

# Bank restrained from demand call on grounds of fraud and unconscionability

The Singapore High Court's decision in *Boustead Singapore Ltd v. Arab Banking Corp (B.S.C.)* [2015] 3 SLR 38 sounds a note of caution to those acting as guarantors in back-to-back guarantees – a guarantor must take care to ensure that the beneficiary's demand for payment is valid, and accords with the terms of the guarantee, before making a corresponding demand for payment from the account party.

This case involved a demand for payment by Arab Banking Corp (ABC) under a facility agreement with Boustead Singapore Ltd (Boustead). The facility agreement was entered into on a back-to-back basis to secure a guarantee issued by ABC in favour of the Bank of Commerce and Development (BCD).

On the facts, the High Court found that BCD's demand for payment under the guarantee was invalid and had been made fraudulently, and that ABC must have or ought to have known of this. The High Court further found that ABC's corresponding demand for payment under the facility agreement had been made in reckless disregard of the invalidity and fraudulent nature of BCD's demand and as such, was itself fraudulent.

Accordingly, the High Court granted two injunctions preventing ABC from paying BCD or receiving payment from Boustead.

It is also significant to note that the High Court went on to hold that even if it was wrong in its findings of fraud, it would still have granted the injunctions; this was because it would be unconscionable to require Boustead to pay on ABC's demand. In so doing, the High Court extended the unconscionability exception, developed in the context of performance bonds, to demands for payment by a bank against its customer under a facility agreement.

The High Court's decision was recently upheld by the Singapore Court of Appeal in *Arab Banking Corp (B.S.C.) v. Boustead Singapore Ltd* [2016] SGCA 26.

## Facts of the case

In 2007, the Organisation for Development of Administrative Centres (ODAC) engaged a joint venture (of which Boustead was a member) to construct a housing development in Al-Marj, Libya.

The contract between ODAC and the joint venture required the latter to issue a performance bond (PB) and an advance payment guarantee (APG) to ODAC. These were subsequently issued by two intermediary banks.

First, Boustead instructed ABC to issue two counter-guarantees (the CGs) in favour of BCD; ABC in turn instructed BCD to issue the PB and APG to ODAC. The CGs, PB and APG all required payment on demand (as opposed to payment on proof of loss), although each had different requirements for a valid demand.

Boustead's relationship with ABC was governed by a facility agreement under which Boustead was to indemnify ABC on demand for any

amounts demanded or paid under the CGs.

Subsequently, following demands made by ODAC under the PB and APG, and BCD in turn under the CGs, ABC made a demand for payment under the facility agreement.

## The High Court's decision on fraud

In the High Court, Boustead argued, amongst other things, that it was not liable to pay on ABC's demand as:

- BCD's demands were made fraudulently and ABC knew of BCD's fraud.
- It would be unconscionable for ABC to obtain payment.

After reviewing the facts of the case in detail, the High Court found as follows:

Firstly, under Libyan law (which governed the PB and APG), ODAC's demands were not valid as they had not been made in accordance with the terms of the PB and APG.

Secondly, under English law (which governed the CGs), BCD's demands were also fraudulent in the sense that they had been made recklessly, and without regard for their truth or falsity. In arriving at its finding, the High Court relied on the following facts:

- The ODAC demands were obviously non-compliant with the terms of the PB and APG, and this would have been apparent to anyone reading these documents together. However, BCD's demands falsely stated that ODAC's demands complied with the terms of the PB and APG.
- ABC had previously put BCD on notice of the importance of presenting a compliant demand from ODAC prior to making any demand under the CGs. In fact, ABC had rejected a prior version of BCD's demand for not being compliant with the terms of the CGs.
- The very concern of a bank is with the documents presented to it. However, BCD did not appear to have examined the ODAC demands before making its own demands under the CGs.
- Lastly, the allegations of fraud made against BCD were unanswered as BCD had refused to participate in the proceedings in the Singapore High Court.

The Court recognised that thus far, the unconscionability exception had only been applied in the context of demand guarantees and performance bonds. However, the Court was of the view that the unconscionability exception should be extended to demands for payment made by a bank against its customer under a facility agreement.

Thirdly, the High Court found that the first three of the four facts above relate to ABC as well as BCD, and ABC must have known or ought to have known that BCD's demands were made recklessly, and without regard for their truth or falsity (i.e. BCD's demands were fraudulent).

Accordingly, the Court held that the fraud exception was satisfied and Boustead was not liable to pay on BCD's demand.

### Extension of the unconscionability exception

It is interesting that the High Court went further and held that even if it was wrong in its findings of fraud, it would still have arrived at the same conclusion on the ground of unconscionability.

The Court reaffirmed that under Singapore law, unconscionability exists as a distinct ground from fraud for restraining payment under a demand guarantee or performance bond. This is unlike English law, which recognises fraud as the only ground for doing so.

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exception should be extended to demands for payment made by a bank against its customer under a facility agreement.

Citing the English High Court decision in *Technical & General Guarantee Company Ltd v. Mark Patterson* (2003) WL 18223105, the Court reasoned that Boustead's obligation to indemnify ABC under the facility agreement was in substance similar to that found in a demand guarantee or performance bond, and as such there was no reason not to extend the unconscionability exception in these circumstances.

On the facts of the case, the Court concluded that it would indeed be unconscionable to require Boustead to pay on ABC's demand, as it was the culmination of a series of demands emanating from ODAC's clearly invalid demands.

### The Court of Appeal's decision

On appeal, the Court of Appeal upheld the High Court's decision and its findings on fraud.

In addition, the Court of Appeal cautioned that fraud on the part of the beneficiary alone will not be enough to restrain a guarantor from making payment to the beneficiary, or receiving payment from the account party: what must be shown is that the guarantor itself had acted fraudulently,

and/or that the guarantor was aware that the underlying beneficiary's demand was fraudulent or was reckless to this fact. In other words, the fraud must be brought home to the guarantor.

Having so concluded, the Court of Appeal declined to express its views on the merits of Boustead's argument that ABC's demand was also unconscionable.

## Conclusion

The High Court's decision in this case serves as a stark reminder for those acting as guarantors to remain vigilant and be alive to any signs that the beneficiary's demand may be invalid or may not be compliant with the terms of the guarantee.

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The basis of the High Court's holding in this regard was that the substance of the obligation under the facility agreement in the present case, was similar to that under a demand guarantee or performance bond.

However, not all facility agreements oblige a customer to make payment to the bank on demand. On the contrary, it is fairly common for payments under a facility agreement to follow a fixed schedule, with fixed amounts payable at fixed times / intervals.

In which event, there does not appear to be any basis to extend the unconscionability exception to such other facility agreements.

Pending further clarification from the Courts on the scope and ambit of the extension of the unconscionability exception, it may be prudent for banks to consider if it will be necessary to expressly exclude the application of the unconscionability exception in their facility agreements with their customers.

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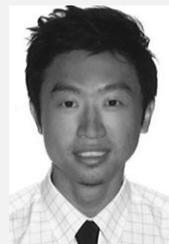
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500986-4-9104-v0.6

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