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PERSPECTIVES

RESISTING BOND CALLS IN THE ENGLISH COURTS – DO RECENT DEVELOPMENTS PROVIDE HOPE FOR CONTRACTORS?

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It is standard practice in international construction projects for a contractor to provide its employer with an on-demand guarantee (also known as an on-demand bond) issued by its bank as security for performance of its contractual obligations. On-demand bonds are typically for 10 percent of a contract value and provide powerful leverage for an employer. The ability for it to make a call on the bond without having to prove that it has an entitlement to monies under the underlying contract between the parties provides the employer with security that the contractor will perform its contractual obligations

and not, for example, abandon its works in the event of a dispute. A call on the bond will enable the employer to recover monies from the contractor without the delays and legal costs that it would otherwise incur recovering the amounts through arbitration proceedings under their contract.

For the contractor, the potential threat of a call being made on the bond will be a great concern. A call on the bond will result in the issuing bank making a call against the contractor's counter indemnity provided to the bank, depriving the contractor of credit. The contractor's reputation will

also be damaged, even if the contractor can later establish by bringing arbitration proceedings against its employer that the employer had no entitlement to the bond monies, such that the call on the bond was wrongful, the contractor will likely be required to disclose the fact of the bond call on bids for future projects, potentially jeopardising its prospects of winning future contracts.

Bond documents are subject to the jurisdiction of the courts, with the courts of England and Wales a popular choice. Historically, when a contractor fears a bond call is imminent it has two options: (i) to obtain an injunction against the beneficiary restraining a call on the bond being made; or (ii) if it

is too late to prevent a call being made, injunction the bank from paying out against the demand.

In either scenario, the contractor must move quickly to obtain injunctive relief. While the issuing bank would prefer to avoid paying against the demand (and thus avoid assuming the risk of recovering the bond monies under a counter indemnity provided to the bank by the contractor) the bank will also be anxious to protect its commercial reputation. A bank is therefore likely to delay paying out against a demand on the bond only for a matter of days.

Emergency arbitrators are now widely provided for in institutional arbitration rules. While an



emergency arbitrator may, in theory, have the power to injunct the beneficiary from making a call on the bond (depending on the scope of the arbitration agreement), an emergency arbitrator typically requires two to three weeks to issue a decision and therefore cannot do so within the required time frame. The contractor's only option is to seek injunctive relief from the courts.

Obtaining relief from the English courts

It is famously difficult to obtain an injunction from the English courts against a bank making payment following a call on a demand bond. The English courts have a long history of robustly rejecting

such applications, recognising the importance for commercial parties of payment obligations under on-demand bank guarantees being honoured, such that on-demand guarantees are considered 'as good as cash'. While in some jurisdictions, notably Singapore and the United Arab Emirates (UAE), relief can be obtained from the courts on slightly broader grounds, the circumstances in which a bank's payment against a call can be injuncted by the English courts are limited to the beneficiary's call failing to comply with the bond document's formal requirements (which occasionally arises, but should never occur) and (when the court is satisfied that "the only realistic inference" that it can



draw based on the evidence before it is that the employer's call was fraudulent and that the issuing bank is aware of the fraud. The high evidentiary threshold to establish fraud has only been satisfied in a handful of exceptional cases.

While it is by no means easy, contractors have had more success in obtaining relief from the English courts restraining beneficiaries from making a call on an on-demand bond. The Technology and Construction Court (TCC) has produced a number of decisions preventing calls being made on the basis that the call was precluded under the terms of the contract giving rise to the payment obligation (see the 2011 and 2013 judgments *Simon Carves v Ensus* and *Doosan Babcock v Comercializadora de Equipos y Materiales Mabe Limitada*). More recent judgments, however, appear to have applied a stricter test for establishing that a call on a bond be restrained, with *Stuart-Smith J in MW High Tech Properties v. Biffa Waste Services Ltd* stressing the high threshold that must be met in stating that "it must be positively established [by the applicant] that [the beneficiary] was not entitled to draw down under the underlying contract".

Nevertheless, given the extreme difficulty of obtaining an injunction against a bank (by establishing that a bond call is fraudulent), obtaining an injunction restraining a beneficiary from making a

call on a bond remains a contractor's best prospect of preventing a bank from being required to pay the

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bond monies. An obvious practical difficulty with obtaining such an injunction is that the contractor may not be given notice that a call is about to be made or, if it is given notice, may not be able to move quickly enough to obtain relief from the courts before the call is made. This difficulty appears to have been removed by the Commercial Court's acceptance in *Shapoorji Pallonji and Company Private Ltd v. Yumn Ltd* that it had the power to grant an injunction requiring a beneficiary to reverse a call that had already been made against a bond by a beneficiary.

Does *Shapoorji* give hope to contractors?

Shapoorji concerned an application to the English courts for an injunction prohibiting payment against

a call that had been made on an on-demand performance bond. Shapoorji argued that the employer's entitlement to the bond monies arose in respect of liquidated damages due for delays to the completion of a power plant in Rwanda for which Shapoorji claimed it was due an extension of time. Shapoorji had referred its disputed entitlement to an extension of time to emergency arbitration.

In accepting that the court had the power to order the bond call be reversed, Pelling QC considered that authorities relating to applications to restrain a bond call were relevant to deciding whether the relief should be granted. However, his review of those authorities provides contractors with less cause for optimism. His judgment makes no mention of, let alone endorse, *Simon Carves* and *Doosan Babcock*, drawing only on authorities from the Commercial Court and Stuart-Smith J's judgment in *MW High Tech v. Biffa Waste*. Relying on those authorities, Pelling QC held that an injunction reversing a bond call being made could only be made when an applicant had shown to an "enhanced merits" standard that contractual pre-conditions (express or implied) to a call on the bond had not been met.

The "enhanced merits" standard identified by Pelling QC would appear the same as Stuart-Smith J's requirement that a contractor must "positively establish", rather than demonstrate on the balance of probabilities, that a call on the bond was precluded by the terms of the contract. However, the decisions in *Simon Carves* and *Doosan*

Babcock have not been overturned and a TCC judge might have more regard to them in considering an application that a bond call be reversed. Furthermore, time is a precious commodity when obtaining relief against a bond call. By applying to reverse rather than prevent a call on a bond, a contractor will have a little more time to prepare the supporting evidence required to "positively establish" that the employer was not permitted by the terms of the underlying contract to call the bond.


What if the entitlement under the main contract is about to be resolved by emergency arbitration?

Shapoorji also illustrates the futility of emergency arbitration proceedings in preventing payment of on-demand bonds. Shapoorji argued that whether the employer was entitled to make its demand – and whether its demand must be withdrawn – was a matter to be decided by the emergency arbitrator. Accordingly, Shapoorji applied under section 44 of the Arbitration Act 1996 (pursuant to which the English courts may grant interim relief in aid of arbitration) for the court to grant orders preserving the status quo until the emergency arbitrator's decision was issued. Shapoorji further argued that in deciding whether the employer was entitled to call the bond the emergency arbitrator would not apply the same high standards as the courts when determining applications under section 37 of the Senior Courts Act 1981, such that the court should

not apply those principles in deciding the application under section 44.

Unsurprisingly, Shapoorji's application was emphatically rejected by the court. The court held that, even on the assumptions that an emergency arbitrator had jurisdiction to issue an order and would apply a more relaxed standard in reaching his or her decision (both of which are highly debatable but were accepted for the purposes of the application), a court must nevertheless apply the same "enhanced merits" principles in determining an application for an injunction preventing a call on a bond irrespective of whether the application was made under section 37 of the Senior Courts Act or section 44 of the Arbitration Act. As *Shapoorji* demonstrated, the reality is that an emergency arbitrator cannot issue an order restraining a bond call quickly enough, such that relief must be sought from the courts and the courts' principles must be satisfied. As such, emergency arbitration proceedings will only be of relevance to restraining a call on a bond when the bond in question is not an on-demand bond but expressly stated to be conditional upon a decision by an emergency arbitrator.

Future trends?

Shapoorji provides a reminder of the English courts' robust approach to upholding on-demand payment obligations and why making bank guarantees subject to the jurisdiction of the English courts is such a popular choice for beneficiaries. However, the possibility of obtaining an order reversing a bond call will provide encouragement to contractors seeking to prevent payment of bond monies as it removes the need to satisfy the fraud exception after a call is made. Given the drastic consequences of a bond call, contractors may look to test whether the TCC will apply an "enhanced merits" threshold to reverse a bond call as strictly as the Commercial Court. 



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