LITIGATION - MALAYSIA

Calling on performance bonds: new test for unconscionability?

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AUTHOR

Min Lee Tan

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Introduction

Providing a performance bond in the form of a bank guarantee to secure the performance of work is not unusual in the construction industry. In the event that a contractor breaches its contractual obligations (eg, fails to complete its work by the completion date), the employer or developer is entitled to call on the bank guarantee. However, the contractor may bring an action in court against this call on the ground that such a demand is unconscionable. With the recent enforcement of the Temporary Measures for Reducing the Impact of Coronavirus Disease (COVID-19) Act 2020 (COVID-19 Act) – the application of which has been extended to 31 March 2021 – a question has arisen as to whether the COVID-19 Act provides a new ground for contractors to challenge calls on bank guarantees. While the high court's decision in *SN Akmida Holdings Sdn Bhd v MTD Construction Sdn Bhd*(1) deals only with the application of the Prevention and Control of Infectious Diseases (Measures Within Infected Local Areas) Regulations (PCIDRs) 2020, it provides insight into how the courts may interpret the COVID-19 Act.

Facts

The plaintiff was a works package contractor and the defendant was the nominated subcontractor (NSC) for the construction of mass rapid transit stations. The plaintiff asked a bank to issue two bank guarantees in favour of the defendant pursuant to the requirement under the nominated subcontract form between the plaintiff and the defendant. The defendant subsequently terminated the subcontract on the ground that the plaintiff had breached it and called on the two bank guarantees. The plaintiff then filed two applications in court to injunct the defendant from, among other things, receiving any proceeds of the bank guarantees from the bank until the dispute between the plaintiff and the defendant was disposed of in arbitration (injunction applications).

Issues

The high court had to consider multiple issues, including whether:

- the defendant's calls on the two bank guarantees were unconscionable;
- the plaintiff could rely on the enforcement of the PCIDRs; and
- the plaintiff could invoke the *force majeure* clause in the subcontract.

Decision

In deciding that the defendant's calls on the two bank guarantees were not unconscionable, the high court found that, among other things, there had been a substantial delay in the performance of the plaintiff's works. As such:

- the plaintiff had no "seriously arguable case that the only realistic inference" was that the defendant's calls on the bank guarantees were unconscionable;
- the plaintiff had failed to adduce a "strong prima *facie case*" that the calls on the bank guarantees were unconscionable; and
- the events which had led to the calls on the bank guarantees were not of such a degree that they would "prick the conscience of a reasonable and sensible person".

The plaintiff attempted to rely on the PCIDRs to argue that the enforcement of the PCIDRs had prevented it from performing its works and that it had been unconscionable for the defendant to call on the bank guarantees in view of the PCIDRs' enforcement. However, the high court rejected such arguments because:

- the delay in the performance of the plaintiff's works had occurred prior to the PCIDRs' enforcement;(2)
- evidence showed that the plaintiff had admitted that it could not complete its works and that it had required another contractor to take over its works; and
- the plaintiff's reliance on the PCIDRs was therefore an afterthought.

The high court rejected the plaintiff's submissions that it had been unconscionable for the defendant to call on the bank guarantees when a *force majeure* event had occurred pursuant to Clause 41 of the subcontract.

Particularly, Clause 41(a) of the subcontract provided as follows:

> *Neither the [Plaintiff] nor the [Defendant] shall be in default of its obligations under this Sub-Contract (or any part of them), other than the payment obligations as a result of the occurrence of an Event of Force Majeure. An "Event of Force Majeure" shall mean:*
>
> > *(i) outbreak of war, hostilities (whether declared or not), invasion, act of foreign enemies;*
> > *(ii) insurrection, revolution, rebellion, military or usurped power, civil war, terrorism;*
> > *(iii) ionizing radiation, or contamination by radio-activity from any nuclear fuel, or from any nuclear waste from the combustion of nuclear fuel, radio-active toxic explosion, or other hazardous properties of any explosive nuclear assembly or nuclear components thereof;*
> > *(iv) pressure waves caused by aircraft or other aerial devices travelling at sonic or supersonic speeds; or*
> > *(v) riot, strike, commotion or disorder, unless solely restricted to employees of the [Defendant] or its personnel, servants or agents; or*
> > *(vi) any operation of forces of nature, other than climatic or weather conditions of the consequences of either of them, against which a skilled, experienced and competent contractor could not have expected to have taken precaution.*

Upon analysing Clause 41, the court held that the PCIDRs' enforcement did not constitute a *force majeure* event within the meaning of the clause. The court further added that even assuming that a *force majeure* event had occurred in light of the enforcement of the PCIDRs, Clause 41(d) of the subcontract expressly stipulated that the rights and liabilities of the plaintiff and the defendant which had accrued prior to the PCIDRs' enforcement were not affected by *force majeure* events. In other words, the plaintiff was not entitled to rely on past events to invoke the *force majeure* clause.

In light of the court's findings (which included other findings not discussed in this article), the plaintiff's injunction applications were dismissed with costs.

Comment

Litigants and affected parties have waited anxiously to see how the courts will interpret the application and effects of the PCIDRs and the COVID-19 Act since their enactment. In this case, the high court showed that a party relying on either the PCIDRs or the COVID-19 Act to escape performance of its obligations under a contract (at least temporarily) cannot rely on past events to prove its inability to fulfil its part of the bargain.

It remains to be seen how the courts will interpret the PCIDRs and COVID-19 Act, including whether they will establish new tests for calling on performance bonds, given that each case has its own specific facts and governing contract.

As the pandemic has affected contract performance for many industry players, the courts must set out appropriate tests for both aggrieved and defaulting parties as soon as this matter lands on the docket, before the floodgates open for aggrieved parties to bring defaulting parties to court.

For further information on this topic please contact Tan Min Lee at Gan Partnership by telephone (+603 7931 7060) or email (minlee@ganlaw.my). The Gan Partnership website can be accessed at www.ganlaw.my.

Endnotes

(1) [2020] MLJU 2038.

(2) The PCIDRs took effect on 18 March 2020, whereas there had been complaints of the plaintiff's delay in performing its works since January 2020.

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