ON-DEMAND BONDS: A REVIEW OF ITALIAN AND ENGLISH DECISIONS ON FRAUDULENT OR ABUSIVE CALLING

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INTRODUCTION

Irrevocable undertakings made by a bank or commercial provider to pay a named beneficiary on the beneficiary's simple demand have a well-established presence in the world of international commerce. With the courts' protection, these undertakings, whether under the guise of irrecoverable letters of credit, guarantees or bonds, were widely used essentially to insure a party from losses arising from the non-performance of the other party in a contract. They are considered the "*lifeblood of international commerce*"[1]. Historically, the English courts have been strongly in favour of upholding and enforcing banks' irrevocable obligations to pay, though the Italian courts' approach did not conform to this practice until relatively recently.

In international construction projects, such irrevocable undertakings to pay a named beneficiary are now being used widely[2] in the form of the on-demand performance bond. Their popularity in the international context has increased in spite of the palpable unfairness for the contractor when an on-demand bond is called incorrectly (ie where "*the underlying transaction has not been broken*"[3]) or, according to recent Italian courts decisions, when the

[1] See *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd* [1978] 1 QB 146 at 155; [1977] 3 WLR 752; [1977] 2 All ER 862 at 870, *Edward Owen Engineering Ltd v Barclays Bank International Ltd* (CA) [1978] 1 QB 159 at 171, *Britten Norman Ltd (in Liquidation) v State Ownership Fund of Romania* [2000] Lloyd's Rep Bank 315 and *Group Josi Re Co SA v Walbrook Insurance Co Ltd* [1995] 1 Lloyd's Rep 153; [1995] 1 WLR 1017; [1994] 4 All ER 181 at 202.

[2] *Oxus Gold plc (formerly Oxus Mining plc) v Templeton Insurance Ltd* [2006] EWHC 864 (Comm) at paragraph 213.

[3] *Bankers' Law*, Volume 1 No 1 – Performance bonds.

calling is "abusive". There is both immediate financial loss to the contractor as the bank debits its account,[4] and incalculable reputational damage since banks may be unwilling to provide future bonds at a commercially viable rate. Despite the fact that they may be open to abuse by employers, to many contractors they remain an inescapable aspect of the industry. As such, if a contractor cannot obtain a commercially viable bond, it is priced out of tendering for all projects requiring them.

This article addresses the approach of both the Italian and English courts to on-demand performance bonds used in international construction projects. The first part of this article summarises the "substance of the obligation" under an on-demand bond, examining the approaches of Italian and English law. The second part reviews each system's position on attempts to restrain calls on on-demand bonds and the ambit of the fraud and/or abuse of right exceptions.

THE SUBSTANCE OF AN "ON-DEMAND" BOND

An on-demand performance bond is a contractual undertaking given by a bank[5] to pay a specified amount to a named beneficiary, on the occurrence of a certain event. They are often, confusingly, referred to as performance guarantees[6] or demand guarantees[7]. The characterisation is "*bedevilled by terminology*"[8]. The difference is, in reality, "*a question of the substance of the obligations.*"[9]

With a true guarantee, the bank's liability is secondary to that of the contractor/principal. The bank can have no liability unless and until the contractor has breached its obligations to perform. However, with an on-demand performance bond, liability arises "*on a mere demand by the beneficiary, even if there is reason to doubt that the primary contractual obligation has been broken.*"[10] As a result, these bonds may be viewed as "*a particularly stringent form of a contract of indemnity*"[11], to be contrasted with a "*conditional bond*"

[4] These losses can ultimately be remedied by bringing bond sums into the final account between parties see *Cargill International SA v Bangladesh Sugar and Food Industries Corporation* [1996] 4 All ER 563 (Morison J) in which the authorities are reviewed, most notably decisions in two Australian cases and dicta of Lord Denning MR in *State Trading Corporation of India Ltd v ED & F Man (Sugar) Ltd* (CA) 17 July 1981, transcript.

[5] or other commercial finance provider.

[6] See *Seele Middle East FZE v Raiffeisenlandesbank Oberosterreich Aktiengesellschaft Bank* [2014] EWHC 343 (TCC).

[7] *Aria Inc v Credit Agricole Corporate and Investment Bank* [2014] EWHC 872 (Comm). Under Italian practice, they are often referred to as "first demand" or "autonomous" guarantee but for the purpose of this article the "on-demand bond" nomenclature will be used.

[8] *Carey Value Added SL v Grupo Urvasco SA* [2010] EWHC 1905 (Comm) at paragraph 17.

[9] *Carey Value Added SL*, fn 8 above.

[10] The Hon Mrs Justice Geraldine Andrews and Richard Millett QC, *Law of Guarantees*, 6th Edition (Sweet & Maxwell, 2012) paragraph 1-015, p 17.

[11] *Law of Guarantees*, fn 10 above.

where the liability of the bank is "*conditional on proof*"[12] of the contractor's breach of the underlying construction contract.

The English Court of Appeal in *Edward Owen Engineering Ltd v Barclays Bank International Ltd*[13] held in relation to on-demand bonds: "A bank … is not concerned … with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation … nor with the question whether the supplier is in default or not. The bank must pay … on demand … without proof or conditions."

This case has been referred to with approval by Italian writers[14]. The Italian Court of Cassation[15] held, inter alia, that the payment shall be made by the guarantor: "Regardless … of any proof from the creditor of the actual breach of the debtor".

Under both English and Italian law, there is no standard nomenclature by which an instrument can automatically be classified as an on-demand bond[16]. The words "on-demand" alone do not have this effect,[17] though parties intending to create an on-demand bond are expected to use such language to indicate the "avowed purpose of the instrument"[18]. The absence of such language creates a strong presumption against the interpretation of the instrument as an on-demand bond[19].

Even where the words "on-demand" are used, their effect can still be a source of debate[20]. The Italian courts have often construed the "on-demand" clause simply to mean that the parties intended the guarantor to pay immediately after the request but not necessarily to create an on-demand bond autonomous from the underlying contract. In this respect the Court of Cassation[21] held that:

[12] *Vossloh Aktiengesellschaft v Alpha Trains (UK) Ltd* [2010] EWHC 2443 (Ch); (2010) 132 Con LR 32.

[13] *Edward Owen*, fn 1 above.

[14] See Rubino Sammartano, "Appalto internazionale, performance bond e provvedimenti di urgenza" *Foro Padano*, 1980, I, c. 238 and Bonelli, *Le garanzie bancarie a prima domanda*, Giuffrè, 1991, p 15.

[15] Court of Cassation, 18 February 2010 No 3947, *Contratti*, 2010, p 440.

[16] *Gold Coast Ltd v Caja de Ahorros del Mediterraneo* (CA) [2001] EWCA Civ 1806; [2002] 1 Lloyd's Rep 617; [2002] 1 All ER (Comm) 142.

[17] *IIG Capital LLC v van der Merwe* (CA) [2008] EWCA Civ 542; [2008] 2 Lloyd's Rep 187; [2008] 2 All ER (Comm) 1173; [2008] All ER (D) 297.

[18] *Hyundai Shipbuilding & Heavy Industries Co Ltd v Pournaras* [1978] 2 Lloyd's Rep 502 at paragraph 508.

[19] *Marubeni Hong Kong and South China Ltd v Government of Mongolia* [2005] 2 Lloyd's Rep 231; *IIG Capital LLC v van der Merwe* (CA) [2008] EWCA Civ 542; [2008] 2 Lloyd's Rep 187; [2008] 2 All ER (Comm) 1173; [2008] All ER (D) 297.

[20] Court of Cassation, 18 February 2010 No 3947, fn 15 above, recognised that the absence of clear wording has been the source of confusion, explaining why there are differing outcomes on similarly worded bonds and, obiter dictum, that the use of expressions like "on-demand" or "without exceptions" can be considered simply as an indication that the intent of the parties was to create an "on-demand" bond, which intent can be ascertained only through the analysis of the entire guarantee. Court of Cassation, 4 July 2003 No 10574, *Banca, borsa e titoli di credito*, 2004, II, 497 held instead that the on-demand clause can be used both in case of autonomous bonds and in the case of conditional guarantees.

[21] Court of Cassation, 3 October 2005 No 19300, *Foro Italiano*, 2006, I, 2132.

> "In order to characterise an autonomous guarantee it is not decisive the use of the expression 'on-demand' or 'at first demand' but instead the relation that the parties intended to create between the underlying obligation and the guarantee."

Under both Italian and English law, the operation of the "bond" is always a question of party intention[22]. Given the inherent uncertainty in establishing parties' intentions, parties should use the clearest possible words to indicate this. Under both Italian and English law, there is unanimous consent that that the bond must contain all necessary wording to make it clear that:

(i) the bond be payable on simple written demand by the beneficiary[23] without the need for the beneficiary to prove the occurrence of the event triggering the calling;[24]
(ii) the guarantee is autonomous from the underlying contract;[25] and
(iii) any right of set-off possessed by the principal/contractor against the beneficiary/employer[26] is excluded.

THE ORTHODOX APPROACH TO ON-DEMAND BONDS UNDER ENGLISH LAW

Despite the industry's familiarity with on-demand performance bonds, the English courts in the 1970s had yet to encounter them[27]. Notwithstanding this, the similarities of performance bonds to other irrevocable undertakings for a party to pay on-demand[28] provided a ready-made source of principles which the courts could apply. For example, in letters of credit cases, the English courts had consistently required the bank to honour a call[29] and

[22] Court of Cassation, 21 April 1999 No 3964, *Rivista del Notariato*, 1999, p 1271.

[23] See Court of Milan, 22 September 1986, *Lloyd Nazionale Italiano v Snamprogetti Spa, Banca, borsa e titoli di credito*, 1987, II, p 331, which clearly stated that the guarantor has to pay on the basis of the simple statement that a default occurred. See also *Cargill International SA, Geneva Branch Cargill (HK) Ltd v Bangladesh Sugar and Food Industries Corporation* (CA) [1997] EWCA Civ 2757; [1998] 1 WLR 461; [1998] 2 All ER 406 at paragraph 413.

[24] The general standard wording contained in on-demand bonds provides that the bank shall pay upon demand from the beneficiary "*stating that the contractor has not fulfilled its obligations*" or "*containing a description of the claimed breach*" or "*stating that the contractor is in breach and the respect in which the contractor is in breach*".

[25] Court of Cassation, 2 April 2002 No 4637 stated that the on-demand bond is not accessory and is therefore unconditional "*in the sense that the guarantor undertakes to pay the beneficiary and to refrain from raising objections based on the underlying contract*" as confirmed by Court of Cassation, 3 October 2005 No 19300, fn 21 above, which stated that: "*the essential requirement of the on-demand bond is the prior waiver of the guarantor to raise any objection […] relating to the underlying contract*," recently confirmed by Court of Cassation, 18 February 2010 No 3947, fn 15 above and *WS Tankship II BV v Kwangju Bank Ltd; WS Tankship III BV v Seoul Guarantee Insurance Co; WS Tankship IV BV v Seoul Guarantee Insurance Co* [2011] EWHC 3103 (Comm) at paragraph 143, *Wuhan Guoyu Logistics Group Co Ltd v Emporiki Bank of Greece SA* (CA) [2013] EWCA Civ 1679 at paragraph 21. [[2014] BLR 119; [2014] 1 Lloyd's Rep 273.]

[26] *BOC Group plc v Centeon LLC* [1999] 1 All ER (Comm) 53, affirmed (1999) 63 ConLR 104.

[27] *Edward Owen*, fn 1 above.

[28] For example, letters of credit.

[29] *United Trading Corporation SA v Allied Arab Bank Ltd; Murray Clayton v Rafidair Bank* (CA) [1985] 2 Lloyd's Rep 554.

refused an application to enjoin a bank or commercial finance provider from paying,[30] unless it was shown that the call was fraudulent.

THE ITALIAN APPROACH TO ON-DEMAND BONDS

The Italian Civil Code only provides for the *fideiussione*,[31] a conditional guarantee intimately linked to the underlying contract. The provider of *fideiussione* is responsible for the fulfilment of the debtor's obligations and will be liable to the same extent as the debtor. As such, the guarantor under the *fideiussione* shall pay only upon actual default and is entitled to raise all the objections that the debtor can raise pursuant to the contract.

It is due to the existence of this codified provision that until quite recently, Italian courts and scholars were uncertain as to the proper treatment of the on-demand bond. At first, Italian courts misinterpreted the on-demand bond: the courts failed to construe it as a different instrument whose main feature is full autonomy and independence from the underlying obligation, treating instead it as a species of the *fideiussione*. The courts failed in particular to understand that, under an on-demand bond, the bond-provider only has to fulfil its own obligation to pay and not the obligation of the debtor (as in the *fideiussione*): this is the essence of the bond's autonomy from the underlying obligation.

Given this misinterpretation, it was then difficult to find a common rationale in the courts' decisions. In some cases, the main feature of the on-demand bond was that the guarantor was obliged to pay immediately upon demand with full right to raise objections based on the underlying contract at a later stage. The mechanism was therefore nothing more than the usual "pay now litigate later" mechanism[32] which is rather ordinary in conditional bonds. The Court of Cassation[33] ruled that:

> "the clause 'without objections' often used together with the clause 'on first demand' is in reality a simple 'solve et repete' clause, which allows the guarantor, once paid the requested amount, to raise any objection based on the underlying contract …"

Even one of the first decisions[34] recognising the on-demand bond stated that:

> "It is valid that the contract allows the creditor to receive the immediate payment from the guarantor with no possibility to raise those exceptions that the debtor can raise"

[30] *RD Harbottle*, fn 1 above; see also *Edward Owen*, fn 1; and *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 Lloyd's Rep 251; [1984] 1 WLR 392; [1984] 1 All ER 351.

[31] Governed by Articles 1936 and following of the Civil Code.

[32] Portale, *Le garanzie bancarie internazionali*, Giuffrè, 1989, at p 135.

[33] Court of Cassation, 29 March 1996, No 2909.

[34] Court of Cassation, 1 October 1987 No 7341 *Banca, borsa e titoli di credito*, 1988, II, p 1, which is however, considered the leading case in respect of the admissibility of the on-demand bond under Italian law.

The court held that the main consequence of this mechanism was nothing more than a shift in the burden of proof from one party (the beneficiary) to the other (the guarantor). In other words, according to the decision, an on-demand bond allowed the beneficiary to obtain the payment without proving its entitlement but the guarantor had to prove the absence of default to obtain restitution of the payment.

The absence of full analysis may well have caused the difficulties which the courts encountered in dealing with on-demand bonds consistently with international commercial needs: the lower courts rather flexibly granted injunctions restraining banks from paying and were even more willing to intervene in cases where the bond contained even simple references to the underlying contract,[35] as these were taken as indicative of a conditional bond or guarantee. In one such case,[36] the court was influenced by the fact that the guaranteed amount was to be automatically reduced in relation to the progress of the work and that non-fulfilment of the progress milestones would have allowed the calling of the bond. As a consequence the Court of Milan allowed the guarantor to raise all the objections based on the underlying contract.

However, the increasing involvement of Italian companies in international transactions and construction projects forced Italian courts to accept a well-developed doctrine[37] demanding deeper analysis of the on-demand bond as something different from the *fideiussione*[38]. The Court of Milan in 1987[39] clearly stated that:

> "The aim of the [on-demand] guarantee, instead of securing the proper fulfilment of the underlying contract, is to secure the satisfaction of the economic interest of the beneficiary, jeopardised by the breach of the debtor".

[35] It took some time for the Italian courts to put the references to the underlying contract in the right context and to admit that any on-demand bond must necessarily contain some references to the underlying contract but that this is not the reason to construe the instrument as a conditional guarantee despite the clear construction reached at international level, see for instance ICC Uniform Rules for Demand Guarantees, Publication No 458 and Article 5 of ICC Uniform Rules for Demand Guarantees, ICC Publication No 758.

[36] Court of Milan 1 October 1990, *Acieroid Italian Spa v Banca Commerciale Italiana Spa*, *Banca, borsa e titoli di credito*, 1991, p 637. Acieroid was the contractor for a construction contract signed with the Ministry of Housing of the Republic of Yemen. Banca Commerciale Italiana issued a performance bond, upon instruction of the contractor, which (i) provided for the reduction of the guaranteed amount on the basis of the progress of works (as certified by the engineer) according to the time scale included in the guarantee and which (ii) could have been called by the Ministry of Housing upon a simple declaration of default issued by the Ministry itself.

[37] Bonelli, fn 14 above, p 25.

[38] It must be underlined that lower Italian courts admitted the validity of the on-demand bond since the 1980s, but the main difficulties were in fully understanding the nature and purpose of the on-demand bond. This is the reason why restraining orders were quite common. See for instance Court of Milan, 17 November 1980, Court of Appeal of Naples, 22 January 1982, Court of Milan, 22 September 1986.

[39] Court of Milan, 30 April 1987, *FEAL SpA v BNL SpA and National Bank of Abu Dhabi*, *Foro Padano*, 1987, p 379.

This approach[40] has been the basis for further development of the proper construction of the autonomy of the on-demand bond in respect of the underlying contract. A different decision from the Court of Cassation[41] held that:

> "The aim of the on-demand bond is not to guarantee the proper fulfilment of the underlying obligation but instead to transfer the risk of the breach and of the improper fulfilment of the same to the bank".

The court confirmed in this way the construction of the on-demand guarantee as an autonomous obligation of the guarantor, allowing the beneficiary to receive prompt payment notwithstanding any objections based on the merits.

The Italian courts have now reached a position consistent with the needs of parties involved in the international construction industry, who use performance bonds as opposed to conditional bonds or guarantees, with the intention they can be called upon a simple written demand where only a lack of honest belief or fraud would prevent immediate payment by the bank. It is thereby widely recognised as an instrument under which the guarantor is obliged to make prompt payment to the employer upon an assertion of a breach of the underlying contract by the contractor, without proof of such breach being provided to the guarantor.

RATIONALE BEHIND THE FRAUD EXCEPTION

The notion that fraud should be an exception to the general rule of immediate payment is consistent with the principle that bonds should be administered "according to their terms". It would be an unsustainable fallacy to suggest that parties ever intended to take the risk of another's fraudulent behaviour, contrary to the interests of international trade[42] and inconsistent with the maxim, *fraus omnia corrumpit*. The ambit of the "fraud exception", and whether fraud should be "the only exception", has however been the source of much litigation. It is clear that the greater the interference by the courts with the machinery of on-demand bonds, the greater the risk that their defining benefit (immediate payment regardless of contractor insolvency) is rendered nugatory.

Further, having confidence in the promises of banks, commercial financing institutions and bond providers to pay and knowing that "irrevocable" means just that, is of fundamental importance to the

[40] The doctrine had already pointed out that this is the substance of the on-demand bond and the rationale of its autonomy. See Portale, *Le garanzie bancarie internazionali*, fn 32 above, p 122 and Bonelli, fn 14 above, p 27.

[41] Court of Cassation, 6 October 1989 No 4006, *Banca, borsa e titoli di credito*, 1990, II, p 5.

[42] *United Trading Corporation SA v Allied Arab Bank Ltd; Murray Clayton v Rafidair Bank* (CA) [1985] 2 Lloyd's Rep 554 at paragraph 561.

reputations of institutions making these promises. As the English court neatly summarised in 1999, "the interest in the integrity of the banking contracts under which banks make themselves liable on their letters of credit or their guarantees is … great"[43].

However, given the grave consequences of an improper call, it is unsurprising that contractors should want to extend the circumstances in which they can prevent a call (and payment) on a bond. The possible ambit of the exceptions under both Italian and English law is considered next.

LIMITS TO UNCONDITIONAL PAYMENT UNDER ITALIAN LAW

Italian courts, in line with various civil law jurisdictions,[44] have consistently held[45] that the bond's autonomy cannot be used fraudulently or abusively[46]. However, there is still considerable confusion in respect of the ambit of fraud and abuse concepts[47]. In the 1990s, the Court of Genoa[48] ruled that:

> "Even if it is true that the guarantor […] cannot raise objections based on the underlying contract […] the guarantor can always object, in order to refuse the payment that the beneficiary is acting fraudulently […]".

In the above case, fraud was found in that fulfilment of the underlying contract had not occurred due to force majeure or supervening impossibility arising out of the embargo against the Republic of Iraq.

There are certainly straightforward cases where "unjust calling" is obvious on the facts. The Court of Milan[49] considered the case where the contractor, pursuant to the underlying contract, delivered to the employer the retention bond in exchange for retention money but this was never paid back by the

[43] *Czarnikow-Rionda Sugar Trading Inc v Standard Bank London Ltd* [1999] 2 Lloyd's Rep 187; [1999] 1 All ER (Comm) 890.

[44] Invalidity of the bond/guarantee agreement and defective calling are not considered in this article. One of the most complete analyses of the court positions in civil law countries is Bonelli, fn 14.

[45] See Court of Milan, 30 April 1987, fn 39 above.

[46] Court of Cassation, 17 March 2006 No 5997, *Foro Italiano*, 2007, I, 1582. It held again that the fraudulent or even the abusive calling allows the guarantor to refrain from paying and the autonomous nature of the bond is not an impediment for the guarantor to raise the excepti doli. The most authoritative analyses of fraudulent and/or abusive calling are in Portale, *Le garanzie bancarie internazionali*, fn 32 above, Bonelli, fn 14 above, and Viale, "Performance Bonds e contratto autonomo di garanzia: il regime delle eccezioni tra autonomia e causalità", *Foro Italiano*, 1987, I, 297.

[47] Portale, fn 32 above, p 78 and following.

[48] Court of Genoa, 9 December 1992, *Fincantieri Spa v Ministry of Defence Republic of Iraq-Rafideian Bank, Banca, borsa e titoli di credito*, 1994, p 182. The contract was (almost) duly performed in August 1990 when Iraqi Republic invaded Kuwait and pursuant to the UN resolution, Italy enacted the embargo law. Fincantieri, as contractor, requested the court to declare the contract terminated for supervening impossibility and as a consequence the termination of the validity of the on-demand bonds issued by Rafideian Bank (and counter-guaranteed by Banca Commerciale Italiana).

[49] Court of Milan, 12 August 1993, *Saipem Spa v Bangladesh Oil Gas and Mineral Corporation and Banque Indosuez Italia Spa, Giurisprudenza Italiana*, I, sec II, p 70.

employer. The court held that the calling of the retention bond would have been abusive and that there was no doubt that the retention money was not repaid. Calling the bond would have unjustly enriched the employer. The court stated that:

> "Despite the autonomy of the on-demand guarantee […] the guarantor can -or even must- refrain from paying when calling is abusive or fraudulent […]".

The decision was also of value as it was one of the first which held that the guarantor should have raised the fraud exception, given that it was fully aware of the fraudulent calling. Certainly guarantors have to preserve their international standing, but Italian courts have recognised the obligation of the guarantor to refrain from paying in those circumstances where the latter is fully aware of the abusive nature of the calling[50]. In a different case, the Court of Milan[51] stated that "the calling of an on-demand bond is abusive when it is the employer who has prevented the due fulfilment of the underlying contract …" in a situation where the employer, without just cause, refused to meet the contractor in order to discuss and settle some technical issues, preventing the continuation of the works. The court held that such behaviour is *contra bona fide* and that calling the bond should be restrained.

The Italian courts have tried to provide better general guidance as to when a call will be considered abusive. The Court of Cassation recently held[52] that calling is fraudulent or abusive "when its payment will unjustly enrich the beneficiary"[53]. A clear conclusion on the meaning of fraud or abuse[54] remains elusive. It is certainly true[55] that there is a degree of confusion arising out of the definitions, but this has been attributed (correctly, in the view of the authors) to the reluctance to approach the matter by the application of the general principles of good faith and fair dealing[56]. There is a sound doctrine which postulates that the use of such principles may confer too much discretionary powers to courts in cases where a restraining order should instead be based on objective facts and clear evidence.

[50] It is clear that the guarantor does not have (except in specific cases) any knowledge on the underlying contractual performance. One issue well debated in Italy was in fact in respect of the obligation of the guarantor to promptly notify the principal of any request of calling. The matter has been recently decided in the sense that the guarantor has to inform the principal in accordance with its duties to act in good faith. This is an additional proof of the fact that Italy is now certainly more in line with international standard and practice (see for instance Article 16 of ICC URDG Publication No 758).

[51] Court of Milan, 22 July 1994, *Italstrade Spa v Cukurova Elektrik AS and Banca Roma*, Giurisprudenza Italiana, I, sec II, p 67.

[52] Court of Cassation, 21 April 1999 No 3964, fn above 22.

[53] The decision, inter alia, specified that the guarantors, pursuant to the good faith principle, have the obligation to promptly inform the principal of the calling, to ascertain autonomously if the calling appears prima facie abusive and to refrain from paying whenever in their judgment the calling is abusive. It must be however recognised that, despite the mentioned set of obligations, in Italy the guarantors (especially if banks) are reluctant to refrain from paying in the absence of a judicial restraining order.

[54] Viale, fn 46 above.

[55] Portale, fn 32 above, p 57 and following.

[56] Dolmetta, "Exceptio doli generalis", *Banca, borsa e titoli di credito*, 1998, I, 147 and followings.

While courts continue to refer without distinction to "fraudulent" and "abusive" calling, it has been correctly suggested[57] that the two concepts are not synonymous. Fraud implies the ascertainment that a party has acted with wilful misconduct. Therefore it required analysis of the intent of the party who has acted deliberately to prejudice to the other party. On the other hand, abuse implies the objective exercise of a right for a purpose other than that provided by law. This is independent of any investigation of intent.

Any investigation of the intent of the beneficiary in calling the bond would certainly be difficult, if not impossible. It seems that "wrongful calling" therefore does not need to be based on the wilful misconduct of the beneficiary but can instead be based on an objective misuse of the instrument to be assessed independently of the real and actual intent of the beneficiary. This is the reason why the Court of Cassation has found the abusive calling in all those circumstances in which the calling: "would allow the beneficiary to obtain an economic rewarding with no justification having the guarantee ceased its function due to the fulfilment of the underlying obligation"[58] and in any event where it is evident: "the prior termination of the underlying obligation either for fulfilment of the obligation or for any other reason"[59].

As argued by Viale,[60] the word "fraud" has frequently been used improperly in many cases where the facts are properly described as "bad faith behaviour" as opposed to fraud. A recent Court of Cassation decision, albeit not one concerning on-demand bonds, has provided some specific parameters in respect of the abuse of law[61] stating that: "the abuse of right recurs when, even in the absence of express prohibition, the right is exercised in violation of the duty of fair dealing and good faith, causing then a disproportionate and unjustified sacrifice of the other party's rights and with the sole purpose of obtaining advantages different from those provided by the law".

The concept of abuse of right is again independent from the investigation of the actual intent of that party but must instead lie in objective misuse of the right which however does not represent, in the view of the author, a pragmatic criterion for the industry. The decision is certainly in line with sophisticated Italian analysis of the abuse of right concept which takes a pragmatic approach in respect of general concepts, such as objective good faith and fair dealing[62].

[57] Portale, *Le garanzie bancarie internazionali*, fn 32 above, p 81. A detailed analysis is conducted in Bonelli, fn 14 above, p 93 and in Viale, "Performance bond e contratto autonomo di garanzia: il regime delle eccezioni tra astrazione e causalità", fn 46 above.

[58] Court of Cassation 12 December 2008, No 29215, *Notariato*, 2009, 2, 137.

[59] Court of Cassation 16 November 2007, No 23786, *Giurisprudenza Italiana*, 2008, 1671.

[60] Viale, fn 46 above.

[61] Court of Cassation, 18 September 2009 No 20106: despite not dealing with the calling of an-demand bond, this is a key decision in the general concept of abuse of law.

[62] The recent doctrine which has analysed the abuse of right has certainly the merit to have analysed it in a detailed manner. Dolmetta, "Exceptio doli generalis", fn 56 above, Barcellona, *L'abuso del diritto: dalla funzione sociale alla regolazione teleologicamente orientata del traffico giuridico*, *Rivista del diritto civile*, 2014/2. For a comparative analysis of certain European countries see Las Casas, *L'abuso del diritto nei sistemi giuridici europei e nell'ordinamento comunitario*, in *Manuale di diritto privato europeo*, Giuffrè.

Recent court decisions have addressed good faith and fair dealing, the absence of which constitutes an abusive calling[63]. Where the behaviour of a party is "*contra factum proprium*" (ie the beneficiary has acted in a way contrary to subsequent modifications of its right[64]), the court[65] has stated clearly that such inconsistent behaviour is abusive when the beneficiary has refrained to accept those circumstances that have modified its entitlement to receive the payment. All these decisions would appear rather basic in the light of international commerce rules and standards[66] but they nevertheless demonstrate the evolution of Italian courts' approach to on-demand bonds. Since this development, it is almost unanimously agreed that any calling can be restrained any time the beneficiary makes a call when it is evident that any payment would unjustly enrich the beneficiary to the contractor's detriment. The actual issue is therefore to ascertain in which cases the payment of an on-demand bond will unjustly enrich the beneficiary. If and to the extent that, as the author believes, the legal cause of an on-demand bond is to be found in the right of the beneficiary to obtain prompt payment and indemnification due to alleged breaches of the principal, then the unjust enrichment has to be found necessarily in the absence of the right of the beneficiary to be indemnified which, in other words, means that the abusive calling will occur in all those circumstances in which the beneficiary calls the bond where there is no right of restoration.

BURDEN OF PROOF

Such analysis will be rather burdensome on an application for an interim measure. Given that the abuse exception is a limitation on the autonomy of the on-demand bond, it follows that it can only be deployed in limited cases. In addition any action aimed at obtaining a restraining order is generally sought by the principal via ex-parte applications. This is the reason why, in Italy, the assessment of the evidence is particularly rigorous. A certain agreement has been reached on the point[67] that the abuse has to emerge in "clear", "manifest" and "evident"[68] way from the available evidence which means that the evidence provided does not require any interpretation

[63] Court of Cassation, 11 December 2000 No 15592, *Wolters Kluwer Italia*, online database.

[64] Court of Cassation, 10 October 2007 No 21265, *Nuova Giurisprudenza Civile*, 2008, 5, 561, – though the decision was not in respect of an on-demand bond, the judgement suggested a definition of abuse of right as the inconsistent behaviour of a party.

[65] Court of Cassation, 11 February 2008 No 3179, *Wolters Kluwer Italia*, online database.

[66] The main reference to good faith and inconsistent behaviour is Articles 1.7 and 1.8 of the UNIDROIT Principles of International Commercial Contracts, 2010 Edition.

[67] The matter has not been fully investigated. See Frigeni "Alcune nuove pronunce sul contratto autonomo di garanzia", in *Banca, borsa e titoli di credito*, 2003, p 267 and Bonelli, fn 14.

[68] Court of Genoa, 9 December 1992, *Fincantieri Spa v Ministry of Defence Republic of Iraq*, above; Court of Cassation, 6 October 1989 No 4006.

and any additional investigation. The concept is usually defined as "*prova liquida*".

One doctrine has recently tried to summarise the concept in accordance with the most recent court decisions[69] to the effect that *prova liquida* does not necessarily mean documentary proof, but certainly the proof must be such that it does not give rise to any doubt and/or misunderstanding and no additional investigation is required[70]. As the standard of proof is strict, the assessment of evidence must be rigorous[71]. This is in line not only with the requirements of the Italian Civil Procedural Code whereby interim relief can be obtained only when there is no need for detailed consideration or investigation of the facts or the law, but also satisfies the needs and expectations of international commerce and the construction industry.

A general consensus has been reached to the effect that in all those circumstances in which a genuine dispute exists between the parties as to the alleged breach (or to the alleged fulfilment of the underlying obligation) abuse cannot occur and payment of the on-demand bond cannot be restrained since this would frustrate the essence and the scope of the on-demand guarantee[72]. As well noted by the Court of Milan, genuine disputes between the parties, as certified by the engineer, excluded any misuse of the on-demand bond and therefore any request of restraining order be rejected.

THE SCOPE OF THE "FRAUD" EXCEPTION UNDER ENGLISH LAW

The 19th Century case of *Derry v Peek*[73] is the classic exposition of fraud in English law, and provides a useful standard by which to evaluate the developments of the law relating to on-demand bonds:

> "Fraud is proved when it is shewn that a false representation has been made knowingly, or without belief in its truth, or recklessly, without caring whether it be true or false. A false statement, made through carelessness and without reasonable ground for believing it to be true, may be evidence of fraud but does not necessarily amount to fraud. Such a statement, if made in the honest belief that it is true, is not fraudulent."

This basic definition was the starting point in the 1970s cases of *RD Harbottle*[74] and *Edward Owen*[75]. Given the restrictive definition of fraud, it is

[69] Frigeni, fn 67 above.

[70] See Bonelli, fn 14 above, p 107; Court of Milan, 12 August 1993, fn 49 above.

[71] The reference to "*immediately available strong evidence*" as contained in UNCITRAL Convention on Independent Guarantees and Stand-by Letter of Credits seems rather helpful.

[72] Bonelli, fn 14 above, p 119.

[73] (HL) (1889) 14 App Cas 337.

[74] [1978] 1 QB 146; [1977] 3 WLR 752; [1977] 2 All ER 862.

[75] [1978] 1 QB 159.

unsurprising that these cases represent the high-water mark of the courts' protection of the on-demand nature of these bonds.

In *RD Harbottle*, the seller had applied for injunctions against both the bank and the buyers. The bank challenged the injunction and the court set aside both injunctions, holding:

> "The courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration … The courts are not concerned with their difficulties to enforce such claims; these are risks which the merchants take."

In *Edward Owen*, the court developed an exception to the *RD Harbottle* rule, of "established or obvious fraud to the knowledge of the bank", stating:

> "The bank ought not to pay under the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances when there is no right to payment"[76].

FRAUD: THE STANDARD OF PROOF

The party alleging fraud was subject to a high standard of proof at the interlocutory stage. While all applications for injunctions are subject to the *American Cyanamid*[77] requirement that there be "a serious issue to be tried", in *Edward Owen* the court made clear[78] that the mere assertion or allegation of fraud is not sufficient: it must be "established" in cases of on-demand bond injunctions. The court in *Dong Jin*[79] confirmed that "one would … while applying *American Cyanamid*, require a considerably higher standard as regards the merits of the plaintiffs' claim before one would intervene in the operation of a letter of credit by injunctive relief."

The principal or guarantor had to provide "strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer"[80], and it would be evidentially significant[81] if the party accused of fraud had "been given an opportunity to answer the allegation" but failed to provide an "adequate answer in circumstances where one could properly be expected". However, the courts have since relaxed this rule where the bank did not have notice of clear fraud at the time of the call, but could subsequently establish it at the hearing. This has had a beneficial effect for a few contractors in unusual[82] circumstances. Waller LJ held in *SAFA*[83] that:

[76] At page 169.
[77] *American Cyanamid Co v Ethicon Ltd* (HL) [1975] AC 396; [1975] 2 WLR 316; [1975] 1 All ER 504.
[78] *Edward Owen*, fn 1; repeated in *Bolivinter Oil SA*, fn 30 at p 393.
[79] *Dong Jin Metal Co Ltd v Raymet Ltd* (CA) 13 July 1993, unreported.
[80] *Solo Industries UK Ltd v Canara Bank* (CA) [2001] EWCA Civ 1059.
[81] *Edward Owen*, fn 1 at p 173.
[82] *SAFA Ltd v Banque Du Caire* [2000] 2 All ER (Comm) 567.
[83] *SAFA*, fn 82 above.

> "It may … be unjust to enter summary judgment against the bank either because the bank has a reasonable prospect of succeeding in a defence of set-off or because there is a compelling reason for a trial of the letter of credit issue."[84]

A stay of execution on the bank's obligation to pay, pending a trial of the fraud issue, is likely to have the same practical consequence for a contractor as an injunction, since the contractor does not suffer financial loss or reputational damage until payment is made. While the *SAFA* decision technically did extend the fraud exception by relaxing the notice requirement established in *RD Harbottle*[85] and *Edward Owen*,[86] the circumstances were so unusual that for most contractors seeking injunction, the fraud exception remained as difficult to establish as ever.

Given the "insuperable difficulties"[87] in enjoining the bank, it is therefore unsurprising that contractors began applying to enjoin the beneficiary, so that the calling party's knowledge, as opposed to the bank's notice, became central to the question of fraud.

The Court of Appeal in *United Trading Corporation SA; Murray Clayton Ltd v Allied Arab Bank Ltd* considered the standard of proof for fraud in this situation, but *chose a different form of words to set* out the fraud test, using pre-Civil Procedure Rules language. It said that the question was whether: "It is seriously arguable that, on the material available, the only realistic inference is that [the beneficiary] could not honestly have believed in the validity of its demands on the performance bonds".

This seemed for a time to have lowered the threshold for proving fraud. However, the court in *Solo Industries UK Ltd v Canara Bank*[88] expressed "reservations" about this reformulation of the test and returned to the "*higher standard than 'a real prospect of success' in relation to all these situations*" established in *Edward Owen* and *RD Harbottle*. In *Dong Jin*, the Court of Appeal expressly held that the same principles applied whether the injunction was sought against employer or bank. Following this, the court in *Group Josi* held that it would not restrain a seller from drawing on a letter of credit on the application of a buyer who disputed the breach of the underlying contract.

The traditional ambit of fraud in on-demand securities, albeit in the area of reinsurance, can be seen in *Group Josi* where the court held, consistently with the principle enunciated in *Derry v Peek*, that the employer or beneficiary will only "be acting fraudulently" if it claims "payment to which *they know* they have no entitlement"[emphasis supplied]. Contrary to counsel's submissions, the court considered that "*doubt*" as to entitlement is not sufficient to grant an injunction on the fraud exception, and Phillips J

[84] *SAFA*, fn 82 above at p 579.
[85] *RD Harbottle*, fn 1 above.
[86] *Edward Owen*, fn 1 above.
[87] *RD Harbottle*, fn 1 above.
[88] *Solo Industries*, fn 82 above.

declined on the facts of *Group Josi* to imply a term into the underlying contract preventing recovery under a letter of credit which did not itself contain such a term. The dictum in *Group Josi* provided an obviously fertile source for disputes concerning the definition of "knowledge" and "entitlement" in this context.

SIRIUS:[89] A CHANGE IN TERMINOLOGY OR A CHANGE IN THE LAW?

The House of Lords in *Sirius*, in addressing the question of "entitlement", looked at a separate but related agreement which sought to regulate the use of the letter of credit. This agreement was between the parties only: it included "*express contractual restrictions on the circumstances in which Sirius would be entitled to draw on the letter of credit*".

The court said that this term made "*the letter of credit … less than the equivalent of cash and Sirius' security was correspondingly restricted*" and held that where there is an express term restricting the beneficiary's entitlement to draw on the bond, those conditions may be enforced by enjoining a call on the bond.

The difference of reasoning in *Sirius* as compared to previous authorities[90] was two-fold. Firstly, the court did not make an explicit finding of fraud, as fraud was not pleaded,[91] but did cite *Group Josi*[92]with approval.

This judgment could be thought to indicate that a finding of fraud is no longer necessary, given the word's absence from the judgment. However, in *Sirius*, the House found that "*Sirius were not entitled to draw down and the money should be treated as [the claimant's]*", given the existence of the agreement relating to the use of the letter of credit, the effect of which was clear. As a matter of fact therefore, no honest belief as to entitlement could be held by the beneficiary in *Sirius*. This places the judgment on all fours with previous authority[93]. Properly understood therefore, *Sirius* did not do much to change the law concerning irrevocable obligations undertaken by banks.

Secondly, the House used the related agreement to interpret the letter of credit between the parties. Historically, there had been heavy judicial emphasis on the autonomy of on-demand securities from their underlying contracts as between the beneficiary and the bank, such that the courts did not investigate, or require the banks to investigate, the potential breach of obligations in the underlying or related agreement. However, in *Sirius* the

[89] *Sirius International Insurance Company (PUBL) v Fai General Insurance Ltd* (HL) [2004] UKHL 54; [2005] 1 Lloyds Rep 461; [2004] 1 WLR 3251; [2005] 1 All ER 191.

[90] See *Group Josi* and *Solo Industries UK Ltd v Canara Ban* following *Edward Owen* and *RD Harbottle*.

[91] At paragraph 31.

[92] *Group Josi*, fn 1 above.

[93] See *Group Josi* and *Solo Industries UK Ltd v Canara Ban* following *Edward Owen* and *RD Harbottle*.

court downplayed the importance of the autonomy principle in favour of giving effect to the related agreement between the parties.

This development was not an irrational one; a basic canon of English law is that interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties at the time of the contract[94].

Parties to an underlying, or related, agreement which envisages the existence of a bond with a third party, necessarily have the background knowledge of both agreements, and should not be permitted to hide behind the principle of bond autonomy to avoid the obligations voluntarily assumed under the underlying contract, which primarily exists for the benefit of the bank. Since *Sirius*, such parties cannot so do. This is best regarded as the proper application of the fraud principle, as opposed to a loosening of the exceptions. As the court made clear in *Sirius* the key issue was still the beneficiary's knowledge that it was or was not entitled to make a call on the bond.

THE DEVELOPMENT IN *SIMON CARVES*[95]

The judgment in *Simon Carves*[96] however marked a sea-change in the court's approach to performance bonds.

Simon Carves Ltd (SCL) was employed by Ensus to supply a processing plant. The contract incorporated the General Conditions of Contract for Lump Sum Contracts published by the Institution of Chemical Engineers in 2001 (known as the "Red Book"). The contract also provided that a performance bond was to be issued. The court noted some of the special conditions of the bond:

> "3.7. Upon the issue of the Acceptance Certificate the Performance Bond shall become null and void (save in respect of any pending or previously notified claims).
>
> 3.8. The Performance Bond shall be returned to the Contractor immediately after it becomes null and void, save where there are pending claims …"

A takeover certificate was issued on 17 February 2010 and Ensus began operating the plant.

In March 2010 foul smelling emissions began to emanate from the plant.

Ensus issued a defect notice pursuant to the contract, but later issued an Acceptance Certificate on 19 August 2010. Once this had been issued, SCL stated the bond was void except as to claims already notified and should be

[94] *Investors' Compensation Scheme Ltd v West Bromwich Building Society, Investors' Compensation Scheme Ltd v Hopkin & Sons (a firm), Alford v West Bromwich Building Society, Armitage v West Bromwich Building Society* [1998] 1 WLR 896; [1998] 1 All ER 98.

[95] *Simon Carves Ltd v Ensus UK Ltd* [2011] EWHC 657 (TCC), [2011] BLR 340; (2011) 135 ConLR 96.

[96] *Simon Carves Ltd*, fn 95 above.

returned to it. The parties disputed the cause of the problems. There were communications between the parties as to liability for the cost of remedial works for the notified defects. SCL sought to enjoin Ensus from calling the bond.

The court held[97] that "Special Conditions 3.7 and 3.8 were clear. Upon the issue of the Acceptance Certificate the Bond was to "become null and void"… The bond is to be mandatorily returned to SCL after it becomes null and void."[98]

Upholding the autonomy principle, the court held that the bond as between Ensus and the Bank "remains valid" but that on the basis of the provisions in the underlying contract, "as between Ensus and SCL, they must treat it as 'null and void'".

As in *Sirius*[99], fraud was not expressly found but, applying the *Cyanamid* test, the court held that on the issue of the bond being "*null and void*" "not only is there merely a serious issue to be tried but that on the evidence … put before the court, SCL's case is a strong one"[100]. As a matter of fact therefore, the employer could not be entitled to call the bond: the contract was clear that the bond had, by the parties' agreement to the terms of the underlying contract, become null and void when the employer issued the Acceptance Certificate.

However, the absence of "knowledge" or "belief" in the court's reasoning was important to the development of the law in this area, as is evident from the obiter dicta:[101]

> "It is possible to get into an academic debate as to whether the proposition which I raise at paragraph 33(d) reflects a type of fraud in that the beneficiary is seeking to call on the bond when it knows or can be taken to know that the underlying contract forbids it from doing so or whether the proposition reflects another exception to the practice that the courts will only rarely intervene to restrain calls being made … It is unnecessary to decide this but in my view it represents a second type of exception.
>
> One can pose this example: on a commercial contract in which there is a bond… the parties reach a full and final settlement which expressly requires the bond to be returned to the other party and no further calls to be made … If the beneficiary … in those circumstances seeks to call on the bond, in breach of the settlement terms, the court could properly restrain the beneficiary from doing either because it is committing a straight breach of contract or because it is or should be taken to be clear fraud by the beneficiary."

The term "*straight breach of contract*" could refer to many things. It may refer to a breach of contract that is completely unjustifiable, such as breach of a "*full and final settlement*" agreement or where, as in *Simon Carves*, a certificate has been issued rendering the bond null and void. If this is what was meant by "*straight breach of contract*", this adds nothing: it is no different

[97] *Simon Carves*, fn 95 above, paragraph 37(a).
[98] *Simon Carves*, fn 95 above, paragraph 37(a).
[99] *Sirius*, fn 89 above.
[100] *Simon Carves*, fn 95 above, paragraph 38.
[101] *Simon Carves*, fn 95 above, paragraph 34.

from the principle in *Sirius* and *Group Josi*. However, the court said that there is a "*second type of exception*", indicating that it meant "*straight breach of contract*" to mean something over and above fraud *stricto sensu*. What exactly this means is unclear.

THE DEVELOPMENT IN *DOOSAN*[102]

Doosan Babcock Ltd (the claimant) agreed to supply two boilers for a power plant in Brazil to Mabe (the defendant). The bank issued two on-demand "performance guarantees", one in relation to each boiler. They each expired on the earlier of the issuing of a taking-over certificate, or 31 December 2013. The employer had not called or threatened to call on the bond. Nevertheless, the contractor made a pre-emptive application for an injunction.

The contractor argued that the bond should be treated as expired since the plant had been taken over when the boilers were taken into use by the employer. It further argued that the employer was in breach of the underlying contract by failing to issue the taking-over certificates and that the employer should not be allowed to profit from its breach by retaining the ability to make a call on a bond which *should* have expired but for the employer's failure to perform its contractual obligations.

The employer did not accept that it was in breach, relying on a provision in the contract which allowed the withholding of a certificate where the unit has been used only as a temporary measure. It claimed that it was not obliged to issue the certificates, because the units had only been used temporarily. On the limited evidence before the court at the later stage of the interim application, it seemed that the plant had been taken into commercial use by the employer. However, this was not investigated fully during the course of the hearing.

The court gave the contractor an injunction, having rejected the employer's interpretation of the "temporary use" term and therefore its justification for withholding the taking-over certificate:[103]

> "I have difficulty in seeing how anyone could in good faith assert that the taking into use of the units by MABE in July 2013 was only a temporary measure … [T]his is not a finding that MABE has not acted in good faith: it is simply my conclusion that the claimant has a realistic prospect of establishing this in the arbitration. It is not a claim that can be dismissed as fanciful."

This decision is a clear departure from previous authorities, which required the claimant to establish that the employer had made a "false representation has been made knowingly, or without belief in its truth, or

[102] *Doosan Babcock Ltd (formerly Doosan Babcock Energy Ltd) v Comercializadora de Equipos y Materiales Mabe Limitada (previously known as Mabe Chile Limitada)* [2013] EWHC 3201 (TCC); [2014] BLR 33.

[103] *Doosan,* fn 102 above, paragraphs 25–26.

recklessly, without caring whether it be true or false", or a claim to "payment to which *they know* they have no entitlement". Had the formulation of the exception in *Group Josi* been followed, the court in *Doosan* would have had to have made a finding of lack of bona fides or "no belief to entitlement" in order to enjoin the employer from calling on the bond. Further, ***t****he court referred with approval to counsel for the claimant's submission that*: "the position is different where the claimant can put in issue the validity of the guarantee or the beneficiary's right to make a call on it", likening *Doosan* to the situation in *Sirius*, where it was held that there was an agreement that regulated the bond's operation between the parties. The court in *Doosan* was content to accept the existence of a second type of exception to restraining calls on bonds: invalidity.

However, the existence of invalidity as a stand-alone exception is not well-settled. While invalidity may have been implicitly recognised as a second exception in *Sirius*, until *Doosan* (as can been seen in *Simon Carves*), invalidity only went as far as the situation where "*the party has expressly agreed that it has no right to call on the bond*" such that a call in these circumstances could not be made with an honest belief in entitlement.

Counsel for Mabe sought to make a "critical distinction" between this type of invalidity and the situation where "the court would have to determine disputes in respect of the underlying contract in order to determine if the claim could properly be made" The court however, did not accept this distinction and said *Simon Carves* "seems … virtually indistinguishable."

The law following *Doosan* is uncertain, but it seems that a claimant need not prove fraud in applications against the employer but can rather rely on claiming "invalidity" based on the terms of the underlying contract. Further, in determining the correct operation of a bond as between the parties, reference can be had both to express terms as in *Sirius*, and implied terms as in *Doosan*. It may also be the case that invalidity is no longer restricted to situations where "the party has expressly agreed that it has no right to call on the bond": it now covers situations where the court "judges" the bond to be invalid, after evaluating the parties' arguments relating to the underlying dispute and considering one side's to be, on balance, less meritorious than those of the other.

The court in *Doosan*,[104] relying on *Sirius*, understood "*straight breach of contract*" to refer to something other than "*fraud*" and proceeded to evaluate the employer's arguments as to why in that case it had not issued a taking over certificate.

Given the courts' starting position that fraud was the "only exception", *Simon Carves*[105] and *Doosan*[106] represent a significant development of the law

[104] *Doosan*, fn 102 above.
[105] *Simon Carves Ltd*, fn 95 above.
[106] *Doosan*, fn 102 above.

in this area. Fraud *stricto sensu* appears no longer to be the only exception to enjoining calls on bonds.

While the influence of *Simon Carves* and *Doosan* will be limited they are only two interim injunction cases at first instance, the utility of these bonds for employers are determined at first instance, as is the reputational harm to contractors: there is no, or little, commercial sense in the parties to the underlying construction contract appealing when attention is being and should be given to the subsequent litigation or arbitration on the dispute under the underlying construction contract. The uncertainty created by this line of case-law will therefore persist as a persuasive force in the TCC until an appeal is deemed worthwhile[107].

The English position is now closer to the position in Singapore, where calls can be restrained on the basis of unconscionability, defined as a lack of *bona fides*[108]. The justification given for the unconscionability approach in Singapore is a perceived difference between a performance bond and letter of credit[109]. The English courts however have explicitly stated that: "[Performance Bonds] stand on the same footing as letters of credit"[110]. The English courts do not in principle, therefore accept the Singaporean basis for the unconscionability exception but, nevertheless, the law seems to now be that, post-*Doosan*,[111] doubt as to the *bona fides* of a call is sufficient to obtain an injunction.

It remains to be seen how the concept of *bona fides* or the absence thereof develops in the English courts: the Italian courts have been frequently seised with the analysis of the proper ambit of "bona fides" and "abuse of right" within the context of the Italian Civil Code. The relative lack of experience of the English courts in this regard may turn the bona fides exception into an "unruly horse" for beneficiaries, contractors and guarantors alike if too broad an interpretation is given to the concept.

Perhaps it is this unfamiliarity with the concept that explains the Technology and Construction Court's refusal in *Doosan*[112] to go as far as to make a finding of a "lack of good faith by the beneficiary". Whatever the explanation may be, the English Technology and Construction Court has departed from the Italian courts' current approach, whereby the "abuse of right" exception necessitates a finding of "an objective misuse of the instrument". However, this development does have the potential to move English law away from an approach protecting the expectations of international parties, whilst the current Italian approach moves towards it.

[107] Permission to appeal was indeed given by Mr Justice Edwards-Stuart on the grounds that he realised he was extending the law: see paragraph 36 of *Doosan* above. An appeal was not pursued.

[108] See *Dauphin Offshore Engineering & Trading Pte Ltd v The Private Office of HRH Sheikh Sultan bin Khalifa bin Zayed Al Nahyan* [2000] 1 SLR 657.

[109] See *JBE Properties Pte Ltd v Gammon Pte Ltd* [2010] SGCA 46.

[110] *Turkiye Is Bankasi AS v Bank of China* (CA) [1998] 1 Lloyd's Rep 250.

[111] *Doosan*, fn 102 above.

[112] *Doosan,* fn 102 above.