GIBRALTAR HOMES LIMITED v. AGROMAN (GIBRALTAR) LIMITED

COURT OF APPEAL (Fieldsend, P., Davis and Neill, JJ.A.):
March 5th, 1997

Guarantee and Indemnity—performance bond—"on demand" bond—contractor's guarantee in respect of performance of remedial building works unconditional if expressed to be payable on demand—no breach of underlying contract necessary for enforcement

Injunctions—prohibitory injunction—enforcement of guarantee—in absence of fraud or illegality, no injunction to restrain guarantor from honouring or creditor from enforcing valid and unconditional guarantee

The respondent applied for an injunction to restrain the appellant from enforcing a guarantee.

The parties entered a contract under which the respondent agreed to design and build a housing development. The contract, which was in standard form with amendments, provided that after each phase of the building had been completed to the satisfaction of the appellant, the appellant would issue a written statement of practical completion, stating the date of completion, whereupon a six-month "defects liability period" would commence in respect of that phase. On the date of practical completion of each phase the respondent was to deposit a bank guarantee for a proportion of the value of the work for that phase, which would be released when the appellant issued a notice that any defects in the work had been remedied or when six months had elapsed from the date of practical completion, whichever was later. The guarantee for each phase stated that the relevant sum would be paid on demand. The appellant was permitted 14 days after the expiry of the liability period to issue a schedule of defects for the phase which the respondent would make good at no extra cost, or could simply issue an instruction to the respondent to remedy any defect appearing within the liability period. An arbitration clause stated that any sums paid under a performance bond or bank guarantee would be taken into account by the arbitrator.

The first and second phases of the building works were completed and the defects liability period for the first phase expired. Major defects in the works were discovered and notified to the respondent shortly before the expiry of the second liability period. The appellant complained to the respondent but gained no satisfaction. No statement of practical completion for the third phase was issued by the appellant. However, a notice of possession was issued and the liability period expired. It was

estimated that remedial works would cost more than the sums guaranteed, and the appellant demanded the cost of such work from the respondent, failing which it would draw on the guarantees. Arbitration proceedings were commenced.

The respondent obtained an injunction restraining the appellant from calling upon the guarantees, on the grounds that the guarantees were conditional, should be treated in the same way as retention moneys held under a standard form contract and could not be enforced whilst arbitration proceedings were pending, and that they had, in any event, expired.

On appeal, the appellant submitted that (a) the guarantees were "on demand" bonds under which the respondent was liable to make payment when requested without the need for any prior breach of the terms of the contract; (b) the guarantees had not expired, since it had not issued statements that all defects in each phase of the work had been made good; and (c) since the standard provision that the recipient of retention moneys would hold them in trust for the contractor had been deleted by the parties, no such fiduciary relationship existed between them and, in the absence of fraud or illegality, it should not be restrained from claiming payment under the guarantee.

The respondent submitted in reply that (a) the guarantees were conditional, since they could only be drawn upon in the event of a breach of the underlying building contract, and to enforce them would be to pre-empt the outcome of the pending arbitration proceedings; (b) in any event, they had expired notwithstanding that no notice of correction of defects had been issued by the appellant, since the appellant had failed to send a schedule of defects to be corrected as it was required to do within 14 days of the expiry of the defects liability period under the contract; and (c) the injunction should remain in place, since retention moneys were commonly held on trust for the contractor, and the parties had not intended to place the appellant in a better position than under the standard terms by substituting guarantees for retention moneys.

Held, discharging the injunction:

(1) Since the guarantees themselves stated that the sums guaranteed would be paid on demand and did not specify that some breach of the underlying contract must first be shown by the appellant, they were unconditional and no further words were required to give effect to the parties' clear intentions (page 92, lines 23–29; page 93, lines 36–44).

(2) It was clear that significant defects in the works performed had arisen and had been brought to the respondent's attention during the relevant defects liability periods, but had not been dealt with by the respondent. Although the appellant should have presented its complaints about the works in the form of a schedule of defects, the respondent had been well aware of the remedial work to be done, and the failure to deliver a schedule within the prescribed time did not preclude the issue of

a notice of completion of remedial work at a later date if the work were completed. Accordingly, the respondent had not made out a good arguable case that the guarantees had expired (page 96, lines 13–41).

(3) It was settled law that in the interests of commerce, the courts would not restrain a bank from making payment under an unconditional bond or guarantee unless there appeared to be some fraud or illegality of which the bank was aware, and the same principle applied to any attempt to restrain the recipient from claiming payment under the guarantee. Accordingly, since the terms of the guarantee were unambiguous and no effect was to be given to the standard form terms relating to retention moneys which had been deleted by the parties, the injunction would be discharged (page 97, line 32 – page 98, line 18).

Cases cited:

(1) *Bolivinter Oil S.A.* v. *Chase Manhattan Bank N.A.*, [1984] 1 W.L.R. 392; [1984] 1 All E.R. 351n; [1984] 1 Lloyd's Rep. 251, considered.
(2) *Deutsche Rückversicherung A.G.* v. *Walbrook Ins. Co. Ltd.*, [1996] 1 All E.R. 791; *sub nom. Group Josi Re* v. *Walbrook Ins. Co. Ltd.*, [1996] 1 Lloyd's Rep. 345, applied.
(3) *Esal (Commodities) Ltd.* v. *Oriental Credit Ltd*., [1985] 2 Lloyd's Rep. 546; [1986] FLR 70, followed.
(4) *Inglis (A. & J.)* v. *John Buttery & Co.* (1878), 3 App. Cas. 552; *sub nom. Union Bank of Scotland* v. *Buttery*, 15 Sc. L.R. 462.
(5) *Owen (Edward) Engr. Ltd.* v. *Barclays Bank Intl. Ltd.*, [1978] Q.B. 159; [1978] 1 All E.R. 976, considered.
(6) *Potton Homes Ltd.* v. *Coleman Contractors Ltd.* (1984), 28 BLR 19; 128 Sol. Jo. 282, considered.
(7) *Queensway Quay Dev. Co. Ltd.* v. *COSEC—Cia. de Seguro de Creditos S.A.*, 1995–96 Gib LR 330, considered.
(8) *Sassoon (M.A.) & Sons Ltd.* v. *International Banking Corp.*, [1927] A.C. 711, applied.
(9) *Trade Indemnity Co. Ltd.* v. *Workington Harbour & Dock Bd.*, [1937] A.C. 1; [1936] 1 All E.R. 454.
(10) *Trafalgar House Constr. (Regions) Ltd.* v. *General Surety & Guar. Co. Ltd.*, [1996] A.C. 199; [1995] 3 All E.R. 737, considered.
(11) *United Trading Corp*. v. *Allied Arab Bank Ltd.*, [1985] 2 Lloyd's Rep. 554; *The Times*, July 23rd, 1984, considered.
(12) *Wahda Bank Ltd.* v. *Arab Bank PLC*, [1996] 1 Lloyd's Rep. 470, considered.
(13) *Wates Constr. (London) Ltd.* v. *Franthom Property Ltd.* (1991), 53 BLR 23; 7 Const. L.J. 243.
(14) *Workington Harbour & Dock Bd.* v. *Trade Indemnity Co. Ltd. (No. 2)*, [1938] 2 All E.R. 101; (1938), 60 Lloyd's Rep. 209.

A. White and *G.C. Stagnetto* for the appellant;
J.P. Wadsworth, Q.C., I.S. Marrache and *J.S. Canepa* for the respondent.

NEILL, J.A.: By a contract in writing dated April 20th, 1990, Agroman (Gibraltar) Ltd. ("Agroman") agreed with Gibraltar Homes Ltd. ("GHL") that Agroman would design and construct a total of 778 low-cost housing units at Westside, Gibraltar. The contract was based on the JCT Standard Form of Building Contract with Contractor's Design (1981 ed.), incorporating Amendments 1 (1986), Amendments 2 (1987), Amendments 3 (1988) and Amendments 4 (1988). In addition, the standard form was amended to a significant extent by the parties.

The contract provided that the building works were to be carried out in three phases or sections which were identified on a plan attached to the contract. Clause 16 of the contract contained provisions relating to the practical completion of each section and the defects liability periods. Clause 16.1 (as amended by the parties) was in these terms:

> "When, in the opinion of the contractor, any section of the works has reached practical completion, the contractor shall notify the employer in writing. Within seven days of the date of such notice the employer shall inspect the works and if the relevant section of the works has reached practical completion the employer shall forthwith give the contractor a written statement to that effect, which statement shall not be unreasonably delayed or withheld, and practical completion of that section of the works shall be deemed for all purposes of this contract to have taken place on the day named in such statement."

By Appendix 1 to the contract, the defects liability period in respect of each section was stated to be six months from the day named in the statement of practical completion of that section. The contract sum stated to be payable by GHL was £25,319,000. Procon Ltd. ("Procon") was named in the contract as GHL's agent for the issuing of instructions under the contract. Article 5 of the contract read together with cl. 39 (as amended) provided for arbitration in Gibraltar in accordance with the Arbitration Ordinance.

I come next to art. 6. It was in these terms:

> "The contractor will deposit with the employer prior to the commencement of the works bonds drawn on a bank in Gibraltar, for the due performance of the works in the form set out in Appendix A in respect of each section of the works in the value of [specified sums] ('the performance bonds'). The said performance bonds shall be released on the date named in the statement of practical completion for the respective section, whereupon the contractor shall deposit with the employer a guarantee issued by a bank in Gibraltar in the form annexed hereto in the value of 2.5% of the value of the respective section. Such guarantees shall be released on the date named in the notice of completion of making good defects for the relevant section or six months after the date named in the statement of practical completion for the respective section,

whichever is the later. The contractor will, in addition, deposit with the employer prior to the commencement of the works a parent company guarantee in the form set out in Appendix A. In any arbitration under art. 5, the arbitrator shall take into account in his award any sums paid to the employer under the performance bonds and/or parent company guarantee."

It seems clear that in the final sentence of art. 6 the parties intended to include the bank guarantees referred to in the second sentence, because cl. 39.3 was amended by the Schedule to the contract to provide that the arbitrator should take into account any sums paid under "any performance bond, bank guarantee or parent company guarantee."

I shall have to set out later the remaining provisions of cl. 16, other than cl. 16.1 which I have already cited, but at this stage it is sufficient to explain that a "notice of completion of making good defects" meant a notice given in accordance with cl. 16.4. For the sake of convenience, I shall call it a "cl. 16.4 notice." I shall also have to refer later to parts of cl. 30 of the contract, which made provision for the payment of the contract sum and for retentions.

On August 3rd, 1992 Procon, as agent for GHL, sent to Agroman a statement of practical completion, subject to certain specified exceptions, in respect of the first phase or section of the works. It was stated that the practical completion was with effect from July 31st, 1992. Thereupon (a) the performance bond relating to the first phase was released in accordance with art. 6, and (b) the defects liability period in respect of the first phase began to run. This liability period expired on January 30th, 1993.

On September 23rd, 1992 Procon sent to Agroman a statement of practical completion, subject to certain specified exceptions, in respect of the second phase or section of the works. It was stated that the practical completion was with effect from September 11th, 1992. Thereupon the performance bond relating to the second phase was released and the defects liability period in respect of that phase began to run. This liability period expired on March 10th, 1993.

No statement of practical completion has been given in respect of the third phase and the performance bond has not been released but, at any rate for the purpose of the present proceedings, it is accepted by GHL that the defects liability period in respect of the third phase expired on February 10th, 1994 and that the performance bond, being conditional, cannot be enforced at present.

We are concerned with the three bank guarantees which were issued in accordance with the second sentence of art. 6. Each of these guarantees was issued by the Gibraltar branch of the Banco Español de Credito S.A. and, save that the guarantee issued in respect of the third phase omitted any reference to the release of retention moneys, was in the same terms. It is sufficient to set out the guarantee issued in respect of the first phase dated August 12th, 1992. It was in these terms:

"WHEREAS:

(a) this guarantee is supplemental to a building contract ('the contract') dated the 20th day of April, 1990 made between you and Agroman (Gibraltar) Ltd. ('the contractor') by which the contractor agreed to undertake certain building works ('the works') for you as therein stated;

(b) Phase 1 of the works has been completed and a statement of practical completion has been issued in respect thereof;

(c) in consideration of certain fees and commission paid to us by the contractor (the adequacy and sufficiency whereof are hereby acknowledged) and in consideration of the release by you to the contractor of £217,221 retention moneys held under the contract in advance of the date and circumstances therefore [*sic*] stipulated in the contract, we have agreed to guarantee payment to you of the sum hereinafter mentioned in the manner hereinafter appearing.

NOW:

1. We hereby guarantee to pay to you on demand the sum of £217,221.00 . . . which represents the sum of 2½% of the value of the said Phase 1 of the works.

2. This guarantee is irrevocable and shall continue in effect until the latest of the following events:

(i) the expiry of six months from the date named in the statement of practical completion of the said phase of the works pursuant to the terms of the contract; or

(ii) the date named in the notice of completion of making good defects for the said Phase 1 of the works pursuant to the terms of the contract.

We shall not be discharged or released from the guarantee by any arrangement made between the contractor and you or by any alteration in the terms of the contract or by any forbearance, whether as to payment time performance or otherwise.

You may assign the benefit of this guarantee to Barclays Bank PLC who may re-assign the benefit of this guarantee to any person to whom it may assign the benefit of the contract in accordance with the terms thereof.

This guarantee shall be subject to the Laws of Gibraltar and we hereby irrevocably submit to the jurisdiction of the courts of Gibraltar in relation to any matter or dispute relating thereto or to any claim hereunder."

I shall have to refer later to the letters which were sent by Procon to Agroman in the period between January 6th, 1993 and January 3rd, 1996 which contained complaints and instructions about alleged defects in the works. Particular attention was drawn in these letters to the problem of damp penetration. At this stage it is sufficient to record that in paras. 7

and 8 of his affidavit sworn on February 6th, 1996, Mr. Nigel Pardo, a director of GHL, stated that numerous defects had been notified to Agroman, including rain penetration causing damp in over 400 of the 778 flats, as well as rain penetration into the roof and into the lift shafts. He also stated:

> "The purchasers' representatives have informed me that the cost of remedial works will far exceed the total of the retention bonds. In July 1995 I was informed by Procon Ltd. that the defects then known could cost in the order of £368,500 to remedy. The defects itemized in para. 7 above [which included the allegations of rain penetration] were not included in Procon's estimate."

It is important to emphasize, however, that the allegations of defective work made by GHL and by Mr. Pardo in his affidavit are disputed by Agroman.

I have already referred to the fact that no certificate of practical completion was issued in respect of the third phase of the works, but a notice of possession was issued in respect of that phase on July 23rd, 1993 to take effect from June 11th, 1993.

On July 24th, 1995 GHL sent letters to Agroman demanding the immediate payment in respect of the first, second and third phases of the sums of £124,000, £124,500 and £120,000. It was said that in default of payment forthwith GHL would exercise its rights under the respective guarantees dated August 12th, 1992, September 12th, 1992 and October 8th, 1993. On July 28th, 1995 Agroman issued an expedited originating summons claiming, *inter alia*, an injunction to restrain GHL from calling upon any of the retention guarantees. On August 1st, 1995 Harwood, A.J. in chambers, on GHL's undertaking not to make any demand on the bank in respect of the three retention guarantees, adjourned the summons to a date to be fixed.

The hearing before the Chief Justice

The summons was heard by the Chief Justice in chambers on March 1st, 1996. By then arbitration proceedings were under way. In these proceedings Agroman is claiming a sum in excess of £1m. and certain declarations as to the dates on which practical completion of certain works shall be deemed to have taken place. The pleadings in these proceedings are not yet closed. Before the Chief Justice, GHL claimed, as it has before us, that it was entitled to claim on the guarantees as "on demand" bonds. Agroman disputed this claim, asserting that the guarantees were no more than guarantees and could not be drawn on until the arbitrator had made his award. In addition, Agroman contended: (a) that the guarantees had expired; and (b) that in any event the court was entitled to grant an injunction against GHL to preserve the status quo.

It would seem from the Chief Justice's judgment in later proceedings, when a dispute arose as to whether Agroman should provide a cross-

undertaking in damages, that the Chief Justice decided both the first two issues against GHL. Thus in his judgment dated June 7th, 1996 he said:

> "First, [GHL] argued that the retention guarantees were 'on demand' bonds and thus the equivalent of cash-in-hand or a letter of credit. I held against GHL and found that Agroman had made a good arguable case that the injunctions should be put in place on two grounds. First, the guarantees are just that; guarantees, and for GHL to call on them may pre-empt the arbitration proceedings. Secondly, Agroman has a good arguable case that the guarantees have expired."

In addition, as is quite clear from the Chief Justice's judgment dated March 1st, 1996, he decided that the balance of convenience lay in preserving the *status quo*. In that judgment he said:

> "Agroman has shown me that it has a good arguable case that the parties intended that the guarantees in question should be treated in the same manner as retention moneys under a standard form building contract. Even if I were to find that the guarantees were, as contended by GHL, 'on demand bonds' (which, on the material before me, I do not), I would still be entitled to put injunctions in place on the authorities . . ."

The Chief Justice held that he was entitled to take this course in the light of the two English authorities to which he was referred, namely, *Bolivinter Oil S.A.* v. *Chase Manhattan Bank N.A.* (1) and *Potton Homes Ltd.* v. *Coleman Contractors Ltd.* (6).

In the event, by an order dated June 6th, 1996, the Chief Justice granted the injunction sought. GHL has now appealed to this court.

The appeal

The three issues which arise for decision on this appeal have been conveniently formulated by counsel for GHL as follows:

1. Whether, on their true construction, the retention guarantees were "on demand" bonds.

2. Whether the retention guarantees have expired.

3. If the retention guarantees have not expired, whether the court should nevertheless restrain GHL from requiring payment to be made.

I can turn at once to the first issue. In recent years it has been a common practice to make provision in large construction contracts for guarantee or performance bonds to be issued to secure a measure of protection for the building owner against default by the contractor in the performance of the contract. The bonds are issued to the building owner, usually by a bank, the bank being protected by an indemnity furnished by the contractor. The parties to the bond are the bank and the building owner.

These bonds are of two main types. The first type is a conditional performance bond or guarantee under which the guarantor becomes liable

only when a breach of the underlying contract has been established and the building owner has shown that he has suffered loss as a result of the breach. It seems that this type of bond has been in existence for over 150 years. It was bonds of this type, which are called conditional bonds, which were considered by the House of Lords in *Trade Indemnity Co. Ltd.* v. *Workington Harbour & Dock Bd.* (9), in *Workington Harbour & Dock Bd.* v. *Trade Indemnity Co. Ltd. (No. 2)* (14) and in *Trafalgar House Constr. (Regions) Ltd.* v. *Gen. Surety & Guar. Co. Ltd.* (10).

In the *Trafalgar House* case the first part of the condition of the bond was expressed in these terms ([1996] A.C. at 203–204):

> "'Now the condition of the above written bond is such that if the subcontractor shall duly perform and observe all the terms provisions conditions and stipulations of the said subcontract on the subcontractor's part to be performed and observed according to the true purport intent and meaning thereof . . . then this obligation shall be null and void but otherwise shall be and remain in full force and effect . . . .'"

Both Lord Atkin in the first *Workington Harbour* case ([1937] A.C. at 17) and Lord Jauncey of Tullichettle in *Trafalgar House* ([1996] A.C. at 208–209) drew attention to the archaic language of these bonds, but nevertheless bonds expressed in the language of an 18th century English bond continue to be used.

The second type of bond is an unconditional or "on demand" bond under which the guarantor will become liable when demand is made upon him by the building owner in the manner provided for in the bond. It is not necessary for the building owner to prove any default by the contractor in the performance of the contract. Bonds of this type are of more recent origin than conditional bonds and appear to be fashioned on "on demand" performance bonds in use in international trade.

In the course of the hearing of this appeal we were referred to a number of cases in which bonds or guarantees of the second type have been considered by the courts. These cases included *Edward Owen Engr. Ltd.* v. *Barclays Bank Intl. Ltd.* (5), *Esal (Commodities) Ltd.* v. *Oriental Credit Ltd.* (3), *United Trading Corp.* v. *Allied Arab Bank Ltd.* (11), *Bolivinter Oil S.A.* v. *Chase Manhattan Bank N.A.* (1), *Wahda Bank* v. *Arab Bank PLC* (12) and *Queensway Quay Dev. Co. Ltd.* v. *COSEC-Companhia de Seguro de Creditos S.A.* (7). Counsel for GHL submitted that the guarantees given by the bank in this case fell clearly into the second category. Clause 1 of the guarantee was plain: "We hereby guarantee to pay you on demand the sum of . . . ." It was true, he said, that the guarantees contained an express provision to the effect that the guarantor should not be discharged or released by any alteration in the terms of the contract or by any forbearance, but this provision did not affect the nature of the guarantee or the obligation imposed. It was an "on demand" guarantee.

Counsel for Agroman, on the other hand, submitted that on their true construction the guarantees were conditional. He advanced an argument on the following lines:

1. The cases in which bonds or guarantees have been held to be unconditional could all be distinguished. In *Edward Owen* the performance guarantee was expressed ([1978] Q.B. at 170) to be payable "on demand without proof or conditions." In *Esal (Commodities) Ltd.* the bond was stated to be a performance bond rather than a guarantee. In *United Trading* the letter of guarantee included an undertaking to pay "unconditionally." In *Bolivinter Oil* the guarantee included these words: "We consider ourselves engaged to pay any amount in the limit of this Guarantee at your first request without any other procedures whatsoever from your side." In *Wahda Bank* the performance bond was payable "upon first demand . . . notwithstanding any contestations by the supplier or . . . by any other party of whatever capacity and despite any objection therefore." In *Queensway Quay* the guarantee included a term (of a kind which is becoming increasingly common) to the effect that a signed statement by the person making the demand would be accepted "as conclusive evidence that the amount claimed, up to the guaranteed amount, is due to the beneficiary under this guarantee."

2. In the present case the documents signed on behalf of the bank were described as guarantees rather than performance bonds and no words had been added to make it clear, if that were the intention, that the guarantees were unconditional. Counsel drew our attention to a passage in the speech of Lord Jauncey in *Trafalgar House* (10), where, in relation to the second part of the condition imposed in that case, he said ([1996] A.C. at 208):

> "There is no doubt that in a contract of guarantee parties may, if so minded, exclude any one or more of the normal incidents of suretyship. However if they choose to do so clear and unambiguous language must be used to displace the normal legal consequences of the contract . . . ."

3. The case for Agroman was strengthened by the presence of the no-waiver provision in the guarantees. Such a provision indicated a conditional guarantee rather than an unconditional "on demand" performance bond.

Despite Mr. Wadsworth, Q.C.'s cogent argument to the contrary I have reached the clear conclusion that the guarantees were unconditional and were payable on demand. The words in cl. 1 of the guarantee are plain and unequivocal; no condition is stated or implied. Furthermore, it is to be noted that (a) in *Trafalgar House* (10) Lord Jauncey seems to have treated *Esal (Commodities) Ltd.* (3) as a case involving a typical example of an "on demand" bond. The language used in *Esal*, apart from the description of the document, is quite close to that used in this case. No additional words such as "unconditionally" were included, and (b) the passage in the speech of Lord Jauncey to which Mr. Wadsworth referred

has to be read in its context. At that stage in his speech he was considering an argument that even though he had concluded, by construing the first part of the condition, that the bond was a conditional guarantee, the position might be affected because of the wording of the second part of the condition. The passage cited was therefore directed to a document which was, at any rate *prima facie*, *not* an "on demand" guarantee.

With respect to the Chief Justice, therefore, I would decide the first issue in favour of GHL.

I turn to the second issue. For the purpose of examining this issue it is necessary to set out the remaining parts of cl. 16 of the contract (as amended):

> "16.2. Any defects, shrinkages or other faults [other than certain specified defects, shrinkages or other faults which were added by amendment but are not presently material] which shall appear in any section within the defects liability period in relation thereto and which are due to failure of the contractor to comply with his obligations under this contract shall be specified by the employer in a schedule of defects for that section, which he shall deliver to the contractor as an instruction of the employer not later than 14 days after the expiration of the said defects liability period and, within a reasonable time after receipt of such schedule, the defects, shrinkages and other faults therein specified shall be made good by the contractor at no cost to the employer unless the employer shall otherwise instruct, and if the employer does so otherwise instruct then an appropriate deduction in respect of any such defects, shrinkages or other faults not made good shall be made from the contract sum.
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> 16.3 Notwithstanding cl. 16.2 the employer may, whenever he considers it necessary so to do, issue instructions requiring any defect, shrinkage or other fault [other than certain specified defects, shrinkages or other faults which were added by amendment but are not presently material] which shall appear in any section within the defects liability period in relation thereto and which is due to failure of the contractor to comply with his obligations under this contract to be made good and the contractor shall, within a reasonable time after receipt of such instructions, comply with the same at no cost to the employer unless the employer shall otherwise instruct, and if the employer does so otherwise instruct then an appropriate deduction in respect of any such defects, shrinkages or other faults not made good shall be made from the contract sum.
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> 16.4. When any defects, shrinkages or other faults which the employer may have required to be made good under cll. 16.2 and 16.3 shall have been made good he shall issue a notice to that effect, which notice shall not be unreasonably delayed or withheld, and completion of making good defects in the relevant section shall be

deemed for all the purposes of this contract to have taken place on the day named in such notice (the 'notice of completion of making good defects').

16.5. [Added by amendment] When practical completion of all the sections has been achieved, the employers shall give the contractor a written statement to that effect (in addition to any statements of practical completion of the sections) which statement shall not be unreasonably delayed or withheld, and practical completion of the whole of the works shall be deemed for all purposes of this contract to have taken place on the day named in such statement."

It will be remembered that the guarantees provided that they should continue in effect until the latest of the following events:

(i) the expiry of six months from the date named in the statement of practical completion of the said phase of the works pursuant to the terms of the contract, or

(ii) the date named in the notice of completion of making good defects [for the relevant phase of the works] pursuant to the terms of the contract.

It is common ground that the dates for each phase specified in the first of these alternatives have long since passed. GHL, however, contend that the guarantees remain in force because no notices under cl. 16.4 have ever been issued. As I mentioned earlier, I shall call these "cl. 16.4 notices." Agroman, on the other hand, submits that the guarantees have been released under art. 6 of the contract because GHL failed to serve any schedule of defects in accordance with cl. 16.2 and that it is now much too late for any cl. 16.4 notices to be issued. Mr. Wadsworth developed this part of his argument as follows:

"1. Clause 16.3 is permissive. It enables the employer to issue instructions requiring any fault which appears within the defects liability period to be made good but he is under no obligation to issue instructions at that stage.

2. Clause 16.2, on the other hand, contains a mandatory requirement. This clause requires the employer to prepare and deliver a schedule of defects specifying any defects, shrinkages or other faults which have appeared within the defects liability period and which are due to the failure of the contractor to comply with his obligations under the contract. This schedule has to be delivered to the contractor as an instruction of the employer not later than 14 days after the expiration of the defects liability period.

3. Once the 14 days in respect of each of the three defects liability periods had expired, then, subject to the *de minimis* principle, no cl. 16.4 notices could be issued.

4. The reference to cl. 16.3 in cl. 16.4 had been inserted as a precaution but did not mean that a cl. 16.4 notice could be issued in respect of cl. 16.3 instructions in cases where no schedule of defects

had been issued in accordance with cl. 16.2. The schedule of defects was clearly intended to replace and collect together any instructions issued during the defects liability period in accordance with the permissive provision in cl. 16.3. Indeed, logically, cl. 16.3 should precede cl. 16.2 in the contract."

To counter this argument, counsel for GHL referred us to the letters which were sent by Procon to Agroman between November 1992 and January 1996 notifying Agroman of the defects. These letters formed part of an exhibit to the affidavit of Mr. Pardo sworn on February 6th, 1996. In addition, Mr. White submitted that a cl. 16.4 notice could be issued in respect of cl. 16.3 defects quite independently of any defects set out in a schedule of defects under cl. 16.2.

I do not think it is necessary to refer to all the letters to which Mr. White drew our attention. Certain matters, however, are clear: (a) the existence of defects for which Agroman was said to be responsible was drawn to Agroman's attention during the relevant defects liability periods; (b) these defects included damp penetration problems; (c) the problems persisted and were specifically referred to in Mr. Pardo's affidavit sworn on February 6th, 1996; and (d) many of Procon's letters remained unanswered.

It is apparent from the Chief Justice's judgment dated March 1st, 1996 that he considered that Agroman had a good arguable case that the guarantees had expired and that the underlying issues fell to be determined by the arbitrator. It seems to me, however, that for the purpose of these injunction proceedings, the court must, as far as it can, examine the rival contentions itself.

I feel great difficulty about the argument put forward on behalf of Agroman that the failure to send schedules of defects to it in accordance with cl. 16.2 wholly disabled GHL from issuing cl. 16.4 notices once the 14-day period specified in cl. 16.2 had expired. Such a construction of cl. 16 seems to me to be excessively technical and to ignore the manner in which construction contracts may operate in practice. Schedules of defects should have been sent, but the letters exhibited to Mr. Pardo's affidavit demonstrate that Agroman was well aware of the faults which it was being asked to make good.

The question which arises is whether Agroman has made out a sufficiently strong case for the grant and continuation of an injunction. In my judgment, it has not. Though the point is not to be finally resolved at this stage, I do not consider that for the purpose of these interlocutory proceedings and on the material at present before the court, Agroman has a good arguable case that the guarantees have expired.

I come finally to the third issue. In his judgment dated March 1st, 1996 the Chief Justice stated that even if he had held that the guarantees were "on demand" bonds he would have imposed an injunction. It seems that in reaching this conclusion he relied on the following matters:

1. In the normal case any retention moneys held by the employer are held in trust for the contractor.

2. Although cl. 30.4.2 in the standard form contract had been deleted by the parties, it was arguable that it was not the intention of the parties to put GHL in a better position than would normally be the case by substituting retention guarantees for retention moneys.

3. Although it was only in an exceptional case that the courts would interfere with the machinery of irrevocable obligations assumed by banks, the position might be different when an injunction is sought not against the bank but against the beneficiary. The Chief Justice referred to and cited passages from the judgment of Eveleigh, L.J. in *Potton Homes* (6) (28 BLR at 27).

4. Agroman had expressed doubts about GHL's ability to satisfy an eventual award to Agroman in the arbitration and these doubts had not been countered by GHL.

5. The balance of convenience was in favour of maintaining the status quo.

In his argument in this court supporting the Chief Justice's conclusion on this issue, Mr. Wadsworth relied strongly on the fiduciary nature of an employer's interest in the retention fund in the standard form contract. He referred us to cl. 30.4.2 of the contract before it was deleted. Clause 30.4.2.1 provided: "The employer's interest in the retention is fiduciary as trustee for the contractor (but without obligation to invest)." Moreover, it was provided by cl. 30.4.2.2 that if requested by the contractor, the employer should place the retention in a separate banking account designated as to identify the amount as the retention held by the employer on trust. This court, it was said, was entitled to look at the deleted clauses to ascertain the character and status of the guarantees.

I am afraid I am unable to accept Mr. Wadsworth's argument and on this issue also I have the misfortune of differing from the Chief Justice. I can state my reasons quite shortly:

1. In the absence of fraud or (*semble*) illegality of which the bank has knowledge, a bank will not be restrained from making payment under an "on demand" bond. To do so would interfere with the life-blood of commerce. The extension of the fraud exception to illegality was tentatively approved in relation to a letter of credit by the Court of Appeal in England in *Deutsche Rückversicherung A.G.* v. *Walbrook Ins. Co. Ltd.* (2) ([1996] 1 All E.R. at 803, *per* Staughton, L.J.).

2. It was argued in that case that the rule against interference with payments by a bank under a letter of credit did not apply when an injunction is sought not against the bank but against the beneficiary. Staughton, L.J. rejected the argument in these terms (*ibid.*, at 801): "In my opinion that cannot be right. The effect on the lifeblood of commerce will be precisely the same whether the bank is restrained from paying or the beneficiary is restrained from asking for payment."

3. In my opinion, in a case where there is no ambiguity to be resolved, the correct view as to the effect of deleted words is that explained by Viscount Sumner in *M.A. Sassoon & Sons Ltd.* v. *Intl. Banking Corp.* (8) ([1927] A.C. at 721):

> "There is a good deal of authority, now old, about the effect of deleting words in a printed form of mercantile contract, which it is not necessary now to cite; but they take it to be settled, in such a case as this, that the effect is the same as if the deleted words had never formed part of the print at all. The words expressly added, of course, remain to be construed."

Further support for this view is to be found in the observations of Lords Hatherley and O'Hagan in *A.& J. Inglis* v. *John Buttery & Co.* (4) (3 App. Cas. at 558 and 571) and in the judgment of Beldam, L.J. in *Wates Constr. (London) Ltd.* v. *Franthom Property Ltd.* (13) (53 BLR at 36).

4. The words in the guarantees appear to be plain. I see no reason to refer to the deleted parts of cl. 30.4.

Accordingly, for the reasons I have endeavoured to outline, I would allow the appeal and discharge the injunction.

FIELDSEND, P. and **DAVIS, J.A.** concurred.

Appeal allowed.