. In terms of Article 3 of the SPC Provisions, courts normally recognise an instrument as independent if:
- (a) the guarantee states that payment shall be on demand;
  - (b) the guarantee states that the model rules for independent guarantee transactions (such as the URDG) applies;
  - (c) pursuant to the contents of the guarantee, the payment obligation of the issuer is independent of the underlying transaction relation and the legal relation resulting from the guarantee application and the issuer only assumes the payment obligation matching the documents presented.
138. Article 3 of the SPC Provisions also provides that:
- (a) courts would not question the nature of the guarantee merely on the ground that the underlying transaction is recorded in the instrument; and
  - (b) the People's Court shall not uphold the assertion of the parties concerned that an independent guarantee is in the nature of a general undertaking or a joint or several undertaking on the ground that it records the underlying transaction.
139. In terms of the SPC Provisions, there may be two situations under which the court may grant an injunction for invocation of the bank guarantee:
- (a) non-conformity of the documents presented by the beneficiary; and
  - (b) fraud.
140. The SPC Provisions specifically note that courts would not grant an injunction on the invocation of a BG on the ground that the beneficiary has defaulted the agreement under the underlying transaction.
- (i) *Non-conformity of the presented documents by the beneficiary*
141. In terms of Article 8 of the SPC Provisions, the issuer of a guarantee has the right and the obligation to examine the documents independently, and may, in its sole discretion, determine whether the documents presented are in conformity with the terms of the guarantee and are consistent with one another and decide to





accept or reject the non-conformity.

142. In case the issuer decides to reject the non-conformity of the documents presented, the court will not uphold the beneficiary's demand only on the ground that the obligor had accepted the non-conformity.

143. An important case explaining this ground *Hyundai Motor Group Co. Ltd. v. Zhejiang Branch of Industrial and Commercial Bank of China*. The facts of this case are as follows:

- (a) Hyundai Motor Group Co. Ltd. ("Hyundai") entered into a contract with Zhejiang Zhonggao Power Technology Co. ("ZPTCO") Ltd. for supply of a diesel generating set;
- (b) in terms of the contract, ZPTCO provided an irrevocable BG to Hyundai;
- (c) the BG was governed by URDG 758, and the terms provided that Hyundai, in its claim, was required to submit the "duplicate of the order clean ocean bill of lading specifying the informant about the freight payable at the destination notify as the applicant";
- (d) ZPTCO failed to make the payment in accordance with the contract, and Hyundai sought to invoke the BG by submitting a duplicate bill of a straight bill of lading;
- (e) the bank rejected the claim on the ground that there were several non-compliances between the receipts submitted by Hyundai and the terms of the guarantee;
- (f) Hyundai approached the Immediate People's Court against this rejection by the bank.

144. The court held that the bank only needed to consider whether the receipts were consistent with the terms of the BG, and since there were several points of non-compliance between the receipts submitted by Hyundai and the terms of the BG, the bank was right to reject Hyundai's claim. On appeal, the High Court upheld this decision.

(ii) *Fraud*

145. Chinese courts are likely to determine the existence of fraud in the following circumstances:

- (a) the beneficiary makes up a false underlying transaction by colluding with the applicant or others;
- (b) the third party's documents presented by the beneficiary are counterfeit or contain false information;





- (c) the debtor in the underlying transaction is deemed to be free of payment or indemnity liability by a court decision or an arbitral award;
  - (d) the beneficiary confirms that the debt obligation under the underlying transaction has been fulfilled in full or that the expiry-triggering event stated in the independent guarantee does not occur;
  - (e) other circumstances where the beneficiary having no right to demand payment intentionally abuses such rights.
146. An injunction on the ground of fraud will be granted by Chinese courts within 48 hours of a cessation application only if all the following conditions are fulfilled:
- (a) the proof filed by the claimant demonstrates that there is a high possibility of the existence of the circumstances for fraud;
  - (b) it is an emergency, and failure to cease the payment immediately would significantly harm the legitimate rights and interests of the claimant; and
  - (c) the claimant has provided sufficient security to compensate the possible loss incurred by the respondent.
147. A landmark case on this ground is *Jiangsu Taihu Boiler Co. Limited v. PT Krakatau Engineering Co. Ltd. and Wuxi Branch of Bank of China Co.*<sup>95</sup>





## J. United States of America

148. It is uncommon for banks in America to issue BGs. The common practice for US banks is to issue standby letters of credit.
149. The Uniform Commercial Code (“UCC”), which is also widely referred to as the “backbone of American commerce” is a comprehensive set of laws governing all commercial transactions in the USA.
150. In terms of Section 5-109 of the UCC, an American court may grant an injunction on the invocation of these instruments in the following cases:
- (a) a required document for invocation is forged or materially fraudulent; or
  - (b) the honour of the invocation would facilitate material fraud by the beneficiary on the bank or the person on whose behalf the BG had been issued.
151. In terms of Section 5-109(b) of the UCC, courts must consider the following while deciding whether to grant an injunction on the invocation of these instruments:
- (a) the relief is not prohibited under the applicable law to an accepted draft or deferred obligation incurred by the issuer;
  - (b) a beneficiary, issuer, or the nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;
  - (c) all of the conditions to entitle a person to a relief under the law of the State have been met; and
  - (d) on the basis of the information submitted to the court, the applicant is more likely than to succeed on its claim for forgery or material fraud and the person demanding invocation does not qualify for protection if he is - (i) a nominated person who has given value in good faith and without the notice of forgery or material fraud; (ii) a confirmer who has honoured his confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person; or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person.
- (i) *Fraud exception*
152. The UCC provides standard of fraud as “material fraud”. The official comment to Article 5 of the UCC (“Official Comment”) provides that “material fraud” in relation





to the letter of credit occurs only when the beneficiary has no colourable right to expect honour and where there is no basis in fact to support such a right to honour.<sup>96</sup>

153. The Official Comment further provides an illustration as to what would amount to material fraud:

*“Assume, the beneficiary has a contract to deliver 1000 barrels of salad oil. Knowing that it has delivered only 998, the beneficiary nevertheless submits an invoice of 1000 barrels. If the two barrels in a 1000 barrel shipment would be an insubstantial and immaterial breach of the underlying contract, the beneficiary’s act, though possibly fraudulent, is not materially so and would not justify an injunction. Conversely, the knowing submission of those invoices upon delivery of only five barrels would be materially fraudulent.”*

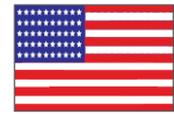
154. An important case considering the standard of material fraud is *Western Surety Co. v. Bank of South Oregon*,<sup>97</sup> the facts of which are as follows:

- (a) Western Surety Co. had issued two performance BGs on behalf of Black Oak Construction, for two projects it was performing in Washington and in Oregon.
- (b) To counter-guarantee the performance BGs, the Bank of South Oregon opened two letters of credit in favor of Western Surety Co.
- (c) Black Oak Construction defaulted its performance in the Washington project, and accordingly the employer invoked the performance BGs.
- (d) Upon invocation of the performance BGs, Western Surety Co. requested the Bank of South Oregon to honour the letter of credit given to counter-guarantee the performance bank guarantee.
- (e) However, the Bank of South Oregon dishonoured the call on the basis that the letter of credit invoked were given for the Oregon project and not the Washington project.

155. Western Surety Co. then approached the court by filing a suit for wrongful dishonour. While considering the fraud on the invocation of the letters of credit, the court adopted the standard as “material fraud” and found that since the bank failed to prove that the letter of credit was given only for specific job, the invocation was not fraudulent and noted that:

*“The relevant Oregon statute provides that an issuing bank, acting in good faith, may dishonor a draft or letter of credit, if the presentation of the draft would facilitate a material fraud by the beneficiary...However, fraud as an affirmative defense to the obligation under the letter of credit is to be narrowly construed.*





*Fraud is not a viable defense if the beneficiary has even a colorable claim or any basis in fact to funds from the letter of credit."*

156. Authors have noted that the standard adopted by court in the above case is same as the standard of "egregious fraud" adopted by the American courts.<sup>98</sup>

157. The position on "egregious fraud" can be understood from the case of *Intraworld Industries Inc. v. Girard Trust Bank*,<sup>99</sup> the facts of which were as follows:

- (a) Intraworld Industries Inc. ("Intraworld") executed a lease on the Hotel Carlton for a term of 15 years, with the rent payable in semi-annual installments.
- (b) The lease required Intraworld to pre-pay the rent for the initial 18-month period, and to procure a performance bond to insure the payment of the rent to the lessor. This performance bond was later cancelled and substituted with two letters of credit which were to be provided after each rental payment, in order to secure the lessor, with one year's rent in advance.
- (c) Intraworld entered into possession of the hotel, and assigned its interest in the lease to its subsidiary. A year later, however, their relationship went awry and concerns regarding the hotel's financial condition arose.
- (d) Intraworld failed to pay the rent due. The lessor terminated the lease and informed Intraworld that it intended to invoke the letters of credit. Intraworld filed for injunctive relief prohibiting the honouring of the letters of credit, on the basis that there was "fraud...not apparent on the face of the documents".

158. The Supreme Court of Pennsylvania provided a litmus test for "egregious fraud" as follows:

*"In light of the basic rule of the independence of the issuer's engagement and the importance of this rule to the effectuation of the purposes of the letter of credit, we think that the circumstances which will justify an injunction against honor must be narrowly limited to situations of fraud in which the wrongdoing of the beneficiary has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served. A court of equity has limited duty of "guaranteeing that [the beneficiary] not be allowed to take unconscientious advantage of the situation and run off with plaintiff's money on a proforma declaration which has absolutely no basis in fact."*

(ii) *Forgery*

159. In terms of Section 5-108 the UCC, an issuer is discharged from its obligations under a letter of credit to the extent of its performance under the letter of credit,





unless the issuer honoured a presentation in which a required signature of the beneficiary was forged.

160. Generally speaking, under American law, the following is considered forgery:

- (a) signing a fictitious name;
- (b) passing off an otherwise true document by false representations dehors the instrument;
- (c) writing a false address or description to a true signature.

161. The UCC gives the issuer the discretion to honour presentations that comply with the terms of the credit, even though the applicant claims that a document is forged. It requires issuers to honour their obligation upon presentation of documents that may be forged, so long as they comply with the terms stipulated, when an assignee acts in good faith.

162. It also provides for a scenario where the fraud is not committed by the beneficiary, but by a stranger to the transaction who forges the beneficiary's signature.<sup>100</sup> The Official Comment provides that if the issuer pays against documents on which a required signature of the beneficiary is forged, it remains liable to the true beneficiary.<sup>101</sup>





## K. Sri Lanka

163. BGs play a significant role as security instruments in Sri Lankan export contracts, some involving permanent exports such as apparel, garments, tea, rubber, agriculture crops; and some involving temporary exports such as gems and jewellery in order to secure the exporter's performance.<sup>102</sup>
164. The law applicable to BGs in Sri Lanka has been heavily derived from English law. The law laid down in landmark English cases such as *Edward Owen Ltd v. Barclays Bank*<sup>103</sup> and *Bolivinter Oil S.A. v. Chase Manhattan Bank*<sup>104</sup> has repeatedly been reiterated in landmark Sri Lankan judgments such as *Indica Trades v. Seoul Lanka Construction*, *Hyderabad Industries v. IADC Trading*, *Hemas Marketing v. P.M. Chandrasiri*, and *Ace Containers private limited v. Commercial bank of Ceylon, PLC.*<sup>108</sup>
165. While Sri Lankan courts rely on English law to establish the grounds on which an injunction may be granted, courts have held that the only ground on which the injunction on invocation may be granted is the ground of fraud.<sup>109</sup>
166. Sri Lankan law provides that an injunction from invocation of BGs would be granted if a claim for payment upon such a guarantee is clearly fraudulent.
167. Similar to Indian law, Sri Lankan law provides that a mere plea of fraud put in for the purpose of bringing the case within the exception and which rest on the uncorroborated statement of the applicant will not suffice, and an injunction may be granted only where there is clear evidence as to:
- (a) the fact of fraud; and
  - (b) the knowledge of the bank as to the facts constituting a fraud.<sup>110</sup>
168. A landmark case to understand this ground is the Sri Lankan Court of Appeal case of *Galle Multipurpose Cooperative society v. Morawakkoralage Gajeru & Ors.*,<sup>111</sup> the facts of which are as follows:
- (a) the plaintiff was appointed as a dealer for the distribution of "lackcow" milk powder for the district of Galle for a period of 1 year under an agreement;
  - (b) in terms of the agreement, the plaintiff and the 1st - 3rd defendants agreed that:
    - (i) the plaintiff was required to submit a BG for Rs. 1 million in favor of the manager of the Bambaplitiya branch of the 4th defendant;
    - (ii) in the event of termination of the agreement, the employer was allowed to appoint another distributor and the BG would stand discharged.
  - (c) After some time, the plaintiff terminated the agreement with the 1st - 3rd





defendants and asked them to discharge the guarantee in terms of the contract;

(d) However, the 4th defendant tried to invoke the BG.

169. The Court of Appeal analysed the principle of fraud under Sri Lankan law, and found that there could not have been any debt due to the 4th defendant. Consequently, the Court of Appeal granted an injunction on the invocation of the BG.





## L. Pakistan

170. Similar to several other jurisdictions, there is no special act governing BGs and letters of credit in Pakistan. A pertinent feature of this jurisdiction is that it was formerly part of India, and hence, it has adopted the Indian Contract Act, 1872. In order to interpret guarantees, courts in Pakistan, rely upon Section 126 of the Contract Act.<sup>112</sup>

171. Under Pakistani law, there are two grounds under which courts may grant an injunction:

- (a) fraud;
- (b) special equities.

172. To seek any injunction from Pakistani courts, the litigants have to establish a prima facie case and have to prove that the balance of convenience is in their favour.<sup>113</sup>

(i) *Fraud*

173. The landmark case which laid down the law of BGs under Pakistani law is *Shipyard K. Damen International v. Karachi Shipyard and Engineering Works*<sup>114</sup>, where the Pakistan Supreme Court held that:

*"[the bank] is not concerned in the least with [whether] the supplier has performed his contractual obligation or not now with the question whether the supplier is in default or not. The bank must pay according to its guaranteeing all demands if so stipulated without proof or condition. The only exception is when there is a clear fraud of which bank has notice"*

174. The fraud exception has been reiterated and applied in a variety of cases, but the general principle established throughout these cases is that courts cannot grant temporary injunctions to enjoin the payment under a BG unless there is a prima facie case of fraud.<sup>115</sup> The case of *Doha Bank Limited v. Pangrio Sugar Mills Limited* elaborates on this:

*"Indeed, all secured financial dealings and business transactions such as execution of a bank guarantee etc. are based on commercial morality and mutual trust and confidence which should not be shaken by taking a turn much against the terms of the guarantee itself... In order to restrain the operation of, inter alia, a bank guarantee, there should be a serious dispute and there should be a good prima facie case of fraud and special equities in the form of preventing the irretrievable injustice otherwise the very purpose of Bank Guarantee would be negative and the fabric of trading operations would get jeopardized."*

(ii) *Special Equities*





175. Some of the questions taken into consideration by the Pakistani courts while adjudicating cases of alleged fraud is whether there exist any “special equities” or “irretrievable injustice” concerns on the invocation of BGs.<sup>117</sup> Courts have refused to grant injunction to restrain encashment unless the plaintiff demonstrates fraud by the creditor which is in the knowledge of the bank, or unless it is a case giving rise to a special equity in favour of the plaintiff.<sup>118</sup>
176. As stated in the landmark case of *Shipyard K. Damen v. Karachi Shipyard & Engineering Works*:
- “In the absence of any special equities and the absence of any clear fraud, the bank must pay on demand, if so stipulated and whether the terms are such must have to found out from performance guarantee, as such. Unqualified terms of guarantee could not be interfered with by the Courts irrespective of the existence of dispute.”*
177. Therefore, a case of special equity or fraud must exist to such an extent as to result in an irretrievable injustice, if the injunction against the invocation of the BG were to be denied by the Court.<sup>120</sup>





## M. Sierra Leone

178. The Sierra Leone law on BGs has been heavily derived from English law. With regard to on-demand guarantees, a strict rule that has been followed in the Sierra Leone courts is that its payment becomes due simply upon service of a written demand for the same, without the requirement of any additional documents. It obligates banks to honour the guarantee according to its terms, without any regard to a potential default on part of the other parties to the contract, since a BG does not require any additional proof of default.<sup>121</sup>

179. Under Sierra Leone law, the only exception to the above rule is fraud.

180. The laws of Sierra Leone derive tremendous substantive and procedural influence from English Law. English cases such as *Edward Owen Ltd v. Barclays Bank, and Esal Commodities v. Oriental Credit & Wells Fargo Bank*<sup>123</sup> have often been cited and referenced by the courts of Sierra Leone.

181. One such landmark case that reiterated English principles while discussing the threshold for fraud is the case of *Union Trust Bank (Plaintiff/ Respondent) v. Goal Sierra Leone (Defendant/ Respondent)*,<sup>124</sup> the facts of which are as follows:

- (a) The applicant entered into a contract with the Plaintiff/ Respondent for the provision of services including the creation of a website for use by the Plaintiff/ Respondent and its contacts. A performance guarantee amounting to USD 56,310 had also been issued by the Defendant/ Respondent (the applicant's banker) in favour of the Plaintiff/ Respondent.
- (b) The Plaintiff/ Respondent however, had effected payment one month after it was due, fundamentally altering and prolonging the original time frame within which the activities were originally expected to be completed. The Plaintiff/ Respondent and the applicant renegotiated certain aspects of the contract several times, but never communicated the same to the Defendant/ Respondent. They argued that there was no breach of the existing contract between the applicant and the Plaintiff/ Respondent as the website that formed the substratum of the contract was up and running.
- (c) The applicant had failed to perform two deliverables, due to which the Plaintiff/ Respondent terminated the contract. The applicant requested the Plaintiff/ Respondent for 24 hours to complete the revised scope of work after signing the amended contract, failing which the Plaintiff/ Respondent was at liberty to claim the full amount of the performance bond issued by the Defendant/ Respondent.
- (d) The applicant failed to perform as agreed in the amended contract, upon





which the Plaintiff/ Respondent called on the guarantee. The applicant however sent a letter to the Plaintiff/ Respondent stating that they were not entitled to any payment since the bank was only obligated to pay under the unchanged, un-amended identical contract. The applicant submitted that the guarantee ceased to apply when the contract was amended, and claimed that the Plaintiff/ Respondent's demand for the money constituted fraud.

182. While determining the question as to whether the present case met the threshold of prima facie fraud, the Sierra Leonian Court of Appeal quoted *Harbottle (RD) Mercantile Ltd. v. National West Minister Bank* while laying down two requirements for an injunction restraining payment:

*"(i) To establish a serious issue to be tried that a fraud exception exists.*

*(ii) To establish that a balance of convenience is in favour of the grant of an injunction."*

183. Sengu Koroma J. ruled that the present case did not meet the threshold for the fraud exception, since the applicant failed to provide any evidence establishing the fraud on part of the Plaintiff/ Respondent, no less that the Defendant/ Respondent had knowledge of the same. The case reiterated the principle that injunctions may be granted in exceptional cases where it is proved that the bank knows that a demand of payment (that has either already been made, or will be made thereafter) is fraudulent.





## N. Hong Kong

184. Courts in Hong Kong have often held that *"being hypercritical of the wording of a demand and an overzealous insistence of strict compliance would only serve to undermine the certainty and reliability of on demand bonds."*<sup>125</sup>
185. The landmark case of *Grande Cache Coal LP & Another v Marubeni Corporation & Another*,<sup>126</sup> lays down the situations in which the invocation of a BG may be enjoined. These are:
- (a) fraud;
  - (b) beneficiary being precluded from making a call.
    - (i) *Fraud exception*
186. Courts have held that restraint of payment under a bond will normally only be made in cases of fraud. To secure an interlocutory injunction on the basis of the fraud exception, *"The claimant must show clear evidence of fraud by the beneficiary, and show that it is obvious that the fraud is being carried out by the beneficiary to the knowledge of the bank."*<sup>127</sup>
187. In the landmark Hong Kong High Court case of *West Kowloon Cultural District Authority v. AIG Insurance Hong Kong Limited*,<sup>128</sup> the Court addressed the evidence put forth by AIG Insurance Hong Kong Ltd., and concluded that the allegations of fraud were unsuccessful since the standard that must be established is a "cogent evidence of fraud" and not simply evidence that is *"little more than a mere assertion"*.
- (ii) *Beneficiary being precluded from making a call*
188. Apart from the fraud exception, it appears that the Hong Kong courts are also open to a consideration of a second circumstance, being where the terms of the underlying contract preclude the beneficiary from making the call.
189. In seeking to restrain payment on the basis of an exception, a plaintiff will be required to meet a higher threshold than merely showing that there is a serious question to be tried:
- "A higher threshold is required to be met - that threshold has variously been described as "it is positively established that the party was not entitled to draw down", or "a strong case" has been shown, or "the 'serious issued to be tried' threshold is in practice a more difficult one to overcome", or "it has been clearly established that the beneficiary is precluded from making a call by the terms of the contract."*





## O. United Nations Convention on Independent Guarantees and Standby Letters of Credit

190. The United Nations Convention on Independent Guarantees and Standby Letters of Credit, 1995 (“UN Convention”) was brought in to toughen the general principles and features that are common to independent guarantees and letters of credit.<sup>130</sup>

191. The official explanation to the UN Convention states that it supplements the operation of the following instruments, by dealing with issues such as fraudulent or abusive demands for payment and the subsequent judicial remedies:

- (a) Uniform Customs and Practice for Documentary Credits (UCP);
- (b) International Standby Practices (ICP); and
- (c) Uniform Rules for Demand Guarantees (URDG)

192. The UN Convention applies:

- (a) to an international undertaking if:
  - (i) the place of business of the guarantor or issuer at which the undertaking is issued is in a contracting state;
  - (ii) the rules of private international law lead to the application of the law of a contracting State, unless the undertaking excludes the application of the UN Convention.
- (b) if the instrument expressly states that it is subject to the UN Convention.

193. Authors<sup>131</sup> have argued that the UN Convention impairs the autonomous character of the instruments, since Articles 19(1)(b), 19(1)(c), and 19(2)(a) - 19(2)(d) require the issuer to look into the underlying transaction for a good cause of payment.

194. Although the word “fraud” is not used in the UN Convention, the exceptions to the payment obligations in Article 19 parallel the accepted fraud exception. Further, Article 20 of the UN Convention requires courts to grant interim measures provided that strong evidence is furnished.



#### IV. CONCLUSION

195. The table below summarises the grounds available in various jurisdictions, to injunct the invocation of BGs:

Sr. No.	Jurisdiction	Grounds
1.	India	<ul style="list-style-type: none"> <li>• Fraud</li> <li>• Special equity in the form of preventing irretrievable injustice</li> </ul>
2.	Australia	<ul style="list-style-type: none"> <li>• Fraud</li> <li>• Unconscionable conduct</li> <li>• Breach of an express or implied restriction in the underlying contract</li> </ul>
3.	Singapore	<ul style="list-style-type: none"> <li>• Fraud</li> <li>• Unconscionable conduct</li> </ul>
4.	Malaysia	<ul style="list-style-type: none"> <li>• Fraud</li> <li>• Unconscionable conduct</li> <li>• Breach of an express or implied restriction in the underlying contract</li> </ul>
5.	UK	<ul style="list-style-type: none"> <li>• Fraud</li> <li>• Irretrievable injury</li> </ul>
6.	Turkey	<ul style="list-style-type: none"> <li>• Violation of the terms of the underlying contract</li> <li>• Abuse of rights</li> </ul>
7.	South Africa	<ul style="list-style-type: none"> <li>• Unfair or fraudulent calls</li> <li>• Illegality</li> </ul>
8.	Germany	<ul style="list-style-type: none"> <li>• Manifest abuse</li> </ul>
9.	China	<ul style="list-style-type: none"> <li>• Non-conformity with the documents presented by the beneficiary</li> <li>• Fraud</li> </ul>
10.	USA	<ul style="list-style-type: none"> <li>• Fraud</li> <li>• Forgery</li> </ul>
11.	Sri Lanka	<ul style="list-style-type: none"> <li>• Fraud</li> </ul>
12.	Pakistan	<ul style="list-style-type: none"> <li>• Fraud</li> <li>• Special Equities</li> </ul>
13.	Sierra Leone	<ul style="list-style-type: none"> <li>• Fraud</li> </ul>
14.	Hong Kong	<ul style="list-style-type: none"> <li>• Fraud</li> <li>• Beneficiary precluded from making a call</li> </ul>
15.	UN Convention	<ul style="list-style-type: none"> <li>• Conditions equivalent to fraud provide as provided under Article 19 of the UN Convention</li> </ul>



196. From the above table, it is clear that the fraud exception is a well-established principle recognised in most jurisdictions. For any contractor furnishing a guarantee, it is imperative to understand the implications under the chosen jurisdiction.

<sup>1</sup> Global Construction Outlook to 2022: Q3 2018 Update, prepared by GlobalData Construction Intelligence Centre available at <https://www.bdcnetwork.com/global-construction-set-rise-us129-trillion-2022-driven-asia-pacific-africa-and-middle-east>

<sup>2</sup> George Ofori, *Nature of the Construction Industry, its needs and its developments: A review of four decades of research*, *Journal of Construction in Developing Countries*, 20(2), 115-135, 2015 available at [http://web.usm.my/jcdc/vol20\\_2\\_2015/JCDC%2020\(2\)%202015-Art.%207\(115-135\).pdf](http://web.usm.my/jcdc/vol20_2_2015/JCDC%2020(2)%202015-Art.%207(115-135).pdf)

<sup>3</sup> Pearce, D. (2003), *The Social and Economic Value of Construction: The Construction Industry's Contribution to Sustainable Development*

<sup>4</sup> Andrew Foulkes, *Defining the Scope of the Construction Sector*, Stalford Centre for Research and Innovation available at <http://www.irbnet.de/daten/iconda/CIB16522.pdf>

<sup>5</sup> The employer can also be the owner's contractor, who further sub-contracts a part or whole of the work independently or as part of a consortium

<sup>6</sup> Edward Witticks, *Construction Contracts: How to Manage Contracts and Control Disputes in a Volatile Industry*, Gulf Publishing Company, Houston Texas (2005)

<sup>7</sup> Stephen Gruneberg, William Hugher, *Understanding Construction Consortia: Theory Practice and Opinions*, (RICS research series, Volume 6, Number 1), 2006

<sup>8</sup> Jitka Chovancova, *Bank Guarantees of Construction Projects, their concepts in management accounting and role in regional development*, 2019 IOP Conf. Ser. Mater. Sci. Eng. 471 022017

<sup>9</sup> *Chitty on Contracts*, 32nd Ed. Vol. II - Specific Contracts at [37-124]

<sup>10</sup> Penn, *Performance Bonds: Are Bankers Free from the Underlying Contract*, 1995 *Lloyd's Mar. & Com. L.Q.* 132

<sup>11</sup> Raymond Cox QC and Niamh Cleary (Fountain Court Chambers), *URDG 758*, available at [https://uk.practicallaw.thomsonreuters.com/6-502-0655?comp=pluk&transitionType=Default&contextData=\(sc.Default\)&firstPage=true&OWSessionId=3ecd19b632de4b039f08af22c7429f1d&skipAnonymous=true#co\\_anchor\\_a892363](https://uk.practicallaw.thomsonreuters.com/6-502-0655?comp=pluk&transitionType=Default&contextData=(sc.Default)&firstPage=true&OWSessionId=3ecd19b632de4b039f08af22c7429f1d&skipAnonymous=true#co_anchor_a892363)

<sup>12</sup> [2014] 1 *Lloyd Rep* 266; recently affirmed in the case of *Shanghai Shipyard Co. Ltd. v. Reignwood International Investment (Group) Company Limited, OPUS Tiger 1 Pte. Ltd.* [2020] *EWHC* 803 (Comm.)

<sup>13</sup> R. Goode, *Abstract payment undertakings in international transactions*, (1996) *XXII Brooklyn Journal of International*

<sup>14</sup> Jens Nielsen & Nicolai Nielsen, *The German Bank Guarantee: Lesson to be drawn from China*, 5 *Geo. Mason J. Intl' Com. L.* 171 (2014)

<sup>15</sup> Raymond Cox QC and Niamh Cleary (Fountain Court Chambers), *URDG 758*, available at [https://uk.practicallaw.thomsonreuters.com/6-502-0655?comp=pluk&transitionType=Default&contextData=\(sc.Default\)&firstPage=true&OWSessionId=3ecd19b632de4b039f08af22c7429f1d&skipAnonymous=true#co\\_anchor\\_a892363](https://uk.practicallaw.thomsonreuters.com/6-502-0655?comp=pluk&transitionType=Default&contextData=(sc.Default)&firstPage=true&OWSessionId=3ecd19b632de4b039f08af22c7429f1d&skipAnonymous=true#co_anchor_a892363)

<sup>16</sup> (1988) 1 *SCC* 174

<sup>17</sup> [1984] 1 *W.L.R.* 392)



- <sup>18</sup> *Mercator Oil & Gas Ltd. v. Oil and Natural Gas Corporation Ltd.*, (2019) SCC Online Bom 1378
- <sup>19</sup> *Hindustan Steel Works and Construction limited v. Tarapore & Co.*, (1996) 5 SCC 34
- <sup>20</sup> CS (OS) No. 1368 of 2006
- <sup>21</sup> FA (OS) No. 649 of 2006
- <sup>22</sup> (1997) 1 SCC 568
- <sup>23</sup> [566] Fed Supp 1210
- <sup>24</sup> *Felguera Gruas India Pvt. Ltd. v. Tuticorin Coal Terminal Pvt. Ltd.*, (2018) SCC OnlineBom 33; *Felguera Gruas India Pvt. Ltd. v. Tuticorin Coal Terminal Pvt. Ltd.*, (2018) SCC OnlineBom 676
- <sup>25</sup> *BSES Ltd. v. Fenner India Limited & Ors.* Appeal (Civil) 955 of 2006; see also *Dwarikesh Sugar Industries Limited v. Prem Heavy Engineering Works Limited* (1997) 6 SCC 450
- <sup>26</sup> *ABG Shipyard Limited v. Government of India & Ors.*, Special civil application no. 17666 of 2017 (Order dated 25 September 2017)
- <sup>27</sup> *Nitin Hasmukhlal Parikh v. Madhya Gujarat Vij Company Limited & Ors.* [I.A. No. 340/2017 in C.P. (IB) No. 2/10/NCLT/AHM/2017]; *ICICI bank Ltd v. C&C Construction Ltd.*, NCLT, Principal Bench (IB-159 (PB)/ 2017)
- <sup>28</sup> *Reed Construction Services Pty Ltd v. Kheng Seng (Aust) Pty. Ltd.*, (1999) 15 BCL 158 at 164-165; see also *Clough Engineering Ltd. v. Oil and Natural Gas Corporation Ltd.*, [2008] FCAFC 136
- <sup>29</sup> *Sugar Australia Pty Ltd. v. Land Lease Services Pty. Ltd.*, [2015] VSCA 98
- <sup>30</sup> *Farley (Aust) Pty Ltd. v. JR Alexander & Sons (Q) Pty Ltd.*, (1946)75 CLR 487
- <sup>31</sup> *Contronic Distributors Pty Ltd. v. Bank of New South Wales*, (1984) 3 N.S.W.L.R. 110
- <sup>32</sup> (1996) 134 FLR 331
- <sup>33</sup> *Inflatable Toy Co. Pty Ltd. v. State Bank of New South Wales*, (1994) 34 NSWLR 243
- <sup>34</sup> *Ibid*
- <sup>35</sup> [1985] 1 NSWLR 545
- <sup>36</sup> *Optus Network Pty Ltd. v. Telstra Corporation Ltd.*, [2009] WL 1998981 (FCA)
- <sup>37</sup> *Australasian Competition and Consumer Commission v. Samton Holdings Pty Ltd.*, (2002) 117 (FCR) 301
- <sup>38</sup> [2016] QCA 214
- <sup>39</sup> [2017] VSCA 368
- <sup>40</sup> *Chow Kok Fong, Law and Practice of Construction Contracts*, 5th Edition Sweet and Maxwell; see also *McConnell Dowell Constructors (Aust) Pty Ltd v. Sembcorp Engineers and Constructors Pte. Ltd.*, [2002] 1 SLR(R) 60
- <sup>41</sup> *Bocotra Construction v. Attorney General*, [1995] 2 SLR 733
- <sup>42</sup> *Master Marine AS v. Labroy Offshore Ltd.*, [2012] 3 SLR 125
- <sup>43</sup> *York International Pte v. Voltas Ltd.*, [2013] 3 SLR 1142



<sup>44</sup>[2018] SGHC 145

<sup>45</sup> [1992] 2 SLR (R) 20

<sup>46</sup> [2016] SGCA 26

<sup>47</sup> *Raymond Construction Pte Ltd. v. Low Yang Tong*, [1996] SGHC 136

<sup>48</sup> [1996] SGHC 136

<sup>49</sup> [1990] 2 SLR(R) 520

<sup>50</sup> [1993] 2 SLR (R) 341

<sup>51</sup> [2000] 3 SLR(R) 198

<sup>52</sup> *Samwoh Asphalt Premix Pte Ltd v. Sum Cheong Piling Pte. Ltd.*, [2001] 3 SLR(R) 716; *Anwar Siraj v. Teo Hee Lai Building Construction Pte. Ltd.*, [2003] 1 SLR(R) 394

<sup>53</sup> *Sato Kogyo(M) Sdn Bhd. v. Salini Malaysia Sdn Bhd.*, [2014] 2 MLRH 661

<sup>54</sup> [2009] 11 MLRH 9

<sup>55</sup> [1998] 19 Sing LR 289

<sup>56</sup> [2004] MLJU 148

<sup>57</sup> [1985] 2 Llyod's Rep 554

<sup>58</sup> [2011] 7 CLJ 21

<sup>59</sup> *Kejuruteraan Bintai Kindenco Sdn Bhd. v. Nam Fatt Construction Sdn Bhd.*, [2011] 7 CLJ 442

<sup>60</sup> *Daya CMT Sdn Bhd. v. Yuk Tung Construction Sdn Bhd.*, [2016] 6 MLRH 263

<sup>61</sup> *Kvaerner Singapore Pte Ltd v. UDL Shipbuilding (Singapore) Pte. Ltd.*, [1993] 3 SLR 350

<sup>62</sup> *Bains Harding (Malaysia) Sdn Bhd. v. Arab-Malaysian Merchant Bank Berhad & Ors.*, [1996] 1 MLJ 425

<sup>63</sup> *Bina Jaya Mantap Sdn Bhd. v. Institute of Technology Petronas Sdn Bhd.*, [2014] 11 MLJ 352

<sup>64</sup> *Royal Design Studio Pte Ltd v. Chang Development Pte Ltd.*, [1991] 2 MLJ 229

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<sup>71</sup> [2004] 7 MLJ 136

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- Representing a Singaporean and an Indian company in an arbitration concerning breach of a consortium agreement for a rig conversion project against an Abu Dhabi shipyard (SIAC Rules, Singapore seated, Singapore law)
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