IN THE COURT OF APPEAL OF THE REPUBLIC OF SINGAPORE

[1999] SGCA 55

CA 309/1998

Between

American Home Assurance Co

… *Appellant*

And

Hong Lam Marine Pte Ltd

… *Respondent*

GROUNDS OF DECISION

Arbitration — Award — Recourse against award; Contract — Contractual terms; Contract — Variation; Insurance — General principles

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American Home Assurance Co v Hong Lam Marine Pte Ltd

[1999] SGCA 55

CA 309/1998
Karthigesu JA; L P Thean JA; Yong Pung How CJ
20 July 1999

Judgment:

YONG PUNG HOW CJ

(delivering the judgment of the court): This is an appeal against the decision of the learned judge to disallow the appellants` application for leave to appeal against the award of the arbitrator made in arbitration proceedings between the appellants and the respondents. The appellants, who are insurers and underwriters, had referred their dispute with the respondents over the ambit of four bonds issued by them in favour of the respondents to the arbitrator. When the application was first heard, both the appellants and the respondents agreed to request the arbitrator to reconsider his position. The arbitrator did so and in his revised award, confirmed his findings in the original award. The appellants, being dissatisfied with the revised award, sought leave to appeal against it.

2. ***Background***

The respondents carry on business, inter alia, as shipowners and charterers. In December 1994, they entered into an agreement (`the shipbuilding agreement`)

with Siong Huat Shipyard Pte Ltd (`the shipyard`) by which the shipyard contracted to construct and complete a bunkering vessel of 6,000 DWT for the respondents. The agreed price for the construction of the vessel was $10,275,000 and the contractual date for completion and delivery of the vessel was `on or about 28 December 1995`.

3.By an addendum to the shipbuilding agreement dated 16 February 1995 (`the first addendum`), the shipyard agreed to procure four performance bonds in favour of the respondents for a total of 65% of the agreed price of the vessel. This varied the requirement in cl 8(5) of the shipbuilding agreement for performance bonds in favour of the respondents for a total of 15% of the agreed price. By another addendum dated 7 November 1995 (`the second addendum`), the delivery date of the vessel was extended to 12 January 1996 and the respondents agreed to make an advance payment of 20% of the agreed price of the vessel.

4.The four bonds issued by the appellants in favour of the respondents were as follows:

	Bond number	Date	Amount
(1)	1000029962	10.02.95	S$1,541,250
(2)	1000029981	10.02.95	S$1,541,250
(3)	1000029982	10.02.95	S$2,055,000
(4)	1000035688	28.09.95	S$1,541,250

By way of assistance to the shipyard, the respondents paid the premia for the bonds.

5.The shipyard failed to complete and deliver the vessel by 12 January 1996. By this time, the respondents had paid the shipyard a total of $9,247,500, amounting to 90% of the contract price. Under cl 14 of the shipbuilding

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agreement, the respondents had two options. The first was to take possession of the uncompleted vessel and claim damages from the shipyard. The second was to seek recovery of the progress payments made to the shipyard, together with interest. On 13 January 1996, the respondents gave notice to the shipyard that they intended to take possession of the vessel. Following legal proceedings in the High Court, the respondents took possession of the uncompleted vessel. The construction of the vessel was completed in another shipyard.

6.Thereafter, the shipyard commenced arbitration proceedings against the respondents for damages and other relief in Arbitration No 6 of 1996 (`the first arbitration`). The respondents counterclaimed. In the meantime, they made four separate demands against the appellants under the bonds, one under each bond. The appellants declined to make payment to the respondents under the bonds on the ground, inter alia, that the liability of the shipyard had yet to be determined in the first arbitration between the respondents and the shipyard. The arbitrators published their award in the first arbitration on 2 April 1997. They found, inter alia, that the shipyard was in breach of the shipbuilding agreement as it had failed to deliver the vessel to the respondents by 12 January 1996, and that the respondents were entitled to terminate the agreement as they did on 12 February 1996. The arbitrators awarded the respondents the sum of $4,452,631.89. In the arbitration between the respondents and the appellants, the respondents claimed that they were entitled to be paid the full amount of the bonds, or alternatively that they were entitled to recover the amount of the award in the first arbitration, or alternatively damages together with expenses and interest.

7.The arbitrator held that the respondents were entitled to recover from the appellants the amount expended in completing the vessel. The appellants were ordered to pay the respondents the total sum of $3,242,449.06, which included

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towing charges and a number of other miscellaneous charges, as well as interest thereon at the rate of 6% pa from 12 February 1996 until date of payment.

8. ***The decision below***

Before the learned judge, the appellants raised six issues. These were as follows: first, whether the bonds issued by the appellants answered a claim for damages by the respondents against the shipyard; second, whether the respondents had made a claim under the bonds within the expiry dates stated therein; third, whether the respondents had misrepresented on 24 November 1994 that the shipyard was obliged to provide bonds for a total of 65% of the contract price; fourth, whether the variation agreements between the respondents and the shipyard discharged the appellants from their obligations under the bonds; fifth, whether the bonds should not be enforced for the reason that the shipbuilding agreement was used by the respondents to deceive the Registrar of Ships; and sixth, whether the respondents were under a duty to disclose the fact that the shipbuilding agreement had been backdated and that there had been variations to it.

9.The learned judge considered the general principles governing the granting of leave to appeal against an award made on an arbitration agreement under s 28 of the Arbitration Act (Cap 10) (`the Act`), as spelt out in the House of Lords decisions in **The Nema** [1982] AC 724 and **The Antaios** [1985] 1 AC 191. In the former case, Lord Diplock referred to the provisions in the English Arbitration Act 1979 which correspond to the provisions of the local Act and laid down the guidelines to be applied in the exercise of judicial discretion. He said at pp 742-743 :

> *Where, as in the instant case, a question of law involved is the construction of a `one-off` clause the application of which to the*

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> *particular facts of the case is an issue in the arbitration, leave should not normally be given unless it is apparent to the judge upon a mere perusal of the reasoned award itself without the benefit of adversarial argument, that the meaning ascribed to the clause by the arbitrator is obviously wrong. But if on such perusal it appears to the judge that it is possible that argument might persuade him, despite first impression to the contrary, that the arbitrator might be right, he should not grant leave; the parties should be left to accept, for better or for worse, the decision of the tribunal that they had chosen to decide the matter in the first instance ... .*
>
> *[R]ather less strict criteria are ... appropriate where questions of construction of contracts in standard terms are concerned ... . But leave should not be given even in such a case, unless the judge considered that a `strong prima facie case` had been made out that the arbitrator had been wrong in his construction; and when the events to which the standard clause fell to be applied in the particular arbitration were themselves `one-off` events, stricter criteria should be applied on the same lines as those ... suggested as appropriate to `one-off` clauses ... .*

10.Predictably, the appellants contended that the relevant clauses in the bonds were standard clauses whereas the respondents asserted that they were `one-off` clauses. In the view of the learned judge, whether the appellants or the respondents were correct was immaterial because on either of the tests enunciated in The Nema in relation to `one-off` clauses or standard clauses, his conclusions would be the same. He then went on to hold that he saw no reason why leave should be granted for an appeal against the award of the arbitrator on all the issues enumerated above, save one - that of misrepresentation - in relation to which the learned judge made no finding. In conclusion, bearing in mind the raison d`tre of the Act - to `promote speedy finality in arbitral awards` - and the comment of Lord Diplock in The Nema that the question a judge should normally ask himself was not whether he agreed with the decision reached by the arbitrator but whether it appeared upon perusal of the award that the arbitrator had misdirected himself in law or that his decision was one that no reasonable arbitrator could reach, and taking all the circumstances into account, the learned judge held that the parties should be left to accept the decision of the

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arbitrator. Leave to appeal against the award of the arbitrator was accordingly refused with costs. The appellants appealed.

11. ***The appeal***

The appellants repeated the issues raised before the learned judge. They essentially contended first, that the bonds issued by them did not answer a claim for damages by the respondents against the shipyard; second, that the bonds were not on demand performance bonds but merely simple default-based guarantees; third, that the respondents had not made a claim under the bonds within the expiry dates stated therein; fourth, that the respondents had through their brokers misrepresented that the shipyard was obliged to provide bonds for a total of 65% of the contract price, and that such misrepresentation entitled the appellants to rescind the contract evidenced by the bonds; fifth, that the variation agreements concluded between the respondents and the shipyard had the effect of discharging the appellants from their obligations under the bonds; sixth, that the bonds should have been held unenforceable for the reason that the shipbuilding agreement had been used by the respondents to deceive the Registrar of Ships; and seventh, that the respondents were under a duty to disclose that the shipbuilding agreement had been backdated to enable the vessel to be registered as a Singapore ship and that the shipbuilding agreement had been varied, and that the effect of non-disclosure was to entitle the appellants to avoid liability under the bonds.

12. ***Exercising the judicial discretion to give leave to appeal: The Nema/Antaios guidelines***

The appellants` contentions will be dealt with seriatim. Before proceeding to the substantive arguments, however, we propose to examine in some depth the

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principles governing the judicial discretion to give leave to appeal under s 28 of the Act. Section 28 is in pari materia with s 1 of the English Act of 1979 and, so far as relevant, reads:

> (3) An appeal under this section may be brought by any of the parties to the reference -
>
> (a) with the consent of all the other parties to the reference; or
>
> (b) subject to section 30, with the leave of the court.
>
> (4) The court shall not grant leave under subsection (3)(b) unless it considers that, having regard to all the circumstances, the determination of the question of law concerned could substantially affect the rights of one or more of the parties to the arbitration agreement; and the court may grant any leave subject to such conditions as it considers appropriate.

13.To begin with, s 28(3) does not contain any indication of how the court`s discretion to give leave is to be exercised. The early view taken of the discretion, according to **Merkin`s Arbitration Law** [1991] at para 19.32, was that leave to appeal should be given readily where there was a point of law likely to affect the rights of the parties and in particular where clear judicial guidance was needed for future cases. The fact that the application for leave to appeal was technical, flimsy or unmeritorious, perhaps based largely on an attempt to delay matters, was not a bar to the grant of leave, and such cases were dealt with by the use of the court`s power to impose conditions on the applicant under s 1(4) of the 1979 Act (the equivalent of s 28(4)): see the leading authorities of **Mondial Trading Co GmbH v Gill and Duffus Zuckerhandelsgesellschaft mbH** [1980] 2 Lloyd`s Rep 376 and **The Wenjiang; International Sea Tankers Inc v Hemisphere Shipping Co Ltd** [1981] 2 Lloyd`s Rep 308. The only real ground for refusing an application for leave recognised by the early cases was where the application was `absolutely hopeless`: **The Kwai; Coral Navigation Inc v Avin Chartering SA** [1981] 2 Lloyd`s Rep 563; **The Evia;**

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Kodros Shipping Corp of Monrovia v Empresa Cubana de Fletes of Havana [1981] 2 Lloyd`s Rep 627.

14.An example of this approach can be found in **The Oinoussian Virtue; Schiffahrtsagentur Hamburg Middle East Line GmbH Hamburg v Virtue Shipping Corp Monrovia** [1981] 1 Lloyd`s Rep 533, where Robert Goff J (as he then was) criticised and refused to follow the guidelines laid down by the Court of Appeal in **The Nema; Pioneer Shipping Ltd v BTP Tioxide Ltd** [1980] QB 547. In the view of Goff J, there was nothing in the express language of the 1979 Act to suggest that a restrictive approach was to be taken to the exercise of the discretion conferred by s 1(3)(b) (s 28(3)(b)), with the consequence that the court should give leave in the case of certain categories of questions of law but decline to give leave in the case of other categories. Whereas the court had to be satisfied that a substantial question of law was involved, as was required by s 1(4), once it was so satisfied the only proper exercise of the discretion was to grant leave to appeal, unless there were special considerations. Under s 1(4) the court also had power to impose conditions when giving leave to appeal, and if the court had reservations about the arguments advanced to it alleging that the arbitrator had erred in law, for example, if the court considered them flimsy or doubted the motives of the applicant, it was open to the court to utilise this power by, for example, requiring the payment of the whole or part of the award into court or the provision of a security. (See also ***The Wenjiang*** , supra.)

15.The conflict was finally resolved by an appeal to the House of Lords in ***The Nema*** , where the previous approach - in particular, the view adopted in the earlier cases that leave should always be given subject to the imposition of conditions - was rejected, as such a construction failed to give sufficient weight to the general discretion arising under s 1(3)(b), by virtue of which it was open

to the court to refuse leave absolutely. Indeed, the central emphasis in the speech of Lord Diplock, which their Lordships approved, was on the discretion inherent in s 1(3)(b) and the policy of the legislature, discernible from the first four sections of the Act, which was perceived as `moving the law towards the greater recognition of the finality of awards in matters of legal determination and away from meticulous legal accuracy`: Thomas, **Appeals from Arbitration Awards** [1994] at para 5.1.3. Lord Diplock recognised the tension between the need for a quick decision and the desirability of legal certainty and accuracy, but found sufficient indications of a preference for the former in the structure of the 1979 Act. He defined the fundamental position of a judge exercising the discretion under s 1(3)(b) in the following terms at p 739 of the report:

> *The judicial discretion conferred by sub-s (3)(b) to refuse leave to appeal from an arbitrator`s award in the face of an objection by any of the parties to the reference is in terms unfettered; but it must be exercised judicially; and this, in the case of a dispute that parties have agreed to submit to arbitration, involves deciding between the rival merits of assured finality on the one hand and upon the other the resolution of doubts as to the accuracy of the legal reasoning followed by the arbitrator in the course of arriving at his award, having regard in that assessment to the nature and circumstances of the particular dispute.*

And later (at pp 739-740):

> *In weighing the rival merits of finality and meticulous legal accuracy there are, in my view, several indications in the Act itself of a parliamentary intention to give effect to the turn of the tide in favour of finality in arbitral awards ..., at any rate where this does not involve exposing arbitrators to a temptation to depart from `settled principles of law`.*

Lord Diplock then proceeded to lay down the guidelines for the giving of leave to appeal under the 1979 Act which were to form the basis of the law, in an oft-cited passage which we have already set out above.

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16.The same theme was subsequently perpetuated by Lord Diplock in **The Antaios; Antaios Compania Naviera SA v Salen Rederierna AB** [1985] AC 191 at p 199, in the context of a dispute of law concerning the construction of a contract, where he perceived the legislative intention underlying the 1979 Act:

> *... to promote speedy finality in arbitral awards rather than that insistence upon meticulous semantic and syntactical analysis of the words in which business men happen to have chosen to express the bargain made between them, the meaning of which is technically, though hardly commonsensically, classified in English jurisprudence as a pure question of law.*

17.The upshot of this approach, as Thomas in his ***Appeals from Arbitration Awards*** at para 5.1.6 puts it, is greatly to restrict the possibility of appeals from awards on questions of law, particularly when compared with the pre-1979 Act law. However, it does not take the law to the opposite extreme of barring appeals completely; on the contrary, it recognises that there may arise cases where it will be appropriate to maintain a measure of control over the legal decisions of arbitral tribunals: per Kerr LJ in **The Derby; Alfred C Toepfer Schiffahrtsgesellschaft GmbH v Tossa Marine Co Ltd** [1985] 2 Lloyd`s Rep 325 at p 333. It is the balance which has been adjusted by the 1979 Act and in weighing the competing claims of finality and legal accuracy a judge must have regard to `the nature and circumstances of the particular dispute` (per Lord Diplock in ***The Nema*** at p 739), which are to be assessed in the context of the new tone established by the 1979 Act. The function of the judge in holding the balance between arbitral finality and meticulous legal accuracy, remarks Thomas at para 5.1.4, is not in itself a wholly new theme. Rather, [t]he significance of the 1979 Act is that it tilts the jurisprudential balance towards finality and to a corresponding degree sacrifices legal accuracy. The judge therefore comes initially to his task against the backdrop of the new statutory posture, wherein the finality of awards, even with regard to questions of law, is promoted; where the exercise of the associated discretion is based on much

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more restrictive criteria than those adopted in the pre-1979 Act era; and where by necessary implication a substantial standard of proof is imposed upon applicants who seek to persuade the court that it should give leave to appeal.

18.The observations that derive from the two House of Lords decisions in ***The Nema*** and ***The Antaios*** relating to the manner in which a judge ought to approach the exercise of his discretion on an application for leave to appeal under s 1(3)(b) of the 1979 Act, as developed by subsequent decisions of the lower courts, have come to be widely referred to as ***The Nema/Antaios*** guidelines. Not only are the guidelines a manifestation of the fundamental approach defined earlier, but they also reveal how that approach may operate in particular circumstances often encountered in practice. They are in effect

> *an enunciation of the kinds of factors and prevailing circumstances that may be taken into account and weighed upon in deciding whether the discretion to grant or refuse leave to appeal should be exercised in favour of or against the applicant. They recognise and apply to identified categories of situations the kinds of relevant considerations which derive from the fundamental tenet of policy developed by Lord Diplock in The Nema, wherein the general policy of finality is entwined with the nature and circumstances of particular disputes: Thomas at para 5.2.1.1.*

For instance, the guidelines in general terms emphasise the significance of the circumstances in which an arbitration has arisen; the provisional assessment by the judge of the correctness or otherwise of the decision of the arbitrator; the nature of the question of law in issue and whether its significance is confined to the arbitrating parties or is of wider interest; and the factual circumstances in which a question of law has arisen for determination. Of these classes of situations the third - the nature of the question of law in issue and whether its significance is confined to the parties or is of wider interest - is of immediate relevance in the present case, and to a consideration of the applicable principles we now turn.

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19.Where a question of law arises in connection with the construction of a contract or contractual term in an application for leave to appeal against the award of the arbitrator, the discretion may be exercised differently according to whether in the first place the question of construction arises in the context of a `one-off` contract or clause, or that of a standard form contract or clause.

20.Where what is in issue is the construction of a `one-off` contract or clause the discretion is to be strictly exercised and leave to appeal normally refused unless the judge is satisfied that the construction given by the arbitrator is `obviously wrong`: see the judgment of Lord Diplock in ***The Nema*** . The key phrase in the context of this category is `obviously wrong`, for prima facie only when a judge so concludes should he give leave to appeal: per Hirst J in **Kansa General Insurance Co Ltd v Bishopsgate Insurance plc** [1988] 1 Lloyd`s Rep 503 at p 511; per Dillon LJ in **The Baleares; Geogas SA v Trammo Gas Ltd** [1991] 2 QB 139 at p 149; [1991] 2 All ER 110 at p 116. Other phrases such as `clearly wrong` (per Hobhouse J in **The Sanko Honour; Reardon Smith Line Ltd v Sanko Steamship Co Ltd** [1985] 1 Lloyd`s Rep 418 at pp 421-422) or `it does not look right to me` (per Griffiths LJ in **The Rio Sun; Italmare Shipping Co v Ocean Tanker Inc** [1982] 1 All ER 517 at p 523; [1982] 1 WLR 158 at p 165), or `plainly wrong` (per Lord Donaldson MR in **The Kelaniya; Seaworld Ocean Line Co SA v Catseye Maritime Co Ltd** [1989] 1 Lloyd`s Rep 30 at p 32) have also been used. If, on the other hand, the judge is satisfied that the view taken by the arbitrator is obviously or clearly right, or is probably right, or is likely to be right or might or may be right, or there is a fifty-fifty chance that the arbitrator is right (see, eg **The Nichos A; Marrealeza Compania Naviera SA v Tradax Export SA of Panama** [1982] 1 Lloyd`s Rep 52 at p 54), then leave to appeal should not be given. In **Aden Refinery Co Ltd v Ugland Management Co Ltd** [1987] QB 650 at p 659, Sir

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John Donaldson MR indicated that `[u]nder ***The Nema*** guidelines in the case of a "one-off" contractual clause, judges are advised to refuse leave to appeal if they consider that the arbitrator might have been right`. And in ***The Antaios*** Lord Diplock rephrased the test and presented it in the following terms (at p 206 of the report): `whether the arbitrator was in the judge`s view so obviously wrong as to preclude the possibility that he might be right`. In the final analysis, the important question is whether an error can be demonstrated quickly and easily; if hours of legal argument are required, the applicant will not have succeeded in satisfying the court that the award is `obviously wrong`.

21.In contrast, the courts will be more ready to entertain a question of law relating to the construction of a standard form contract or clause than is the case with a `one-off` contract or clause, notwithstanding the initial reference to arbitration. A less guarded approach is adopted; and the courts are more willing to substitute their own determination for that of the arbitrator. In essence, the guidelines spelt out in ***The Nema*** as far as the instant category is concerned require that the judge be satisfied as to two cumulative requirements before being prepared to consider giving leave to appeal. First, the judge must be satisfied that the resolution of the question of construction would add significantly to the clarity, certainty and comprehensiveness of the law. Second, when so satisfied, that there is strong prima facie evidence that the arbitrator has gone wrong in his construction. The two components of the test are cumulative; and when the first requirement is not satisfied, the guideline appropriate to `one-off` contracts and clauses would appear prima facie to apply: ***The Nichos A*** (supra) at pp 53-54.

22.This two-step approach has been endorsed by the way in which the guideline has been judicially formulated in subsequent authorities. For example, in **The Kerman; BVS SA & Anor v Kerman Shipping Co SA** [1982] 1 All ER 616

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at p 621; [1982] 1 WLR 166 at p 171, Parker J phrased the guideline in the following words:

> *... even if the decision on the question of construction in the circumstances of the particular case would add significantly to the clarity and certainty of English commercial law, leave should not be given unless the judge considers that a strong prima facie case that the arbitrator was wrong has been made out.*

And in ***Aden Refinery*** (supra), Sir John Donaldson MR expressed his understanding of the guideline in the following terms (at p 659 of the report):

> *In the case of standard terms ... [judges] are advised to apply rather less strict criteria, taking account of whether or not a decision on the question or questions of law would add significantly to the clarity and certainty of English commercial law. But even then the advice is that leave to appeal should be refused, unless the judge considers that a strong prima facie case has been made out that the arbitrator has been wrong in his construction.*

23.The vital phrase here is `strong prima facie case`: in making an assessment of the correctness or otherwise of the decision of the arbitrator, leave should not be given unless the judge is satisfied that a strong prima facie case has been made out that the arbitrator is wrong in the construction he has adopted. If, on the contrary, the judge is satisfied that the arbitrator is right or is probably right or there is at the very least a strong prima facie case that the arbitrator is right, then normally leave ought to be refused (see, eg ***Aden Refinery*** (supra) and **The Kwai; Coral Navigation Inc v Avin Chartering JA** [1981] 2 Lloyd`s Rep 563), notwithstanding that an appeal might contribute beneficially to the development of the law. The test is clearly less strict than that applicable to the category of `one-off` contracts and clauses, but otherwise raises difficulties as to its precise meaning. What exactly is meant by a `strong prima facie case`? The guidelines deny any fixed standard, and any attempt to arrive at a precise abstract definition would not only be inappropriate but also unrewarding. In this

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respect, we found the following passage from the judgment of Lord Donaldson MR in **Ipswich Borough Council v Fisons plc** [1990] Ch 709 at p [1990] 1 All ER 730 at p 734, particularly useful:

> *So how strong is strong? No meter can be applied or indeed devised. It is a matter of relative values. If the chosen arbitrator is a lawyer and the problem is purely one of construction, the parties must be assumed to have had good reason for relying on his expertise and the presumption in favour of finality or, to put it the other way round, the strength needed to rebut it, will be greater. So, too, if the dispute really centres on an issue calling for non-legal expertise, albeit with some underlying question of law, and the chosen arbitrator has that expertise. But if the chosen arbitrator is not a lawyer and the whole dispute centres on a difficult question of law, less strength may be required.*
>
> *Similarly, the degree of strength will be affected by whether the clause in question is one of a class commonly encountered, so that others would benefit from an authoritative decision on its meaning or application, and I see no reason why some account should not be taken of the seriousness of the consequences to the parties of the arbitrator`s error, if error there be. But the bottom line must always, I think, be that the judge concludes that there is a more or less strong, but still `strong` prima facie case that the arbitrator has erred in law. To adopt any other approach would be to fly in the face of the legislative preference for finality.*

The relevance of this dicta in the context of the present case is that the parties selected as arbitrator an experienced lawyer of many years` standing; and in so far as the dispute centred on a question of construction of the contract and other related issues of law, must be assumed to have had good reason for relying on the arbitrator`s legal expertise. This correspondingly raised the strength of the presumption in favour of finality.

24.To summarise (Thomas at para 5.2.3.14):

> *[W]hen a disputed question of law assumes the character of a question of construction of a one-off contract or contractual term and the parties are content to refer the question of law to the decision of an arbitrator, there is a strong presumption that the decision of the arbitrator shall be final and immune from judicial intervention. The court will not lightly substitute its own*

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> *determination for that given by the appointed arbitrator. In this circumstance the maxim that referring parties take their arbitrator for better or for worse assumes a more literal truth than it generally enjoys in arbitral law, and there is a near parallel as between questions of fact and law.*

Whereas the gist of the test where the disputed question of law takes the form of the construction of a standard form contract or clause

> *... would appear to be that the applicant must satisfy the judge that there exists a real possibility that the arbitrator has gone wrong in his construction ... . The discretion is less stringently applied than is the case in relation to `one-off` questions of contractual construction and with the court more ready to intervene and substitute its own determination ... : Thomas at paras 5.2.4.6 and 5.2.4.17.*

25.Thus the applicable criteria or guidelines where the court is faced with an application for leave to appeal against an award of the arbitrator, which differ according to whether the question of law at hand is the construction of a `one-off` contract or clause on the one hand, or of a standard form contract or clause on the other, are not in doubt. Instead, the more difficult question - and it is a problem associated with The Nema/Antaios guidelines as a whole - is the antecedent one of characterisation. What is meant by a `one-off` contract or contractual clause, and how are the boundaries of the concept of `one-off` to be delineated? Is the category to be understood as something very precise, with clearly delineated parameters; or is to be comprehended as a more amorphous phenomenon? Similarly, what is the meaning of a `standard form` contract or contractual clause?

26.Merkin has a simple answer. What he terms `one-off cases` includes, in his view: (a) an individually negotiated contract containing non-standard terms - this is to be contrasted with a standard form contract containing no special clauses; (b) an individually negotiated clause in a standard contract - if the clause is in a standard form, even if it is individually negotiated, the matter

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cannot be one-off; and (c) a standard form contract which has to be construed in the light of unique or highly unusual circumstances. (See his ***Arbitration Law*** at para 19.35.) Thomas, however, puts it in the following manner (at para 5.2.3.8): the essence of a `one-off` contract is that it is

> *one negotiated, drafted and agreed to de novo to accommodate the personal positions of the parties in the circumstance of the particular transaction they have entered into. It has no wider application beyond the particular parties and their respective positions*

Indeed, this appears to be the approach taken by Lord Diplock in ***The Nema*** , where he explained the rationale underlying the categorisation (of cases into `one-off` and `standard`) and the associated judicial attitude to the exercise of discretion in the following language. He said at p 736 of the report:

> *In the case of a `one-off` contract where the exact combination of words and phrases that fall to be construed has not only never been used before and so did not possess an already established meaning of which each party was entitled to assume the other knew when he entered into the contract, but is also unlikely to be used in future by any other parties, it is not self-evident that an arbitrator or arbitral tribunal chosen by the parties for his or their experience and knowledge of the commercial background and usages of the trade in which the dispute arises, is less competent to ascertain the mutual intentions of the parties than a judge of the Commercial Court ... . A lawyer nurtured in a jurisdiction that did not owe its origin to the common law of England would not regard it as a question of law at all. ...*

27.But the facts of and the speeches in ***The Nema*** also illustrate that to fall within the category of `one-off` contracts a contract need not be wholly novel and original in its conception, design and drafting. A contract may be `one-off` notwithstanding that its basis is a standard form contract, if it has received substantial amendments and/or additions to meet the particular needs and expectations of the parties. On the other hand, it is equally clear that it is not every amendment, addition or deletion that is capable of converting a standard form contract into a `one-off` contract. It is ultimately a question of degree, and

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where the line is to be drawn may on occasions give rise to difficult questions. Nor will it necessarily be the case that a contract will be incapable of being characterised as `one-off` by virtue of the fact that it incorporates what may be described as some standard contractual terms. Although again in each case it will be a question of degree, the mere existence of some standard clauses will not result in what is primarily a `one-off` contract losing its dominant identity. Further (Thomas at para 5.2.3.12):

> *[a]lthough there is a generally understood difference between a `one-off` and a standard form contract, it is a difference which is not always a simple matter to apply to the facts of particular situations; nor in practice is it invariably a choice between two distinct alternatives. Rather than representing an either/or question, the position may assume more the circumstance of a spectrum with contracts and contractual clauses being characterised not on the basis that they fall clearly into either extreme alternative, but by virtue that they incline more greatly in one direction than the other. So also the uniqueness of a `one-off` contractual provision will not necessarily preclude a generic interest. A clause which by virtue of its drafting clearly falls to be characterised as `one-off`, may nonetheless represent a variant of a class of clause frequently incorporated into contracts generally or in relation to specific kinds of contracts, with the consequence that the response of the courts to the particular clause may be by analogy with the wider interest*

28.The same difficulties arise when defining a `standard form` contract or clause. The traditional understanding of a standard form contract is that of a pre-prepared contract, invariably in printed form, which the parties adopt either directly by signing (whether in person or through agents) or indirectly by incorporation by reference or some other mode of adoption: Thomas at para 5.2.4.13. As in the case of a `one-off` contract, it is equally possible for

> *a printed standard form contract or term to change its characterisation to a `one-off` contract or term by virtue of its amendment by the parties. It will in each case be a question of degree whether a particular amendment or cluster of amendments effect a change in characterisation of the contract as a whole or any contractual term. Contrariwise it would appear possible for standard terms incorporated into a `one-off` contract*

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> *to retain their character as standard contractual terms provided they are capable of existing independently and their construction is not coloured by the new contractual environment: Thomas at para 5.2.4.15*

29.Confronted with the problem of characterisation - as to whether a question of construction falls within or without either guideline - the better approach, suggests Thomas, is not to embark on the exercise by first attempting an all-embracing definition of a `one-off` contract or clause, or of a standard form contract or clause, but by emphasising the underlying rationale associated with the characterisation. Thus the essence of the `one-off` concept is that it

> *raises an issue of concern which is confined to the particular contracting parties and `in which the general market and commercial fraternity has no interest`. It is a `question of a singular character unlikely to recur`. It is this associated philosophy which calls for initial emphasis, so that the threshold question comes to be framed not in terms of seeking a meaning of the phrase `one-off` when used in relation to contracts, but as an enquiry into the degree of interest in the resolution of the contractual dispute in issue: at para 5.2.3.13.*

Conversely, the crux of the `standard` concept is that `the potential interest extends beyond the immediate contracting parties to the community at large or to a determinable section of the community`: at para 5.2.4.16.

30.Reverting to the instant case, it was the considered opinion of this court that the main question of law in issue - the scope and effect of the bonds issued by the appellants in favour of the respondents - had to be characterised as `one-off` rather than `standard`. The resolution of this question depended entirely on the true nature of the bonds, which, it is trite law, is entirely a question of construction. In turn, the question of construction involved taking into account not only the words used by the parties to express their mutual obligations, but also the factual matrix or surrounding circumstances. When all this was considered, it led to the conclusion that the question of law was `one-off` and

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not `standard` in character, for two reasons: first, the evidence showed that the relevant portions of the bonds were tailored to meet the parties` respective positions - the epitome of a `one- off` case; and second - and more importantly - our decision on the question of construction one way or the other would merely be another factual illustration of well-established principles and would be incapable of adding anything to the existing jurisprudence. The appellants therefore had to satisfy us, to the degree of an `obvious`, ie readily demonstrable, error, that the award of the arbitrator was bad in law. If we were wrong in our characterisation, however, we would agree with the learned judge that the appellants would not have succeeded in satisfying even the less stringent criterion of a `strong prima facie case` of error.

31. ***Scope and effect of the bonds***

We now turn to the first and second issues, which should be considered together. Clause 8(5) of the shipbuilding agreement which required the shipyard to furnish a performance bond in favour of the respondents provided as follows:

> *Payment of the contract price shall be made by the purchaser to the builder by instalments as follows:*
>
> (a) 10% on signing of this agreement;
>
> (b) 20% seven weeks from date of (a) payment or on completion of keel laying or delivery of 30% of steel materials required, whichever is later;
>
> (c) 20% on completion of hull erection;
>
> (d) 20% on installation of main engine;
>
> (e) 20% on launching;
>
> (f) 10% on delivery of vessel.
>
> *The builder shall produce to the purchaser a 15% performance bond of the contract price in the terms provided for in cl 19.*

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Clause 19 of the shipbuilding agreement was in the following terms:

> *Performance bond*
>
> (1) It shall be a condition precedent to the payment obligations of the purchaser under cl 8 of this agreement that the builder shall procure performance bonds in the terms of the draft annexed hereto as Appendix B executed by a bank or such reputable financial institution acceptable to the purchaser in favour of the purchaser (`the performance bond`).
>
> (2) Notwithstanding any provision relating to insurance under this agreement, the purchaser shall be entitled to proceed in the first instance to claim on the performance bonds or under the provisions relating to insurance: provided any such proceedings shall not constitute a bar to any subsequent claim or proceeding under the provisions relating to insurance or under the performance bonds as the case may be.

Appendix B to the shipbuilding agreement set out a draft form of the performance bonds required. In the event, the bonds issued by the appellants followed closely the form contained in Appendix B, the drafting of which, in the opinion of the learned judge, left much to be desired. The text of the first bond, bond no 1000029962, was as follows:

> *To: Hong Lam Marine Pte Ltd*
>
> *Block 1 Wholesale Centre*
>
> *[num]03-08 Pasir Panjang Road*
>
> *Singapore 0511*
>
> *Whereas a shipbuilding agreement dated 16 March 1993 (`the agreement`) was entered into between you and Siong Huat Shipyard Pte Ltd (`the builder`) for the construction and purchase of a vessel (identified in the said agreement as builder`s Hull No 2589 and more fully described in the drawings and specification referred to in Appendix A to the agreement).*
>
> *And whereas it is agreed that the builder shall provide an insurance bond for the amount of Singapore Dollars One Million Five Hundred and Forty One Thousand Two Hundred and Fifty Only (S$1,541,250.00) of the relevant progress payments in your favour in exchange for payment of the relevant progress payments by you to the builder under the agreement, which*

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> *insurance bond* ***shall be payable on your exercise of any of your rights of termination/rescission under the agreement****. [Emphasis added.]*
>
> 1 Now we, American Home Assurance Company, a corporation of the State of New York with its statutory home office at 70 Pine Street, New York, New York 10270, United States of America and its registered branch office at 78, Amoy Street, Singapore 0106 at the request of the builder and in consideration of the premises and your agreeing to pay each progress payment under the agreement at our request, ***hereby guarantee repayment to you by the builder*** of a sum or sum(s) not exceeding in the aggregate of Singapore Dollars One Million Five Hundred and Forty One Thousand Two Hundred and Fifty Only (S$1,541,250.00). [Emphasis added.]
>
> 2 This bond is valid from 14 February 1995 for 12 months and shall remain in force until the vessel is delivered by the builder to you and the same is accepted by you under the agreement, whichever date is later.
>
> …

All four bonds were in identical terms, save in the case of bond no 1000029982 as to amount, and in the case of bond no 10000135688, as to date.

32.As the learned judge noted, the scope and effect of the bonds issued by the appellants in favour of the respondents was the main issue here. The respondents took the view that these were performance bonds payable on demand whereas the appellants asserted that they were repayment or refund guarantees. Prima facie, as the respondents had exercised their rights of termination under the shipbuilding agreement by taking possession of the uncompleted vessel, they would without more be entitled to payment under the bonds if the recital was not contradicted by the operative part of the bonds. The appellants, however, argued that effect should not be given to the words in the recital because cl 1 of the bonds provided that the appellants `guaranteed repayment ... by the builder of a sum or sum(s) not exceeding ...`. They submitted that it was evident from cl 1 that the right of the respondents to make demands under the bonds arose

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only if they exercised their right to claim back from the shipyard the progress payments paid by them and not when they opted to take possession of the vessel under cl 14 of the shipbuilding agreement. As it was clear from the operative part of the bonds that they were repayment guarantees, the recital could not be used to alter the scope of the operative part of the bonds.

33.In the view of the learned judge, the simple answer to the appellants` arguments was that the arbitrator did not regard the wording of cl 1 of the bonds sufficiently clear to determine the nature of the bonds. Hence, it was necessary to take into account the words in the recital. The arbitrator was also entitled to look at the factual matrix, referred to in **Moschi v Lep Air Services Ltd** [1973] AC 331 at p 354, where Lord Simon said:

> *It is not permissible to construe a contract by reference to negotiations leading thereto ... However, in order to ascertain what a promisee had a right to expect from the words used it is permissible to look not merely to the words but to all the circumstances. As Lord Wilberforce said in* ***Prenn v Simmonds*** *(at pp 1383H, 1384A): `The time [has] long passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic considerations.`*

The arbitrator noted that it was clear from the correspondence which passed between Minet, the insurance brokers who procured the bonds on behalf of the shipyard, and AIU, the appellants` managing agents in Singapore, that the parties contemplated the issuance of performance bonds. For instance, in a letter dated 10 November 1994, Minet`s Esther Kwan (`Kwan`) sent AIU`s Tan Thian Seng (`Tan`) a draft version of the proposed bond. In her letter, she wrote as follows:

> *As mentioned, the builders agreement between Siong Huat Shipyard and Hong Lam Marine requires the issuance of a performance bond.*

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On 28 November 1994, Tan wrote to Kwan. Under the heading `Performance Bond`, he pointed out that there was

> *[s]trong rejection from NY on wording you furnished. The bond was first rejected until I proposed to change wording.*

Tan enclosed a fresh draft of the proposed bond. Instead of stating that the surety was to `irrevocably and unconditionally undertake ... to pay on demand ... if and whenever the builder shall be in default of its obligations ...`, the fresh draft stated that the appellants were to `guarantee repayment ... by the contractor` upon the exercise by the respondents of their rights of termination or rescission under the shipbuilding agreement.

34.The arbitrator did not think that much turned on the label attached to the bonds. He noted at para 28 of his revised award that

> *[t]he bonds were variously described as performance bonds or repayment guarantees in the documents. The parties themselves appear to have used the two terms interchangeably. The question is really one of construction. In* ***Moschi v Lep Air Services Ltd****, Lord Diplock said at p 349:*
>
> *`Even the use of the word `guarantee` is not in itself conclusive. It is often used loosely in commercial dealings to mean an ordinary warranty. It is sometimes used to mis-describe what is in law a contract of indemnity and not of guarantee. ... Every case must depend on the true construction of the actual words in which the promise is expressed.`*

The arbitrator took the view that it was evident that, at all material times, the parties contemplated the issuance of bonds in the nature of performance bonds. It could never have been their intention that the appellants` liability would arise only if the respondents chose to recover the progress payments made to the shipyard, and there was no reason why the respondents would have wanted to limit their right to seek payment under the bonds to such an event. The respondents wanted an immediate source of funds in the event that the shipyard

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was unable to perform its contractual obligations. As such, they required a third party to issue performance bonds which would enable them to obtain payment irrespective of the position between them and the shipyard. The appellants were aware of this and the bonds were issued in response to this purpose even though they were couched as repayment guarantees. The appellants may have rejected the wording of the bonds proposed by the respondents but they did not object to the fundamental nature of the bonds required to be issued, ie bonds designed to provide the respondents with a ready source of funds on the termination or rescission of the shipbuilding agreement, regardless of the position between the respondents and the shipyard. The recital to the bonds attested to this as it made it clear that the bonds would be payable on the respondents` exercise of any of their rights of termination or rescission under the shipbuilding agreement. In the arbitrator`s view, it was inconsistent with the avowed object of the bonds for the applicants to contend that they were only repayment guarantees.

35.As for the appellants` argument that meaning must be accorded to the word `repayment` in the bonds, the arbitrator`s answer at para 54 of his revised award was that

> *[t]he plain purpose of the bonds was to provide the [respondents] with a ready source of funds on the termination or rescission of the agreement. The quantum of funds was determined by reference to the progress payments made by the [respondents]. To that extent, the bonds constituted a `repayment` of sums expended by the [respondents]. ... it is not possible to give the word `repayment` the interpretation proposed by the [appellants]. The factual matrix resulting in the issuance of the bonds, the commercial purpose of the bonds and the intentions of the parties at the time the bonds were issued are against the [appellants`] interpretation.*

36.In any event, even if the bonds were repayment guarantees, the appellants would still be liable to the respondents because they guaranteed the performance by the shipyard of its obligations to make payment of any sum or sums payable

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to the respondents on the termination or rescission of the shipbuilding agreement, up to the maximum amounts stated in the bonds. The learned judge found that the arbitrator had provided adequate reasons for his conclusions on the scope and effect of the bonds, and that on either of the tests formulated by Lord Diplock in ***The Nema*** for `one-off` clauses and standard clauses, there was no reason why leave should be granted for an appeal against the decision of the arbitrator.

37.The central issue, as both the arbitrator and the learned judge rightly recognised, was the scope and effect of the bonds issued by the appellants in favour of the respondents. Whether or not the appellants were liable to make payment to the respondents on their claim under the bonds depended on the characterisation of the bonds: were they on demand performance bonds or repayment (or refund) guarantees? If the bonds were performance bonds payable on demand, the appellants` obligation to pay was not dependent on the sums of money claimed being damages or repayment of progress payments, as the bonds stood independently of the shipbuilding agreement. The obligation of the appellants would have been simply to pay the specified sums of money on the termination or rescission of the agreement. If, on the other hand, the bonds were repayment or refund guarantees, the appellants were not obliged to pay out on the respondents` claim for damages; that was not a claim which the appellants had contracted to meet and the respondents` claim would have been misconceived.

38.A repayment or refund guarantee has been described in Curtis, ***The Law of Shipbuilding Contracts*** (2nd Ed, 1996) at p 229 as:

> *an undertaking of a bank or other surety acceptable to the buyer that, if the builder should for any reason fail to refund the advance instalments of the contract price upon the buyer`s*

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> *rescission, the bank or surety will make the payment on the builder`s behalf.*

It is a species of guarantee which, in the true sense, is a contract whereby the surety (or guarantor) promises the creditor to be responsible, in addition to the principal, for the due performance by the principal of his existing or future obligations to the creditor, if the principal fails to perform those obligations: see G Andrews and R Millett, ***Law of Guarantees*** (2nd Ed, 1995) at p 3 para 1.4. Although the expressions `creditor` and `debtor` are often used to denote the underlying obligee and obligor, the liability which is guaranteed may consist of performance of some obligation other than the payment of a debt, and does not have to be a contractual liability, though it usually is.

39.The liability of the guarantor has been defined as a liability not only to perform himself, if the principal fails to do so, but to procure that the principal performs his obligations: **Moschi v Lep Air Services Ltd** [1973] AC 331 especially per Lord Diplock at pp 348-349. However, given that in practice the guarantor is rarely in a position to compel the principal to perform his obligations, it is probably more accurate to describe the guarantor`s promise as a promise that the obligation will be performed, in the sense that the guarantor will be personally liable for the `debt, default or miscarriage` (see s 4 of the Statute of Frauds 1677) of the principal. Therefore, even if the guarantor has not in terms guaranteed the payment of damages to the creditor, he will normally be liable in damages to the same extent as the principal for breach of the latter`s obligations: ***Moschi v Lep Air Services*** .

40.The essential distinguishing feature of a contract of guarantee is that the liability of the guarantor is always ancillary, or secondary, to that of the principal, who remains primarily liable to the creditor. There is no liability on the guarantor unless and until the principal has failed to perform his obligations.

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In **Lakeman v Mountstephen** [1874] LR 7 HL 17 at p 24, Lord Selborne put the matter succinctly thus:

> *There can be no suretyship unless there be a principal debtor, who of course may be constituted in the course of the transaction by matters ex post facto and need not be so at the time, but until there is a principal debtor there can be no suretyship. Nor can a man guarantee anybody else`s debt unless there is a debt of some other person to be guaranteed.*

It follows from the secondary nature of the obligation that the guarantor is generally only liable to the same extent that the principal is liable to the creditor, and that there is usually no liability on the part of the guarantor if the underlying obligation is void or unenforceable, or if that obligation ceases to exist. In other words, a guarantee will only extend to a liability precisely answering the description contained in the guarantee: this is often known as the principle of co-extensiveness. The corollary of this is that a material variation in the principal contract will discharge the guarantor - a material variation meaning for this purpose any variation which cannot be seen to be insubstantial, or one that cannot be otherwise than beneficial to the guarantor: the rule in **Holme v Brunskill** [1878] 3 QBD 495 at p 505. An immaterial variation is that in respect of a matter which is not reasonably capable of being considered by the guarantor, either from its bearing on the risk or in any other way, as of any importance whatsoever: see G Moss and D Marks (eds), ***Rowlatt on Principal and Surety*** (5th Ed, 1999) at p 79 para 4-55; if this is not self-evident, no enquiry as to the materiality of the variation will be entered into: **Re Darwen and Pearce** [1927] 1 Ch 176. Thus, most guarantees will make provision for variation of the terms of the principal contract without effecting a discharge of the guarantor. As will be seen later, the absence of such a provision in the bonds issued by the appellants in favour of the respondents in this case was not without significance.

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41.A performance bond, in contrast, is a somewhat different creature. As described in McGuinness, **The Law of Guarantee** [1986] at pp 13-14 para 12.8:

> *The performance bond provides assurance that a party will perform a contract as required by its terms. The basic purpose of a performance bond is to indemnify the obligee against the costs of completion in the event that the principal defaults in the performance of the contract.*

The essential character of a performance bond is more akin to a promissory note than to a true guarantee: see **Edward Owen Engineering v Barclays Bank International Ltd** [1978] QB 159 per Lord Denning MR at p 170 and Geoffrey Lane LJ at p 175. Also commonly called a performance guarantee, it is a binding contractual undertaking given by a person, usually a bank, to pay a specified amount of money to a named beneficiary on the occurrence of a certain event, which is usually the non-fulfilment of a contractual obligation undertaken by the principal to the beneficiary, rather than a promise to see to it that the contract will be performed: Andrews and Millett, ***Law of Guarantees*** at p 11 para 1.16 and p 444 para 16.1. Similarly, the obligations of the bank or other financial institution which issues the performance bond are much more analogous to obligations arising under a letter of credit than to those arising under a guarantee: see **United City Merchants (Investments) Ltd v Royal Bank of Canada** [1983] AC 168 per Lord Diplock at p 184 and **Howe Richardson Scale Co Ltd v Polimex-Cekop** [1978] 1 Lloyd`s Rep 161 per Roskill LJ at p 165. Thus, the various equitable defences which are available to a surety are not available to the issuer of a performance bond, and as a general rule he will not be concerned with the rights or wrongs of any underlying dispute between the beneficiary and the principal (or account party), or with the factual accuracy of otherwise of any statement made to him by the beneficiary or the genuineness of any document presented to him in order to obtain payment. His obligation to pay in accordance with the terms of the agreement is entirely independent of the

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underlying contract between the account party and the beneficiary: see **Esal (Commodies) Ltd v Oriental Credit Ltd** [1985] 2 Lloyd`s Rep 546 and **United Trading Corp v Allied Arab Bank Ltd** [1985] 2 Lloyd`s Rep 554. Indeed, performance bonds are not guarantees in the true sense, but have been described as a particularly stringent form of contract of indemnity by which a primary liability, wholly independent of any liability which may arise as between the principal and the creditor, falls upon the surety. The fact that the obligation to indemnify is primary and independent has the effect that the principle of co-extensiveness does not apply to contracts of indemnity. Thus an indemnity not only effectively shifts the burden of the principal`s insolvency onto the surety, but also potentially safeguards the creditor against the possibility that his underlying transaction with the principal is void or otherwise unenforceable: see **Yeoman Credit v Latter** [1961] 2 All ER 294[1961] 1 WLR 828 and **Goulston Discount Co Ltd v Clark** [1967] 2 QB 493. Further, the discharge of the principal or any variation or compromise of the creditor`s claims against him will not necessarily affect the liability of the surety under a contract of indemnity.

42.It is well established that, if the beneficiary seeks payment in accordance with the terms of the bond, the bank must pay, regardless of how unfair that might be to the account party. This is exemplified by the leading case of **Edward Owen Engineering Ltd v Barclays Bank International Ltd** [1978] QB 159, in which the performance bond was payable `on first of our demand without any conditions or proof`. The bond was called on by a buyer who had failed to provide a letter of credit, after the suppliers had accepted this as a repudiation of the contract. The Court of Appeal held that the bank had to honour the bond in accordance with its terms. Similarly, if the performance bond is expressed in terms that the bank will pay if the account party fails to do

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something, such as deliver goods to the beneficiary, the bank is obliged to pay regardless of any justification which might exist for the non-delivery, as in **Howe Richardson Scale Co Ltd v Polimex-Cekop** [1978] 1 Lloyd`s Rep 161. As with letters of credit, once a demand has been made (or documents produced) in accordance with the requirements of the bond, the sole basis on which a bank may justify a refusal to pay (and, at least in theory, the account party may obtain an order restraining the bank from payment), is where the bank has notice of fraud at the time when the beneficiary calls on the bond, or where payment by the bank would in itself be fraudulent. So, as Kerr J put it in **RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd** [1978] QB 146 at p 155:

> *It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are treated as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts.*

43.The term `performance bond` or `performance guarantee` is sometimes used to denote a genuine contract of guarantee or indemnity. To make matters even more confusing, a guarantee or indemnity may be given in circumstances in which one might expect to find a true performance bond. The nature of the particular contract, whether it happens to be a guarantee or an indemnity, or a performance bond, and whether the normal incidents of a contract of that class have been modified, is ultimately a question of its construction in each case, and is often very difficult to resolve: see, eg **Trade Indemnity Co v Workington Harbour and Dock Board** [1937] AC 1; **General Surety & Guarantee Co v Francis Parker Ltd** [1977] 6 Build LR 16; **Wardens and Commonalty of the Mystery of Mercers of the City of London v New Hampshire Insurance Co** [1992] 2 Lloyd`s Rep 365; **Trafalgar House Construction (Regions) Ltd v**

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General Surety & Guarantee Co Ltd [1994] 10 Const LJ 240 (CA); [1996] AC 199. So, for instance, a contract of suretyship preserving liability in circumstances in which a guarantor would otherwise be discharged (such as the granting of time to the principal or a material variation of the underlying contract without the surety`s consent) will usually be construed as a guarantee, because such a provision would be unnecessary if the contract was an indemnity. The contract may also contain a provision to the effect that the surety is to be liable in circumstances in which the principal debtor has ceased to be liable, eg on disclaimer of a lease, or the release of the principal debtor by the creditor. Again, for the same reason, this tends to indicate that the contract is a guarantee. On the other hand, if the contract provides that the surety is to be liable in circumstances in which the principal debtor was never liable (eg because the principal debtor lacked the capacity to contract), it may indicate that the contract is an indemnity.

44.A reference to the latter two cases will suffice to illustrate the point. In **Trafalgar House Constructions (Regions) Ltd v General Surety & Guarantee Co Ltd** [1994] 10 Const LJ 240, the plaintiffs were the main contractors on a project for the construction of a leisure complex for Maidstone Borough Council. They subcontracted certain groundworks to subcontractors named Chambers. The plaintiffs took a bond from Chambers and the defendants for an amount equal to 10% of the subcontract value. The bond provided that Chambers and the defendants (who were described as `the surety`)

> *are held and firmly bound unto [the contractor] in the sum of 101,285 for the payment of which sum the subcontractor and the surety bind themselves, their successors and assigns jointly and severally by these presents ...*
>
> *... if the subcontractor shall duly perform and observe all the terms provisions conditions and stipulations of the said subcontract ... or if on default by the said main contractor thereby up to the amount of the above-written bond then this obligation*

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> *shall be null and void but otherwise shall be and remain in full force and effect but no alteration in terms of the said subcontract made by agreement between the main contractor and the subcontractor or in the extent or nature of the subcontract works to be constructed and completed thereunder and no allowance of time by the main contractor under the said subcontract nor any forbearance or forgiveness in or in respect of any matter or thing concerning the said subcontract on the part of the main contractor shall in any way release the surety from any liability under the above-written Bond.*

Chambers went into receivership before the groundworks were completed, and the plaintiffs completed those works. A claim was made by the plaintiffs for summary judgment against the defendants for the full amount of the bond. The main question to be determined was whether the bond was a contract of guarantee, entitling the defendant to raise claims of set-off which could have been relied on by Chambers in defence to an action for damages for breach of contract, or whether it was a performance bond. The Court of Appeal (Sir Thomas Bingham MR, Saville and Beldam LJJ) upheld the decision of Mr Recorder Knight QC granting the plaintiffs summary judgment, on the grounds that the bond was not a contract of suretyship, but gave rise to an entirely independent obligation to pay on demand the damages sustained by the plaintiffs by reason of the failure of the subcontractors to carry out the subcontract. Although the bond was silent as to a demand, the court held that a demand had to be implied in order to give effect to the correct interpretation of the contract, and any such demand had to be made in good faith. Saville LJ said that the obligation under the bond was to pay, up to the amount of the bond, that which the main contractors asserted in good faith to be the amount of the damages. The decision was largely influenced by what the Court of Appeal perceived to be the underlying commercial nature of the bond, namely, to provide a security which was capable of prompt realisation in the event that extra costs were incurred by the main contractor as a result of the subcontractor`s breach. Saville LJ said that

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> *it is obvious that any significant default by the subcontractors is likely to put the main contractor in or at risk of breach of the main contract, or at least risk interruption of the cashflow under that contract, if remedial action is not taken immediately. It goes without saying that remedial action is likely to cost money. What the main contractor wants, therefore, is some assurance of immediate funds in this event.*

The language of the bond was consistent with an immediate undertaking to pay, which would only be released on the occurrence of the specific events referred to in the second part of the clause, namely performance by the subcontractor of his obligations or payment by him of the damages.

45.The construction of the bond by the Court of Appeal as giving rise to an on demand autonomous obligation proved to be extremely unpopular, particularly because earlier courts had always treated bonds of this type as guarantees and, as a result, this is how they were regarded in the trade: see, eg **Calvert v London Dock Co** [1838] 2 Keen 638; ***Clydebank and District Water Trustees v Fidelity and Deposit Co of Maryland*** 1915 SC 362 at p 372; **Trade Indemnity Co Ltd v Workington Harbour and Dock Board** [1937] AC 1 at p 17; **City of Glasgow District Council v Excess Insurance Co Ltd** [1986] SLT 585; **Kono Insurance v Tins Industrial Coal** [1987] 42 Build LR 110[1987] HKC 71. More recently, but before the ***Trafalgar House*** case, a differently constituted Court of Appeal (Parker, Scott and Nolan LJJ) in the case of **Wardens and Commonalty of the Mystery of Mercers of the City of London v New Hampshire Insurance Co** [1992] 2 Lloyd`s Rep 365, was faced with the task of construing an `Advance Payment Bond` which was in equally archaic language, and which also included a joint and several liability. They held that it was not a performance bond but a guarantee.

46.The bond in question related to an advance payment of a sum in excess of 4m made by Mercers to the contractors, RTL, under a building contract. The

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building contract provided for Mercers to give possession of the site to RTL in mid-May 1989, but allowed that period to be deferred until about the end of June 1989. In fact possession was not given until 24 July. RTL went into receivership before completing the contract, which automatically terminated the contract. About 75% of the advance payment remained unapplied and it was no longer capable of being applied for the purposes of the contract. As in the ***Trafalgar House*** case, the bond was entered into by RTL and the defendant insurers as joint obligors. It stated that it was `given to save the obligee (Mercers) harmless against any and all losses which may result from the failure of the Principal (RTL) to faithfully employ for the purpose of the said contract and liquidate in accordance with the terms and conditions of the said contract all or any portion of the advance payments so made`. As in the ***Trafalgar House*** case, it contained a condition that the obligation under the bond would be void on the occurrence of a specific contingency: in this case `if the aforementioned advance ... is liquidated in accordance with the terms and conditions of the said contract and is faithfully employed for the purpose of the said contract`. The Court of Appeal deprecated the language (Parker LJ described the bond as `a most unsatisfactory document` and Scott LJ said that it `resists tidy categorisation`) but had no difficulty in construing it as a genuine contract of suretyship. They held that the plain purpose of the bond was to ensure that, in the event and to the extent that RTL did not earn under the contract the full amount of the advance payment, RTL and the defendants would be jointly and severally primarily liable to Mercers for the balance. This was not a guarantee of performance, but a guarantee of payment. Much the same reasoning could have been applied to the bond in the ***Trafalgar House*** case, but, despite the obvious similarities between the two bonds, there was no discussion of the ***Mercers*** case by the Court of Appeal in ***Trafalgar House*** .

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47.When the ***Trafalgar House*** case reached the House of Lords, Lord Jauncey, who gave the leading speech, was clearly strongly influenced by the fact that bonds of a similar form had existed for more than 150 years and had been treated by the parties thereto and by the courts as guarantees. There were indications in the bond itself that it was to be regarded as a guarantee (eg the definition of the giver of the bond as `the surety` and the provision that the granting of time or variation of the underlying contract would not discharge him). He said that the second part of the bond, which provided the circumstances in which the bond was to be null and void, in no way detracted from the nature of the first part, which was a plain and simple guarantee of payment. It was not, as the Court of Appeal had construed it, a binding and immediate obligation to pay with provision for release on the happening of one or other of two specified events. In his own words, at p 207 of the report:

> *In this case the Court of Appeal by determining that the appellants` liability under the bond arose on the failure of Chambers to complete the contract followed by a demand in good faith for the amount of the damages which they claim to have suffered were effectively treating it as a type of on demand bond. ...*
>
> *... I have no doubt that the Court of Appeal were in error in concluding that the bond was not a guarantee but was akin to an on demand bond. No distinction can, in my view, properly be drawn between the effect of this bond minus the second part of the condition and the bond considered by Lord Atkin in the* ***Workington*** *case [1937] AC 1, 17 and other bonds using this or similar wording which have for many years been generally treated as guarantees:* ***Hudson`s Building and Engineering Contracts*** *(11th Ed, 1995), Vol 2, pp 1499-1500, para 17-007. ...*

48.Before us, the appellant`s arguments, as set out earlier, were that the bonds issued by them were default-based guarantees and not performance bonds payable on demand. Specifically, they guaranteed repayment by the shipyard of the progress payments made by the respondents in the event of a breach of

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contract by the shipyard which would give rise to a right to recover the instalments paid. A claim for payment made by the respondents thus had to be within the ambit of the bonds, with reference to the terms of the underlying contract - the shipbuilding agreement. Under cl 14 of the shipbuilding agreement, the respondents had two options on the termination or rescission of the agreement: the first was to take possession of the vessel and claim damages, and the second was to seek recovery of the progress payments made to the shipyard, together with interest. As the respondents had chosen the first option, the shipyard was not liable to repay them under the terms of the agreement. As such, it followed that the appellants also came under no liability to the respondents under the bonds, as they did not cover a claim for damages but only the obligation of the shipyard to repay, when it arose. The word `repayment` could only mean repayment of the instalments paid under the shipbuilding agreement and not damages, since there could not be repayment by the shipyard of damages which had not been paid by the respondents to the shipyard.

49.The short answer to this was simply that the bonds issued by the appellants were on demand performance bonds and not repayment or refund guarantees, as they contended. As such, the bonds were independent of the shipbuilding agreement, and were effective to secure payment by the appellants to the respondents regardless of the position between the latter and the shipyard. The bonds did not incorporate the terms of the agreement, nor was liability under them in any way contingent upon the position the respondents chose to adopt in their claim against the shipyard. Although cl 1 of the bonds did not say when the appellants` obligation to pay would be triggered, the recitals provided that the specified amounts were payable on the respondents` exercise of any of their rights of termination or rescission under the agreement. Thus, the appellants` obligation to pay was triggered by the respondents` demands, and all the

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respondents had to do was to exercise their rights of termination or rescission. The respondents duly did that and the appellants were neither entitled nor in a position to ascertain whether the demands had been properly made. Their obligation was simply to make payment on the termination or rescission of the agreement, and proof of default was unnecessary. It followed that the fact that the respondents went on to opt for possession of the vessel and damages, instead of repayment of the progress payments made to the shipyard, was immaterial to the obligations undertaken by the appellants. This was the view taken by both the arbitrator and the learned judge for the reasons given by them, and in our opinion it was the correct view.

50.To begin with, the arbitrator stated that the matter was not so much one of the nomenclature used by the parties, which was inconclusive, but rather was one of construction in the light of the parties` intentions. For that purpose, he was entitled to consider the factual matrix surrounding the procurement and execution of the bonds: ***Moschi v Lep Air Services*** , including the correspondence passing between the relevant parties and the commercial object of the bonds. It was clear from both that what was contemplated at all times was the issuance of bonds in the nature of performance bonds, so that the respondents would have recourse to a ready source of funds in the event that the shipyard was unable to fulfil its contractual obligations. As such, what was required was for a third party to issue performance bonds which would enable the respondents to obtain payment irrespective of the position between them and the shipyard. For the appellants to now assert that the bonds were repayment or refund guarantees was inconsistent with the avowed object of the bonds and flouted business common sense. The difficulty posed by the use of the word `repayment` in cl 1 of the bonds was overcome by pegging the amount the appellants were liable to pay to the amount already paid by the respondents to

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the shipyard in the form of progress payments: `to that extent the bonds constituted a repayment of sums expended by the respondents`.

51.The arbitrator had clearly covered all angles. For example, when taking into account the interpretation which the parties themselves placed on the bonds at the time the respondents first sought to enforce them, the arbitrator observed that the respondents took the view that they were entitled to payment under the bonds as though they were on demand performance bonds, and wrote to the appellants for payment on 12 February 1996. The appellants` reaction, however, as though the respondents had a legitimate claim, was to write to the shipyard the following day demanding payment of $6,678,750, the total sum demanded by the respondents under the four bonds. Having said that, the arbitrator went on to comment at para 57 of his revised award that

> *it would be going too far to imply from this reaction on the part of the [appellants] that they regarded the bonds as performance bonds, rather than that they were taking precautions to reserve whatever rights they may have possessed against the shipyard. At worst, even if the [appellants] misapprehended their legal position at the time formal demands under the bonds were made, the attitude they then adopted is not an aid to the proper construction of the bonds, and the [appellants`] liability under them.*

52.We would add that the appellants` point that it is `unusual in international shipbuilding projects for the builder to provide a performance bond` and that the practice common to most international shipbuilding contract forms is to restrict the buyer to the `recovery of his advance instalments and interest should he choose to rescind the contract on the grounds of the builder`s default`, citing Curtis, ***The Law of Shipbuilding Contracts*** at p 229 was irrelevant, because, as we have said, whether the contract constituted in any particular case is to be categorised as a performance bond or a repayment (or refund) guarantee is really a question of construction on the facts and is not dependent on what the

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prevailing practice is. Further, and of especial pertinence in the present case, the bonds did not contain a provision preserving the liability of the appellants in the event of the granting of an extension of time to the principal (the shipyard) or a material variation of the shipbuilding agreement: this suggested that the bonds were on demand performance bonds and not default-based guarantees.

53.To sum up on the scope and effect of the bonds issued by the appellants, they were performance bonds payable on demand and not repayment or refund guarantees. Accordingly, the appellants were liable to pay on the respondents` demands made under the bonds which were triggered by the exercise of their rights of termination or rescission, notwithstanding that what was claimed was not repayment of the progress payments paid to the shipyard but possession of the vessel and damages. Neither a `strong prima facie case` was made out that the arbitrator had erred in his construction of the bonds, nor could it be said that he was `obviously wrong`. There was thus no reason why leave should be granted for an appeal against the decision of the arbitrator on this point.

54. ***Effect of variations to the shipbuilding agreement***

These were effected by the first and second addendums dated 16 February 1995 and 7 November 1995 respectively, as mentioned earlier. It was accepted that the appellants did not consent to, and were in fact unaware of the existence of, the variations until after the respondents had made demands for payment under the bonds.

55.The appellants took the view that these unauthorised variations discharged them from liability under the bonds. However, the arbitrator did not share their view. With regard to the first addendum which varied the requirement in cl 8(5) of the shipbuilding agreement for performance bonds in favour of the

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respondents for 15% of the agreed price for the construction of the vessel to 65% of the agreed price, the arbitrator found that it was executed to correct an obvious error in the shipbuilding agreement. In his view, the parties were aware that bonds were to be furnished for 65% of the agreed price and not 15%. As such, this variation did not discharge the appellants from liability under the bonds. As for the second addendum, the arbitrator pointed out that whether or not an extension of time or prepayment constituted a material variation depended on the particular obligations undertaken by the appellants. In the present case, the variation of the terms on delivery and payment in the shipbuilding agreement was immaterial to the appellants` obligations under the bonds because the appellants did not take these terms into account when deciding whether or not to undertake the risk. In fact, they executed the bonds without looking at the shipbuilding agreement. In view of this, the appellants were not discharged from liability under the bonds. The learned judge, after examining the reasons given by the arbitrator for his decision on this point, adopted them and refused leave to appeal.

56.It should be said at once that the appellants` position on the effect of the variations was misconceived. We have found that the bonds were not suretyship agreements imposing a secondary liability on the appellants, but were on demand performance bonds imposing a primary obligation on them to make payment to the respondents on the termination of the shipbuilding agreement. As a matter of principle and common sense, as the bonds were independent of the agreement, it followed that any variation in the latter did not discharge the appellants from liability under the bonds. In any event, even if the bonds were repayment or refund guarantees to which the rule in ***Holme v Brunskill*** (referred to earlier) applied, the variations could not by definition be material variations, as the terms which were varied were not taken into account by the

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appellants when deciding whether or not to undertake the risk. The arbitrator found as a fact that the appellants showed no interest in the shipbuilding agreement at all, and that their interest appeared to have been directed solely at arriving at a consensus with the respondents on the terms of the bonds, and thus to secure the business. That also appeared to have been the preoccupation of the brokers, Minet, and it was not until 13 February 1996 that the shipyard supplied Minet with a copy of the shipbuilding agreement. This was evident from the following exchange which took place between counsel for the respondents and Tan during cross-examination:

> Q: Did the brokers send you a copy of the shipbuilding agreement at or about that time (ie 13 February 1996)?
>
> A: No, that`s why we don`t have.
>
> Q: And you didn`t bother to ask for it?
>
> A: It could be that we overlook.

The appellants` apparent disregard of the contractual position between the respondents and the shipyard was confirmed from Tan`s replies in re-examination:

> Q: Now, CB3, Mr Tan, p 126. You earlier referred to this page, and this is actually a compliment slip from Siong Huat to Minet enclosing a copy of the shipbuilding contract, after the claim had already been made on AIG or AHA. I am puzzled by your statement that you did not see a copy of the shipbuilding agreement even at this stage. Did you not receive a copy of the shipbuilding agreement in February 1996?
>
> A: I did not receive any documents before the claims.
>
> Q: Before the claims; but at this time, on 13 February 1996 or thereabouts?
>
> A: This after the claims, so it could be that I didn`t receive anything, but anyone from my company whether they have

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> received or not, then I am not sure. As far as I am concerned, … I did not receive, as an underwriter.
>
> Q: You have earlier told us that you had not seen the shipbuilding agreement until after the claims had been made.
>
> A: Yes.
>
> Q: Were you aware of the fact that there was a provision in the shipbuilding agreement which provided for bonds up to 15% of the contract value only?
>
> A: I have been told that the bond is 50% required - five zero.
>
> Q: My question was, and I repeat this, were you aware of the fact that there was a provision in the shipbuilding agreement that the bonds were to be for 15% only? Were you aware of that?
>
> A: One five?
>
> Q: Yes.
>
> A: No

The arbitrator concluded that, in the face of the evidence that the appellants did not even bother to ascertain the terms of the shipbuilding agreement when the assumption of risk was under consideration, it was difficult to see how it could be argued that the addenda, even if they purported to effect variations to the agreement, could have released the respondents from liability under the bonds. In summary, there were ample grounds for the arbitrator`s decision and the learned judge had not erred in refusing leave to appeal on this point.

57. ***Validity of the demands***

Clause 2 of the bonds provided that they were to be valid until 13 February 1996 or the date the vessel was satisfactorily delivered by the shipyard to the respondents, whichever was the later. On 12 February 1996, the respondents made formal written demands for payment under each bond. Each of the letters of demand included the following paragraphs:

> *We refer to the subject bond issued by you in our favour.*

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> *Siong Huat Shipyard Pte Ltd (`the builder`) failed to effect delivery of the vessel to us on 12 January 1996. We have, accordingly, exercised our rights of termination of the shipbuilding agreement.*
>
> *We hereby demand immediate payment of the sum of $1,541,250 ... .*

58.The appellants attacked the validity of the demands on two grounds. First, they contended that the respondents` demands were in respect of amounts paid by them to the shipyard, which sums would have been repayable under the bonds, but only if the respondents had exercised the second option available to them under cl 14 of the shipbuilding agreement. Second, even if the respondents` demands were in respect of damages and the bonds answered a claim for damages, no claim for damages was made before the deadline for making a claim. The arbitrator disagreed. He said that the bonds did not expressly make provision for demands, let alone the terms of the demands, and held that the demands were for the amounts of the bonds and not for damages. He added at para 79 of his revised award:

> *The primary claim in the present arbitration is for repayment of the bonds. The claim for damages is in the alternative. In my judgment, the [respondents`] demands were in appropriate terms. They constituted valid and timeous claims for repayment under the bonds, and were so treated by [the appellants] when they were received, [their] attitude then having been, in effect, that their liability depended upon the shipyard being held liable to the [respondents] ... .*

The arbitrator therefore concluded that the respondents` demands had been validly made within the period stipulated by cl 2 of the bonds. The learned judge concurred in the arbitrator`s decision on this point and saw no reason to grant leave to appeal.

59.Again, the appellants` first argument was misconceived. It was in reality a reformulation of the argument, dealt with earlier, that the bonds being

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repayment or refund guarantees, the claim in order to be valid had to fall within the ambit of the relevant section in the shipbuilding agreement, namely cl 14. As we have decided, however, the bonds were in fact performance bonds payable on demand and stood independently of the shipbuilding agreement; it was thus immaterial whether the respondents` demands were in respect of damages or repayment of progress payments. All the respondents needed to do was to exercise their rights of termination or rescission, and make a demand for the amounts specified in the bonds respectively. It was not to the point to say that the bonds did not provide for the making of a demand, as that could naturally be implied to give effect to the nature or the bonds as performance bonds. It followed from this that the appellants` second argument was rendered equally untenable for the same reasons applicable to the first argument. In conclusion, there was no room for the view that the arbitrator`s decision was `obviously wrong` or that a `strong prima facie case` had been made out that it was so, and leave to appeal on this point would be refused.

60. ***Misrepresentation***

The appellants alleged that the respondents through Minet had misrepresented on 24 November 1994 that the shipyard was obliged to provide bonds for a total of 65% of the contract price, which in fact was not the case as the shipbuilding agreement only required bonds for 15% of the contract price to be issued. The alleged misrepresentation was contained in a facsimile from Kwan of Minet to Tan of AIU which stated that

> *Siong Huat is obliged to furnish a total guarantee for 65% of which the first 15% will be by Bank Guarantee, the balance 50% as requested here.*

It was not in dispute that, as the appellants were not furnished with a copy of the shipbuilding agreement until after the respondents made a claim under the

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bonds, the appellants never knew that the shipbuilding agreement only required the issuance of bonds for up to 15% of the contract price. It was also the case that, when the appellants issued bonds for 50% of the contract price on 10 February 1995 (which bonds made reference to the shipbuilding agreement), the shipbuilding agreement itself at that time required no more than the issuance of bonds for 15% of the contract price. In the circumstances, there was an operative misrepresentation by Minet and/or the respondents which entitled the appellants to avoid the contracts contained in or evidenced by the bonds.

61.The arbitrator noted that Tan was aware in early November 1994 that the shipyard was looking to the appellants to furnish performance bonds of up to 50% of the contract price. Then, on 24 November 1994, Kwan wrote to Tan informing him that the shipyard was `obliged to furnish a total guarantee for 65% of which the first 15% will be by Bank Guarantee, the balance 50% as requested here`. At some point prior to 24 November 1994, Kwan had met with Tan and his superior Kenneth Liang (`Liang`), following which Tan sent a facsimile to Liang on 24 November referring to the fact that the shipyard was obliged to furnish a total guarantee of 65% of the contract price, of which 15% would be by way of bank guarantee and the balance 50% by way of bond to be issued by the appellants. The arbitrator found that the appellants were advised of the true position by Minet, on the basis of which they agreed to assume the risk, and that it was not correct to say that they acted on a misrepresentation that operated on their minds. It was a fact that the appellants were not aware of the first addendum, but all that the addendum did was to formalise matters of which the appellants were already aware. That this was so was apparent from the evidence of Tan:

Arbitrator:	But Mr Ratnam is suggesting to you that even though you did not know about this addendum,

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	as of mid-February you already knew all that there was to know, and even if you knew about the addendum, it would not have added anything to your knowledge. Do you understand?
A:	Yes, I agree with that.
Q:	Is that correct?
A:	Yes.

62.The arbitrator found that the evidence adduced during the arbitration established the following: (a) that at the time of the issuance of the bonds, the appellants were always aware that the respondents required bonds equivalent to 65% of the contract price; (b) that the first addendum to the shipbuilding agreement was only a formality, and the fact that the appellants were unaware of its existence was therefore irrelevant; and (c) that in any event, the appellants were not concerned about the terms of the agreement, as they were prepared to issue the bonds on payment of the premia. We only found it necessary to add that the arbitrator`s finding in this regard was a finding of fact: first, on the appellants` knowledge of the relevant requirement; and second, on the irrelevance to them of the terms of the agreement. As such, we were mindful that we should not be quick to overturn it and substitute our own finding therefor. At any rate, the arbitrator`s finding could not be said to be unsupported by the evidence, or obviously wrong; nor could a strong prima facie case be made out that it was so. Leave to appeal on this point would therefore be refused.

63. ***Illegality***

It was common ground that the shipbuilding agreement was concluded in December 1994 but was backdated to 16 March 1993. The reason for this was to avoid compliance with reg 13F of the Prevention of Pollution of the Sea (Oil) Regulations (Oil Regulations 1991), which was in the following terms:

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> *Prevention of oil pollution in the event of collision or stranding*
>
> (1) This Regulation shall apply to oil tankers of 600 tons deadweight and above:
>
> (a) for which the building contract is placed on or after 6th July 1993; or
>
> (b) in the absence of a building contract, the keels of which are laid or which are at a similar stage of construction on or after 6th January 1994; or
>
> (c) the delivery of which is on or after 6th July 1996; or
>
> (d) …

There was no doubt that reg 13F applied to the vessel and that the vessel did not comply with the regulation. The appellants asserted that the agreement was backdated to deceive the Registrar of Ships (`the Registrar`) into registering the vessel as a Singapore ship, which he would not have done but for the backdating, having regard to the provisions of reg 13F. The appellants argued that this deception tainted the shipbuilding agreement with illegality and thus rendered it and the bonds issued by them unenforceable.

64.The arbitrator adopted the findings and view of the arbitrators in the first arbitration, which were as follows. In the first place, the arbitrators noted that the alleged deception was not the shipbuilding agreement itself but rather the backdating of it to enable the vessel to be registered in Singapore, which it otherwise would not have been entitled to. It was not in dispute that there was nothing illegal in the shipbuilding agreement itself. It was for the construction of a vessel which was to be chartered to Shell International Eastern Trading Company for a period of eight years. Under the charterparty, there was no requirement for the vessel to be Singapore-registered. The shipbuilding agreement was thus entered into for an entirely legitimate and proper purpose, and it was the backdating which constituted the alleged illegality.

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65.The crux of the appellants` submissions before the arbitrators in the first arbitration was that although the shipbuilding agreement was ex facie legal, it was unenforceable because it was entered into for an unlawful purpose or to achieve an unlawful end. The appellants relied on two decisions in support of their position: **Suntoso Jacob v Kong Miao Ming** [1986] SLR 59 [1986] 2 MLJ 170 and **Alexander v Rayson** [1936] 1 KB 169. In the former case, LP Thean J (as he then was), delivering the judgment of the Court of Appeal, said at p 174:

> *Where a transaction which on the face of it is lawful is entered into for an unlawful purpose or to achieve an unlawful end, the transaction is tainted with illegality and is unenforceable.*

In that case, the appellant, an Indonesian, held 95% of the paid-up capital of a Singapore company while the balance was held by the respondent, a Singaporean. The appellant decided to purchase a tugboat for the purpose of chartering it to Pertamina. In order to obtain financing, the tugboat had to be registered as a Singapore vessel. However, under the then administrative guidelines laid down by the Registrar, such a vessel would not be accepted for registration if it was foreign-owned, and a vessel was considered to be foreign-owned if the majority of shares in the company which owned it were owned by foreigners. As such, in order to facilitate the registration of the tugboat as a Singapore vessel, it was agreed that the appellant would transfer sufficient shares to the respondent so that he could become the majority shareholder and the tugboat could then be registered as a Singapore vessel. It was also agreed that the shares would be held by the respondent on trust for the appellant. Subsequently, the appellant wanted to transfer the shares to another nominee but the respondent refused to do so. The appellant thereupon issued proceedings against the respondent claiming that the shares were held on trust for him. The court refused to give effect to and enforce the trust in his favour, holding that

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he had `soiled his hands` by practising `a deception on the public administration` and could hardly expect the court to lend its assistance to him. It is important to note that, in ***Suntoso Jacob*** , the appellant founded his claim for the shares on an express trust. The appellants also relied on ***Alexander v Rayson*** , a decision of the English Court of Appeal which was cited with approval in ***Suntoso Jacob*** . In that case, Romer LJ, delivering the judgment of the court, said at p 182:

> *It is settled law that an agreement to do an act that is illegal or immoral or contrary to public policy, or to do any act for a consideration that is illegal, immoral or contrary to public policy, is unlawful and therefore void. But it often happens that an agreement which in itself is not unlawful is made with the intention of one or both parties to make use of the subject matter for an unlawful purpose, that is to say a purpose that is illegal, immoral or contrary to public policy. The most common instance of this is an agreement for the sale or letting of an object, where the agreement is unobjectionable on the face of it, but where the intention of both or one of the parties is that the object shall be used by the purchaser or hirer for an unlawful purpose. In such a case any party to the agreement who had the unlawful intention is precluded from suing on it.* ***Ex turpi causa non oritur actio****. The action does not lie because the court will not lend its help to such a plaintiff. Many instances of this can be found in the books.*

The Privy Council decision of **Palaniappa Chettiar v Arunasalam Chettiar** [1962] MLJ 143 was also cited in ***Suntoso Jacob*** . There a father transferred to his son without consideration 40 acres of a rubber plantation with a view to avoiding the Rubber Regulations then in force in Malaysia and thereafter sought to recover from his son the land he had transferred. It was found by the trial judge that the transfer was made to deceive the public administration. The Privy Council held that the father in order to succeed in his claim had not only to prove that the property was transferred to his son without any consideration but also to rebut the presumption of advancement in favour of his son in respect of the property and he could only succeed in discharging these burdens by disclosing

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that he had practised a deceit on the public administration, and as such the courts would not lend their aid to him to recover the property. Lord Denning, delivering the judgment of the Board, said at p 145:

> *In these circumstances it was essential for the father to put forward a convincing explanation why the transfer took the form it did, and the explanation that he gave disclosed that he made the transfer for a fraudulent purpose, namely, to deceive the public administration into thinking that he only held 99 acres of land and his son 40 acres, whereas in truth he himself meant to hold the whole 139 acres. Once this disclosure was made by the father, the courts were bound to take notice of it, even though the son had not pleaded it: see* ***Scott v Brown, Doering, McNab & Co*** *[1892] 2 QB 724.*

The arbitrators agreed with the proposition that if a contract is entered into for an unlawful purpose or to achieve an unlawful end, such a contract is unenforceable even though it may have been legal on the face of it.

66.The arbitrators also approved the statement of LP Thean J in ***Suntoso Jacob*** at [1986] SLR 59, 65C, [1986] 2 MLJ 170, 174 that `the intention of the parties and the purpose of the transaction are clearly relevant`, and considered those cases in which the courts upheld or enforced contracts or transactions notwithstanding the presence of elements of illegality. The first of these was **Sajan Singh v Sardara Ali** [1960] MLJ 52 , another Privy Council decision. In that case, there was an illegal arrangement between the plaintiff and the defendant whereby the plaintiff bought a lorry, registered it in the name of the defendant and obtained a haulage licence, also in the name of the defendant. The plaintiff paid for the expenses incurred and operated the lorry on his own account. This arrangement contravened the Road Transport Ordinance 1949. When the parties fell out, the defendant took possession of the lorry. The plaintiff sued the defendant for detinue and trespass, and succeeded. Lord Denning said at p 54:

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> *Their Lordships do not overlook the fact that the defendant remained registered as the owner of the lorry and that no permission was given for the sale: but this did not prevent the property in it passing to the plaintiff. The registration book is not in Malaya, any more than it is in England, a document of title. The title passed by the sale and delivery of the lorry to the plaintiff. The absence of registration would no doubt put the plaintiff in difficulty if he had to prove his title, but it would not invalidate it ... . In this case, on the facts pleaded and the findings of the trial judge, the plaintiff had a clear cause of action. He had actual possession of the lorry at the moment when the defendant seized it. Despite the illegality of the contract, the property had passed to him by the sale and delivery of the lorry ... . When he commenced this action, he had the right to immediate possession. Their Lordships think that in these circumstances he had a claim in detinue.*

It was noted that ***Sajan Singh*** was considered by the Court of Appeal in ***Suntoso Jacob*** and distinguished [at [1986] SLR 59, 64-65; [1986] 2 MLJ 170, 173] as one of those cases where

> *the plaintiffs were not relying on the illegal arrangement which they had entered into but on their rights of ownership of the properties concerned; such rights subsisted independently of the illegal arrangements.*

The arbitrators then referred to **Hilti Far East Pte Ltd v Tan Hup Guan** [1991] SLR 736 [1991] 3 MLJ 237 , where the plaintiffs had bought a car which was to be used by the defendant who was then their employee. The car was registered as a private vehicle in the name of the defendant and the defendant made a declaration of trust to the effect that he possessed the car in trust for the plaintiffs. When the defendant was dismissed from employment he refused to return the car. In defence to the plaintiffs` claim, he raised the issues of revenue evasion and deception of the public administration. Chan Sek Keong J (as he then was), referred to the decisions of ***Alexander v Rayson*** , ***Suntoso Jacob v Kong Miao Ming*** and ***Palaniappa Chettiar v Arunasalam Chettiar*** , but chose to follow ***Sajan Singh v Sardara Ali*** . He said at [1991] SLR 736, 741-742; [1991] 3 MLJ 237, 240:

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> *In the present case, although the plaintiffs had claimed a declaration of trust, it was not that trust which gave them a right to possession of the said car. The said trust, in terms, did not oblige the defendant to deliver possession of the said car to the plaintiffs. It only obliged him to effect the transfer of the said car, ie the registered ownership of the car. The defendant did not own the car and the registration in his name did not make him the owner at law.*

67.Like Chan Sek Keong J, the arbitrators chose to follow the ***Sajan Singh*** line of cases. They distinguished ***Suntoso Jacob*** , ***Alexander v Rayson*** and ***Palaniappa Chettiar*** on the following grounds. First, in all three cases, the purpose of the transaction was to deceive some authority. In ***Suntoso Jacob*** , the purpose of the trust was to deceive the Registrar; in ***Alexander v Rayson*** , the purpose of the separate agreement was to deceive the rating authority; and in ***Palaniappa Chettiar*** , the purpose of the transfer was to deceive the public administration. In the present case, however, the purpose of the shipbuilding agreement was not to deceive the Registrar. In fact, the purpose of the agreement was perfectly legitimate and proper. The building of the vessel involved no illegality. Even the backdating itself was not illegal and it was the purpose of the backdating which was tainted with illegality; in other words, the backdating only became illegal when it was used for an illegal purpose - to obtain registration of the vessel in Singapore, which it was not entitled to. Second, in all three cases, the plaintiffs had to reveal the illegal purpose in seeking the assistance of the courts to enforce the contract or transaction. In ***Suntoso Jacob*** , the plaintiff had to reveal the unlawful intention behind the share transfer in order to prove that the shares were held by the defendant on trust for him; in ***Alexander v Rayson*** , the plaintiff had to explain the reasons for having two agreements, one being a lease and the other being a services agreement: the agreement was suppressed in order to defraud the rating authority; and in ***Palaniappa Chettiar*** , the father had to disclose the fraudulent purpose behind the transfer of the land. In the present case, in contrast, the respondents did not

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need to rely on the backdating in order to succeed in their counterclaim against the shipyard. It was not necessary for them to found their claim against the shipyard as the owners of a Singapore-registered ship, as their cause of action was based on the delay in the delivery of the vessel in breach of a specific term of the shipbuilding agreement. If they had to go behind the backdating to prove the actual date of the shipbuilding agreement in order to succeed in their claim, or if their claim was dependent on the status of the vessel as a Singapore-registered ship, the cases cited by the shipyard (viz ***Suntoso Jacob*** , ***Alexander v Rayson*** and ***Palaniappa Chettiar***) might be relevant and applicable since the respondents would be basing their claim on a state of affairs which was obtained through a deception on the registrar. The arbitrators would then have agreed that they were precluded from doing so. That, however, was not the case here. The learned judge agreed with the decision of the arbitrator (who, it will be recalled, concurred with the arbitrators) and held that there were insufficient grounds for the granting of leave to appeal on this point.

68.There was nothing to suggest that this decision should be interfered with. The arbitrators had correctly distinguished ***Suntoso Jacob*** , ***Alexander v Rayson*** and ***Palaniappa Chettiar*** on the facts as being inapplicable to the present case, a view for which there was ample justification. In addition, the ***Sajan Singh*** line of cases was preferred. In those cases it was held that the cause of action was unaffected by the illegality in question as it could be established independently of the illegality. This was found to be particularly germane in the first arbitration, as the respondents did not need to rely on the backdating in order to found their claim against the shipyard. We would add, a fortiori in the present proceedings between the appellants and the respondents, as the basis of the cause of action was the bonds issued by the appellants in favour of the respondents and not the shipbuilding agreement. Indeed, as it has

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been found that the bonds were on demand performance bonds independent of the underlying agreement, there was no reason why the illegality in the form of the backdating had to have any effect on the respondents` claim. In the premises, leave to appeal would be refused.

69. ***Uberrimae fidei and non-disclosure***

The appellants contended that the respondents failed to disclose (a) that the shipbuilding agreement had been backdated to avoid compliance with reg 13F of the Prevention of Pollution of the Sea (Oil) Regulations (Oil Regulations 1991); and (b) that the agreement had been varied before the issuance of the bonds, which variation was formalised in the first addendum dated 16 February 1995. The respondents were required to disclose these facts as the bonds were in the nature of insurance contracts to which the principle of utmost good faith, or uberrimae fidei, applied, and the effect of such non-disclosure was to entitle the appellants to avoid liability under the bonds.

70.The arbitrator, who made it clear that he did not consider the bonds to be in the nature of insurance contracts, took the view that the principle of uberrimae fidei which is applicable to contracts of insurance, did not apply to performance bonds or guarantees: **Workington Harbour v Trade Indemnity Co Ltd** [1934] 49 Lloyd LR 430. He added that, even if there was a duty of disclosure in the present case, the question of a breach did not arise because it was not established that the appellants had been induced by the alleged non-disclosure to enter into the contracts. The appellants contended that the requisite inducement was present, pointing to the evidence-in-chief of Tan, where he said:

> *I did not know nor was it ever disclosed to the [appellants] that the building contract had been backdated to 16 March 1993 for*

> *the purpose of deceiving the Singapore authorities into registering the vessel as a Singapore ship as has now been decided in an arbitration between the [respondents] and [the shipyard]. Had I known that the contract had been backdated for the purpose of deceiving the Singapore authorities I would not have recommended the bonds favourably to AIU Taipei as the [appellants] would not have wanted to be involved in issuing bonds relating to a contract which was to be used for deceiving the authorities.*

This evidence was not challenged in cross-examination. However, the arbitrator found that Tan knew, or ought to have known, that the shipbuilding agreement had been backdated. He was aware that its terms had been agreed in December 1994, as a draft of the proposed bond was sent to him by Minet in early February 1995. That indicated the date of the agreement as 16 March 1993. Tan initialled on the draft, but made no comment about the date. Then, on 10 February 1995, Tan sent Minet drafts of three bonds the appellants were then prepared to issue, and all the drafts indicated the date of the agreement as 16 March 1993. The arbitrator therefore concluded that Tan, and through him the appellants, were clearly disinterested in the backdating of the agreement for whatever reason this was done, and that the appellants were not induced by the non-disclosure of the backdating into issuing the bonds.

71.As for the terms of the shipbuilding agreement, the appellants were equally disinterested in them. They did not see a copy of the agreement until after the respondents had made demands on the bonds, and were prepared to and did issue the bonds without having regard to the terms of the agreement. The arbitrator found that the appellants were only interested in receiving the premia for the bonds and that, in any event, the first addendum did not constitute a material variation to the agreement. In the circumstances, he held that the appellants were not induced to enter into the contracts by the non-disclosure of

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the backdating and the variations. The learned judge agreed with this and saw no reason to grant leave to appeal on this point.

72.In the premises, we did not find it necessary to say more than that there were sufficient reasons for the decision of the arbitrator and the learned judge, and that there was thus no basis for the grant of leave to appeal on this point.

73. ***Conclusion***

For the foregoing reasons, we dismiss the appeal with costs and refuse the appellants leave to appeal against the award of the arbitrator. The security deposit for the appeal will be paid out to the respondents` solicitors to account of the respondents` costs.

74.Before we leave this judgment, we feel compelled to say that the manner in which the appeal was argued before us was highly unsatisfactory, with counsel making lengthy and interminable oral arguments on the substantive issues but with no discernible focus whatsoever, instead of focusing on the essential and crucial requirement at hand - that of satisfying the criteria or requirements for leave to appeal, whether that be to the standard of an obvious or a strong prima facie case of error. In this context, therefore, we would venture to suggest that reform be made in the procedure to be followed in applications of the instant type along the lines suggested by Lord Diplock in ***The Antaios*** (supra), as codified in s 69(5) of the English Arbitration Act 1996 - whereby applications for leave to appeal are on a documents-only basis unless the judge chooses to waive that procedure and to hear oral arguments. That would streamline the procedure to be adopted by the High Court for determining whether an award was erroneous and put an end to the lengthy oral arguments so typical of this type of application, thereby saving time for all concerned.

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Karthigesu JA
L P Thean JA
Yong Pung How CJ

Prem Gurbani and Melissa Goh (Gurbani & Co) for the appellants
Scott Thillagaratnam and Robert Phua (Ramdas & Wong) for the respondents

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