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# Performance Bonds, Bankers' Guarantees, and the *Mareva* Injunction

## I. INTRODUCTION

Performance bonds and bankers' guarantees<sup>1</sup> are common features of international sales and construction contracts.<sup>2</sup> They figure prominently in contracts with buyers and employers in the Middle East.<sup>3</sup> In recent years, the amounts represented by these instruments have grown so large that banks have begun to syndicate them in order to limit the exposure of any one bank.<sup>4</sup> With so much at stake, it is imperative that traders, bankers, and lawyers understand the legal implications of performance bonds and bankers' guarantee agreements and the treatment of such agreements by the courts. This Comment will address some of the problems associated with performance bonds and bankers' guarantees in international trade and the response of the English courts to these problems. In particular, it will discuss the means by which payment of a performance bond may be stopped or impeded under English law, focusing especially on the use of the *Mareva* injunction in the context of an alleged fraudulent demand on the bond or guarantee.

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<sup>1</sup> Throughout this Comment the terms "performance bond" and "bank" or "bankers' guarantee" are used interchangeably. There is no real distinction for the purposes of the legal analysis to follow, and English courts have tended to use the terms interchangeably. See *United Trading Corp. S.A. v. Allied Arab Bank Ltd.*, (C.A. July 17, 1984) (available on LEXIS, Enggen library, Cases file) (term "performance bond" used throughout by Lord Justice Ackner to refer to "unconditional bank guarantee" in contract). For an attempted distinction between performance bonds and bankers' guarantees, see White, *Banker's Guarantees and the Problem of Unfair Calling*, 11 J. MAR. L. & COM. 121, 123-26 (1979).

<sup>2</sup> See Penn, *Performance Bonds: Are Bankers Free From the Underlying Contract?*, 1985 LLOYD'S MAR. & COM. L.Q. 132; Edwards, *The Role of Bank Guarantees in International Trade*, 56 AUSTL. L.J. 281 (1982); and White, *supra* note 1.

<sup>3</sup> See *R.D. Harbottle (Mercantile) Ltd. v. Nat'l Westminster Bank Ltd.*, [1978] 1 Q.B. 146, 150 (1977). See also Gnitche, *The Intricacies of Performance Guarantees in Saudi Arabia*, 100 BANKING L.J. 354 (1983).

<sup>4</sup> See Kronfol, *The Syndication of Risk in Unconditional Bonds*, 1984 J. BUS. L. 13.

## II. A SIMPLE HYPOTHETICAL

A useful introduction to the problems of performance bonds in international trade is to imagine a simple hypothetical contract between an employer in Saudi Arabia and an English construction company. Typically, the Saudi party will have more bargaining power than the English party, who might need the business, and therefore might agree more readily to the Saudi's terms.<sup>5</sup> To insure performance of the contract, the Saudi party will undoubtedly require the English party to obtain a performance bond or bankers' guarantee in the amount of at least five or ten percent of the contract price.<sup>6</sup>

The English party will go to a bank and request that a bond or guarantee in the requisite amount be arranged in favor of the Saudi party. The bank will no doubt request a promise of indemnification from the English party for the amount of the bond in the event it is paid out.<sup>7</sup> If the amount of the bond is so large that the bank does not want to risk the exposure alone, it may arrange for the syndication of the bond with other banks.<sup>8</sup>

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<sup>5</sup> Edwards says, "[t]hese on-demand performance guarantees are virtually imposed on the exporters by powerful importers who have the whip hand in negotiations. Exporters are usually faced with a take or leave it attitude and reluctantly agree to the on-demand guarantee as part of the deal." Edwards, *supra* note 2, at 284. Penn notes that "[i]n the early 1970s . . . recession in the home markets forced British suppliers and contractors to look to new outlets for additional business; often in markets where performance and other bonds were required if business was to be won." Penn, *supra* note 2, at 132.

<sup>6</sup> Macdonald, *Construction Guarantees in Saudi Arabia*, INT'L FIN. L. REV., July 1982, at 22, 23. Macdonald states that:

[i]n the private sector, it is usual for an unconditional performance bank guarantee to be 10 per cent of the value of the works whereas in the public sector, article VII of the Saudi procurement law requires a *final deposit* of five per cent of the value of the contract in all contracts other than direct purchase, consultant contracts or the purchase of spare parts for which no deposit is required.

*Id.*

<sup>7</sup> See *Harbottle*, [1978] 1 Q.B. at 149. Justice Kerr stated that:

[a]ll the contracts provided that the plaintiffs were to establish a guarantee confirmed by a bank of 5 per cent. of the price in favour of the buyers. These were in effect to be performance bonds. They were called guarantees simpliciter, but their purpose was to provide security to the buyers for the fulfilment by the plaintiffs of their obligations under the contracts. They were to be established with the respective Egyptian banks. The machinery was that the plaintiffs instructed the bank to confirm the guarantees to the respective Egyptian bank, which therefore became the bank's correspondent in Egypt for this purpose. The Egyptian banks in turn confirmed the guarantees to the buyers. The guarantees were backed by counter-indemnities by the plaintiffs to the bank. The plaintiffs agreed to indemnify the bank in the widest terms and gave authority for payment under the guarantees and to debit the plaintiffs' account accordingly.

*Id.*

<sup>8</sup> Kronfol states that "contractors in the past few years . . . [have resorted] to the syndication technique as an efficient method in dealing with such bonds whose size has grown to a point where it . . . [has become] almost impossible for any one bank to take a huge exposure all on its own." Kronfol, *supra* note 4, at 13.

It is quite probable that the performance bond or guarantee issued by the English party's bank will be of the "demand" or "unconditional" type.<sup>9</sup> Generally, this will mean that the Saudi party may request payment in the amount of the bond by simply making a demand to the appropriate bank at any time prior to the expiration date of the bond, regardless of whether the English party has actually performed under the contract.<sup>10</sup> Unless the bank knows that the demand on the bond is fraudulent,<sup>11</sup> the bank will have little choice but to pay out on the bond.<sup>12</sup>

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<sup>9</sup> Macdonald states that:

[e]mployers do not favor surety bonds or *conditional* guarantees as, by their terms, they require proof of default and thus justification of a claim under a bond or guarantee. The norm is still for unconditional guarantees . . . . There . . . is no trend in the direction of Saudi employers accepting conditional guarantees or surety bonds."

Macdonald, *supra* note 6, at 22-23.

<sup>10</sup> See *State Trading Corporation of India Ltd. v. ED & F Man (Sugar) Ltd.* (C.A. July 17, 1981) (available on LEXIS, Enggen library, Cases file) (statement of Lord Denning, Master of the Rolls, that.

performance bonds fulfil a most useful role in international trade. If the seller defaults in making delivery, the buyer can operate the bond. He does not have to go to far away countries and sue for damages, or go through a long arbitration. He can get damages at once which are due to him for breach of contract. The bond is given so that, on notice of default being given, the buyer can have his money in hand to meet his claim for damages for the seller's non-performance of contract).

See also *Edward Owen Eng'g Ltd. v. Barclays Bank Int'l Ltd.*, [1978] 1 Q.B. 159, 168 (1977).

<sup>11</sup> This is the well-known "fraud exception" or "fraud rule" best summed up by the maxim "fraud unravels all" which English courts borrowed from cases involving irrevocable letters of credit for use in cases involving demand performance bonds or bank guarantees. See *United City Merchants (Investments) Ltd. v. Royal Bank of Canada*, [1982] 2 All E.R. 720. In *Edward Owen*, Lord Denning, M.R., cited the United States case of *Sztejn v. J. Henry Schroder Banking Corp.*, 177 Misc. 719, 31 N.Y.S.2d 631 (N.Y. Sup. Ct. 1941), for the proposition that "the bank ought not to pay under the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances when there is no right to payment." *Edward Owen*, [1978] 1 Q.B. at 169. For the general rule that when an irrevocable letter of credit is issued and confirmed by a bank, the bank must pay if the documents conform to the terms of the letter of credit agreement, see *Hamzeh Malas & Sons v. British Imex Indus. Ltd.*, [1958] 2 Q.B. 127, 129 (1957) (statement of Lord Justice Jenkins that: "the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties . . ."). In *United Trading Corp.*, *supra* note 1, Ackner, L.J., stated, with respect to the relevant date for establishing the bank's knowledge of fraud, that:

[W]here payment has in fact been made, the bank's knowledge that the demand made by the beneficiary on the performance bond was fraudulent must exist prior to the actual payment to the beneficiary and that its knowledge at that date must be proved. Accordingly, if all a plaintiff can establish is such knowledge after payment, then he has failed to establish his cause of action. The bank would not have been in breach of duty in making the payment without the requisite knowledge.

*Id.* But cf. *Edward Owen*, [1978] 1 Q.B. at 170-71 (statement of Lord Denning, M.R., that "the banks will rarely, if ever, be in a position to know whether the demand is honest or not. At any rate they will not be able to prove it to be dishonest. So they will have to pay.").

<sup>12</sup> From the bank's point of view, it is in its best interest to pay out on the bond even in suspect circumstances in order to preserve its good name and reputation in international commerce. In *Harbottle*, [1978] 1 Q.B. at 151, Kerr, J., stated that the bank's "reputation depends on strict compli-

While the English party may have agreed to such an arrangement, included the amount of the bond in the contract price, and perhaps even insured against the risk of a demand on the bond,<sup>13</sup> it seems inequitable that the Saudi party should be allowed to call on the bond with such impunity, particularly if performance is only beginning or has already taken place.<sup>14</sup> Nonetheless, there are persuasive reasons for allowing banks to make payments of performance bonds even in suspect circumstances.<sup>15</sup> Here, the question is whether the English party may prevent

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ance with its obligations. This has always been an essential feature of banking practice." In *Bolivinter Oil S.A. v. Chase Manhattan Bank*, [1984] 1 Lloyd's L.R. 251, 257 (1983), Sir John Donaldson, Master of the Rolls, stated that "[i]f . . . [the customer] is to be allowed to derogate from the bank's personal and irrevocable undertaking . . . he will undermine what is the bank's greatest asset . . . namely its reputation for financial and contractual probity."

<sup>13</sup> The alternative of including the amount of the bond in the contract price is suggested by both Lord Denning, M.R., and Lord Justice Lane in *Edward Owen*, [1978] 1 Q.B. at 170, 176. It is submitted that this may not always be possible. See Edwards, *supra* note 2, at 285. In regard to the insurance alternative, Edwards notes that:

Most countries have State institutions which should provide insurance cover against the arbitrary calling on an on-demand guarantee, that is, without justification and there being no fault on the part of the seller. Most of these government agencies—for example, the Canadian Export Development Corporation, British Export Credit Guarantee Department, Australian Export Finance and Insurance Corporation—also provide insurance against abusive drawing of a stand-by letter of credit issued in lieu of an on-demand guarantee. Such insurance usually presupposes the existence of an export contract and would not, as was the situation with the *Edward Owen* case . . . provide any cover if the export contract has not been established.

Edwards, *supra* note 2, at 285.

<sup>14</sup> See *Edward Owen*, [1978] 1 Q.B. at 166 (Libyan party called on bond before *Edward Owen* had an opportunity to perform); *United Trading Corp.*, *supra* note 1 (performance bonds demanded by Iraqi government concern, Agromark, after certain contracts had already been performed).

<sup>15</sup> The oft-cited rationale for English courts' unwillingness to stop payments of performance bonds and bank guarantees even in admittedly suspect circumstances was first articulated by Kerr, J., in *Harbottle*, [1978] 1 Q.B. at 155-56. Kerr, J., said that:

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 regarded 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. The courts are not concerned with their difficulties to enforce such claims; these are risks which the merchants take. In this case, the plaintiffs took the risk of the unconditional wording of the guarantees. The machinery and commitments of banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce could be irreparably damaged.

*Id.* For similar statements of this view, see *Discount Records Ltd. v. Barclays Bank Ltd.*, [1975] 1 W.L.R. 315, 320 (1974) (statement of Justice Megarry that he "would be slow to interfere with bankers' irrevocable credits, and not in the least in the sphere of international banking unless a sufficiently grave cause is shown; for interventions by the court that are too ready or too frequent might gravely impair the reliance which, quite properly, is placed on such credits"); *ED & F Man (Sugar) Ltd.*, *supra* note 10 (statement by Lord Denning, M.R., that "performance bonds fulfil a most useful role in international trade"); *Intraco Ltd. v. Notis Shipping Corp.* (The "Bhoja Trader"), [1981] 2 Lloyd's L.R. 256, 257 (statement of Lord Justice Donaldson that "[t]hrombosis will occur if, unless fraud is involved, the Courts intervene and thereby disturb the mercantile practice of treating rights thereunder as being the equivalent of cash in hand"); and *Bolivinter Oil*, [1984]

the payment of the bond to the foreign party after an allegedly fraudulent demand has been made.

### III. THE RESPONSE OF THE COURTS

Performance bonds and bankers' guarantees have often been equated with and compared to irrevocable letters of credit commonly used in international trade.<sup>16</sup> In some instances, particularly under United States law, the so-called performance bond or bankers' guarantee is, in fact, a type of letter of credit.<sup>17</sup> Thus, it is not entirely surprising that letter of credit law has been applied with some regularity to cases involving performance bonds.<sup>18</sup>

In dealing with parties seeking to enjoin payment of a demand bond or bank guarantee, English courts have almost uniformly compared such instruments to the irrevocable or confirmed letter of credit.<sup>19</sup> The courts have held that, as with the irrevocable letter of credit, the establishment of an unconditional performance bond or bank guarantee by the seller in favor of the buyer constitutes a contract between the seller and the

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1 Lloyd's L.R. at 257 (statement of Sir John Donaldson, M.R., that: "the value of all irrevocable letters of credit and performance bonds and guarantees will be undermined," if the courts interfere too frequently with their payment). For a contrary view, see *United Trading Corp.*, *supra* note 1 (statement of Ackner, L.J., that the strength of the proposition that to delay payment under letters of credit and performance bonds strikes not only at the proper workings of international commerce but also at the reputation and standing of the international banking community "can be overemphasized.").

<sup>16</sup> See *Harbottle*, [1978] 1 Q.B. 146; *Howe Richardson Scale Co. Ltd. v. Polimex-Cekop*, [1978] 1 Lloyd's L.R. 161 (1977); *Edward Owen*, [1978] 1 Q.B. 159; and *Bolivinter Oil*, [1984] 1 Lloyd's L.R. 251. *But see* *Potton Homes Ltd. v. Coleman Contractors Ltd.* (C.A. Feb. 24, 1984) (available on LEXIS, Enggen library, Cases file) (statement by Lord Justice Eveleigh that he did not regard Lord Denning, M.R., in *Edward Owen* "as saying that one should approach every case upon the basis that the bond is a letter of credit and to have no regard to the circumstances which brought it into existence.").

<sup>17</sup> See Federal Deposit Insurance Corporation Regulations, 12 C.F.R. § 337.2(a) (1985); Federal Reserve Board Conditions of Membership of State Banks, 12 C.F.R. § 208.8(d)(1) (1986). See also *Potton Homes*, *supra* note 16. In *Potton Homes*, Eveleigh, L.J., noted that:

References to the similarity to a letter of credit . . . are to be expected in the American courts where banks have adapted the letter of credit (calling it a standby letter of credit) to take the place of a performance bond.

*Id.* Macdonald states that "[b]anks in the United States issue a *letter of credit* in lieu of a *guarantee* as US [sic] law prohibits U.S. banks to issue guarantees as such. Such a letter of credit operates in substance like a guarantee as it is a contractual undertaking of the bank to pay. Such letters of credit are often referred to as *standby letters of credit*." Macdonald, *supra* note 6, at 22 n.1 (emphasis in original). Note, however, that foreign branches of United States banks which are members of the Federal Reserve System and Edge and Agreement corporations may issue guarantees subject to certain limitations. See *International Operations of United States Banking Organizations*, 12 C.F.R. §§ 211.3(b)(1), 211.4(e)(iv) (1986).

<sup>18</sup> See *supra* note 16.

<sup>19</sup> *Id.*

seller's banker that is separate and distinct from the contract of sale between the seller and the buyer.<sup>20</sup> The performance bond agreement or contract between the seller and the seller's banker imposes upon the banker the absolute obligation to pay the bond in the event of a demand, irrespective of any dispute there may be between the buyer and seller with regard to the performance of the contract.<sup>21</sup>

If the contract involves parties in different countries, the seller's bank will generally arrange for a bank in the buyer's country to pay the bond or guarantee in the requisite amount upon demand.<sup>22</sup> The seller's bank will promise to indemnify the foreign bank in the event payment of the bond is demanded. The foreign bank will "confirm" or promise to pay the buyer the amount of the bond on demand.<sup>23</sup> Consequently there are contracts between the parties and their respective banks and contracts between the banks themselves which are on a completely different

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<sup>20</sup> See *Hamzeh Malas*, [1958] 2 Q.B. at 129 (statement of Jenkins, L.J., that: "the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to contract or not."); *Harbottle*, [1978] 1 Q.B. at 156 (statement of Kerr, J., that: "[b]anks are not concerned with the rights or wrongs of the underlying disputes but only with the performance of the obligations which they themselves have confirmed."); *Howe Richardson*, [1978] 2 Lloyd's L.R. at 165 (statement of Lord Justice Roskill that:

Whether the obligation arises under a letter of credit or under a guarantee, the obligation of the bank is to perform that which it is required to perform by that particular contract, and that obligation does not in the ordinary way depend on the correct resolution of a dispute as to the sufficiency of performance by the seller to the buyer or by the buyer to the seller as the case may be under the sale and purchase contract; the bank here is simply concerned to see whether the event has happened upon which its obligation to pay has arisen);

and *Edward Owen*, [1978] 1 Q.B. at 169 (statement of Lord Denning, M.R., that:

A performance bond . . . has many similarities to a letter of credit . . . . It has been long established that when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between [the parties] must be settled between themselves).

<sup>21</sup> See *id.*

<sup>22</sup> See *Harbottle*, [1978] 1 Q.B. at 149 (performance bonds established by plaintiff sellers' London bank with Egyptian banks); *Edward Owen*, [1978] 1 Q.B. at 166 (plaintiff suppliers' London bank established performance bond with Libyan bank); and *Bolivinter Oil*, [1984] 1 Lloyd's L.R. at 257 (plaintiff oil company's London bank gave a letter of credit to a Syrian bank which established a guarantee in favor of the defendant oil refinery).

<sup>23</sup> In *Edward Owen*, Barclays asked the Libyan bank to issue a performance bond in favor of the Libyan buyers. When asked by the Libyan bank to "confirm that you will pay total or part of said guarantee on first of our demand without any conditions or proof . . .," Barclays replied to the Libyan bank: "We confirm our guarantee . . . payable on demand without proof or conditions." The guarantee issued to the Libyan buyers by the Libyan bank stated:

[c]onsidering the fact that the contract relating to this transaction calls for the issue of a bank guarantee for an amount of £50,203 . . . We, the undersigned, guarantee to you the firm "Edward Owen" to the extent of the above mentioned amount and it is understood that the said amount will be paid on your first demand, which must reach us within the period of validity of the letter of guarantee. This guarantee is valid until August 31, 1978, after which its validity will expire and the letter of guarantee will have to be returned to this bank.

*Edward Owen*, [1978] 1 Q.B. at 166-67.

level from the underlying contract of sale between the buyer and the seller.<sup>24</sup>

As with the irrevocable letter of credit, English courts will not enjoin payment of a demand bond or bank guarantee unless the party seeking the injunction can show that the demand on the bond or guarantee is fraudulent and that the bank knew it to be fraudulent.<sup>25</sup> The difficulty for the plaintiff lies in proving this knowledge of fraud on the part of the bank.<sup>26</sup> Unlike some United States courts, English courts will not, at present, enjoin payment of an irrevocable letter of credit or demand bond or bank guarantee upon a mere suspicion of fraud.<sup>27</sup>

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<sup>24</sup> See *Harbottle*, [1978] 1 Q.B. at 156 (statement of Kerr, J., that the "machinery and commitments of banks are on a different level" from the underlying contracts of merchants).

<sup>25</sup> See *supra* note 11. But cf. *ED & F Man (Sugar) Ltd.*, *supra* note 10 (statement of Lord Denning, M.R., that the only implied term:

to be imported [into the performance bond agreement] is that the buyer, when giving notice of default, must honestly believe that there has been a default on the part of the seller. Honest belief is enough. *If there is no honest belief, it may be evidence of fraud.* If there is sufficient evidence of fraud, the court might intervene and grant an injunction. But otherwise not. So long as the buyer honestly believes there is a default on the part of the seller, that is sufficient ground for notice of default to be given.)

*Id.* (emphasis added). Lord Denning, M.R., did not make clear whether a bank's knowledge of a buyer's lack of honest belief was sufficient for the bank to legitimately refuse payment of the performance bond or whether the seller attempting to enjoin payment of the bond could attempt to show that the bank had knowledge of the buyer's lack of honest belief. It is possible Lord Denning, M.R., was alluding to a statement he made in *Edward Owen* that "so long as the . . . customers make an honest demand, the banks are bound to pay . . . ." *Edward Owen*, [1978] 1 Q.B. at 170-71 (emphasis added). In *Dodsai PVT Ltd. v. Kingpull Ltd.* (C.A. July 1, 1985) (available on LEXIS, Enggen library, Cases file), Lord Justice Neill distinguished between fraud and lack of honest belief, stating that in the line of cases extending from *Hamzeh Malas* through *United Trading Corp.*:

the grounds upon which the court has contemplated that an injunction could be granted appear to have been limited to *knowledge of fraud or lack of honest belief*. There may . . . be cases where no injunction could be granted against a bank because they had no reason to know of, or even suspect, any fraudulent conduct but where relief could be obtained against the beneficiary whose lack of honest belief in his right to make a claim could be clearly demonstrated. But the cases show that in the absence of *bad faith*, the bond or guarantee will be enforced.

*Id.* (emphasis added). Presumably "bad faith" is equivalent to fraud or lack of honest belief in this context, though arguments could certainly be made that "bad faith" is a lesser standard. It is clear that mere breach of contract by the party calling on the bond or guarantee does not constitute fraud for the purposes of the fraud exception. See *Edward Owen*, [1978] 1 Q.B. at 168; *supra* note 20 (bank's obligations independent of the underlying contract between buyer and seller and any disputes between buyer and seller). In *United Trading Corp.*, *supra* note 1, Ackner, L.J., noted in the course of his discussion of the United States performance bond rules that the United States conception of fraud is far wider than the United Kingdom's and "would appear to include ordinary breach of contract."

<sup>26</sup> See *United Trading Corp.*, *supra* note 1.

<sup>27</sup> See *id.* (By noting that in the United States "a temporary restraining order is made essentially on the basis of suspicion of fraud," Ackner, L.J., implicitly suggested that such an order was not available upon a mere suspicion of fraud under English law).



### A. The *Edward Owen* Case

The leading English case in the field of performance bonds is *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.*,<sup>28</sup> in which Lord Denning, M.R., laid the foundations for virtually all performance bond law. Called the "*locus classicus*" of performance bond law, *Edward Owen* established the strict application of the fraud rule to performance bond cases, a rule which has been followed with little variance to date.<sup>29</sup>

*Edward Owen* involved a contract between the Agricultural Development Council of Libya and an English concern, Edward Owen Engineering Ltd., for the construction of a number of large greenhouses in Libya.<sup>30</sup> The parties agreed that Libyan law would govern the contract and that any disputes between the parties would be taken up in a Libyan court.<sup>31</sup>

As a precondition to the making of any contract, the Libyan party demanded a performance guarantee from Edward Owen in the amount of ten percent of the final contract price, which was to remain valid up until the final delivery date.<sup>32</sup> Edward Owen instructed its English bankers, Barclays, to arrange for a performance bond in the requisite amount. Barclays then asked the Libyan bank to issue the guarantee in favor of the Libyan party.<sup>33</sup> Later, Barclays confirmed via telex to the Libyan bank that the guarantee was "payable on demand without proof or conditions."<sup>34</sup> Barclays, of course, obtained an indemnity agreement from Edward Owen guaranteeing that Owen would pay the amount of the bond in the event it was called on by the Libyans.<sup>35</sup>

Under the terms of the contract, the Libyans were to arrange for a confirmed letter of credit in favor of Edward Owen for the payment of

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<sup>28</sup> [1978] 1 Q.B. 159.

<sup>29</sup> *United Trading Corp.*, *supra* note 1.

<sup>30</sup> *Edward Owen*, [1978] 1 Q.B. at 164.

<sup>31</sup> *Id.* This is not at all uncommon in international contracts involving performance bonds. See *United Trading Corp.*, *supra* note 1 (Iraqi law governed the contracts and any disputes between the parties were to be taken up in Iraqi courts).

<sup>32</sup> *Edward Owen*, [1978] 1 Q.B. at 166.

<sup>33</sup> *Id.*

<sup>34</sup> See *supra* note 23.

<sup>35</sup> The indemnity agreement signed by Edward Owen Engineering Ltd. stated that:

In consideration of your procuring the giving by Barclays Bank International Ltd. of a . . . guarantee . . . we . . . agree to keep you indemnified . . . and . . . irrevocably authorise you to make any payments and comply with any demands which may be claimed or made under the said . . . guarantee . . . and agree that any payment which you shall make . . . shall be binding upon . . . us and shall be accepted by . . . us as conclusive evidence that you were liable to make such payment or comply with such demand.

*Edward Owen*, [1978] 1 Q.B. at 167.

the contract price. The Libyans issued a letter of credit but it was not the *confirmed* letter of credit required by the contract. After several months of fruitless negotiations conducted by Edward Owen with the purpose of persuading the Libyans to amend the letter of credit, Edward Owen wrote to the Libyans, stating that "[s]ince the letter of credit is not operative, it obviously follows that our guarantee has no effect."<sup>36</sup> Notwithstanding the fact that they were in default, the Libyans, upon receiving the foregoing notice from Edward Owen, demanded payment of the performance bond from the Libyan bank. Relying on the guarantee agreement and telexed confirmation, the Libyan bank then demanded payment from Barclays.<sup>37</sup>

Upon hearing of the demand on the performance bond by the Libyans, Edward Owen sought and obtained a High Court injunction against Barclays, restraining Barclays from paying the Libyan bank the amount of the bond.<sup>38</sup> Barclays succeeded in its application to have the injunction lifted. Edward Owen then appealed, asking for restoration of the injunction and claiming that they would have no remedy in the Libyan courts if the English court allowed payment of the bond. The case was heard in the Court of Appeal by Lord Denning, M.R., and Lord Justices Brown and Lane.<sup>39</sup>

Lord Denning, M.R., called the performance bond "a new creature" and compared it to the irrevocable letter of credit, citing the United States letter of credit case, *Sztejn v. J. Henry Schroder Banking Corporation*,<sup>40</sup> for the proposition that "the bank ought not to pay under the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances where there is no right to

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<sup>36</sup> *Id.* at 165. This would appear to have been a significant strategic mistake on the part of Edward Owen because it prompted the Libyan party to immediately call on the bond.

<sup>37</sup> *Id.* at 168.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 159.

<sup>40</sup> 177 Misc. 719, 31 N.Y.S.2d 631 (N.Y. Sup. Ct. 1941). *Sztejn* involved the issuance of an irrevocable letter of credit by Schroder in favour of Transea Traders Ltd. of Lucknow, India for the purchase of bristles by the plaintiffs, Sztejn and Schwarz. Transea, however, filled fifty crates with cowhair and other rubbish in an attempt to deceive Sztejn and Schwarz. Transea then drew a draft on the letter of credit to the order of Schroder's Indian correspondent bank, which presented the draft and accompanying documents to Schroder for payment. After discovering Transea's attempted fraud, Sztejn and Schwarz brought an action to restrain payment of the drafts under the letter of credit issued by Schroder. Justice Sheintag granted the injunction, stating that "where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller." *Id.* at 634. For a more complete treatment of *Sztejn*, see HARFIELD, LETTERS OF CREDIT 81-85 (1979).

payment.”<sup>41</sup> Lord Denning, M.R., stated that:

A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice.<sup>42</sup>

Without explicitly addressing the question of whether the Libyan demand was fraudulent, Lord Denning, M.R., held that the injunction must be discharged and Barclays allowed to pay the amount of the bond to the Libyan bank.<sup>43</sup>

### B. The *Bolivinter Oil* Case

The Court of Appeal has had several occasions to reexamine *Edward Owen* and elaborate on the principles set forth by Lord Denning, M.R.<sup>44</sup> While it has remained a somewhat controversial case among commentators,<sup>45</sup> *Edward Owen* has, for the most part, been followed faithfully by the Court of Appeal.<sup>46</sup> Sir John Donaldson, M.R., strongly reaffirmed the principles of *Edward Owen* in the case of *Bolivinter Oil S.A. v. Chase Manhattan Bank*.<sup>47</sup>

*Bolivinter Oil* involved a performance guarantee given by Bolivinter in favor of Homs, a Syrian refinery. Bolivinter gave a cash deposit to Chase Manhattan Bank (“Chase”) as an indemnity for a letter of credit Chase issued to the Commercial Bank of Syria (“CBS”) in the amount of the guarantee. CBS then issued the guarantee to Homs.<sup>48</sup> After a number of disputes between Bolivinter and Homs during the course of performance, the parties reached an alleged settlement agreement provid-

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<sup>41</sup> *Edward Owen*, [1978] 1 Q.B. at 169.

<sup>42</sup> *Id.* at 171.

<sup>43</sup> *Id.* at 172.

<sup>44</sup> See *ED & F Man (Sugar) Ltd.*, *supra* note 10; *Bolivinter Oil*, [1984] 1 Lloyd's L.R. 251; *Potton Homes*, *supra* note 16; *United Trading Corp.*, *supra* note 1; *Dodsal PVT*, *supra* note 25; and *Esal (Commodities) Ltd. v. Oriental Credit Ltd.* (C.A. July 31, 1985) (available on LEXIS, Enggen, Library, Cases file).

<sup>45</sup> Professor C.M. Schmitthoff stated that *Edward Owen* was “wrongly decided.” See Schmitthoff, *Export Trade: Bank's Liability under Unconditional Performance Bond*, 1977 J. BUS. L. 351, 353. But see White, *supra* note 2, at 129 (Schmitthoff's view of *Edward Owen* “commands much respect; but it seems unlikely to be followed.”).

<sup>46</sup> See *supra* note 44.

<sup>47</sup> [1984] 1 Lloyd's L.R. 251 (1983). It is interesting to note that in the *Bhoja Trader*, [1981] 2 Lloyd's L.R. 256, Donaldson, L.J., did not once refer to *Edward Owen* in his judgment despite the fact that the *Bhoja Trader* involved the attempted injunction of a bank guarantee.

<sup>48</sup> *Bolivinter Oil*, [1984] 1 Lloyd's L.R. at 252-53.

ing that the performance guarantee would be released by Homs upon the arrival of the last of Bolivinter's vessels carrying oil to Syria.<sup>49</sup> In apparent reliance on this agreement, Bolivinter notified Chase of the release of the performance guarantee. Chase sought confirmation from CBS that the guarantee had been cancelled. CBS informed Chase that Homs had demanded payment of one million dollars under the CBS guarantee and that CBS was claiming one million dollars indemnification under the letter of credit issued by Chase in CBS's favor.<sup>50</sup>

Upon hearing of the claim and before payment could be made, Bolivinter obtained a Commercial Court injunction restraining Homs from claiming the CBS guarantee or claiming the \$1 million under the Chase letter of credit and restraining Chase from paying on the letter of credit. After a further hearing, the court held that the injunctions against Chase and CBS should be discharged. However, the court allowed the injunctions to remain in place until Bolivinter could appeal.<sup>51</sup>

After quoting extensively from *Edward Owen*<sup>52</sup> and the letter of credit case *United City Merchants (Investments) Ltd. v. Royal Bank of Canada*,<sup>53</sup> Sir John Donaldson, M.R., addressed the question of "the relevant time at which the state of knowledge of the guarantor, or issuer of the letter of credit, fell to be considered," pointing out that in the instant case Chase and CBS knew more after the matter had been investigated by the court than when CBS first demanded payment.<sup>54</sup> Donaldson, M.R., however, avoided answering the question as to what time the knowledge of the bank as to fraud should be considered. Instead he concluded that it was

clearly debatable whether Homs . . . acted fraudulently in making their claim on the CBS guarantee or whether they . . . merely acted in breach of their release agreement with Bolivinter. . . . Such knowledge is quite insufficient to justify a Court in preventing Chase and CBS complying with their contractual obligations. . . .<sup>55</sup>

The Court of Appeal dismissed Bolivinter's appeal and lifted the injunctions against CBS and Chase, but not the injunction against Homs, because Homs had not requested that the injunction be discharged. Nevertheless, Donaldson, M.R., noted that "nothing in the injunction

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<sup>49</sup> *Id.* at 253.

<sup>50</sup> *Id.* at 254.

<sup>51</sup> *Id.*

<sup>52</sup> [1978] 1 Q.B. 159.

<sup>53</sup> [1982] 2 All E.R. 720.

<sup>54</sup> *Bolivinter Oil*, [1984] 1 Lloyd's L.R. at 256.

<sup>55</sup> *Id.* This statement by Donaldson, M.R., lends support to the conclusion that there is a distinction for the purposes of the fraud exception between breach of contract and fraud on the part of the beneficiary of the performance bond or bank guarantee. See *supra* note 26.

... against Homs is in any way to inhibit the freedom of CBS to make payment in accordance with its contractual obligations under the performance guarantee,"<sup>56</sup> thus effectively allowing Homs to obtain payment under the guarantee despite the injunction. This outcome and the stress Donaldson, M.R., laid on the fact that very clear evidence is required—"both as to the fact of fraud and as to the bank's knowledge"<sup>57</sup> in order for the court to grant an injunction against a performance bond or bank guarantee—strongly reinforced the strict fraud exception principles established by Lord Denning, M.R., in *Edward Owen*.<sup>58</sup>

### C. The *Potton Homes* Case

Despite the reaffirmation of the principles of *Edward Owen* in *Bolivinter Oil* by Donaldson, M.R., Eveleigh, L.J., seemed to derogate somewhat from the strict fraud exception of *Edward Owen*<sup>59</sup> in *Potton Homes Ltd. v. Coleman Contractors Ltd.*,<sup>60</sup> which followed shortly after *Bolivinter Oil*. However, the outcome of *Potton Homes* indicates that the discussion by Eveleigh, L.J., of a more flexible fraud exception was mere dicta.<sup>61</sup>

Both parties in *Potton Homes* were English companies. The plaintiffs had agreed to supply the defendants with prefabricated building units for shipment to Libya. The plaintiff suppliers gave performance bonds for each of the two contracts. A dispute arose between the parties over moneys owed and alleged defects in the houses that had been delivered. The defendants made a demand on the performance bonds, but the plaintiffs were able to obtain an interim injunction restraining the defendants from calling on the bonds.<sup>62</sup>

Eveleigh, L.J., considered the extent to which the performance bond is to be regarded as independent of the underlying contract between the buyer and the seller. He stated that "[w]hile from the point of view of the bank the underlying contract is irrelevant and the bank's contract with the seller is independent of it, non-the-less *as between buyer and seller the underlying contract may not be irrelevant.*"<sup>63</sup> What Eveleigh,

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<sup>56</sup> *Bolivinter Oil*, [1984] 1 Lloyd's L.R. at 257.

<sup>57</sup> *Id.*

<sup>58</sup> [1978] 1 Q.B. 159. See *supra* note 11.

<sup>59</sup> *Id.*

<sup>60</sup> See *supra* note 16.

<sup>61</sup> *Id.* For the orthodox view that the bank's obligations are independent of the underlying contract between the buyer and the seller, see text accompanying notes 20-21. See also Schmitthoff, *Editorial: Performance Bonds and Letters of Credit*, 1984 J. Bus. L. 106, 108.

<sup>62</sup> *Potton Homes*, *supra* note 16.

<sup>63</sup> See *supra* note 61.

L.J., seemed to imply was that where the beneficiary of the performance bond had breached the underlying contract with the seller or supplier, the court might treat a call on the performance bond, in view of the breach, as something akin to fraud; and therefore the court might be willing to impose an injunction restraining the beneficiary from calling on the bond or dealing with the proceeds.<sup>64</sup> Such an approach differs from the orthodox view that the underlying contract between the buyer and the seller is separate and distinct from the obligation of the bank to pay the amount of the bond or guarantee on demand notwithstanding any disputes or claimed breaches of contract between the parties.<sup>65</sup>

The situation apparently contemplated by Eveleigh, L.J., would involve parties within the jurisdiction of the court who had agreed that English law would govern the contract and that any dispute would be settled in an English court.<sup>66</sup> The parties need not be English, but the paying bank would probably have to be within the court's jurisdiction.<sup>67</sup> In such a case, if there were a dispute between the parties and one party could claim lawful avoidance of the contract, then following language from the judgment of Eveleigh, L.J., in *Potton Homes*, a court could treat the performance bond as cash in hand and issue an injunction restraining the defendant from demanding the bond or the bank from paying until the case could be heard and the amount of damages, including the amount represented by the bond, be determined.<sup>68</sup>

However, in *Potton Homes*, Eveleigh, L.J., held that the plaintiffs had failed to prove that they had not breached the contract and therefore could lawfully avoid it. Thus, a demand on the bond by the defendants

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<sup>64</sup> Eveleigh, L.J., stated that:

As between buyer and seller the underlying contract cannot be disregarded so readily. If the seller has lawfully avoided the contract *prima facie*, it seems to me he should be entitled to restrain the buyer from making use of the performance bond. *Moreover, in principle I do not think it possible to say that in no circumstances whatsoever, apart from fraud, will the court restrain the buyer.* The facts of each case must be considered. If the contract is avoided or if there is a failure of consideration between buyer and seller for which the seller undertook to procure the issue of the performance bond, I do not see why, as between the seller and buyer, the seller should not be unable to prevent a call upon the bond by the mere assertion that the bond is to be treated as cash in hand.

*Potton Homes*, *supra* note 16 (emphasis added).

<sup>65</sup> See *supra* note 61.

<sup>66</sup> Unless the parties had agreed that English law would govern the contract and that any disputes would be settled in an English court, the court would presumably have no basis for determining whether or not consideration had failed or the contract had been breached. Cf. *Edward Owen*, [1978] 1 Q.B. 159.

<sup>67</sup> See *The Bhoja Trader*, [1981] 2 Lloyd's L.R. at 258 (statement of Donaldson, L.J., that "payment in one country can be a very different matter from payment in another . . .").

<sup>68</sup> See *Potton Homes*, *supra* note 16 (judgment of Eveleigh, L.J.).

would not be fraudulent.<sup>69</sup> Eveleigh, L.J., also recognized that the purpose of the performance bond was to allow the defendants to obtain the funds without establishing breaches of contract on the part of the plaintiffs. On this ground, Eveleigh, L.J., stated that he did not think "it right for the court to order what would in effect be a variation of the terms of the parties' agreement in relation to the bond."<sup>70</sup> The court denied the injunction the plaintiffs sought and permitted the defendants to call on the bonds. This outcome effectively limited the precedential value of the discussion of the bond as cash in hand between the parties by Eveleigh, L.J. It is submitted that this discussion may be safely regarded as dicta.<sup>71</sup>

#### D. The *United Trading Corporation* Case

Following *Potton Homes*, the Court of Appeal handed down another performance bond case, *United Trading Corporation S.A. v. Allied Arab Bank Ltd.*,<sup>72</sup> parts of which might be read as implying that the Court of Appeal was contemplating a more flexible approach to the strict fraud rule of *Edward Owen*.<sup>73</sup> As in *Potton Homes*, however, the Court of Appeal upheld the fraud rule in the end and the plaintiffs failed in their attempt to prevent payment of the performance bonds.<sup>74</sup>

*United Trading Corporation* involved nineteen contracts for the sale of foodstuffs by a group of English traders to an Iraqi government concern, Agromark. The contracts were governed by Iraqi law and all disputes were to be submitted to Iraqi courts. However, the indemnity agreements between the plaintiff sellers and their English banks were subject to English law.<sup>75</sup>

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<sup>69</sup> *Id.* See *supra* note 25 for a discussion of the relationship between breach of contract and the fraud exception.

<sup>70</sup> *Potton Homes*, *supra* note 16.

<sup>71</sup> Lord Justice May in his judgment in *Potton Homes* concurred with Eveleigh, L.J., that the defendants were entitled to demand payment of the bond and that the bank must pay. *Id.* However, he did so, not on the grounds of the discussion by Eveleigh, L.J., of the conduct of the parties, but on the more orthodox grounds of the *Harbottle*, *Howe Richardson*, and *Bhoja Trader* cases. Professor C.M. Schmitthoff has stated that:

The difference between Eveleigh, L.J. and May, L.J. [in *Potton Homes*] concerned a situation in which a dispute arose between the seller and the buyer out of the underlying contract and this dispute extended to the bond facility. Here Eveleigh, L.J. was prepared to admit certain defences arising from the underlying contract in addition to that of fraud. But May, L.J. adopted the doctrine of strict autonomy of the financial instrument which is typical of the letter of credit and would not admit such additional defences.

It is respectfully thought that the the stricter view of May, L.J. is correct. Schmitthoff, *supra* note 61, at 108.

<sup>72</sup> (C.A. July 17, 1984) (available on LEXIS, Enggen library, Cases file).

<sup>73</sup> [1978] 1 Q.B. 159. See *supra* note 11.

<sup>74</sup> *United Trading Corp.*, *supra* note 1.

<sup>75</sup> *Id.*

Agromark required the plaintiffs to establish performance bonds for the contracts through Rafidain, the Iraqi state bank. The Iran-Iraq war delayed performance of the contracts and disputes arose between the parties concerning moneys owed under the contracts and the repeated demands by Agromark for renewal of the performance bonds.<sup>76</sup> When Agromark began to call in the performance bonds, the English sellers claimed the demands were fraudulent and sought injunctions restraining their English bankers from paying out to Rafidain.<sup>77</sup>

Ackner, L.J., considered the standard of proof of fraud required for a court to enjoin payment of a performance bond.<sup>78</sup> In a remarkably candid tone, he compared United States law to English law and implicitly suggested that, in his view, the somewhat more flexible United States rules as to proof of fraud for the injunction of performance bonds had merit.<sup>79</sup> More importantly, Ackner, L.J., rejected a stricter test of fraud set forth by Justice Neill, in the lower court.<sup>80</sup>

Neill, J., believed that the fraud test to be applied should be "the standard of the hypothetical reasonable banker in possession of all the relevant facts," and that unless the banker can say "this is plainly fraudulent; there cannot be any other explanation," the courts cannot inter-

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<sup>76</sup> *Id.* The "extend or pay" type of demand requiring that the seller or supplier extend the date of validity of the performance bond or pay the amount of the bond is fairly common and one of the more unpleasant aspects of the demand performance bond. See *Harbottle*, [1978] 1 Q.B. at 150 ("buyers demanded extensions of the guarantees . . . more or less as a matter of routine") and *Esal*, *supra* note 44 (a number of requests for extension of validity of performance bond or payment made by the Egyptian buyers). See also Edwards, *supra* note 2, at 285-86.

<sup>77</sup> *United Trading Corp.*, *supra* note 1.

<sup>78</sup> Ackner, L.J., stated that:

The evidence of fraud must be clear, both as to the fact of fraud and as to the bank's knowledge. The mere assertion or allegation of fraud would not be sufficient . . . . We would expect the court to require strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer. In general, for the evidence of fraud to be clear, we would also expect the buyer to have been given an opportunity to answer the allegation and to have failed to provide any, or any adequate answer in circumstances where one could properly be expected. If the court considers that on the material before it the only realistic inference to draw is that of fraud, then the seller would have made out a sufficient case of fraud.

*Id.*

<sup>79</sup> After describing the United States rules regarding the granting of injunctions in performance bond situations, Ackner, L.J., said:

There is no suggestion that this more liberal approach has resulted in the commercial dislocation which has, by implication at least, been suggested would result from rejecting the respondent's submissions as to the standard of proof required from the plaintiffs. Moreover, we would find it an unsatisfactory position if, having established an important exception to what had previously been thought an absolute rule, the courts in practice were to adopt so restrictive an approach to the evidence required as to prevent themselves from intervening. Were this to be the case, impressive and high-sounding phrases such as "fraud unravels all" would become meaningless.

*Id.*

<sup>80</sup> *Id.*



vene.”<sup>81</sup> Ackner, L.J., preferred the apparently less stringent standard of the “only realistic inference” test, stating that:

The corroborated evidence of a plaintiff and the unexplained failure of a beneficiary to respond to the attack, although given a fair and proper opportunity, may well make the only realistic inference that of fraud, although the possibility that he may ultimately come forward with an explanation cannot be ruled out.<sup>82</sup>

However, even when Agromark remained silent and did not answer the plaintiffs’ claims that Agromark’s demands on the bonds were fraudulent, Ackner, L.J., said this did not entitle the court to draw any strong inference of guilt on the part of Agromark. As Ackner, L.J., recognized, “Agromark [did] not “wish to submit to the jurisdiction of the English courts and quite understandably take the view that it is Iraqi law that has to be applied to the resolution of the disputes and . . . that litigation should take place in Iraq” pursuant to the choice of law clauses in the contracts.<sup>83</sup> On this and several other grounds,<sup>84</sup> Ackner, L.J., held that the plaintiffs failed to meet the standard of proof of fraud required for the court to grant an injunction against payment of the performance bonds.<sup>85</sup>

#### E. The *Dodsall* and *Esal* Cases

Despite language in *Potton Homes* and *United Trading Corporation* which might indicate that the Court of Appeal was taking a more flexible line toward the fraud exception in performance bond cases, two of the more recent unreported cases, *Dodsall PVT Ltd. v. Kingpull Ltd.*<sup>86</sup> and *Esal (Commodities) Ltd. v. Oriental Credit Ltd.*<sup>87</sup> indicate that, for the

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<sup>81</sup> See *supra* note 78. Ackner, L.J., applied his test to the facts of the case by asking: “Have the plaintiffs established that it is seriously arguable that, on the materials available, the only realistic inference is that Agromark could not honestly have believed in the validity of its demands on the performance bonds?” *Id.* Note how Ackner, L.J., incorporated the “honest belief” standard of *ED & F Man (Sugar) Ltd.* into his question. For more on the “honest belief” rule, see *supra* note 25. For the view that there is little difference between the reasonable banker standard put forward by Neill, J., and the “only realistic inference” test advanced by Ackner, L.J., see Schmitthoff, *Export Trade: Performance Bonds; Standard of Proof Where Fraud is Alleged*, 1984 J. Bus. L. 426, 428.

<sup>82</sup> *United Trading Corp.*, *supra* note 1. See *supra* note 81.

<sup>83</sup> *United Trading Corp.*, *supra* note 1.

<sup>84</sup> *Id.* The most significant “other ground” for the denial of the plaintiffs’ injunction by Ackner, L.J., was that the plaintiffs impliedly had “unclean hands” since over the course of time in which Agromark had made repeated “extend or pay” demands with respect to performance bonds for contracts which had already been performed, the plaintiffs had granted the extensions without disclosing to the bank that any calls on the bonds during such extended periods would be fraudulent. *Id.* Professor C.M. Schmitthoff says that “[f]ortunately this statement in an otherwise elucidating judgment is merely a dictum.” Schmitthoff, *supra* note 81, at 429.

<sup>85</sup> *United Trading Corp.*, *supra* note 1.

<sup>86</sup> (C.A. July 1, 1985) (available on LEXIS, Enggen library, Cases file).

<sup>87</sup> *Esal*, *supra* note 44.

moment, the Court of Appeal remains wedded to the stricter principles of *Edward Owen*.

*Dodsall* involved a lease agreement between Kingpull, English lessors of pipelaying equipment, and Dodsall PVT, an Indian pipeline company. The lease agreement called for a "bid bond" to be established at a London bank as security for the lessee's performance of its obligations under the lease.<sup>88</sup> When Dodsall went into arrears on its payments under the lease agreement, Kingpull demanded payment of the bond from Standard Chartered, the London bank holding the bond. Upon hearing of the demand, Dodsall attempted to negotiate with Kingpull to persuade them to withdraw their instructions to Standard Chartered invoking the bond. When these attempts failed, Dodsall brought an action against Kingpull to stop payment on the bond.<sup>89</sup>

The court granted Dodsall an injunction until there could be an *inter partes* hearing. The effect of the injunction was that the funds from the bond were paid into court while awaiting the hearing. At the hearing, Justice Lawson called the bond "a penalty" and stayed the injunction, granting Kingpull leave to appeal.<sup>90</sup>

In response to Dodsall's claim that Kingpull's attempt to enforce the bond was unconscionable conduct sufficient to constitute fraud, Neill, L.J., in the Court of Appeal, cited *Hamzeh Malas*,<sup>91</sup> *Edward Owen*,<sup>92</sup> *Howe Richardson*,<sup>93</sup> and *United Trading Corporation*<sup>94</sup> for the proposition that "the contract between the bank and the beneficiary is a contract quite distinct from that between the principal parties."<sup>95</sup> Neill, L.J., stated that:

In each of these cases . . . the grounds upon which the court has contem-

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<sup>88</sup> *Dodsall*, *supra* note 25.

<sup>89</sup> *Id.*

<sup>90</sup> Lawson, J., treated Kingpull's call on the bond as a penalty because the amount by which Dodsall was in arrears was so small—between \$2,500 and \$9,000—in comparison to the amount of the bond (\$350,000). *Id.* This would appear to be an unprecedented approach to a performance bond of this type and one contrary to prior law. The treatment of demand performance bonds as penalties was implicitly rejected by Lord Denning, M.R., in *Edward Owen*, [1978] 1 Q.B. at 170 (statement that:

that course of action [demand on the bond and payment by the confirming bank] . . . can be followed, not only when there are substantial breaches of contract, but also when the breaches are insubstantial or trivial, in which case they bear the colour of a penalty rather than liquidated damages: or even when the breaches are merely allegations by the customer without any proof at all: or even when the breaches are non-existent. The performance guarantee then bears the colour of a discount on the price of 10 per cent. or 5 per cent. . . .").

<sup>91</sup> [1985] 2 Q.B. 127.

<sup>92</sup> [1978] 1 Q.B. 159.

<sup>93</sup> [1978] 1 Lloyd's L.R. 161.

<sup>94</sup> (C.A. July 17, 1984) (available on LEXIS, Enggen library, Cases file).

<sup>95</sup> *Dodsall*, *supra* note 25.

plated that an injunction could be granted appear to have been limited to knowledge of fraud or lack of honest belief. There may, of course, be cases where no injunction could be granted against a bank because they had no reason to know of, or even suspect, any fraudulent conduct but where relief could be obtained against the beneficiary whose lack of honest belief in his right to make a claim could be clearly demonstrated. But the cases show that in the absence of bad faith the bond or guarantee will be enforced.<sup>96</sup>

Finding no fraud or lack of honest belief on the part of Kingpull, Neill, L.J., held that the injunction should be lifted and Kingpull allowed to demand and receive payment under the bond.<sup>97</sup>

The most recent performance bond case at the time of this writing was *Esal (Commodities) Ltd. v. Oriental Credit Ltd.*<sup>98</sup> This case dealt with the question of what notice the issuing bank had to give the seller or seller's bank in the event of a request for payment of the bond with an option to extend the bond's expiration date. Ackner, L.J., held that in the absence of a contractual provision or course of dealing between the parties that might give rise to some implied agreement, the issuing bank had no duty to give notice to the seller or seller's bank of such a demand.<sup>99</sup>

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<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

<sup>98</sup> *Esal*, *supra* note 76. The *Esal* case involved an English commodity trader, Reltor, who entered into a contract for the sale of sugar with Estram, an Egyptian corporation. Oriental Credit Ltd. were Reltor's London bankers. Oriental Credit instructed the London branch of Wells Fargo to arrange a confirmed performance bond through Wells Fargo's Egyptian correspondent, Banque du Caire, in favor of Estram.

Estram later made an extend-or-pay demand to Banque du Caire who informed Wells Fargo in London and asked for a reply. Wells Fargo neither passed on this demand to Oriental Credit nor replied to Banque du Caire. Shortly thereafter, Estram made a similar demand which Banque du Caire passed on to Wells Fargo which then notified Oriental Credit but did not say that a prior request had been made. Oriental Credit then spoke to Reltor which refused to authorize the extension and claimed that that performance bond had expired between the date of the first and second demands. Estram made two more demands on the bond, both of which were refused by Reltor on the same grounds. Banque du Caire was given no authority to comply with the demand. Estram then brought arbitration proceedings against Banque du Caire for the amount of the bond.

Sometime after the Egyptian arbitration tribunal had found in favor of Estram and against Banque du Caire in the amount of the bond, plus interest and costs, Reltor went into liquidation. The Court of Appeal treated the case as a claim for summary judgment in the amount of the bond by Banque du Caire against Wells Fargo and, if successful, a claim by Wells Fargo against Oriental Credit Ltd. Lord Justices Ackner, Neill and Glidewell found in favor of Banque du Caire against Wells Fargo and in favor of Wells Fargo against Oriental Credit. *Id.*

<sup>99</sup> Ackner, L.J., stated that there is no "implied condition which obliges a bank to inform the customer before it pays pursuant to the demand." However, Ackner, L.J., made the point that "we can be confident that the bank will promptly inform [the customer] of any claim that it meets, in order to obtain its indemnity." *Id.* With regard to the question of whether the bank had to give the customer notice of an extend-or-pay request, Ackner, L.J., said "[t]he fact that as a matter of good business practice and courtesy, a bank would refer such a request to the customer, does not in itself

#### IV. THE *MAREVA* INJUNCTION

##### A. Introduction

In many of the previously discussed cases involving the attempted injunction of performance bonds and bank guarantees, the plaintiffs sought, and in some instances the Court of Appeal considered, the grant of a *Mareva* injunction against either the party demanding the bond, the bank being called upon to either indemnify or pay on the bond, or the party holding the proceeds of the bond.<sup>100</sup> In some cases, the lower courts granted *Mareva* injunctions temporarily, usually pending an *inter partes* hearing.<sup>101</sup> In no case has the Court of Appeal granted a *Mareva* injunction to a plaintiff seeking to enjoin the payment of a performance bond or bank guarantee, though it has indicated its willingness to do so if a plaintiff supplied the necessary proof of fraud.<sup>102</sup> The remainder of this Comment will examine the character and development of the *Mareva* injunction and past attempts to use the *Mareva* injunction against alleged fraudulent demands on performance bonds and bankers' guarantees.

The *Mareva* injunction is an *ex parte*, interlocutory measure intended to freeze a defendant's assets prior to judgment in order to prevent the removal of those assets from the jurisdiction of the court.<sup>103</sup> It is roughly equivalent to United States attachment procedures and the French *saisie conservatoire*.<sup>104</sup>

The *Mareva* injunction came into being in 1975 in the case of *Nippon*

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create any duty, unless in addition there was such a course of dealing between the parties as to give rise to some implied agreement . . . ." *Id.*

<sup>100</sup> See *Edward Owen*, [1978] 1 Q.B. at 171 (statement of Lord Denning, M.R., that "[t]his case is altogether different from *Mareva* . . ."); *The Bhoja Trader*, [1981] 2 Lloyd's L.R. at 257-58 (*Mareva* injunction granted in lower court by Justice Staughton restraining sellers from removing proceeds of bank guarantee from the jurisdiction and recognition by Donaldson, L.J., in the Court of Appeal that the Court might in an appropriate case impose a *Mareva* injunction upon the fruits of a letter of credit or guarantee); *Potton Homes*, *supra* note 16 (conclusion of May, L.J., that Justice Hawser in the lower court did not err in law in refusing to grant the plaintiffs' *Mareva* injunction); *United Trading Corp.*, *supra* note 1 (*Mareva* injunction granted temporarily against Rafidain by Neill, J., and holding of Ackner, L.J., in the Court of Appeal that "plaintiffs must . . . fail in their application for a *Mareva* injunction"); and *Dodsai*, *supra* note 25 (refusal of Neill, L.J., to impose a *Mareva* injunction on the proceeds of the bid bond when received by Kingpull and statement by Lord Justice Balcombe that "the question of a *Mareva* injunction does not arise . . .").

<sup>101</sup> See *The Bhoja Trader*, [1981] 2 Lloyd's L.R. 256 and *United Trading Corp.*, *supra* note 1.

<sup>102</sup> See *United Trading Corp.*, *supra* note 1.

<sup>103</sup> See *Mareva Compania Naviera S.A., v. International Bulkcarriers S.A.*, [1975] 2 Lloyd's L.R. 509. See also Powles, *The Mareva Injunction*, 1978 J. BUS. L. 11; Powles, *Mareva Round-up—I*, 1982 J. BUS. L. 383; Asher, *Where to Now Mareva?*, 1983 N.Z.L.J. 360; and Martin, *Mareva Injunctions*, 59 Austl. L.J. 22 (1985).

<sup>104</sup> See Tetley, *Attachment, the Mareva Injunction and Saisie Conservatoire*, LLOYD'S MAR. & COM. L.Q. 58 (1985).

*Yusen Kaisha v. Karageorgis*,<sup>105</sup> although it takes its name from the second case in which it was applied, *Mareva Compania Naviera S.A. v. International Bulkcarriers S.A.*<sup>106</sup> The statutory basis claimed by Lord Denning, M.R., for the *Mareva* injunction in *Nippon Yusen Kaisha* was section 45(1) of the Supreme Court of Judicature (Consolidation) Act 1925.<sup>107</sup> More recently, the court's power to grant *Mareva* injunctions has been confirmed by section 37(3) of the Supreme Court Act 1981.<sup>108</sup>

In *Mareva Compania Naviera S.A.*,<sup>109</sup> the plaintiffs owned the ship *Mareva* and had leased it to International Bulkcarriers. International Bulkcarriers then sublet the ship to the Indian government.<sup>110</sup> However, International Bulkcarriers failed to pay the plaintiffs a portion of the contract price, even though International Bulkcarriers had themselves been paid by the Indian government. The plaintiff shipowners then brought a

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<sup>105</sup> [1975] 1 W.L.R. 1093. *Nippon Yusen Kaisha v. Karageorgis* involved the charter of three ships by the plaintiff Japanese shipowners to the defendant Greek charterers. The Greek charterers failed to pay the charterparty hire. However, the plaintiffs discovered that the defendants had funds on deposit at London banks and sought an injunction to restrain their removal. *Id.* at 1094. Lord Denning, M.R., stated that:

There is no reason why the High Court or this court should not make an order such as is asked for here. It is warranted by section 45 of the Supreme Court of Judicature (Consolidation) Act 1925 which says that the High Court may grant a mandamus or injunction or appoint a receiver by an interlocutory order in all cases in which it appears to the court to be just or convenient so to do. It seems to me that this is just such a case. There is a strong *prima facie* case that the hire is owing and unpaid. If an injunction is not granted, these moneys may be removed out of the jurisdiction and the shipowners will have the greatest difficulty in recovering anything.

*Id.* at 1095. Lord Justices Browne and Lane agreed with Lord Denning, M.R., that the plaintiffs should be granted the injunction they sought. Lane, L.J., stated that "there is no reason why the court should not assist a litigant who is in danger of losing money to which he is admittedly entitled." *Id.*

<sup>106</sup> [1975] 2 Lloyd's L.R. 509.

<sup>107</sup> See *supra* note 105.

<sup>108</sup> In *Z Ltd. v. A-Z and AA-LL*, [1982] 1 Q.B. 558, 571 (1981), Lord Denning, M.R., stated that "[t]he *Mareva* injunction is now an established feature of English law. The principles applicable to it . . . have been stated in numerous cases from 1975 to 1981. They have been given statutory force by section 37(3) of the Supreme Court Act 1981 . . ." Chapter 54, section 37(1)-(3) states that:

(1) The High Court may by order (whether interlocutory or final) grant an injunction or appoint a receiver in all cases in which it appears to the court to be just and convenient to do so.

(2) Any order may be made either unconditionally or on such terms and conditions as the court thinks just.

(3) The power of the High Court under subsection (1) to grant an interlocutory injunction restraining a party to any proceedings from removing from the jurisdiction of the High Court, or otherwise dealing with, assets located within that jurisdiction shall be exercisable in cases where that party is, as well as in cases where he is not, domiciled, resident or present within that jurisdiction.

1981 U.K., ch. 54. It has been claimed by at least two commentators that the jurisdictional basis of the *Mareva* injunction has shifted from § 45(1) of the Supreme Court of Judicature (Consolidation) Act 1925 and § 37(3) of the Supreme Court Act 1981 to the inherent obligation of the courts to administer justice. See Martin, *supra* note 103, at 23 and Hetherington, *Inherent Powers and the Mareva Jurisdiction*, 10 SYDNEY L. REV. 76 (1983).

<sup>109</sup> [1975] 2 Lloyd's L.R. 509.

<sup>110</sup> *Id.*

claim in the High Court for damages in the unpaid amount.<sup>111</sup> Upon discovering that there were funds sufficient to satisfy the judgment in the defendants' London bank account, the plaintiffs sought "an injunction to restrain the disposal of those moneys . . . in the bank."<sup>112</sup> Lord Denning, M.R., stated that:

If it appears that the debt is due and owing—and there is a danger that the debtor may dispose of his assets so as to defeat it before judgment—the Court has jurisdiction in a proper case to grant an interlocutory judgment so as to prevent him disposing of those assets.<sup>113</sup>

Finding that there was a danger that the shipowners might not get the amounts due to them under the time charter if the funds were withdrawn from the London bank, Lord Denning, M.R., held that the court should grant the shipowners the injunction they sought.<sup>114</sup> Roskill, L.J., noted in his judgment that "[i]f therefore this Court does not interfere by injunction . . . the plaintiffs will suffer a grave injustice which this Court has power to help avoid. . . ."<sup>115</sup>

## B. The Development of the *Mareva* Injunction

Since the *Mareva* case, the *Mareva* injunction has become a much-used tool of English civil procedure.<sup>116</sup> The Court of Appeal and the House of Lords have gradually established rules governing the application of the *Mareva* injunction to particular situations and tests which must be met before a *Mareva* injunction will be granted.<sup>117</sup> Perhaps the most significant *Mareva* case to date is *Siskina (Cargo Owners) v. Distos Compania Naviera S.A.*,<sup>118</sup> in which the House of Lords held that plain-

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<sup>111</sup> *Id.* at 510.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> *Id.* at 511.

<sup>115</sup> *Id.*

<sup>116</sup> See Comment, *Prejudgement Attachment in England: The Mareva Injunction*, 5 LOY. L.A. INT'L & COMP. L.J. 143, 144 (1982).

<sup>117</sup> See *Rasu Maritima S.A. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara (The "Pertamina")*, [1978] 1 Q.B. 644 (1977) (*Mareva* injunction applies to both money and goods); *Siskina (Owners of Cargo Lately Laden on Board) v. Distos Compania Naviera S.A.*, [1979] A.C. 210 (1977) (parties seeking a *Mareva* injunction must have a pre-existing cause of action under English law); *Third Chandris Shipping Corporation v. Unimarine S.A.*, [1979] 1 Q.B. 645 (guidelines for parties seeking *Mareva* injunctions set out by Lord Denning, M.R.; *Barclay-Johnson v. Yuill*, [1980] 1 W.L.R. 1259 (*Mareva* injunction may be applied to English as well as foreign defendants); *Clipper Maritime Co. Ltd. of Monrovia v. Mineralimportexport*, [1981] 1 W.L.R. 1262 (terms of *Mareva* injunction may be varied if they have an adverse effect on third parties); and *Z Ltd. v. A*, *supra* note 108 (rules established by Lord Denning, M.R., for the application of the *Mareva* injunction to banks and other third parties).

<sup>118</sup> [1979] A.C. 210. The *Siskina* case involved an attempt by the owners of cargo which had been on board the *Siskina* to attach the London insurance proceeds stemming from the sinking of

tiffs applying for a *Mareva* injunction must have a preexisting cause of action under English law against the defendant that is separate and distinct from the plaintiff's application for a *Mareva* injunction.<sup>119</sup> That is, under *Siskina*, an application for a *Mareva* injunction cannot be used by a plaintiff to bring into English court an action English courts would not otherwise have the jurisdiction to hear.<sup>120</sup> This limitation on the *Mareva* injunction clearly stands as a hurdle to those parties who, like the parties

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the *Siskina* shortly after its owners had unloaded its cargo at Cyprus and put a lien on the cargo for the payment of the charterparty by the third party charterers. The bills of lading upon which the owners of the cargo based their claim against the shipowners contained a clause giving exclusive jurisdiction to the courts of Genoa, Italy. But the only assets of the defendant shipowners were the insurance proceeds to be paid in London for the loss of the ship. In the Court of Appeal, Lord Denning, M.R., and Lawton, L.J., granted the plaintiffs' *Mareva* injunction. Recognizing that he was extending the scope of the *Mareva* injunction significantly, Lord Denning, M.R., quoted Cowper, stating:

To the timorous souls I would say . . .  
"Ye fearful saints, fresh courage take,  
The Clouds ye so much dread  
Are big with mercy, and shall break  
In blessings on your head."  
Instead of "saints," read "judges."  
Instead of "mercy," read "justice."  
And you will find a good way to law reform.

*Id.* at 236. While the approach advocated by Lord Denning, M.R., may be appealing to the more equity-minded and those in favor of judicial activism, it received short shrift, first, from Lord Justice Bridge who dissented in the Court of Appeal, and later from Lord Hailsham of Saint Marylebone in the House of Lords. Bridge, L.J., stated that he was "clearly of the opinion that we should not allow the urgent merits of particular plaintiffs, whom we see in peril of being deprived of any effective remedy, to tempt us to assume the mantle of legislators. The clouds in Lord Denning, M.R.'s adaptation of William Cowper may be big with justice but we are neither midwives or rainmakers." *Id.* at 243. Lord Hailsham of Saint Marylebone in the House of Lords stated that:

The second point upon which I wish to comment is the argument of Lord Denning, M.R., fortified by the authority of a quotation from *Hymns Ancient and Modern*, that the judges need not wait for the authority of the Rules Committee in order to sanction a change in practice, indeed an extension of jurisdiction, in matters of this kind. The jurisdiction of the Rules Committee is statutory, and for judges of first instance or on appeal to pre-empt its functions is, at least in my opinion, for the courts to usurp the function of the legislature.

*Id.* at 262.

<sup>119</sup> Lord Diplock stated that:

A right to obtain an interlocutory injunction is not a cause of action. It cannot stand on its own. It is dependent upon there being a pre-existing cause of action against the defendant arising out of an invasion, actual or threatened by him, of a legal or equitable right of the plaintiff for the enforcement of which the defendant is amenable to the jurisdiction of the court. The right to obtain an interlocutory injunction is merely ancillary and incidental to the pre-existing cause of action. It is granted to preserve the status quo pending the ascertainment by the court of the rights of the parties and the grant to the plaintiff of the relief to which his cause of action entitles him, which may or may not include a final injunction.

*Id.* at 256.

<sup>120</sup> Lord Diplock went on to state that:

To argue that the claim to monetary compensation is justiciable in the High Court because *if it were justiciable* it would give rise to an ancillary right to a *Mareva* injunction . . . appears to me to involve the fallacy of *petitio principii* or, in the vernacular, an attempt to pull oneself up by one's own bootstraps.

*Id.* at 257 (emphasis in original).

in *Edward Owen and United Trading Corporation*, have agreed that a contract will be governed by foreign law and that all disputes will be settled in a foreign court.<sup>121</sup>

The first comprehensive set of guidelines for the grant of a *Mareva* injunction were established by Lord Denning, M.R., in *Third Chandris Shipping Corporation v. Unimarine S.A.*,<sup>122</sup> which followed the *Siskina* decision by the House of Lords. Lord Denning, M.R., said an applicant for a *Mareva* injunction should: (1) make "full and frank" disclosure of all matters in its knowledge which are material for the judge to know; (2) give particulars of the claim against the defendant, including the grounds of the claim and the amount in issue, and the points made against the claim by the defendant; (3) provide some grounds for believing the defendant has assets within the jurisdiction; (4) give some grounds for believing that there is a risk of assets being removed from the jurisdiction prior to judgment or satisfaction of the award; and (5) undertake to pay damages in the event the claim fails or the injunction proves to be unjustified.<sup>123</sup>

In the enigmatic case of *Z Ltd. v. A-Z and AA-LL*,<sup>124</sup> Lord Denning, M.R., established ten requirements to be met by plaintiffs seeking to impose *Mareva* injunctions on defendants' funds or other assets in the possession of a bank or other third party within the jurisdiction of the court.<sup>125</sup> First, to the extent that a bank is asked or required to take action, incurs expenses, or is exposed to liability on account of the injunction, the plaintiff is required to recoup all expenses and indemnify the bank against any liability.<sup>126</sup> Second, the plaintiff must inform the bank or other third party with as much precision as possible what to do or not to do with regard to the assets in question, identifying, if possible, by branch and heading the bank account and any other asset subject to the injunction.<sup>127</sup> Third, in the event the plaintiff is unable to identify the bank account or other asset with any degree of precision, the plaintiff may request the bank or other third party to conduct a search for any assets of the defendant currently being held, if the plaintiff promises to pay the cost of the search.<sup>128</sup> Fourth, the plaintiff should tell the judge in

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<sup>121</sup> See *supra* note 31 and accompanying text.

<sup>122</sup> [1979] 1 Q.B. 645.

<sup>123</sup> *Id.* at 668-69.

<sup>124</sup> [1982] 1 Q.B. 558.

<sup>125</sup> *Id.* at 575-77.

<sup>126</sup> *Id.* at 575.

<sup>127</sup> *Id.*

<sup>128</sup> *Id.* However, according to Lord Denning, M.R., "[t]he bank may not tell the plaintiff the result of the search, lest it breaks the confidence of the customer. But if it finds that the defendant



his application for a *Mareva* injunction the names of the banks and other third parties the plaintiff proposes to give notice of the injunction.<sup>129</sup>

The fifth requirement set forth by Lord Denning, M.R., states that, depending upon the facts and circumstances of the case, the plaintiff should insert a maximum amount of funds to be restrained in order to avoid unfairly preventing the defendant from dealing with any excess funds.<sup>130</sup> Sixth, also depending upon the facts and circumstances of the case, the defendant should be allowed to use a specified amount for "normal living expenses."<sup>131</sup> Seventh, if the defendant's funds are believed to be in a joint account, the injunction may be issued in terms wide enough to include the joint account.<sup>132</sup> Eighth, in the event that a *Mareva* injunction is granted *ex parte*, the court retains the right to grant it only for a few days or until the defendant and the bank or other third party can be heard.<sup>133</sup> Ninth, the plaintiff seeking a *Mareva* injunction should undertake to pay the defendant for any damages incurred as a result of the injunction and, as previously mentioned, pay the bank or other third party for any expenses reasonably incurred by them as a result of the injunction.<sup>134</sup> Tenth, the defendant may be required by the court on the return date to specifically disclose the existence of assets sufficient to meet the claim.<sup>135</sup>

### C. The Application of the *Mareva* Injunction to Performance Bonds

Long before the *Mareva* injunction came into being, Lord Denning, M.R., granted an injunction against a banker's guarantee in the case of *Eliau and Rabbath v. Matsas and Matsas*.<sup>136</sup> While recognizing that "a

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has an account, it will freeze it for its own protection: so that it will not be in contempt of court." *Id.*

<sup>129</sup> *Id.* at 576. This, however, does not preclude the plaintiff from giving notice to other banks and third parties in the event more information is obtained. *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.* at 577.

<sup>133</sup> *Id.*

<sup>134</sup> *Id.*

<sup>135</sup> *Id.* Lord Denning, M.R., stated that if the defendant comes on the return date and says he has assets sufficient to meet the claim, then he ought to specify them. If the defendant refuses to disclose his assets, his refusal will go to show he is attempting to evade payment. *Id.*

<sup>136</sup> [1966] 2 Lloyd's L.R. 495. *Eliau* involved a bank guarantee given by a Beirut shipping firm to Greek shipowners' London agents as consideration for the release of a lien the shipowners had exercised against the goods. The shipowners released the first lien but later imposed another lien. The shipowners then sought to enforce the guarantee which was at a London bank. Lord Denning, M.R., thought it unfair that the shipowners should be able to demand the guarantee when a second lien had been imposed despite the apparent understanding between the parties that once the guarantee was given the original lien would be lifted and no more liens imposed by the shipowners. *Id.* at 496-97.

bank guarantee [was] very much like a letter of credit [which] . . . Courts will do their utmost to enforce . . . according to its terms," Lord Denning, M.R., nonetheless stated that "[c]ircumstances may arise such as to warrant interference by injunction."<sup>137</sup> Lord Denning, M.R., went on to say that he believed this was "a special case in which an injunction should be granted."<sup>138</sup> Lord Justice Danckwerts agreed, stating that "[w]hatever may be the final result of the case, it seems to me this is an instance where the Court should interfere and prevent what might be an irretrievable injustice being done to the plaintiffs in the circumstances."<sup>139</sup> But in the *Edward Owen* case twelve years later—in which the facts infer more strongly than in *Eliau* that the plaintiffs were being treated unjustly—Lord Denning, M.R., merely stated that the *Edward Owen* case was "different from the other cases which are cited to us, such as *Eliau and Rabbath v. Matsas and Matsas*. . . . This [*Edward Owen*] is a new case on a performance bond or guarantee which must be decided on the principle applicable to it."<sup>140</sup>

In *Howe Richardson Scale Co. Ltd. v. Polimex-Cekop*,<sup>141</sup> a performance bond case cited by Lord Denning, M.R., in *Edward Owen*, Roskill, L.J., distinguished *Eliau*, noting that *Eliau* should "be regarded as a very special case; it certainly goes further than the subsequent cases."<sup>142</sup> Therefore, despite *Eliau*'s appealing fairness-oriented rationale, it is suggested that the *Eliau* case is of little precedential value for the injunction of bankers' guarantees and performance bonds.

In *Edward Owen*, Lord Denning, M.R., said that the *Edward Owen* case was "altogether different from *Mareva Compania Naviera S.A. v. International Bulkcarriers Ltd.* . . . and the *Siskina*. . . ."<sup>143</sup> Lord Denning, M.R., attempted to distinguish the *Mareva* and *Siskina* cases from *Edward Owen* by pointing out that in *Mareva* and *Siskina* the court had stopped money in England from being paid out to debtors who were likely to remove assets from England in order to avoid paying their debts.<sup>144</sup> While he did not make clear the distinction, Lord Denning,

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<sup>137</sup> *Id.* at 497.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.* at 498. Note the similarity of this statement to the statement of Roskill, L.J., in *Mareva*. See note 115 and accompanying text.

<sup>140</sup> *Edward Owen*, [1978] 1 Q.B. at 172.

<sup>141</sup> [1978] 1 Lloyd's L.R. 161.

<sup>142</sup> *Id.* at 165.

<sup>143</sup> *Edward Owen*, [1978] 1 Q.B. at 172.

<sup>144</sup> *Id.* It is interesting to note that the plaintiffs' counsel in *Edward Owen* did not argue for the application of a *Mareva* injunction. Rather, they sought an interim injunction against the performance bond on the basis of the "balance of convenience" standard of *American Cyanamid Co. v. Ethicon Ltd.*, [1975] A.C. 396. Counsel for the defense stated rather flatly that "the principle [of

M.R., apparently regarded the status of the Libyan party in *Edward Owen* as somewhat different from the foreign parties in the *Mareva* and *Siskina* cases.<sup>145</sup>

The question of whether a *Mareva* injunction could be applied to a bank guarantee came up squarely in *Intraco Ltd. v. Notis Shipping Corporation (The "Bhoja Trader")*.<sup>146</sup> The *Bhoja Trader* involved a bank guarantee given by the buyers of the ship *Bhoja Trader* to the sellers as part of the purchase price. After the ship had been arrested in Calcutta in apparent contravention of the sellers' promise that the ship would be free of all liens and encumbrances at the time of delivery, Justice Goff granted the buyers an *ex parte* injunction restraining the sellers from demanding payment of the guarantee from the London bank. The buyers brought arbitration proceedings in London against the sellers for breach of the sale contract. The sellers, however, had no assets in England save their rights under the bank guarantee.<sup>147</sup>

After hearing both parties' arguments, Staughton, J. lifted the first injunction but imposed a *Mareva* injunction restraining the sellers "from removing from the jurisdiction or otherwise disposing of any of their assets and in particular moneys payable under [the] guarantee. . . ."<sup>148</sup> When the case came before the Court of Appeal, Donaldson, L.J., stated that the fraud exception "did not prevent the court, in an appropriate case, from imposing a *Mareva* injunction upon the fruits of the letter of credit or guarantee."<sup>149</sup> However, Donaldson, L.J., went on to point out that the banker's guarantee in question was payable not in London but in Piraeus, Greece, and that if the guarantee were to be treated as cash in hand between the parties, it must be treated as cash in hand in Greece.<sup>150</sup> On that ground, Donaldson, L.J., held that the *Mareva* injunction restraining the sellers must be discharged.<sup>151</sup> Lord Denning, M.R., later

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*Mareva*] cannot apply here because the asset is not that of the wrongdoer. The present case is a long way from the *Mareva* principle which applies to securing the asset of a wrongdoer in this country." *Edward Owen*, [1978] 1 Q.B. at 163. For the distinction between the *American Cyanamid* interim injunction and the *Mareva* injunction, see Asher, *supra* note 103, at 361.

<sup>145</sup> But cf. *Z Ltd. v. A*, *supra* note 108, at 574 (statement of Lord Denning, M.R., that the *Mareva* injunction "does not prevent payment under a letter of credit or under a bank guarantee . . . but it may apply to the proceeds as and when received by or for the defendant.").

<sup>146</sup> [1981] 2 Lloyd's L.R. 256.

<sup>147</sup> *Id.* at 257.

<sup>148</sup> *Id.* The *Mareva* injunction granted by Staughton, J., had the effect of freezing the proceeds of the bond. *Id.*

<sup>149</sup> *Id.* at 258. Donaldson, L.J., went on to state that "[e]njoining the beneficiary from removing the cash asset from the jurisdiction is not the same as taking action, whether by injunction or an order staying execution, which will prevent him obtaining the cash . . . ." *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

affirmed the assertion by Donaldson, L.J., that a *Mareva* injunction could be applied to the proceeds of a bank guarantee or performance bond in *Z Ltd. v. A*,<sup>152</sup> where he stated that, while the *Mareva* injunction does not prevent payment under a letter of credit or bank guarantee, "it may apply to the proceeds as and when received by or for the defendant."<sup>153</sup>

Although a *Mareva* injunction was not granted to the plaintiffs in *Potton Homes*,<sup>154</sup> Hawser, J., in the lower court, recognized that under the *Bhoja Trader* case he had jurisdiction in an appropriate case to grant a *Mareva* injunction against the proceeds of a performance bond in the hands of the recipient. However, in light of the defendants' financial status, Hawser, J., decided that this was not an appropriate case for the grant of a *Mareva* injunction.<sup>155</sup> In the Court of Appeal, Eveleigh, L.J., addressed the reluctance of Hawser, J., to grant a *Mareva* injunction restraining the buyers from making a call on the bond. Eveleigh, L.J., stated that he:

would wish at least to leave it open for consideration how far the bond is to be treated as cash in hand as between the buyer and seller. It is sufficient to say that I do not think that the court is restrained by authority to say that it has no jurisdiction to consider this matter under section 37 of the Supreme Court Act 1981. . . . The court's power under section 37 is very wide. . . . The learned judge [Hawser, J.] did not consider the exercise of his jurisdiction under section 37. Consequently, this court is free to do so.<sup>156</sup>

Eveleigh, L.J., did, however, defer to the decision of Hawser, J., that a *Mareva* injunction was not appropriate in this case, pointing out that the facts of the case did not warrant the court's interference with the parties' agreement with regard to the bond.<sup>157</sup>

In *United Trading Corporation S.A. v. Allied Arab Bank Ltd.*,<sup>158</sup> the Court of Appeal contemplated granting the plaintiff sellers a *Mareva* injunction against the London banks indemnified to pay the performance bonds which had been called on in alleged bad faith by the buyers, Agromark. Initially, Neill, J., granted the plaintiffs a *Mareva* injunction against Rafidain, restraining it from removing from the jurisdiction or otherwise dealing with funds received by its London branch from Barclays, the sellers' bank, under one of the performance bonds.<sup>159</sup> Nonetheless, after hearing both parties' arguments sometime later, Neill, J.,

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<sup>152</sup> [1982] 1 Q.B. 558.

<sup>153</sup> See *supra* note 145.

<sup>154</sup> *Potton Homes*, *supra* note 16.

<sup>155</sup> *Id.*

<sup>156</sup> *Id.* For the text of section 37, see *supra* note 108. See also Hetherington, *supra* note 108.

<sup>157</sup> *Potton Homes*, *supra* note 16.

<sup>158</sup> *United Trading Corp.*, *supra* note 1.

<sup>159</sup> *Id.*

discharged the *Mareva* injunction against Rafidain.<sup>160</sup>

In the Court of Appeal, the plaintiffs sought injunctions that would prevent the London banks which were to indemnify Rafidain in the amount of the performance bonds from paying any money to Rafidain. The plaintiffs also sought to restrain Rafidain from paying the proceeds of the guarantees to the Iraqi government.<sup>161</sup> While acknowledging that the plaintiffs had a very strong case, Ackner, L.J., held that "they ha[d] not established a good arguable case that the only realistic inference [was] that the demands were fraudulent. . . ."<sup>162</sup> On that ground and others, the Court of Appeal held that "the plaintiffs must . . . fail in their application for a *Mareva* injunction."<sup>163</sup> This outcome and the language used by Ackner, L.J., implies that, had the plaintiffs met their burden of proof as to the fraudulent demands for the bonds and the banks' knowledge thereof, the Court of Appeal would have been prepared to impose *Mareva* injunctions on both the English issuing banks and the London branch of Rafidain.<sup>164</sup>

#### D. The Present State of the Law

Despite the candid discussion by Ackner, L.J., of a potentially lower standard of proof of fraud in *United Trading Corporation*, the outcome of that case, as well as the more recent *Dodsal* and *Esal* cases, indicates that the Court of Appeal will, for the present, continue to adhere to the strict fraud rule. The court will not grant an injunction of payment of a performance bond or bankers' guarantee unless the plaintiff can provide clear proof of fraud or lack of honest belief on the part of the defendant and knowledge thereof on the part of the paying bank at the time of the demand.<sup>165</sup> One might well ask whether this moots the question of the *Mareva* injunction's applicability to performance bonds and bank guarantees altogether. However, it is clear that where a plaintiff satisfies the

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<sup>160</sup> *Id.* The injunctions were, however, allowed to remain in place pending the plaintiffs' appeal.

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

<sup>164</sup> *Id.* Apparently Barclays were to pay the amount of the bond to Rafidain's London branch which would then either credit the appropriate account or transfer the funds to Iraq. So it would have been possible for the plaintiffs to obtain a *Mareva* injunction against the proceeds of the bond after Barclays had paid it to Rafidain's London branch. The funds would still have been within the jurisdiction of the court. Parties required to give performance bonds or bank guarantees would do well to inquire as to the location of the paying bank and whether it has a London branch. One might even attempt to make the bond or guarantee payable in London, though this might require more bargaining power than the average seller possesses.

<sup>165</sup> See *supra* note 11.

jurisdictional requirements of *Siskina*<sup>166</sup> and complies with the guidelines established by Lord Denning, M.R., in *Third Chandris*<sup>167</sup> and *Z Ltd. v. A*,<sup>168</sup> the court may, in an appropriate case, impose a *Mareva* injunction on the proceeds of a performance bond or bank guarantee.<sup>169</sup>

There is some question as to the suitability of the *Mareva* injunction in demand bond cases where the parties have agreed that the contract is to be governed by foreign law and all disputes taken up in a foreign court.<sup>170</sup> By definition, the *Mareva* injunction contemplates future arbitration or litigation within the jurisdiction of the court granting the *Mareva* injunction.<sup>171</sup> Wholly apart from the jurisdictional requirements

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<sup>166</sup> [1979] A.C. 210. See *supra* notes 118-20 and accompanying text.

<sup>167</sup> [1979] 1 Q.B. 645. See *supra* notes 122-23 and accompanying text.

<sup>168</sup> [1982] 1 Q.B. 558. See *supra* notes 124-35 and accompanying text.

<sup>169</sup> See *The Bhoja Trader*, *supra* note 15. See also *supra* notes 146-52 and accompanying text.

<sup>170</sup> See *United Trading Corp.*, *supra* note 1. Wholly apart from the jurisdictional question, it can be argued that the *Mareva* injunction is peculiarly well-suited for application to certain performance bond situations, especially those instances where there is a danger of funds leaving the jurisdiction quickly. See *Barclay-Johnson*, [1980] 1 W.L.R. at 1264, 1266 (statements by Sir Robert Megarry, Vice-Chancellor, that "the heart and core of the *Mareva* injunction is the risk of the defendant removing his assets from the jurisdiction and so stultifying any judgment given by the courts in the action" and that "the £3,300 in the bank account, like the £70,000 in the *Chartered Bank* case [1980] 1 W.L.R. 107, can as Lord Denning, M.R. put it at p. 113, 'be removed at the stroke of a pen from England outside the reach of creditors.'").

In *United Trading Corp.*, at least one of the performance bonds was payable by Barclays to the London branch of Rafidain, the buyer's Iraqi bank. See *supra* note 164. Presumably, the funds would then be transferred from the London branch of Rafidain to the Iraqi branch that had paid the Iraqi buyers on demand. The speed with which funds of this sort can be moved prompted Lawton, L.J., to state in *Third Chandris*, [1979] 1 Q.B. at 670 that:

By a few words spoken into a radio telephone or tapped out on a telex machine bank balances can be transferred from one country to another and within seconds can come to rest in a bank which is untraceable or, even if known, such balances cannot be reached by any effective legal process.

However, quite often there will be a gap between the time payment of the bond or bank guarantee is demanded and the time the bank actually makes payment. See *Dodsal*, *supra* note 25 (amount of performance bond payable to Kingpull by bank on the twenty-eighth day following the bank's receipt of written demand). It is suggested that sellers whose performance bonds or bank guarantees have been called on in suspect circumstances use this time gap for discovery and, if appropriate, application for a *Mareva* injunction against payment of the bond. See Rosenblith, *What Happens When Operations Go Wrong: Enjoining the Letter of Credit and Other Legal Stratagems*, 17 U.C.C.L.J. 307, 323 (1985). Depending on the circumstances, the seller may seek a *Mareva* injunction against (1) the amount of the bond being held by the paying bank prior to payment as in *Dodsal*; and/or (2) the proceeds of the bond if they are to be or already have been paid out by the paying bank to the beneficiary where the beneficiary or his bank account is within the jurisdiction and the bond is payable within the jurisdiction, *The Bhoja Trader*, [1981] 2 Lloyd's L.R. 256; or (3) the proceeds of the bond if they are to be or already have been paid out to a paying bank or its London branch by another bank also within the jurisdiction, see *supra* note 164; or (4) the amount to be paid out by the issuing bank within the jurisdiction as indemnification to the foreign paying bank where the foreign bank has already paid out on the bond. See *Edward Owen*, [1978] 1 Q.B. 159; *Bolivinter Oil*, [1984] 1 Lloyd's L.R. 251; *Esal*, *supra* note 76.

<sup>171</sup> See *supra* note 103 and accompanying text.

of *Siskina*, there is the question of whether a court may impose a *Mareva* injunction on an issuing or paying bank, thereby compelling the foreign party to either forget about the bond or submit to the jurisdiction of the court and pursue a legal remedy even if the terms of the contract or performance bond agreement clearly manifest the intent of the parties to avoid such a result.<sup>172</sup> These considerations, however, may be disregarded if the plaintiff can show that the demand on the performance bond or bank guarantee was fraudulent and that the bank had knowledge of that fraud.<sup>173</sup> Lord Diplock stated in *United City Merchants (Investments) Ltd. v. Royal Bank of Canada* that:

The exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim *ex turpi causa non oritur actio* of, if plain English is to be preferred, "fraud unravels all." The courts will not allow their process to be used by a dishonest person to carry out a fraud.<sup>174</sup>

Thus, in the event the plaintiff satisfies the proof requirements of the fraud exception, it appears that the court will impose a *Mareva* injunction on both the issuing banks and, if it is within the jurisdiction of the court, the paying bank or its branch.<sup>175</sup> The beneficiary of the bond would then have the option of either acquiescing to the injunction or bringing an action in the jurisdiction to show that the demand was not in fact fraudulent.

Apart from recourse to the courts to enjoin a performance bond called on in bad faith, there are other alternatives for the seller or supplier who must give a performance bond or bank guarantee but would like to minimize the risk of a bad faith call. In *Esal (Commodities) Ltd. v. Oriental Credit Ltd.*, Ackner, L.J., stated by way of dicta that:

The requirement that [the buyer] must when making his demand for payment in order to support his request for an extension, also commit himself to claiming that the contract has not been complied with, may prevent some of the many abuses of the performance bond procedure which undoubtedly occur.<sup>176</sup>

Ackner, L.J., seemed to suggest that it might be useful for sellers to require buyers demanding payment of a performance bond to affirmatively state to a paying bank that the seller failed to perform under the contract.<sup>177</sup> While the bank has no means of checking the veracity of such an assertion, the mere requirement of the statement might have a mini-

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<sup>172</sup> See *supra* note 10.

<sup>173</sup> *United City*, [1982] 2 All E.R. at 725.

<sup>174</sup> *Id.*

<sup>175</sup> See *supra* note 164 and accompanying text.

<sup>176</sup> *Esal*, *supra* note 76.

<sup>177</sup> *Id.*

mal deterrent effect against would-be fraudulent demands.<sup>178</sup> From an *ex post* perspective, the statement might have useful evidentiary value to a seller attempting to show that the demand was in fact fraudulent and that the bank knew or should have known it to be so. Such a condition, however, would have to be established between the parties in the performance bond agreement; its presence or absence would depend on the parties' respective bargaining power.<sup>179</sup>

If conditionality is not a realistic option, sellers or contractors required to give performance bonds might consider other alternatives such as a higher contract price and insurance. In a competitive bidding situation, however, a higher contract price is not always an option if the party hopes to be awarded the contract.<sup>180</sup> And in a falling commodity market, traders' profit margins may be so thin that any amount otherwise reserved to protect against a bad faith demand may be squeezed out.<sup>181</sup> Furthermore, if the establishment of a performance bond or bank guarantee is a precondition to the making of a contract and the bond is called on in bad faith, the seller will not get any of the contract price.<sup>182</sup> A seller or contractor may be able to obtain insurance in the amount of the bond against a bad faith call. Such insurance is available in the United Kingdom from the government's Export Credits Guarantee Department and Lloyd's.<sup>183</sup> However, in the event that the seller cannot include the amount of the bond in the contract price and insurance is unavailable or too costly, the seller's final recourse will be to the courts for an injunction if there is a bad faith call on the bond.

## V. CONCLUSION

It is not suggested that the standard of proof of fraud required to enjoin a performance bond or bankers' guarantee be lowered or that

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<sup>178</sup> See Edwards, *supra* note 2, at 286. Edwards states that:

a rule to the effect that the beneficiary must sign a statement detailing how the principal has been at fault might discourage abusive calling for example: "We undertake to pay upon your first demand stating inter alia in what respect our principals have not complied with the contract." If such a statement had to be sworn it could be used in subsequent legal proceedings relating to the underlying contract. It would make a beneficiary think twice before he claimed the on-demand guarantee since most beneficiaries would hesitate to sign a declaration which is manifestly untrue.

*Id.*

<sup>179</sup> *Id.* at 284 (whether "the exporter can sell the idea of some documentation to accompany a claim under the on-demand guarantee . . . will depend on his bargaining skill . . .").

<sup>180</sup> See *supra* note 13.

<sup>181</sup> *Id.*

<sup>182</sup> See Edward Owen, [1978] 1 Q.B. 159.

<sup>183</sup> See White, *supra* note 2, at 131.



*Mareva* injunctions be granted more readily.<sup>184</sup> While it may seem inequitable that in many cases Middle Eastern buyers should be able to call on demand bonds and bankers' guarantees successfully in situations where extensive post-demand discovery might reveal fraud, it must be remembered that the performance bond agreement is an enforceable contract which has been negotiated between the parties and is reflected in the contract price.<sup>185</sup> One might argue with some force that acknowledged inequalities of bargaining power, the large sums at stake, and certain ethical and cultural considerations militate in favor of a policy of aggressive intervention by the courts in suspect performance bond situations. English courts have resisted such an approach to date on the ground that irrevocable letters of credit, demand performance bonds, and bank guarantees are the lifeblood of international commerce and that to interfere unnecessarily might prove dangerous to the continued use of such instruments in international trade.<sup>186</sup>

Performance bonds and bankers' guarantees, like irrevocable letters of credit, play an important role in international trade, making possible transactions and services that physical distance and cultural differences might otherwise render impossible.<sup>187</sup> Yet for the seller or contractor who is a party to an international contract, demand bonds and bank guarantees represent risks that must be accounted for whether through sound commercial judgment, a higher contract price, insurance, or recourse to the courts. By requiring that a party seeking to enjoin payment of a demand bond or bank guarantee provide clear proof that a demand was fraudulent and that the bank knew it to be so, the English courts have assured the continued use of such instruments in international trade. The policy judgment the courts have made is that the usefulness of performance bonds and bank guarantees in international trade outweighs any of the inequities which might accrue to individual traders from the payment of such instruments in suspect but not necessarily fraudulent circumstances.<sup>188</sup> This approach implicitly recognizes the im-

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<sup>184</sup> But cf. *supra* notes 79-80 and accompanying text. See also *Barclay-Johnson*, [1980] 1 W.L.R. at 1266 (statement of Sir Robert Megarry, V.-C. regarding the granting of *Mareva* injunctions: "[t]he court, like other human institutions, must at times take some risks; and in doing so, I think that it should initially err on the side of conservation rather than dispersion.").

<sup>185</sup> See *Edward Owen*, [1978] 1 Q.B. at 170 (statement of Lord Denning, M.R., that the "possibility [of a demand on the bond] is so real that the English supplier, if he is wise, will take it into account when quoting his price for the contract.").

<sup>186</sup> See *supra* note 15. See also Harfield, *Identity Crises in Letter of Credit Law*, 24 ARIZ. L. REV. 239 (1982).

<sup>187</sup> See White, *supra* note 2, at 121-22 (performance bonds bridge a "gap of distrust" between the buyer and the seller in an international contract).

<sup>188</sup> See *supra* note 15.

portance of the sanctity of private contracts in an international setting.<sup>189</sup> While there might be many persuasive reasons for lowering the standard of proof of fraud and granting *Mareva* injunctions against performance bonds and bank guarantees more readily, it is submitted that, in view of the long-term interests of international trade, the approach taken by the English courts is the correct one.

*Peter S. O'Driscoll*

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<sup>189</sup> *Id.*