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Lifting the Veil of Autonomy: Unconscionable Conduct as Grounds for Injunctive Relief in Australia and Singapore – A Study in the Context of Independent Trade Finance Instruments

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Abstract

The independence of letters of credit and demand guarantees from the underlying contract of sale that gave rise to them is fundamental to the integrity of the market in which they operate and is the core of the economic certainty provided by the product. In the absence of material fraud, stakeholders expect the separation between the two to be maintained. However, the application by courts in three countries of the principles of unconscionable conduct to lift the veil of autonomy separating the two has given rise to some concern about the efficacy of the independent instrument product.

The use of unconscionability to ground injunctions preventing the benefit of an instrument from flowing to its beneficiary is perceived to increase uncertainty and transactional risk. This thesis argues that this need not be the case – that a properly-formed category of independent instrument unconscionability that is tailored to the specific attributes of independent instruments will provide judicial stability and stakeholder assurance while reflecting contemporary market expectations of commercial behaviour.

The use of unconscionability as a basis to restrain a demand-right or payment obligation has struggled to achieve consistency within and across jurisdictions because, it is posited herein, the jurisprudential basis for the doctrine has not been appropriately developed with specific reference to the independent instruments to which it is being applied. The relationship between the characteristics of independent instruments and the elements for proving independent instrument unconscionability have not been clarified in the courts or the literature. The result is a mash of procedural and substantive unconscionability principles being applied to adjudicate allegations of unconscionable conduct.

This thesis is predicated on the proposition that independent instrument unconscionability is necessary, reasonable, and justifiable for protecting applicant parties from the economic distress caused by abusive demands for payment.

This thesis examines the law of unconscionable conduct (procedural and substantive), the development of independence in trade finance instruments, and analyses the case law in both Singapore and Australia where unconscionable conduct has been alleged. This aggregation and analysis is used to distil the elements of independent instrument unconscionability into the framework provided in Chapter Six.

Declaration by Author

This thesis *is composed of my original work, and contains* no material previously published or written by another person except where due reference has been made in the text. I have clearly stated the contribution by others to jointly-authored works that I have included in my thesis.

I have clearly stated the contribution of others to my thesis as a whole, including statistical assistance, survey design, data analysis, significant technical procedures, professional editorial advice, and any other original research work used or reported in my thesis. The content of my thesis is the result of work I have carried out since the commencement of my research higher degree candidature and does not include a substantial part of work that has been submitted *to qualify for the award of any* other degree or diploma in any university or other tertiary institution. I have clearly stated which parts of my thesis, if any, have been submitted to qualify for another award.

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Publications During Candidature

- Wooler, G., 'The 'New Asplenium Clause' – Unconscionability Unwound?' (2016) (Mar) *Singapore Journal of Legal Studies* 169-182.

Publications Included In This Thesis

- Wooler, G., 'The 'New Asplenium Clause' – Unconscionability Unwound?' (2016) (Mar) *Singapore Journal of Legal Studies* 169-182.
  - Partially incorporated in Chapter 3, p141, and Chapter 4, p181.

Contributions By Others To The Thesis

No contributions by others.

Statement Of Parts Of The Thesis Submitted To Qualify For The Award Of Another Degree

None

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To my partner through this journey, Farah, I also pay tribute. Without her tireless support, endless encouragement, and angelic fortitude given all the challenges that living with me brings, I know I would never have been able to complete this. She has always made me want to be a better person. I've tried.

This thesis is the end of a very long road for me that started at Coorparoo Adult Education Centre in 1984 when, as a 25 year-old, I thought I might give 'finishing high school' a shot. I've seen the inside of many, many classrooms since then. So, I'd like to also acknowledge all the teachers and lecturers and tutors and fellow students who taught me and learned with me, and ultimately taught *with* me over all these years. I wish I could tell them personally that they each helped me in their own way. The sound advice and generosity of spirit I have received from some of them remains a gift with me to this day.

Finally I would like to acknowledge my late father, Harry Wooler. His response to this work would be understated perhaps, probably not really understanding the accomplishment, but I am fairly certain he would see it as worthwhile and of value. I'd like to think he would be a little bit proud of it, too.

Keywords

Autonomy Principle, Unconscionability Exception, Letter of Credit, Standby Letter of Credit, Demand Guarantee, Independent Instrument, Procedural Unconscionable Conduct, Substantive Unconscionable Conduct, Independent Instrument Unconscionability, Trade Finance Risk.

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Chapter 1. Project Scope and Legal Fundamentals

Section A. Thesis

1.0 Research Question

Given the unique legal character of independent instruments, how would a category of unconscionable conduct specific to their use be framed in law?

2.0 Hypothesis

That, properly described under law, there exists a special category of independent instrument unconscionability which, with sufficient materiality, is sufficient to ground an injunction.

3.0 Rationale

Abusive demands on independent instruments[1] cannot be priced by the party carrying nearly all the downside risk to the primary underlying contract: the applicant account holder. An abusive demand cannot be presumed. The risk of an abusive demand cannot be offset nor insured against. The risk of an abusive demand will not generally be contractually offset under the (underlying) contract given the inequality of the parties' bargaining positions.

The *raison d'être* for the 'autonomy principle' rests with its contribution to the risk mitigation properties of the instrument. The application of any exception to that principle fundamentally contradicts the precepts of party autonomy[2] in international private commercial law. In some jurisdictions, courts have allowed concepts of 'fair behaviour' to negatively impact the relative commercial certainty provided by the independence of Documentary Credits and Demand Guarantees.

The only relief typically available for unconscionable demands on independent instruments is the equitable remedy of injunction. Equity will not suffer a wrong without a remedy;[3] an abusive demand is not an event that a party can presume

1 See Usage, p.18.

2 By "party autonomy" it is meant that the parties to a commercial contract have an arguable right to choose the rules that will determine the operation of the contract entered into, including apropos, the rules that allow the agreement to be set aside, ie party autonomy is the capacity of parties to a "business contract [being] free to choose the governing law" and rule sets for incorporation into the transaction. See: H Watt, '"Party Autonomy" In International Contracts: From The Makings Of A Myth To The Requirements Of Global Governance' (2010) (3 ERCL) *Columbia University Alliance Program Papers* at <www.columbia.edu/cu/alliance/Papers/Article_Horatia-Muir-Watt.pdf>

3 *Ashby v White* (1703) 92 ER 126: "*Ubi jus, ibi remedium*…If the plaintiff has a right, he must of necessity have a means to vindicate and maintain it, and a remedy if he is injured in the exercise or enjoyment of it".

and is therefore a *wrong*. Under Australian statute, the doctrine of unconscionability in relation to independent instruments remains to be fully formed. In Singapore the courts' equitable jurisdiction provides the head of power to ground injunctions and enjoys much greater clarity.

The protection of the independence principle and the inherent risk-allocation value of independent instruments in the market is paramount. Inept application of the notion of unconscionability on the integrity of the independence principle can damage the reputation of the product and cause rational users to consider alternate products. The obligation on issuers to honour a complying presentation should never be tampered with; it is argued herein that *restraint must always lie against the beneficiary*.

Where *abusive* demands are enabled by the court and serious economic and possibly social harm results from such a demand, the danger to the product's reputation and use profile is arguably greater. Unconscionable conduct in relation to demands on independent instruments have not been comprehensively framed due to a paucity of explanation available on how the special character of independent instruments juxtaposes with the law of unconscionable conduct *as it exists and is developing*. Therefore, a state of dissonance exists in this area of law that requires address.

This thesis *inter alia* posits that pleadings of unconscionability with respect to demands on independent instruments require sufficient materiality to restrain a demand, ie egregious unconscionable conduct needs to be proven *prima facie* to ground an injunction. This does not include a requirement to demonstrate any moral obloquy.

This thesis also provides support for the proposition that to set aside the independence of demand guarantees, and their equivalents, a lesser degree of materiality should be required than for letters of credit. This is proposed subject to the condition that the obligation to honour held by the issuer is not interfered with; that only the demand-right held by the beneficiary is restrained.

It is the object of this research to demonstrate that the intersection of unconscionable conduct and the commercial law can be successfully managed within a clearly defined, inter-jurisdictionally acceptable nomothetic framework. It must be designed to provide guidance for circumscribing the range of behaviours

allowed to negatively impact commercial undertakings and the elements that need to be considered to found a pleading of sufficiently egregious unconscionable conduct.

Section B. Research Contribution, Assumptions and Methodology

1.0 Contribution to the Body of Knowledge

This dissertation contributes original research in the discipline of international letter of credit and demand guarantee law by:

(1) Providing a complete analysis of the jurisprudence in every superior court case dealing with unconscionable conduct in relation to demands on letters of credit and demand guarantees in both Australia and Singapore;

(2) Compilation and discussion of all major letter of credit and demand guarantee governing rules relating to the independence principle;

(3) Providing a framework of elements for independent instrument unconscionability supported by law and analysis.

2.0 Caveat Regarding Reader's Prior Knowledge

This thesis has been researched and written at a doctoral level. Given the character of this study of letters of credit and demand guarantees, it presumed that the reader will have a complete knowledge of the principles of usage and the terminology of the discipline.

It is presumed that the reader will be familiar with the fundamental rule sets operational throughout the industry, and the major organisational stakeholders:

- Uniform Customs and Practice for Documentary Credits (currently UCP600)[4]
- Uniform Rules for Demand Guarantees (URDG758)
- International Standby Practices (ISP98)[5]
- International Standard Banking Practice (ISBP2013)[6]

[4] J Byrne (ed), *LC Rules & Laws: Critical Texts for Independent Undertakings* (Institute of International Banking Law & Practice, Inc., 6th ed, 2014), p.2.
[5] <https://iiblp.org/resources/isp98/>
[6] *Byrne*, n4, 103.

- UNIDROIT Principles of International Commercial Contracts (PICC)[7]
- Principles of European Contract Law (PECL)[8]
- Convention on the International Sale of Goods (CISG)[9]
- United Nations Convention on Independent Guarantees and Standby Letters of Credit (UN-CIGSLC)[10]
- Uniform Commercial Code (USA) (UCC)[11]
- Trade Practices Act/Australian Consumer Law (AUS) (TPA/ACL)[12]
- The Rules Sets of the Supreme People's Court Concerning Hearing Letter of Credit Cases (SPC-LCC)[13]
- International Chamber of Commerce (ICC)
- Institute of International Banking Law and Practice (IIBLP)
- United Nations Commission on International Trade Law (UNCITRAL)

From this point, no footnote reference will be made with respect to any of the above except where specific sections/articles are addressed.

It is also presumed that the reader will be familiar with the various legal systems in which independent instrument law operates and the hierarchies of the court systems.

For more detailed explanations, the reader might refer generally to *Ellinger and Neo*,[14] or Vout's excellent tome on the laws of unconscionable conduct in Australia.[15] Many terms are extensively defined in the various international rule sets that frame documentary credit usage as the reader will be aware.

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7 <www.unidroit.org/english/principles/contracts/principles2004/integralversionprinciples2004-e.pdf>
8 <http://www.jus.uio.no/lm/eu.contract.principles.parts.1.to.3.2002/>
9 <http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html>
10 <http://www.uncitral.org/uncitral/en/uncitral_texts/payments/1995Convention_guarantees_credit.html>
11 <https://www.law.cornell.edu/ucc>
12 *Trade Practices Act* (Cth) 1974: <http://www.austlii.edu.au/au/legis/cth/num_act/tpa1974149/> and *Competition and Consumer Act 2010* (Cth), Schedule 2 - The Australian Consumer Law: <http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/sch2.html>
13 *Rules Concerning Jurisdiction Over Foreign-Related Civil and Commercial Cases* (PRC), 2002; *Rules of the Supreme People's Court Concerning Hearing Letter of Credit Cases* (PRC), 2005; *Independent Guarantee Provisions of the PRC Supreme People's Court* (PRC) 2017: <http://www.asianlii.org/cn/legis/cen/laws/potspcosicttocodoloc1163/>
14 E Ellinger, and D Neo, *The Law and Practice of Documentary Letters of Credit* (Hart Publishing, 1st ed, 2010)
15 P Vout (ed), *Unconscionable Conduct : The Laws of Australia* (Thomson Reuters, 2nd ed, 2009).

3.0 Methodology

The research will use material drawn from the case law and both academic and judicial commentary.

The theoretical research to describe this hypothesis will be doctrinal in nature, and therefore qualitative. The research will consider the black-letter law of the statute, case law and the rule sets on which international commercial law and independent instrument transactions are founded.

Analysis will be conducted in context with the general principles of unconscionable conduct:

a. within equity broadly;
b. considering the general concepts of good faith;
c. as defined in statute proscribing Unconscionable Conduct; and
d. statutory interpretation.

The method for studying 'black-letter' law:

> focuses heavily if not exclusively, upon the law itself as an internal self-sustaining set of principles which can be accessed through reading court judgements and statutes with little or no reference to the world outside the law.[16]

The 'scientific method', described by Karl Popper as the 'hypothetico-deductive' method, has been employed in this thesis.[17] Donley states:

> Deductive research begins with a theory…that leads to the development of a research question or hypothesis to be tested through data that is then collected and analysed…[The] theory generates hypotheses; hypotheses point to certain kinds of data required to test them; data is analysed to determine whether they support a hypothesis or not.[18]

This thesis commences with the hypothesis that a properly-framed category of independent instrument unconscionability can operate to provide injunctive relief against sufficiently material abusive demands while maintaining the integrity of the

16 M McConville, and W Chui (ed), *Research Methods For Law* (Edinburgh University Press, 2007) 4. Also E.L. Rubin, "Law and the Methodology of Law" (1997) *Wisconsin Law Review* 525.
17 K Popper, *The Logic of Scientific Discovery* (Routledge, 2nd ed, 1992).
18 A Donley, *Research Methods* (Publ: Facts On File, 2012), 9.

independence principle and the commercial value of independent instruments themselves. It then sets out to demonstrate that this is so with reference to an international body of law and opinion.

Section C. Terminology, Syntax and Vocabulary

1.0 Usage in This Thesis

Both letters of credit and demand guarantees are 'independent instruments' but the rights and obligations of each operate quite differently and have had their 'independence' treated differently by different courts.[19] Letters of credit are widely referred to as 'Documentary Credits',[20] although the latter term could include other independent instruments.

For most purposes the terms 'Demand Guarantee', 'Independent Guarantee', 'Bank Guarantee', 'Bank Bond', 'Demand Bond', 'Performance Bond', 'Financial Guarantee', and 'Standby Letter of Credit' are functionally identical and are often interchanged or used incorrectly.

Throughout this dissertation these instruments are referred to jointly and severally as 'independent instruments' when being discussed in a general context. They will be referred to separately as 'letters of credit' and 'demand guarantees' when it is necessary to differentiate between them. 'Demand guarantee' will be used when referring to all similar instruments unless discussing a specific instrument related to a specific case, such as a 'performance guarantee'. Original terms will be used in all extracts.

Where the analysis is dealing with specific aspects of unconscionability that only affect demand guarantees, as opposed to letters of credit, notice will be given in the footnotes.

For the purposes of this thesis the term "abusive demand" is a generic which refers to a demand for payment on an independent instrument or similar bank instrument that is *prima facie* fraudulent, unconscionable, oppressive[21] or illegal.[22]

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19 For example: *JBE Properties Pte Ltd v Gammon Pte Ltd* [2010] SGCA 46 [10] (*JBE(No.2)*).
20 For example, UCP600 does not refer to 'Letters of Credit'.
21 *GHL Pte Ltd v Unitrack Building Construction Pte Ltd* [1999] 4 SLR 604 [20] (*GHL*).
22 See generally: N Enonchong, 'The Problem of Abusive Calls on Demand Guarantees' (2007) *Lloyds Maritime and Commercial Law Quarterly* 83.

2.0 Independent Instrument Naming Conventions

The word “guarantee” is widely used for an extensive array of instruments and other fiscal relationships. This thesis does not attempt to formulate any kind of meaningful taxonomy to classify them all. The word now has the nature of a generic. In documentary credit law, ‘Guarantee’ is used to describe both the obligation *and* the instrument.

‘Guarantee’ is also used in the moniker of both dependent *and* independent bank obligations. The terms ‘unconditional’ and ‘independent’ are also interchanged when they mean quite separate things.[23]

US law prohibits banks providing ‘guarantees’ (in the strict banking law sense) and therefore called their ‘demand guarantee’ equivalent instruments ‘standby letters of credit’.[24] ‘Guarantee’ is occasionally used to describe instruments that are in essence a ‘bond’. ‘Guarantee’ is also often modified by a descriptor relating to its function, such as ‘Performance Guarantee’ or ‘Financial Guarantee’.

The Court has repeatedly stated that a Guarantee must be honoured “according to its terms”,[25] meaning in part that it is irrelevant what the issuer or applicant *call* the instrument, its character will be drawn by the rights and obligations provided for in the ‘conditions’ of the instrument and, in the terms of the underlying contract when dependent, or otherwise lacking ‘independence’. Regardless of the *name* given the instrument, if it is **not** independent it is not strictly a Demand Guarantee in its commonly-used sense.

Definition is also provided by the rules sets that govern independent instruments. For example, under UCP600, a ‘Credit’:

> is any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation.[26]

A ‘Guarantee’ under the URDG means:

> any signed undertaking, however named or described, providing for payment on presentation of a complying demand.[27]

---

23 See discussion p.30 under ‘The Nomenclature of Independence’.
24 *Ellinger*, n14, 5. *Chartered Electronics Industries Pte Ltd v Development Bank of Singapore* [Unreported] Suit No 485/1990 [1999] 4 SLR 655, 668[38].
25 *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] QB 159, 171-A.
26 UCP600 [Art.2].
27 URDG [Art.2].

The term 'letter of credit' has been defined as "a specialized commercial document arising from an agreement between a bank and its customer" and are "unique commercial instruments… governed by their own unique rules."[28] There are no contradictions inherent in these two definitions.

3.0 The 'Contractual' Nature of Independent Instruments

Courts often refer to independent instruments as 'contracts'. Strictly speaking, this is inaccurate. Both letters of credit and negotiable instruments such as cheques and Bills of Exchange are considered by some academics as "specialty contracts", as opposed to 'ordinary' contracts.[29]

Wunnicke refuses to take a position either way but points out that the hybrid nature of these instruments makes for controversy. Wunnicke lists five principles of common law contract that have been applied to letters of credit by US courts:

1. Ambiguity is construed against the issuer;
2. Terms should be interpreted in a manner that is "fair and customary and which prudent persons would enter into";
3. The construction of terms should be interpreted to make the letter of credit operable if possible;
4. Where a discrepancy exists, typed or handwritten provisions are to be preferred over those printed;
5. Issuers of credits governed by *UCC* §5-102(a)(7) are subject to a duty of good faith.[30]

What can be said with certainty is that some elements of contract law apply to independent instruments, but not all. Consideration is not required, there is an absence of privity of contract, and the beneficiary incurs any obligations or rights under the terms of the instrument that would normally accrue under a common contract.[31]

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28 *Western Surety Co v North Valley Bank* 2005 Ohio 3453 (Ct. App.).

29 G McLaughlin, 'Exploring Boundaries: A Legal and Structural Analysis of the Independence Principle of Letter of Credit Law' (2002) 119 *Banking Law Journal* 501, 501-503. For an analysis of the history of this term, see B Kozolchyk, 'The Legal Nature of the Irrevocable Letter of Credit' (1965) 14 *American Journal of Comparitive Law* 395, 412[IV].

30 B Wunnicke, D Wunnicke, and P Turner, *Standby and Commercial Letters of Credit* (Wiley Law Publications, 2nd ed, 1996), 5-6.

31 *Kozolchyk*, n29, 400.

None of the legislation or rule sets that govern independent instruments refer to such instruments as 'contracts', preferring such terms as "arrangement",[32] "binding undertaking",[33] and "definite undertaking".[34]

4.0 Referencing, Punctuation and Grammar

Due to the need to minimise word count, and the nature of legal references, an abbreviated form of AGLC referencing is used. Footnotes have been formatted to achieve minimum word count without sacrificing comprehensibility.

Section D. The Argument for Independent Instrument Unconscionability[35]

The purpose for this section is to address the reasoning upon which Chapter Six is premised. This author strongly supports the Courts' prohibition of unconscionable conduct in relation to abusive calls on independent instruments. This thesis contends that the application of both statute and equity is valid, although its jurisprudential foundations have arguably not been sufficiently well reasoned in the courts or in the literature to date.

Despite extensive research, almost no discussion exists in the literature with respect to the rights' relationships in independent instruments.
Kozolchyk in 1965 stated in relation to the study of commercial letters of credit:

> Discussions of the nature of legal institutions are infrequent in contemporary legal literature. Pragmatic inquiries into the use and application of legal institutions, as well as their casuistic evaluation, seem to have displaced their analytic treatment.[36]

The focus of almost all extant research is either on practice matters or examines defences to the *status quo*. Very little of the obiter or literature discusses unconscionability with respect to the rights and powers being affected.

It is proposed here that the reluctance within the industry to accept a lower standard of fraud might reflect this lack of intellectual debate among scholars. It might to some extent be simply reactionary and an adherence to the *status quo*.

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32 UCP600 [Art.2].
33 ISP98 §1.06(a).
34 *UCC-Revd.5* §5-102(a)(10).
35 The expression "Unconscionability Exception" is a bespoke term in the documentary credit/demand guarantee paradigm that refers to the application of principles and law related to unconscionable conduct as an exception to the autonomy of letters of credit and demand guarantees.
36 *Kozolchyk*, n29, 395. This remains the only extant work that thoroughly describes the rights and obligations of commercial letters of credit.

All law should develop and adjust to meet the demands of the market as they arise. The refusal to allow for a lesser standard of fraud can, it is posited, only serve to make demand guarantees less attractive to those called upon to provide them.

It is posited in this thesis that the right to make a demand against an independent instrument – which is referred to herein as the "demand-right" – arises in the underlying contract, and not in the instrument itself. The reasoning in support of this postulation follows.

The obligation undertaken by the issuer is unilateral, ie there is an absence of 'legal relations' (privity) between the issuer and the beneficiary. The issuance of an independent instrument does not compel the beneficiary to meet any obligation or undertake any action with regard to the instrument.

The obligation to honour a complying presentation does give rise to a right to sue for unlawful dishonour.[37] It provides the beneficiary with the *liberty* to make a presentation, but the beneficiary has no *obligation* to do so. There is no demand-right in the instrument itself because this right is founded on the express and implied obligations inherent in the underlying contract.

This position is given strong support by analogy to the fraud exception, which is universally recognised by the courts in the major independent instrument user jurisdictions. The fraud exception allows the issuer to refuse to honour. The fraudulent conduct is completely removed from the instrument itself – it reflects a deliberate abrogation of the contractual commitments (express and implied) in the underlying contract. Where challenged, fraud allows the court to restrain the beneficiary's right to make a demand.[38]

If the demand-right can be denied or restrained for fraud in the underlying contract, it follows that the demand-right arises pursuant to the proper performance of the beneficiary's contractual obligations. It cannot exist anywhere else – the fraudulent conduct does not, in fact *can* not, occur in relation to the obligation to honour.

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37 M Andrews, 'Hohfeld's Cube' (1982-83) 16(3) *Akron Law Review* 471: This follows Hohfeldian logic that an duty/obligation undertaken by one person generally gives rise to a right in another person.

38 In *Olex Focas Pty Ltd v Skodaexport Company Ltd* [1998] 3 VR 380, 406 (*Olex*$^{(No.1)}$) both the beneficiary and the issuer were subject to injunctions. The Court in *Boral*$^{(No.2)}$, n61 [91-92] only restrained the beneficiary. *Board Solutions*, n676 [5] saw both the beneficiary and the issuer restrained. It is argued here that Courts which restrain the issuer's obligation to pay unnecessarily breach the independence of the instrument.

The instrument does not bestow upon the beneficiary any rights except the right to sue for wrongful dishonour. There is nothing therefore in the instrument upon which to found the restraint – here it's proposed to be founded upon the breach in the underlying contract.

That the demand-right is a *substantive* right that arises in the underlying contract was also recognised by the Court of Appeal in *Mount Sophia*:

> [A] finding of unconscionability is a conclusion applied to conduct which the court finds to be so lacking in *bona fides* such that **an injunction restraining the beneficiary's substantive rights** is warranted.[39]

It is arguable whether independent instrument fraud is unlike fraud in the common law in that an allegation of independent instrument fraud can be proved without proving the necessary intention.[40] Gao provides a thorough analysis of the different schools of thought on this, in addition to a study of the materiality of fraud.[41]

The standard of fraud that must demonstrated requires balance. As Gao notes:

> If the standard of fraud for the application of the fraud rule is set too low…it may lead to abuse of the rule by the applicant. Temptation to abuse always exists.[42]

The materiality may be important because 'extent' may be the only meaningful differentiation between independent instrument fraud and independent instrument unconscionability if an absence of intent is not fatal to an allegation of fraud.

Independent instrument unconscionability might be seen as a part of a broad law of fraud in equity. In *Dynamics Corp* it was held that "fraud has a broader meaning in equity [than at law] and **intention to defraud or to misrepresent is not a necessary element**."[43]

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39 *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] SGCA 28 [45] (*Mount Sophia*). Emphasis added. See discussion with respect to lifting the veil of autonomy and the parties restrained at p.129.

40 *Ellinger*, n14, 142 points out that "A potential problem concerns the degree of knowledge of fraud that is required of the beneficiary before he is infected by the fraud exception…actual knowledge rather than constructive knowledge."

41 X Gao, *The Fraud Rule in the Law of Letters of Credit* (Kluwer Law, 2002), 67-73.

42 Ibid 76-77.

43 *Dynamics Corp of America v Citizens & Southern Bank* 356 F.Supp.991 (N.D.Ga 1973), 998-999. Emphasis added.

Typically independent instrument matters in common law jurisdictions alleging fraud are seeking injunctions to restrain the benefit of the instrument. The court will therefore be operating within its equitable jurisdiction and therefore it may consider fraud in equity, and unconscionable conduct. However, it is only with the greatest difficulty that the *material* difference between independent instrument fraud and unconscionable conduct can be made out by the court.[44]

There is little discussion of these matters anywhere in the literature and the overall impression is that the refusal to countenance independent instrument unconscionability is somewhat reactionary.

It has not been settled why a demand-right exists in the contract only for the purposes of setting it aside for fraud, and not for any other purpose. If the demand-right exists in the contract, as this author postulates, then it must also be susceptible to other remedies, such as those for acting unconscionably or (in civil law jurisdictions) failing to act in good faith.[45] The courts in Singapore, Australia, and Malaysia have recognised this, albeit without explaining the doctrinal underpinnings for it as detailed in Chapter Six.

This thesis acknowledges that this view is contrary to independent instrument law and practice to date. However this thesis maintains that the law is – and must be – a living, evolving entity. A failure to grow and adapt is ultimately self-destructive and the accommodation of unconscionability and good faith is necessary to meet the changing demands of the market.

It is also argued herein that the reason the courts in many jurisdictions have failed to allow bad faith and unconscionability as a means to restrain the demand-right is that it has not been argued within a logical framework.

Finally, it is argued in this thesis that the term “unconscionability exception” is a misnomer where the restraint is laid against the demand-right, as opposed to the honour-obligation. Restraining the demand-right, it is posited herein, *reinforces* the independence of the instrument by refusing to interdict the legal obligation of the issuer to honour a complying presentation.

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44 *Westdeutsche Landesbank v Islington* [1996] AC 669: “A person who takes property by means of fraud will have dealt unconscionably with it”. Cited in A Hudson, *Equity and Trusts* (E-Books Corporation, 8th ed, 2015) [Pt.4.12.1.1].

45 For a detailed discussion on contractual good faith, see G Kuehne, 'Implied Obligations of Good Faith and Reasonableness in the Performance of Contracts' (2006) 33 *University of Western Australia Law Review* 63, 65.

Some courts have failed to recognise the difference, and some have gone so far as to say that they are one and the same thing.[46] With respect, this thesis will argue that this position fails to properly recognise the right which is being restrained and is not sustainable.

Only where the obligation to *honour* is restrained does the court reach through the veil of autonomy and interfere with the independence of the undertaking – the abusive behaviour is generally within the underlying contract to which the issuer has no privity. This, in addition to the court's reluctance to undermine the integrity of the instrument itself, must ultimately make the instrument more attractive to rational users.

While fundamental to the overall argument in this thesis, the jurisprudential basis for unconscionability as grounds to restrain the demand-right is only a relatively small part. The courts in Singapore, Australia and Malaysia have determined that unconscionability can in appropriate cases be thus applied. It is the the lack of a complete portrait of the character of this doctrine that this thesis seeks to address. The courts in those jurisdictions have applied unconscionability, and other jurisdictions have considered it. None have satisfactorily described it in any manner that comprises a fully-formed doctrine.

Section E. Chapter Summary

Chapter Two analyses and explains the independence principle – one the fundamental pillars of independent instrument law. Chapter Three examines the law of unconscionable conduct in equity and statute. From these, in conjunction with the independent instrument unconscionability case analyses in Chapters Four and Five, the necessary characteristics of 'independent instrument unconscionable conduct' can be extrapolated and framed in law in Chapter Six.

Chapter Six consolidates the academic and the judicial analyses on the subject provided in Chapters Two through Five to propose a complete description of the Doctrine of Independent Instrument Unconscionability.

[46] See discussion p.129.

Chapter 2. The Independence Principle – Context, Exceptions, Case Law and Legal Analysis

Section A. The Independence Principle

1.0 The Independence Principle in Context

This chapter analyses and explains the terminology and application of the doctrine of independence. This process begins with study of the independence principle, its historical context and economic effect, and its character and scope in light of the extant academic analysis and judicial pronouncements.

A complete table of rules pertaining to independence is provided.

The 'risk allocation' purpose for independence is discussed in conjunction with a brief examination of the two other 'exceptions' to independence, fraud and illegality, for purposes of context and completeness.

In conjunction with the studies on unconscionable conduct provided in Chapters Three, Four and Five, the scope of the doctrine of independence and its legal enforceability are examined in the face of abusive demands.

1.1. Origins and Development of Independence

The law of independent instruments evolved from the *lex mercatoria* or 'merchant law' which developed over centuries to facilitate international trade and to regulate cross-border disputes between traders.[47] With its foundations based in ancient Rome, where *ius gentium* "regulated the economic relations between foreigners and Roman citizens", *lex mercatoria* evolved over centuries and has proven itself remarkably robust. Traces of an ancient *lex mercatoria* have been identified in the middle east.[48]

Much trade law was developed in England during its ascendency as a world trading power in the mid-eighteenth century. London was for a time the world's largest commercial and naval centre; its law literally "ruled the seas".[49] Major clearing banks emerged in London,[50] and the first global trading house, the East India Company, was quartered there during the three hundred years it dominated

47 *McLaughlin*, n29, 553.
48 A Rodriguez, 'Lex Mercatoria' (2002) 2(2) *Retsvidenskabeligt Tidsskrift* 46, 46.
49 Reference to the British national air, "Rule, Britannia!".
50 E Ellinger, *Ellinger's Modern Banking Law* (Oxford Press, 5th ed, 2011), 5[2(i)].

global naval trade.[51] Relatively large private organisations such as Lloyds of London also emerged in the United Kingdom to finance and insure cargo and ships, which fuelled economic growth and trade:[52]

> With innovative responses from financial intermediaries and cooperation between the Treasury and the Bank of England a wider and deeper capital market developed in London to service the financial needs of agriculture, internal trade, and commerce overseas alongside the provision of credit and loans for the state.[53]

The *lex mercatoria* continues to develop internationally to address ongoing developments in trade, finance and technology. Contemporary examples of user-defined trade law include the various rule sets governing independent instrument usage developed by such organisations as the ICC.[54]

However, trade rules *per se* are constrained as to enforcement. They rely on domestic law and judicial systems to decide and enforce dispute settlements. Corte notes:

> [T]he classical theory of the *lex mercatoria* as an autonomous system of law finds its own limits at the enforcement stage…(it) depend(s) upon national law, because at the moment of truth, legitimate enforcement remains a monopoly of the governments of nation states.[55]

Enforcement aside, there has always been a demand for safe and reliable methods of monetary transfer. Bills of exchange and letters of credit arose early to deal with this,[56] and demand guarantees were developed more recently to address new market needs.[57] The associated usage rules were developed and refined over

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51 E Erikson, *Between Monopoly and Free Trade: The East India Company, 1600-1757* (Princeton University Press, 2014), 31: "The period in which the English East India Company grew and expanded [stretched] roughly from 1500 to somewhere between 1750 and 1800."

52 B Allen, 'Lloyd's of London' (1980) 22(5) *Education+Training* 152, 152.

53 L Neal (ed), *The Cambridge History of Capitalism: From Ancient Origins to 1848* (Cambridge University Press, 2014), Ch.12; O'Brien, P., *The Formation of States and Transitions to Modern Economies*, 367.

54 See Ch.1 Sect.C.2.0 above.

55 C Corte, 'Lex Mercatoria, International Arbitration and Independent Guarantees' (2015) 3(4) *Transnational Legal Theory* 345, 347.

56 J Bentley (ed), *The Cambridge World History: The Construction of a Global World* (Cambridge University Press, 2015), Ch.6, F. Trivellato, *The Organisation of Trade In Europe and Asia, 1400-1800*, 176.

57 *Trafalgar House Construction v General Surety and Guarantee Co* [1996] 1 AC 199, 206, per Lord Jauncey of Tullichettle who also observed: "In recent years there has come into existence a creature described as an 'on demand bond' in terms which the creditor is entitled to be paid merely on making a demand for the amount of the bond."

relatively long periods of time, including how these instruments would interface with other elements of the transaction to which they relate.

As a means to deal with fraud in arm's-length transactions, financial instruments assuring payment were separated in principle from the contracts of sale; the principal was fundamentally reliant on honest brokers to make payment to a named beneficiary strictly on the basis of agreed-to documents. The system also relied on a strong, impartial judicial environment capable of enforcing contractual agreements.

Merchants developed the independence principle and it has merged with the growing body of recognised rules comprising modern *lex mercatoria* through mention in multiple rule sets and court opinions. Carr explains:

> Although UCP600 is not law, and cannot of itself mandate the independence of a letter of credit absent law, with regard to independence it does reflect the law merchant. Under modern commercial law, virtually all legal systems give effect to the independent character of the letter of credit.[58]

Ultimately various trading instruments such as Bills of Exchange (which are also independent[59]), in company with their associated usage rules, became so widely used that codification became essential.[60]

The 'independence' of letters of credit and demand guarantees "is a cardinal principle in letter of credit law"[61] but needs to be avoided for the court to ensure the benefit does not flow to satisfy an abusive demand. Courts globally have contributed to the general understanding of the scope of the independence principle and in particular, framed the circumstances where the principle can be avoided. With respect to the integrity of the independence principle, the court ought to restrain the beneficiary from making a demand and not interfere with the bank's obligation to pay.[62] This is partly to maintain market confidence in the instruments themselves and partly for public policy reasons.

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58 J Byrne, *UCP600 - An Analytical Commentary* (IIBLP, 2010), 296.

59 I Carr, *International Trade Law* (Routledge-Cavendish, 4th ed, 2010), 464: "The bill of exchange is an autonomous contract and is not affected by breach in the underlying contract".

60 *Bills of Exchange Act* (UK) 1882; *Bills of Exchange Act* (Cth) 1909; *UCC-Revd.5*, §3-302.

61 *Boral Formwork and Scaffolding v Action Makers Ltd* [2003] NSWSC 713 [22] (*Boral(No.2)*): "an essential characteristic of a letter of credit that it is an autonomous contract". Also *Wunnicke*, n30, 20.

62 See discussion with respect to lifting the veil of autonomy and the parties restrained at p.129.

Ortego states that "[t]he rule of the independence of a letter of credit from the underlying transaction is based on two public policy considerations":

> First, given that in the absence of privity, issuers have no control over the formation or content of the underlying contract, and therefore have no cause to assume any liability for its performance.
>
> Second, that the value of documentary credits to trade facilitation would be degraded if issuers were required to "look beyond the credit's specific terms to [any] underlying contractual controversy".[63]

Reliance on these public policy positions underpins the fortitude of the independence principle.

The independence principle also has a very practical effect – it "gives the letter of credit its unique qualities as a swift, certain, flexible and *economically efficient* payment mechanism and contributes to its widespread acceptance in the international marketplace."[64]

This economic efficiency, in addition to the reduction of risk[65] afforded by independence, makes these instruments more attractive to rational users in the market.[66] For these reasons, courts are reluctant to interfere with the sanctity of financial instrument independence.

There are however exceptions where the Court has seen fit to disregard instrument autonomy. The exceptions include fraud, illegality, and most recently unconscionability. The remainder of this chapter explains and defines the independence principle and its exceptions through the lens of academic and judicial reasoning.

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63 J Ortego, and E Krinick, 'Letters of Credit: Benefits and Drawbacks of the Independence Principle' (1998) 115 *Banking Law Journal* 487, 488. Research reveals no evidence to support this contention.

64 *McLaughlin*, n29, 501. Emphasis added.

65 To the beneficiary at least.

66 *McLaughlin*, n29, 503.

2.0 Nomenclature of 'Independence' and 'Autonomy'

Within the documentary credit world, as with the law generally, adherence to specific terminology is often inconsistently applied in the courts and in the literature. The 'Independence Principle' is occasionally referred to as a 'Doctrine of Independence'. The term 'independence' is often interchanged with 'autonomy', especially in academic literature.[67]

Of further concern is the use, oft-times by judges, of the term 'unconditional' to mean 'independent' when referring to the nature of the independent instrument.[68] Kozolchyk points out:

> The bank's undertaking in an irrevocable letter of credit...may not be considered as an "unconditional promise in writing" since it is conditioned upon the presentation of documents or on the occurrence or non-occurrence of certain events.[69]

These examples are intermingled with terminological confusion regarding the appropriate appellation for the instruments themselves, as discussed above.[70]

'Independence' and 'autonomy', in the context of documentary credits and other independent instruments, refers to the character of the legal relationship between the obligations undertaken by the issuer and all other contractual relationships entered into between any parties related to that transaction, or any other transactional relationship:

> A transaction is independent if that transaction is abstracted from the transactions that gave rise to it so that the LC obligation is not linked to the performance of undertakings that may have given rise to it.[71]

'Independence' in independent instrument terms means that the instrument is independent of the rights and obligations of the parties in all other relationships.[72]

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67 For example: R Garcia, 'The Autonomy Principle of Letters of Credit' (2010) 3(1) *Mexican Law Review* 67 or V Panicker, 'Autonomy, Unconscionability and Entitlement in the Operation of Performance Bonds in Australia' (2009) 25(4) *Building and Construction Law Journal* 230. See also *Ellinger*, n14, 138.

68 For example *Olex*$^{(No.1)}$, n38, 389-390. The use of 'unconditional' stems from the fact that demands against independent guarantees are not 'conditioned' upon any requirement to demonstrate a breach of contract, a debt or other financial obligation, or damage. They are conditioned upon, at very least, the making of a demand.

69 *Kozolchyk*, n29, 414.

70 Chapter 1, Section B1.0, Terminology.

71 *Byrne*, n58, 296.

72 *McLaughlin*, n29, 503.

Much of the language of 'independence' is provided from the international rule sets under which many independent instruments are issued.[73] The language of independent instruments is the language of the user community and not the product of any particular court, jurisdiction, or organ of state.[74]

Both courts and academics often rely on the definitions and commentary provided in the rules sets for usage and clarity of meaning when discussing aspects of independence.[75]

2.1. The Veil of Autonomy

This thesis coins the term "Veil of Autonomy"[76] to describe the character of the legal fiction that exists between two interlinked legal positions or sets of legal obligations.[77]

The fiction holds that where the instrument is independent, the Court is required to maintain a policy of non-interference with these obligations unless an established exception applies.

When discussing the fictional legal firewall between agreements which include an independent instrument, the term 'veil of autonomy' is used throughout to describe it.

73 See the Table of Rules p.39.

74 The committees and working groups who develop these rules sets are staffed on a *pro bono* basis by legal, logistics, insurance, and banking business exponents.

75 *Wunnicke*, n30, 8-9.

76 The term resonates with the well-known "corporate veil" metaphor, especially regarding the necessity for the Court to 'lift' or 'pierce' the veil to ascertain the factual matrix surrounding a demand alleged to be unconscionable (or otherwise).

77 This contributes to the argument about whether independent instruments are in fact 'contracts'. The obligation undertaken by an issuing bank cannot be objectively described as an 'agreement' given that the beneficiary makes no contribution to the terms of the undertaking nor does he adopt any obligations/duties. If the terms of the instrument itself are not compliant with the requirements set out in the terms of the underlying contract, the breach of contract would ground a refusal to perform it. Damages in contract might follow. However, this is speculative and flies in the face of both commercial reality and the fundamental power positions of the parties.

3.0 Theoretical Foundations for the Independence Principle

"The notion of independence is at the heart of the modern letter of credit."[78] The doctrine of independence for letters of credit and demand guarantees is a legal shield developed "to give to a seller the assurance that as long as he presented conforming documents, he would be paid".[79] The effect of the recognised exceptions[80] to the independence of these instruments is to prevent the shield being used as a sword in the form of abusive demands that take illicit advantage of the protection this principle affords the beneficiary.[81]

Much effort has gone into examining the general legal nature of letters of credit and independent instruments[82] to inform the market on how best to frame sound rule sets and control systems. Some of this analysis examines the two doctrinal pillars that underpin the law of independent instruments – the Doctrine of Independence and the Doctrine of Strict Compliance.[83]

The independence principle "plays a central role in letter of credit analysis"[84] and the "separation of the letter of credit from the sale transaction [is] regarded as sacrosanct".[85] Davidson refers to the principle as the "backbone" of letters of credit,[86] describing it as "fundamental, critical and essential to the operation of letters of credit and independent guarantees."[87]

The courts agree. The US Bankruptcy Court in Texas for example held that "[l]etter of credit financing will cease to be a viable component of finance world-wide unless the independence principle is preserved."[88]

McLaughlin suggests that, as a "specialty contract", independent instruments are subject to bespoke rules and "[c]hief among these special rules is the so-called 'independence principle.'"[89] In a broad empirical study, he provides and analyses

78 J Byrne, 'The Four Stages in the Electrification of Letters of Credit' (2012) 3(2) *Journal of International Commercial Law* 253, 278[fn71].
79 *Ellinger*, n14, 138.
80 Fraud, abuse, illegality and unconscionable conduct are all recognised to one extent or another.
81 G Wells, 'The Doctrine of Unconscionability: A Sword As Well As A Shield' (1977) 29 *Baylor Law Review* 309, 309: "The courts of equity have long recognised the doctrine of unconscionability as a 'shield' to prevent enforcement of a grossly unfair and unreasonable contract."
82 For example: *Ellinger*, n14; or *Kozolchyk*, n29.
83 B Kozolchyk, 'Strict Compliance and the Reasonable Document Checker' (1990) 56 *Brooklyn Law Review* 45. Also *Carr*, n59, 474-482. Strict compliance is not dealt with here.
84 *Boyd v Sachs* 153 B.R. 510 (Bankr. W.D. Mich. 1993), 515.
85 *Carr*, n59, 476.
86 A Davidson, *A Comparative Analysis and Evaluation of the Development of the Principle of Autonomy in the Neoteric Letter of Credit Transaction* (Doctoral Thesis, University of Queensland, 2002), 96.
87 *Davidson*, n86, 143. Original hyperbole.
88 *In Re Originala Petroleum Corporation* (1984) 39 BR 1003 (Bankr ND Tex), 1008.
89 G McLaughlin, 'Letters of Credit and Illegal Contracts: The Limits of the Independence Principle' (1989) 49 *Ohio State Law Journal* 1197, 1197.

twenty-three different letter of credit transactions, describing the different party transaction relationships, in order to demonstrate why independence is "so critical to the utility of the letter of credit in both the commercial and financial market places."[90] He describes the nature of the independence principle as "intra-transactional", meaning that the principle:

> separates the letter of credit obligation ***only*** from the other contracts and arrangements that are part of the ***one*** overall commercial or financial transaction.[91]

The corollary of this is that independence does not extend to any transaction or contract "outside its 'intra-transactional' boundaries", ie any dispute "unrelated to the letter of credit".[92]

A strict enforcement of the separation of the independent instrument from the underlying contract is that once an independent instrument is issued:

> [i]t is not open to anyone (including the buyer) to argue that there has been a breach of the underlying contract of sale, and hence, deny the seller payment.[93]

The most widely recognised exception to this rule is where there is fraud in the documents. In some jurisdictions, fraud in the contract will also ground an order for non-payment.[94] The UK and US courts also have different standards of proof for fraud with the former having a very narrow fraud exception and the latter allowing temporary restraining orders for a strong suspicion of fraud.[95]

The fundamental purpose of the independence principle with respect to trade finance instruments is to provide a legal demarcation between the underlying contract entered into between the applicant and the beneficiary, and the contracted-for instrument itself. This ensures that disputes between the contracting parties do not affect the inherent obligation on the issuer to honour the obligation, given a complying demand/presentation.[96]

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90 *McLaughlin*, n29, 528.
91 Ibid 506. Emphasis added.
92 Ibid 502-528.
93 J Chua, *Law of International Trade: Cross Border Commercial Transactions* (Sweet & Maxwell, 4th ed, 2009), 535.
94 J Browne, 'The Fraud Exception To Standby Letters of Credit In Australia: Does It Embrace Statutory Unconscionability?' (1999) 11(1) *Bond Law Review* 98, 101. The fraud exception is developed more fully below.
95 C Murray, D Holloway and D Timson-Hunt (ed), *Schmitthoff's Export Trade - The Law and Practice of International Trade* (Sweet and Maxwell, 12th ed, 2013), 241[11-044,fn295].
96 *Carr*, n59, 477-478.

In the US, the Courts have made clear that it views the independence principle as essential to trade security, stating:

> It would be a calamity to the business world if for every breach of a contract between buyer and seller a party may come into a court of equity and enjoin payment on drafts drawn upon a letter of credit issued by a bank which owed no duty to the buyer in respect of the breach.[97]

The independence principle developed in response to a need to:

- ensure both parties to the underlying transaction are fully aware of where the transaction risk agreed to by the parties is allocated and that this allocation will be preserved in the case of a contractual dispute;[98] and
- insulate this mutually agreed-to allocation of risk from allegations by contractual disputants.[99]

However, Carr is of the opinion that the independence principle does not provide equal rights to the parties. She points out:

> The principle of autonomy favours the banks…and the seller. Banks are not placed under an obligation to ensure that the cargo corresponds to the contract description. Risk is on the buyer, because he cannot involve the issuing bank to police [*sic*] the seller's activities in the exporting country.[100]

Denning MR described a letter of credit as being "like a bill of exchange"[101] with respect to the independence of the obligation to pay from the underlying contract. The autonomy of independent instruments does reflect the autonomy in Bills of Exchange and other negotiable instruments – again, they've both been described as "specialty contracts" and this is therefore unsurprising.[102]

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97 *Frey Son, Inc. v Sherburne Co.* (1920) 193 App. Div. 849 (N.Y. App. Div.), 854.

98 J Dolan, 'Tethering the Fraud Inquiry in Letter of Credit Law' (2006) 21(3) *Banking Finance Law Review* 479, 480.

99 *Ellinger*, n14, 356: "The purpose of the principle [of autonomy] is to insulate the payment system from the transaction, rather than the other way around." Also *Originala*, n88, 1007: "The independence principle preserves the allocation of risk to the issuing bank by requiring the issuing bank to honor a draw request notwithstanding a dispute between the customer and the beneficiary as to an alleged breach of the underlying contract."

100 Carr, n59, 445.

101 *Power Curber International Ltd v National Bank of Kuwait* [1981] 1 WLR 1233, 398(II).

102 *McLaughlin*, n29, 501-503.

In practice, the independence principle is given substance by the constraint on issuers to deal only with documents and not to concern themselves with the terms of, or disputes concerning, the underlying contract.[103] This operational restraint is also an element of the veil of autonomy that protects the beneficiary. However, the Court's dealings with the independence principle is fraught with difficulty, circularity, and inherent contradiction.

To begin, the independent nature of these instruments requires the issuer to honour a demand pursuant to a complying presentation and without reference to other matters.[104] Contrary to this, applications for injunctions to restrain payment require the Court to analyse for example, the construction of the underlying contract, or conduct in relation to its terms, in order to ascertain whether the character of the demand itself or any beneficiary conduct during contract performance should ground restraint.

A court may have to consider terms relating to the "central transaction" itself,[105] terms relating to the demand process,[106] or conduct in relation to either. Either way, any analysis of terms or behaviour confounds independence because a strict application of the independence principle provides that a complying presentation on an independent instrument must be met without reference to *any other thing*. Ergo, the inherent contradiction.

While not expressly addressing this contradiction, McLaughlin explains the effect of the principle in practice. He first notes that the issuance of an independent instrument depends on the existence of a condition precedent within a contract or other arrangement. Typically an independent instrument's existence is a condition precedent to the operation of an underlying contract.[107] Therefore in such cases the beneficiary of the obligation under the independent instrument that arises upon issue[108] must be formally advised before any obligations under the contract of sale can arise. One acts *a priori* to the other.

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103 Ademuni-Odeke, *Law of International Trade* (Blackstone, 1999), 285.

104 Issuers refer to their client's instructions; the rule set under which it is issued (if any); and international standard banking practice rules.

105 For example *Min Thai*, n591, where a *force majeur*e clause was held to operate.

106 For example *Asplenium(No.2)*, n212, where the parties had contractually agreed not to avail themselves of the unconscionability exception.

107 *McLaughlin*, n29, 505. It is possible to construct a scenario where there is no underlying contract. For example where a party has an independent instrument issued to a beneficiary as a demonstration of good faith but in the absence of any underlying undertaking on the part of the beneficiary. Also demand guarantees are regularly issued between parent and subsidiary companies without a formal underlying contract: K Sindberg, 03 August, 2017 correspondence with this author.

108 UCP600 [Art.7(b)]: An issuing bank is irrevocably bound to honour as of the time it issues the credit.

McLaughlin explains:

> Once the letter of credit obligation becomes enforceable against the issuer, the independence principle in a sense "cuts the credit loose" from these prior enabling arrangements…"[A] letter of credit is traditionally an instrument of commerce that travels with no baggage except that which is acquired by its terms."[109]

This is especially important with regard to developing an understanding independent instrument unconscionability.

Byrne has expressed serious reservations about some court's understanding of the independence principle.[110] In a similar vein, he also expressed the view that "[s]ome courts, however, turn LCs into mush by treating LC rights and obligations like those under ordinary contracts or suretyship arrangements."[111]

The independence principle not only acts to separate the obligation under the independent instrument from all other transactions, but also facilitates the operability of other fundamental elements of the rules that apply. For example, it is the *efficacy* of autonomy that enables banks to meet their obligations as to document examination and strict compliance within relatively tight time frames.[112] If banks were required to enquire further than the face of the documents presented under a demand, it would likely be impossible to meet any five banking-day[113] or seven business-day[114] examination limit, with the possible result that the issuer would be precluded from asserting any non-compliance.[115] This efficiency dividend provides an economic benefit to the issuer with the knock-on effect that the instruments are less expensive to use.

Independent instruments are arguably a unique type of arrangement and required specialised rules to manage the various obligations and rights among the parties. McLaughlin, while discussing the scope and limitations of the doctrine of independence, states:

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109 *McLaughlin*, n29, 505. The case referred to: *In Re Air Conditioning* 72 B.R. 657 (S.D. Fla. 1987). Under UCP600 [Art.7(b)] the obligation becomes enforceable immediately upon issue.

110 J Byrne, 'Why Judges Should Keep Their Consciences Out of LC Fraud Issues' (2009) (April) *Documentary Credit World* 20.

111 J Byrne, and C Byrnes (ed), *Institute of International Banking Law & Practice Annual Survey* (Institute of International Banking Law & Practice, 1999), 35. Also *Rickett*, n329.

112 *McLaughlin*, n29, 527.

113 *Inter alia*, UCP600 [Art.14(b)].

114 Ibid [Art.16(f)]; *UCC-Revd.5* §5-108(b).

115 The 'preclusion' rule is provided *inter alia* in ISP98 [Art.5.03(a)].

> Exploring the boundaries of the independence principle requires not only careful statutory and rule analysis but attention to mercantile policies as well. One must always keep in mind that the independence principle is a rule of specialty contracts and grew out of the *lex mercatoria*.[116]

In summary, the independence principle is a fundamental element to the function and strength of independent instruments. It enables swift and sure payment, and is economically rational. Once issued, the obligation rests with the issuer and the underlying contract no longer impinges on that obligation.

4.0 Legal Regimes Grounding the Independence Principle

As stated, the independence principle arose from the *lex mercatoria* or 'customary law'. Analogous to the law of equity itself, *lex mercatoria* has over time developed sophisticated sets of rules that are on an equal footing to other purpose-developed rule sets within national legal systems.[117]

However, over time the rules of practice have, to differing extents, been formalised and in some jurisdictions, legislated. Mandatory provisions have been enacted in the US and two rule sets have been decreed by the Chinese Supreme People's Court.[118]

Discussing historical trade usage of independent instruments, Corte states:

> [D]ue to practical, economic and political reasons, some of these terms, practices and usages of trade have become virtually universal…Due to their importance, and with a view to imbuing them with more certainty, these usages of trade have been collected and written, and to a certain extent codified and 'positivised', by international organisations of traders, such as, quintessentially, the International Chamber of Commerce.[119]

In the process of 'positivising' the usage rules relating to 'specialty contracts', the independence principle has by necessity been formally

116 *McLaughlin*, n29, 553.
117 *Corte*, n55, 351-355.
118 *Byrne*, n4, 303. Within the Chinese LC economy, the UCP is "the norm in both law and practice."
119 *Corte*, n55, 356.

defined and explained in a number of legal 'regimes',[120] including those promulgated and endorsed by the ICC.

These regimes are the jurisprudential footings for the principle and are drawn from independent instrument law internationally.

The most significant 'regimes'[121] are:

1. Uniform Customs and Practice for Documentary Credits (UCP)
2. Uniform Commercial Code (UCC)
3. International Standby Practices (ISP98)
4. United Nations Convention on Independent Guarantees and Standby Letters of Credit (UN-CIGSLC)
5. Uniform Rules for Demand Guarantees (URDG758)

In addition, of critical importance to global trade, in 2002 and subsequently in 2005 the independence principle was recognised within Chinese law:

6. Rules of the Supreme People's Court of China

The following legal regimes also support the Principle:

- The Common Law[122]
- The General Law[123]
- Uniform Rules for Bank Payment Obligations (URBPO)[124]
- Uniform Rules for Contract Guarantees (URCG)[125]
- Uniform Rules for Bank-to-Bank Reimbursements Under Documentary Credits (URR)[126]
- United States Comptroller of Currency Interpretive Letter §7.106[127]

120 *Davidson*, n86 discusses the regimes in his unpublished doctoral dissertation.

121 The specific rules/articles relevant to the independence principle in these five 'regimes' are analysed in §5.0. below.

122 This is with reference to the international legal systems which recognise the principle of *stare decisis*, such as members of the British Commonwealth, the United States and Canada. They generally also have an equity jurisdiction.

123 This refers to all legal systems not included under the 'common law' classification.

124 *Uniform Rules for Bank Payment Obligations* (URBPO), section 6(a): "A BPO is separate and independent from the sale or other contract on which the underlying trade transaction may be based."

125 *Uniform Rules for Contract Guarantees* (URCG325). Replaced by URDG458 but provided here for completeness.

126 *Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits* (URR725) [Art.3] which provides for independence between "a reimbursement authorization…[and]…the credit to which it refers".

127 Davidson has indicated that he does not agree with Dolan that this constitutes a separate regime as it fails to provide any additional authority other than that provided under the laws and rules already in place. Listed for the sake of completeness. See J Dolan, 'Weakening the Letter of Credit Product: The New Uniform Customs and Practice for Documentary Credits' (1994) 2 *International Business Law Journal* 149 [fn50].

5.0 The Independence Principle in Documentary Credit Rule Sets

A review and analysis of the independence principle in the most widely referred-to rule sets follows.

5.1. Independence in Documentary Credit Rule Sets

The Independence Principle in Independent Instrument Rules Sets	
Article or Rule	**Comment**
Uniform Customs and Practices (UCP600)	
Article 4 Credits v. Contracts a. A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary. A beneficiary can in no case avail itself of the contractual relationships existing between banks or between the applicant and the issuing bank.	Article 4, UCP600 is widely referenced in the literature in relation to the independence principle.[1] The language and comprehensive character of this article lends itself to use as an exemplar for explaining the effect of the principle. Part a. describes the independent nature of letters of credit issued under the rules, constrains the Bank, and restrains the rights of both the applicant and beneficiary in relation to any contracts within the particular transaction.
b. An issuing bank should discourage any attempt by the applicant to include, as an integral part of the credit, copies of the underlying contract, proforma invoice and the like.	Sub-rule 4(b) exhorts the issuing bank to encourage instrument independence by discouraging applicants from including any element of the underlying or associated contracts into the instrument itself.
Article 5 Documents v. Goods, Services or Performance Banks deal with documents and not with goods, services or performance to which the documents may relate.	Article 5 deals with the obligation of the banks involved to ensure that compliance is based on the documents alone. Banks should disavow involvement in any matter other than the documents presented to establish the right to make a drawing on the letter of credit, except where fraud is brought to their attention.
Article 7 Issuing Bank Undertaking c. An issuing bank undertakes to reimburse a nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the issuing bank. Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not the nominated bank prepaid or purchased before maturity. An issuing bank's undertaking to reimburse a nominated bank is independent of the issuing bank's undertaking to the beneficiary.	Articles 7(c) and 8(c) provide for the undertakings by the issuing and confirming banks respectively. They provide that the obligation to reimburse other banks in the transaction is "independent of the (issuing/confirming) bank's undertaking to the beneficiary."

[1] Independence has been an element of independent instrument rule sets since at least the UCP82 in 1933. Article 1: "Commercial Documentary Credits are essentially distinct transactions from sales contracts, on which they may be based, with which Banks are not concerned.".

Uniform Customs and Practices (UCP600) [cont'd]	
Article 8 Confirming Bank Undertaking c. A confirming bank undertakes to reimburse another nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the confirming bank. Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not another nominated bank prepaid or purchased before maturity. A confirming bank's undertaking to reimburse another nominated bank is independent of the confirming bank's undertaking to the beneficiary.	
Article 14 Standard for Examination of Documents a. A nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank must examine a presentation to determine, on the basis of the documents alone, whether or not the documents appear on their face to constitute a complying presentation.	Article 14(a) sets out standards for document examination, reinforces the independence of letters of credit by constraining such examination to the documents presented and not to any other matter other than fraud. It is not within the issuer's mandate therefore to question further or to withhold payment on any basis other than non-compliant documents.
Uniform Commercial Code (UCC) Revised Article 5 – Letters of Credit	
Section 5-103. Scope. (d) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.	The 'Official Comment' to UCC Section 5-103 makes clear the general intent of Article 5 in relation to the independence of letters of credit, stating that "the independence principle recognized throughout Article 5 states that the issuer's liability is independent of the underlying obligation."
Section 5-108. Issuer's Rights and Obligations. (f) An issuer is not responsible for: (1) the performance or nonperformance of the underlying contract, arrangement, or transaction.	The UCC provides, with regard to the obligations of the issuer, complete independence from all substantive unconscionability.

The Independence Principle in Independent Instrument Rules Sets	
Article or Rule	**Comment**
International Standby Practices (ISP98)	
Rule 1.06 Nature of Standbys a. A standby is an irrevocable, independent, documentary, and binding undertaking when issued and need not so state.	The ISP98 rules are used to govern standby letters of credit and demand guarantees.[2] The Preface to the rules declares that the ISP is "more precise" than the UCP because the ISP98 "states the intent implied in the UCP rule".[3] This 'precision' is apparent, particularly with respect to the independence of standbys under the rules: Each of the elements of this definition is addressed sequentially in subsequent sub-sections.
c. Because a standby is independent, the enforceability of an issuer's obligations under a standby does not depend on: i. the issuer's right or ability to obtain reimbursement from the applicant; ii. the beneficiary's right to obtain payment from the applicant; iii. a reference in the standby to any reimbursement agreement or underlying transaction; or iv. the issuer's knowledge of performance or breach of any reimbursement agreement or underlying transaction.	The Official Commentary to this rule notes that the inter-related transactional environment in which standbys are issued is complex but [t]he obligation under a standby does not depend upon any relationship or undertaking except the undertaking of the issuer to the beneficiary…even if the standby contains a reference to the underlying agreement…[4]
Rule 1.07 Independence of the Issuer-Beneficiary Relationship An issuer's obligations toward the beneficiary are not affected by the issuer's rights and obligations toward the applicant under any applicable agreement, practice, or law.	The Official Commentary to this rule describes it as "a formulation of the independence principle" rendered to spare drafters of standbys the need to "formulate the independence principle in each standby". The Commentary states comprehensively: No defence or claim, whether based on the lack of or failure of consideration running from the applicant to the issuer, absence of causa, applicant insolvency, non-reimbursement, misrepresentation or fraudulent inducement by the applicant can excuse the issuer's obligation under the standby.[5]

[2] J. Byrne (ed), *LC Rules & Laws: Critical Texts for Independent Undertakings* (Institute of International Banking Law & Practice, Inc., 6th ed, 2014), 29, *Editor's Overview to the ISP98*.
[3] J. Byrne (ed), *LC Rules & Laws: Critical Texts for Independent Undertakings*, 31, *Preface to the ISP98*.
[4] J. Byrne, *Official Commentary on International Standby Practices, (1998)* (Institute of International Banking Law & Practice, Inc., 1998), 26[5].
[5] J. Byrne, *Official Commentary on International Standby Practices, (1998)*, 29[2].

United Nations Convention on Independent Guarantees and Standby Letters of Credit	
Article 3. Independence of undertaking For the purposes of this Convention, an undertaking is independent where the guarantor/issuer's obligation to the beneficiary is not: (a) Dependent upon the existence or validity of any underlying transaction, or upon any other undertaking…; or (b) Subject to any term or condition not appearing in the undertaking, or to any future, uncertain act or event…"	The Explanatory Note to the Convention by the UNCITRAL Secretariat explains that the Convention is particularly designed to facilitate the use of independent guarantees and stand-by letters of credit…[and]…also solidifies recognition of common basic principles and characteristics shared by the two.[6] Among these "principles and characteristics" is the Independence Principle. The Explanatory Note states that "[t]he relationship between the guarantor/issuer and its customer…largely falls outside the scope of the Convention",[7] i.e. the contractual relationship between those parties is independent of any issued standby or guarantee and therefore is beyond the scope of the Convention.
Uniform Rules for Demand Guarantees (URDG758)	
Article 5: Independence of Guarantee and Counter Guarantee (a) A guarantee is by its nature independent of the underlying relationship and the application, and the guarantor is in no way concerned with or bound by such relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claims or defences arising from any relationship other than a relationship between the guarantor and the beneficiary.	It is noteworthy that the URDG refers to the underlying 'relationship' which broadens its scope insofar as it does not reference a 'contract' specifically.
Article 6: Documents v. Goods, Services or Performance Guarantors deal with documents and not with goods, services or performance to which the documents may relate.	Almost identical to UCP600 Article 5. The article supports a narrow view of the scope of the guarantor's responsibilities.

[6] *Explanatory Note by the UNCITRAL Secretariat on the UN-CIGSLC* (1995), Introduction, [2].
[7] *Explanatory Note by the UNCITRAL Secretariat on the UN-CIGSLC* (1995) [6].

Rules of the Supreme People's Court of China	
Article 5: Time for Honor of Letter of Credit Undertaking …A people's court shall not give effect to a defence based on the underlying transaction between the applicant and the beneficiary unless it is based on the circumstances provided in Article 8 [*fraud provision*].	The People's Republic of China has become "one of the largest users of letters of credit in the world.[8] As early as 2002, use of letters of credit for trade purposes in China had increased exponentially and the litigation which followed that rise created jurisdictional issues in the absence of any letter of credit law *per se*. To begin the process of alleviating this situation, the Supreme People's Court handed down a set of guidelines for dealing with letter of credit cases, included "reserving" letter of credit cases for special courts with expertise in the area.[9] The 2005 Rules is an "opinion" handed down by the Supreme People's Court to "provide a useful skeletal framework for the evolution of Chinese letter of credit law that should be the envy of most other legal systems".[10] The 2005 rules also deal with independence of the letters of credit, albeit in a somewhat unobtrusive manner.
Article 7: Independence in Examination and Waiver The issuing bank has rights and obligations to examine the documents independently, is entitled to determine by itself whether or not the documents appear on their face in compliance with the terms and conditions of the Credit or consistent with one another, and can decide by itself whether to accept or reject the documents if they are discrepant.	The meaning of the phrase "examine documents independently" is unclear but it could be taken to mean that the examination is undertaken independently of any consideration of any other documents or transactions. This is probably a translation confusion. "Independent examination" could be taken to mean that the examination of the documents is done independent of the results of any other examination conducted by a Confirming or Nominated bank.

5.2. Summary – Independence in Independent Instrument Rules Sets

From the above independent instrument governance it's clear autonomy is so fundamental that every major rule set incorporates reference to it. The independence principle makes these instruments functional and contributes to their unique commercial character in the world of international trade finance.

6.0 Case Law on Independent Instrument Independence

The disengagement of the obligations and rights under independent instruments, allows the parties to predetermine the allocation of risk in the event of dispute.[128] To protect this contractual freedom as a matter of public policy, the principle requires judicial recognition and strict enforcement.

Courts globally have provided this – "[t]he number of cases applying the independence principle is legion".[129] The *lex mercatoria*-developed independence principle as it applies to letters of credit and demand guarantees has long been a widely-accepted principle of law.[130] The application of the principle is nuanced however, with independent instruments enjoying different degrees of strictness in enforcement.[131]

The independence principle has a powerful pedigree. It has been addressed and affirmed in the world's highest courts. It is universally recognised in practice.

As Mugasha notes:

> [T]he ethos among some judges seems to be moving away from applying strict commercial doctrine, which is the cornerstone of mercantile specialities such as letters of credit, towards enforcing broad standards of conduct which appeal to public perceptions of fairness and justice.[132]

128 R Johns, and M Blodgett, 'Fairness at the Expense of Commercial Certainty: The International Emergence of Unconscionability and Illegality as Exceptions to the Independence Principle of Letters of Credit and Bank Guarantees' (2011) 31 *Northern Illinois University Law Review* 297, 306.

129 *Wunnicke*, n30, 20[§2.7].

130 It is beyond the scope of this paper to do more than note a few relevant cases in the jurisdictions of Australia, Singapore, Malaysia, the UK, and the US.

131 *JBE(No.2)*, n19 [10]. Also K Loi, 'Two Decades of Restraining Unconscionable Calls On Performance Guarantees - From Royal Design to JBE Properties' (2011) 23 *Singapore Academy of Law Journal* 504, 505[II.2]. See discussion p.249.

132 A Mugasha, 'Enjoining The Beneficiary's Claim On A Letter Of Credit Or Bank Guarantee' (2004) 1 *Journal of Business Law* 515

In the 1941 seminal US letter of credit fraud case, *Sztejn*, Shientag J stated:

> It is well established that *a letter of credit is independent of the primary contract of sale* between the buyer and the seller. The issuing bank agrees to pay upon presentation of documents, not goods. This rule is necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade.[133]

The independence principle was also specifically addressed in 1958 by the British Court of Appeal in *Hamzeh*.[134] Jenkins LJ stated the Court's view that a confirmed documentary credit:

> imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties.[135]

The Court's view is quite clear from the outset that no contractual dispute between the applicant and beneficiary is a considered variable for the issuer when determining whether to meet a complying demand. In the US, Smith J held in *Venizelos* that "[t]he letter of credit constitutes the sole contract of the bank with the seller and is completely independent of the other contracts."[136]

In another seminal independent instrument case, *Edward Owen Engineering*, Browne LJ stated:

> It is well established that in the case of a confirmed irrevocable credit in respect of a contract for the sale of goods the confirming bank is not in any way concerned with disputes between the buyers and the sellers under the contract of sale which underlies the credit.[137]

In 1979 Barwick CJ stated in *Wood Hall*:

> [T]here is no basis whatever upon which the unconditional nature of the bank's promise to pay on demand can be qualified by reference to the terms of the contract between the contractor and the owner. Equally, there is no basis on which the owner's unqualified right at

133 *Sztejn v J Henry Schroder Banking Corporation* (1941) 31 N.Y.S. 2d 631, 633. Emphasis added.
134 *Hamzeh Malas and Sons v British Imex Industries Ltd* [1958] 2 QB 127 (*Hamzeh*).
135 Ibid Jenkins LJ [2].
136 *Venizelos, S.A. v. Chase Manhattan Bank* 425 F.2d 461, 465 (2d Cir.1970) [8].
137 *Edward Owen*, n25, 172[G].

> any time to demand payment by the bank can be qualified by reference to the terms or purpose of that contract.[138]

This statement provides for an autonomy principle with two distinct branches:

1. the duty of the issuer to pay; and
2. the right of the beneficiary to make a demand.

This point is important insofar as the application for injunctions is concerned, because either the duty to pay or the right to demand (or both) can be enjoined. For the integrity of the independence principle, the demand-right which, it is posited in this thesis, arises out of the underlying contract, must be restrained and the issuer's duty to honour left undisturbed.[139]

This is supported in *Mount Sophia* where the Court of Appeal stated that sufficiently material unconscionable conduct warrants "an injunction restraining the beneficiary's substantive rights."[140]

The parties in *Wood Hall* aided the Court by having the issuer include independence as a condition:

> In each of the performance guarantees there was an express provision that the liability of the Bank should not be discharged or impaired by reason of any variation or variations in any of the stipulations or provisions of the contract or things to be done under it.[141]

In *Power Curber*, the UK Court of Appeal led by Denning MR stated:

> It is vital that every bank which issues a letter of credit should honour its obligations. The bank is in no way concerned with any dispute that the buyer may have with the seller.[142]

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138 *Wood Hall Ltd v Pipeline Authority* (1979) 24 ALR 385, 387 (*Wood Hall*).

139 *Olex(No.1)*, n38, 396: "[by] restraining the bank from honouring that [letter of credit] undertaking…at all frequently, the value of all irrevocable letters of credit and performance bonds and guarantees will be undermined." Also see the discussion on the difference between enjoining the beneficiary versus the issuer, commencing at p.128.

140 *Mount Sophia*, n39 [45].

141 *Wood Hall*, n138, 395. Typically today no mention of the underlying contract is made in the independent instrument.

142 *Power*, n101, 398.

In the US meanwhile, the Court examined the state Uniform Commercial Code in *Colorado National Bank*. After quoting from the authorities that the "independence of the letter of credit from the underlying contract has been called the key to the commercial vitality of the letter of credit",[143] the Court held:

> The letter of credit is essentially a contract between the issuer and the beneficiary and is recognized by [*UCC* Art.5] as **independent of the underlying contract** between the customer and the beneficiary…In view of this independent nature of the letter of credit engagement the issuer is under a duty to honor the drafts for payment which in fact conform with the terms of the credit without reference to their compliance with the terms of the underlying contract.[144]

In the 1983 appeal to the House of Lords in *United(No.4)*, Lord Diplock affirmed the independence principle when describing the letter of credit transaction cycle by stating that "[i]t is trite law that there are four *autonomous though interconnected* contractual relationships involved."[145]

Of these his Honour expanded on the relationship between the issuer and the beneficiary and the importance of independence, noting that "autonomy of the documentary credit…is its *raison d'etre*".[146] The Court held that the "seller's right to payment by the confirming bank…[was independent of]…the buyer's rights against the seller under the terms of the contract for the sale of goods."[147]

In 1990 Singapore, Thean J in the earliest 'unconscionability exception' case in that jurisdiction, *Royal Design*, followed *Edward Owen*, quoting that "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".[148] Five years later, also in Singapore, Karthigesu JA in *Bocotra* noted that from "a comprehensive and judicious survey of the relevant case law" that "four principles may be extracted" including that under

143 *Colorado National Bank v Board of County Commissioners* 634 P.2d 32 (1981) [*CNB*].
144 Section 4-5-114, *Official Comment 1*, C.R.S. 1973. Cited in *CNB*, n143, 37. N.B.: C.R.S. = Colorado Revised Statute. Emphasis added.
145 *United City Merchants v Royal Bank of Canada* [1983] 1 A.C. 168 HoL, *United(No.4)*, 183. Emphasis added.
146 Ibid 185.
147 Ibid 185.
148 *Royal Design Studio Pte Ltd v Chang Development Pte Ltd* [1990] SLR 1116 [16] (*Royal Design*) citing *Edward Owen*, n25, 26.

"[t]he 'autonomy' principle — the guarantee constitutes a separate contract from the underlying transaction".[149]

Despite the statements made in *Colorado National Bank* heard twelve years earlier,[150] Wunnicke describes the independence principle in the US as "unequivocally confirmed, applied, and clearly set forth in *Optopics Laboratories*".[151]

The independence of letters of credit under UCP500 Art.3 was confirmed in *Montrod.*[152] The Court acknowledged autonomy as set down in those rules, holding that the issuer was obliged to make payment when the documents presented were compliant "on their face"[153] irrespective of any other consideration. Potter LJ, following the finding in *United(No.4)*, stated that Lord Diplock had in that matter "resoundingly affirmed the autonomous nature" of letters of credit in relation to the underlying contract.[154]

In the US in 2010, independence was held to survive bankruptcy of the applicant. In *BankPlus*,[155] the issuer of the letter of credit refused to honour a complying presentation on the basis that their customer had filed for bankruptcy[156] and there was no likelihood that the issuer would be able to collect the funds owing. The Court relied on *UCC* Art.5, UCP600,[157] and relevant case law to find that the obligation held by the issuer to the beneficiary was independent of any other matter, including the account holder's bankruptcy:

> Insofar as letters of credit embody obligations between the issuer and beneficiary, such contractual rights and duties are entirely separate from the debtor's estate.[158]

Finally, as explained below,[159] in *Boustead(No.1)* the Court held that autonomy applied to a 'Facilities Agreement' between the Plaintiff and his bank and subsequently extended along a chain of transactions which included guarantees and counter-guarantees:

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149 *Bocotra Construction Pte Ltd v A-G (No.2)* [1995] 2 SGCA 51 [33(a)-(d)] (*Bocotra*).
150 *CNBD*, n143.
151 *Optopics Laboratories Corp. v Savannah Bank of Nigeria* 816 F.Supp. 898 (SDNY, 1993). *Wunnicke*, n30, 21.
152 *Montrod*, n286 [22].
153 Ibid [37].
154 Ibid [45].
155 *US Bank National Association v BankPlus* (2010) WL 1416505 (S.D.Ala., 2010) (*BankPlus*).
156 Ibid 7[IV.A].
157 [Art.15].
158 *BankPlus*, n155, 8[IV.A].
159 See discussion in *Arab Banking Corporation v Boustead Singapore Ltd* [2016] SGCA 26 (*Boustead(No.2)*) p.180: "Applying the unconscionability exception to financial services agreements was a considerable widening of its scope."

> The principle of autonomy posits that the underlying contract...is independent from the guarantee. The guarantee is, in turn, independent from the counter-guarantee...The corollary of the principle of autonomy is...that the issuer is concerned with documents and not external facts. This means that the guarantor or counter-guarantor pays against and only against a demand for payment accompanied by the presentation of specified documents…Apart from the conformity of the demand or documents, the guarantor or counter-guarantor is not concerned with the truth or accuracy of the statements contained within those documents.[160]

The case law demonstrably favours a resilient independence principle, holding that, with few exceptions, the obligation to pay is strict and autonomous from consideration of any other matter.

Note on 'The Status Quo"

Courts, when explaining their decision to allow an *ex parte* injunction to stand, sometimes declare themselves to be maintaining the 'status quo'.[161] The '*status quo*' to which the parties contractually agreed is actually one where, in the case of dispute and in the absence of fraud, the issuer's obligation to pay is absolute upon receipt of a complying presentation.[162]

160 *Boustead Singapore Ltd v Arab Banking Corporation* [2015] SGHC 63 (*Boustead*$^{(No.1)}$) [52-53].

161 See *Olex*$^{(No.3)}$ discussion p.191.

162 Note that the '*status quo*' has wrongly been held to be the maintenance of the interlocutory injunction, which in fact *breaches* the *status quo* as represented in the rights afforded under the terms of the independent instrument.

7.0 Risk Allocation: The Practical Effect of the Independence Principle

The allocation of risk provided by the autonomy principle[163] creates risk asymmetry in favour of the beneficiary, with the potential to facilitate abusive demands.[164] As noted in *Boral*$^{(No.2)}$, independent instruments are "to protect the beneficiary from carrying credit risk during the course of a dispute".[165]

The fewer documents of evidence that are required to constitute a complying presentation, the easier it may be for a beneficiary to make an abusive demand. While there is no empirical evidence available to suggest that this procedural ease significantly increases the likelihood of abusive demands, it is a reasonable proposition to make. Documentary credits for which a complying presentation requires only a simple demand with no additional documentation[166] are particularly at risk.[167]

The Court in Singapore has repeatedly expressed concern about abusive demands, stating in *GHL*: "It should not be forgotten that a performance bond can be used as an oppressive instrument".[168] It is in part to offset the risk of such oppressive behaviour that the Court in that jurisdiction developed the unconscionability exception to independence.[169]

Recognising this risk, the Court in *Sumatec*$^{(No.3)}$ stated:

> [T]he certainty of payment to the beneficiary under the autonomy principle has tipped the balance of risk heavily in favour of the beneficiary, sometimes resulting in inequitable result to the account party whilst achieving the desired commercial result.[170]

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163 *Originala*, n88, 1007: "The independence principle preserves the allocation of risk to the issuing bank by requiring the issuing bank to honor a draw request notwithstanding a dispute between the customer and the beneficiary as to an alleged breach of the underlying contract."

164 Y Zhang, 'Documentary Letter of Credit Fraud Risk Management' (2012) 19(4) *Journal of Financial Crime* 343, 344: "This instrument has two fundamental principles: the autonomy or independence principle and the doctrine of strict compliance. Such principles intending to facilitate international transactions make L/C easy to be abused by fraudsters."

165 *Boral*$^{(No.2)}$, n61 [36].

166 Sometimes referred to as a 'clean credit' or 'suicide credit': *Wunnicke*, n30, 18.

167 As *Loi*, n131, points out: "An employer who makes a call on the contractor's performance guarantee exerts enormous financial pressure on the contractor; calls, if abused, may be extremely oppressive."

168 *GHL*, n21, [20].

169 T Rodrigo, 'Unconscionable Demands Under On-Demand Guarantees - A Case of Wrongful Exploitation' (2012) 33 *Adelaide Law Review* 481, 484.

170 *Sumatec Engineering and Construction v Malaysian Refining Company* [2012] 3 CLJ 401, 414[20] (*Sumatec*$^{(No.3)}$).

However, in defence, Johns and Blodgett assert:

> Despite this asymmetry in protection, the independence principle preserves the utility of these instruments by reducing payment and delivery risks to levels the parties nevertheless find acceptable.[171]

The asymmetry in the risk allocation[172] is in part a reflection of the power asymmetry extant between transacting parties in almost every commercial transaction[173] – it is relatively unusual for parties to have equal leverage in a bargain. The power imbalance in turn reflects the capacity of one party to offset their own risk relative to that of their trading partner through introduction of contractual terms such as those requiring provision of an independent instrument.[174]

Independent instruments in their various guises, while theoretically acting as a cash equivalent or to secure against breach or consequent damage, do not necessarily require proof that either has been suffered for a demand to be complying.

However, if the instrument requires that the beneficiary make a statement to that effect, and it can later be proved that the beneficiary knew it was not true when it was made, a case of fraud can be made out more easily against that person.[175]

It is this very attribute, the 'Veil of Autonomy', that makes demand guarantees more attractive to rational users.

Risk-laden transactions for the sale of goods, notably in international trade, are often facilitated by 'commercial' letters of credit.[176] These are honoured on presentation of a complying document portfolio typically involving documents that verify and authenticate delivery, transport, and contractual performance. As a result these particular instruments have a far more balanced risk symmetry than

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171 *Johns*, n128, 307.

172 J Rindt, and S Mouzas, 'Exercising Power in Asymmetric Relationships: The Use of Private Rules' (2015) 48 *Industrial Marketing Management* 202, 202: "[A]symmetric business relationships are those relationships where there is an imbalance of power between the counterparts…In asymmetric business relationships, the stronger party is likely to be able to dominate and exercise power over the conclusion of contracts and, thereby determine the processes and outcomes of the relationship".

173 *Burleigh Forest Estate Management v Cigna Insurance Australia* [1992] 2 Qd R 54, 59: "Performance bonds…are really a risk distributing device agreed upon by the principal contracting parties."

174 K Cowan, A Paswan, and E Steenburg, 'When Inter-firm Relationship Benefits Mitigate Power Asymmetry' (2015) 48 *Industrial Marketing Management* 140, 143: "…the more powerful, dominant firm takes on the leadership role to manage and distribute risks and benefits, either equitably or opportunistically." Also at 140: "[P]ower asymmetry and unequal distribution of benefits are a fact of ongoing inter-firm relationships".

175 *Enonchong*, n22, 89: "if the beneficiary makes such a statement knowing that those conditions have not been satisfied the false statement may amount to a fraudulent misrepresentation and therefore the fraud exception may apply."

176 See *Kozolchyk*, n29, 398-400 for an exposition on the development of commercial letters of credit.

demand guarantees. The power to insist on an irrevocable commercial letter of credit is given to the seller.[177]

In the construction industry, the use of independent instruments, particularly 'performance bonds', 'financial guarantees', and also 'standby letters of credit' (essentially identical to 'demand guarantees' in Europe and other jurisdictions[178]) is commonplace and has "a long and well-established history"[179] as an offset to transaction risk.[180]

These instruments serve to indicate the intention of the contracting parties (at formation) as to which of the parties have elected to carry the transactional risk in the event of a contractual dispute.

Fundamental to risk mitigation is the engagement under contract of a third-party issuer (usually a bank) to ensure that the appropriate party[181] is paid once a compliant demand for payment has been presented.[182]

With demand guarantees, the developer or owner has the power to insert the condition precedent into the underlying contract requiring the contractor to accept a significant amount of the project risk. The contractor does so in order to compete for the work. It is not unknown however for sub-contracting builders in return to negotiate provision of a 'financial performance guarantee' from owner-developers to ensure payment undertakings are met.

Where the power imbalance is less pronounced between the parties, it might be possible for the account party to have the instrument issued as actionable on documentary proof of default or have an express negative stipulation in the underlying contract making any demand on the guarantee subject to proof of an unmet obligation.[183] These would *not* be *independent* instruments.

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177 *Wunnicke*, n30, §3.7.

178 *Enonchong*, n22, 83[fn3]: "The on demand bond is also known as a performance bond, performance guarantee, demand guarantee, first demand guarantee or independent guarantee." Also *Wunnicke*, n30, 39§2.14.

179 D Barru, 'How To Guarantee Contractor Performance on International Construction Projects' (2005) 37 *George Washington International Law Review* 51, 61-62.

180 *Clough Engineering v Oil and Natural Gas Corporation* (2008) 249 ALR 458 (*Clough(No.4)*), 494: "The wide purpose of the performance bank guarantees and their character [is] an allocation of risk and a provision of security to their holder".

181 This might be the beneficiary of the instrument or the confirming bank or a nominated bank.

182 UCP600 [Art.2]: "Complying presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice." [Art.15]: "When an issuing bank determines that a presentation is complying, it must honour."

183 For example *Boral(No.2)*, n61 [14]: The Standby LC provided by Boral, who was obliged to pay by cash transfer, held a negative stipulation stating that payment against the LC would only take place after "demand for payment…has been made by the beneficiary on Boral…and such demand has remained unsatisfied." This proved influential on the outcome.

To offset the inequity that arises from independent instrument risk asymmetry, exceptions to independence have developed in a few jurisdictions that enable the Court to lift the veil of autonomy. The fraud exception has long been recognised[184] but exceptions for illegality, abuse, and unconscionable conduct have also developed.

It is to be expected that a doctrine grounded on matters as amorphous[185] and subjective as the character of behaviours that constitute unconscionable conduct will become extraordinarily complex.

New applications to commercial transactions for this doctrine are being attempted in many jurisdictions[186] and "is an emerging preoccupation of the judiciary in the common law world".[187] For beneficiaries, the risk of a disputed call being restrained for unconscionability is one that they must accommodate.

The related pool of subject material is vast, complex and often contradictory or uncertain, especially where jurisdictional issues arise. Many attempts have been made, with some success, to categorise and rationalise the various findings of unconscionable conduct in case law to build a consistent legal framework around the vexatious and litigious issue of fairness in commerce.[188]

From an understanding of the judicial policies behind the law of unconscionable conduct, it can be extrapolated that the unconscionability exception is a necessary by-product of risk management.[189] The need to mitigate abusive demands on independent instruments lodged behind the protective veil of autonomy arises to give traction to those policies.[190]

Courts deal with transactional disputes that carry a diverse range of risks, and seek to ensure as far as possible that the allocation of risk remains as the parties contracted for. Risk fluctuates relative to the context in which transactions are conducted.

For example, the jurisdiction element of the transaction affects a transaction's risk profile – international trade is far more risk-rich than domestic trade in developed

184 Since at least 1765: see p.56.
185 *JK Integrated v 50 Robinson Pte Ltd* [2015] SGHC 57 [23] (*JKI*): "An amorphous concept…difficult to define."
186 M Kelly-Louw, 'Limiting Exceptions to the Autonomy Principle of Demand Guarantees and Letters of Credit' in Visser & Pretorius (ed), *Essays in Honour of Frans Malan: Former Judge of the Supreme Court of Appeal* (2014) 197, 216.
187 *Parkinson*, 'Notion of Unconscionability', in *Vout*, n15, 107.
188 See Chapter 3B-1.4, 'Categorising Unconscionable Conduct' below.
189 *Johns*, n128, 297-98.
190 *GHL*, n21 [24].

economies; trade transactions with certain individual jurisdictions also carry a higher risk profile than with others.[191]

Among the inherent risks of trade are those arising from the applicable law itself – the enforcement of contract and property rights for example – and risks that arise from both jurisdictional recognition of specific legal principles and the conflict of laws that arises between jurisdictions.[192]

Wunnicke notes some of the risks that independent instruments cannot always mitigate:

1. Country of Issuer risk;
2. *Force Majeure* risk;
3. Issuer Insolvency risk;
4. Issuer Reputation risk;
5. Authenticity risk;
6. Location risk;
7. Document-related risk.[193]

In order to successfully appraise risk exposure and to formulate mitigation strategies, lawyers must be fully cognizant of the nuance and difference in law and the effect of these on the risk profile of a particular transaction in a particular jurisdiction.[194]

The business community finds it unsettling when breaches in uniformity arise where the law was thought well settled.[195] This state also affects practitioners who struggle to provide advice in such circumstances.[196] The development of the unconscionability exception to the independence principle was such a breach and now needs judicial clarity.

191 F Niepmann, T Schmidt-Eisenlohr (2014) *International Trade, Risk and the Role of Banks* (CESifo Working Paper No.4761) <www.CESifo-group.org/wpT>, 2-4.

192 C Wallace, *Legal Control of the Multinational Enterprise* (Martinus Nijhoff Publishers, 1983), 4-5.

193 *Wunnicke*, n30, 4-5.

194 S Gopalan, 'Transnational Commercial Law: The Way Forward' (2003) 18(4) *American University International Law Review* 803, 805-807.

195 Y Zhang, 'Documentary Letters of Credit Fraud Exception Rules: A Comparative Study of English Law and Chinese Law' (2015) 30(4) *Journal of International Banking Law and Regulation* 210, 211: “It is widely acknowledged that a good commercial law shall be able to facilitate commerce and provide certainty and predictability for the commercial community.”

196 A Mason, 'Foreward to "Contract: Death or Transfiguration?"' (1989) 12 *UNSW Law Journal* 1.

Concern as to whether the exception is deleterious to the efficacy of independent instruments has been widely expressed.[197] Much debate remains as to its actual effect in the market. Garcia points out that “practitioners argue that the disputes arising from L/Cs are very sporadic since the good faith and reliability of the parties play a distinctive role.”[198]

It is moot that transactional risk can never be entirely eliminated – at best it can only be limited in scope or effect. It is also well understood that risk increases as the number of variables affecting the transaction increases. It is reasonable then to suggest that any significant shifts in the law pertaining to a particular transaction introduces new variables and therefore new risk. The corollary of this premise is that greater understanding of any new variables will provide a greater understanding of any new risk the variable introduces.

The fundamental purpose of independent instruments is to act to militate against performance risk in the underlying contract for the beneficiary. It broadly transfers that risk directly to the applicant in the form of the risk of an abusive demand. Yet the independence principle has been held to protect review of that underlying performance even in the face of unconscionable conduct allegations. Therefore, an examination of the nature of any developing legal doctrine in relation to independent instruments is essential to developing an understanding of how that doctrine will affect the risk mitigation characteristics of the instrument itself.

Risk mitigation can be found in virtually every aspect of business: ‘Director and Officer Liability Insurance’ provides against corporate malfeasance;[199] credit default swaps were developed to hedge against the realisation of default risk in debt securities;[200] and independent instruments[201] are designed to alleviate the transaction risk emergent between trading parties who may fail to perform their contractual obligations.[202]

197 See *Wunnicke*, n30, 158.

198 *Garcia*, n67, 96.

199 J Olsen, J Dickey, A Goodman, and G McPhee, 'Current Issues in Director and Officer Indemnification and Insurance' (2013) 27(7) *Insights: The Corporate & Securities Law Advisor* 12.

200 M Glantz, and R Kissell, *Multi-Asset Risk Modelling - Techniques for a Global Economy* (Elsevier, 2014), 381: “The CDS model functions similarly to an insurance policy, with the swap buyer paying the swap seller a premium to protect against losses resulting from a defined credit event such as bankruptcy, reorganization, moratorium, payment default, or repudiation.”

201 The term "performance bond" in Singapore, when used in the context of credit instruments utilised in construction transactions, refers to an independent instrument. However, in the USA, the term “performance bond” refers to an instrument that is *dependent* of the underlying contract.

202 H Bennett, 'Performance Bonds and the Principle of Autonomy' (1994) Nov *Journal of Business Law* 574, 574[6].

The genesis of a specific transactional risk need not be complex. It can arise from a simple lack of confidence between the parties due to an absence of trading history or as a result of political or fiscal tensions within or between trading nations. The absence of an historical trading relationship creates the traditional problem of sellers who do not trust buyers to pay in full and on time, and buyers who cannot afford to trust sellers to provide the goods or services contracted for.

To resolve this historical impasse, the risk of loss must be limited to an acceptable level[203] and this can be effectively achieved by use of an independent mechanism through which the interests of each party can be adequately protected.[204]

The inherent value of independent instruments rests upon how confident the 'user community' is that the obligation to pay will be respected by the 'issuer community' and the judiciary alike. A failure by either body to recognise the independence of such instruments from their underlying contracts can only result in a deterioration in the efficacy of the instrument itself.[205]

Presentation of a demand may be procedurally proper, ie it meets the terms of the instrument, but yet not be substantively proper inasmuch that the *basis* for the demand is not grounded in law and therefore that payment would result in the unjust enrichment of the beneficiary. Should this arise, the aggrieved party will usually attempt to obtain a temporary injunction or interdict, often *ex parte*, against either the issuer making payment or the beneficiary making a demand for payment, or both.

It follows that if the plaintiff is initially successful, a full judicial hearing will eventuate to determine whether the injunction(s) should stand or be set aside. For this reason, such hearings may be determined subject to the law of injunctions,[206] not independent instruments, and are therefore lost for the purposes of examining exceptions to autonomy.

However, the central point is the judicial respect for the autonomy of independent instruments from the underlying transaction. Quite often issuers who are joined in actions linked to substantively improper behaviour refrain from presenting a

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203 *Johns*, n128, 307.

204 E Guttman, 'Bank Guarantees and Standby Letters of Credit: Moving Toward a Uniform Approach' (1990) 56(1) *Brooklyn Law Review* 167 at 168.

205 *Enonchong*, n22, 94 "Demand Guarantees Will Lose Their Commercial Utility".

206 A Barclay, 'Court orders against payment under first demand guarantee used in international trade' (1989) 4(3) *Journal of International Banking Law* 110, 120.

judicial position to the Court other than a willingness to accede to the decision of the Court, once advised.[207]

Logically, the value of the credit instrument as a means to mitigate risk is necessarily and positively correlated to the belief held by the beneficiary that (a) the independent third party is free of the control of the applicant and (b) judicial enforcement of the independence of the instrument is assured.

Until relatively recently, the issuance of injunctions to stop payment on an independent instrument was predicated on fraud.[208] However, in Singapore particularly, the idea of 'unconscionable conduct' as grounds to restrain a payment guarantee had, until more recently, the legal traction to potentially concern business users and the academic community.[209] Davidson's prediction in 2012 that it was "doubtful the decision would be followed outside [the] three jurisdictions" of Singapore, Malaysia and Australia[210] appears to have been well-founded as the unconscionability exception has been either ignored or defeated[211] elsewhere.

Furthermore, as shall be seen in *Asplenium*$^{(No.2)}$,[212] the exception has in fact been weakened by the Singapore Court of Appeal and may no longer be a significant contributor to beneficiary transactional risk.

207 *Olex Focas Pty Ltd v Skodaexport Company Ltd* [1997] HCATrans 74 (*Olex*$^{(No.3)}$), 74: For example, where the Court was advised that "the second respondent [Hong Kong Bank of Australia] does not wish to be represented at the hearing of the application for special leave to appeal and will submit to any order of the Court save as to costs." This is the ordinary position of issuers in such proceedings.

208 X Gao, and R Buckley, 'The Development Of The Fraud Rule In LC Law' (2002) 23(4) *University of Pennsylvania Journal of International Economic Law* 663.

209 *Johns*, n128, 317: "Unconscionability and illegality damage the independence principle, in particular, and commercial certainty, in general".

210 A Davidson, 'Unconscionability in Letters of Credit and Demand Guarantee Transactions' (2012) 1(2) *International Journal of Technology Policy and Law* 183, 16.

211 *TTI Team Telecom v Hutchison 3G UK Ltd* [2003] 1 All ER (Comm) 914.

212 *CKR Contract Services Pte Ltd v Asplenium Land Pte Ltd* [2015] SGCA 24 (*Asplenium*$^{(No.2)}$).

Section B. Exceptions to Independence: Fraud and Illegality

1.0 Fraud in Brief

As with all transactions between parties, the fraud exceptions[213] *ex turpi causa non oritur actio*[214] and *fraus omnia vitiat* [215] both apply to letters of credit and other independent undertakings. Given the focus in this work on the unconscionability exception, the following brief discussion on fraud in the context of trade finance instruments is for contextual purposes.[216] Fraud as a ground to obtain an injunction or to set aside a contractual obligation can arise as part of the formation and/or execution of the underlying agreement, or as part of the process of making a payment demand against a credit instrument.

Where some contention lies is whether the fraud exception is limited to fraud in the documents presented as part of the demand for payment, or whether it extends to fraud in the underlying contract.[217] An example of the former might be a false description of the shipped goods on the Bill of Lading. Of the latter, a shipment of goods that indicates a fraudulent attempt to avoid contractual supply obligations but are not falsely described in the documents presented.[218]

Loi points out that "[m]uch ink has been spilt over what amounts to fraud in the context of letters of credit"[219] and this area of law continues to be a vibrant subject for discussion as new case law arises.[220] The *UN-CIGSLC* points out that "allegations of fraud have a tendency to arise when there is a dispute as to the performance of an underlying contractual obligation."[221]

The 'fraud exception' to the independence principle in independent instruments was widely seen as being established in contemporary jurisprudence in the "landmark"[222] case *Sztejn v Schroder Banking*, which saw the beneficiary's demand

213 R Lee, 'Strict Compliance and the Fraud Exception: Balancing the Interests of Mercantile Traders in the Modern Law of Documentary Credits' (2008) 5 *Macquarie Journal of Business Law* 137, 162[B].
214 *United(No.4)*, n145, 184: "From a dishonourable cause an action does not arise."
215 "Fraud vitiates everything."
216 For substantial analysis of documentary credit fraud law: *Gao*, n41; *Gao & Buckley*, n208; *Davidson*, n210, 4-6; *Gao*, n292; and *Browne*, n94.
217 *Wunnicke*, n30, 161: "Proponents of a broader interpretation of the fraud exception have argued that what is meant by fraud in the transaction in §5-114(2) is fraud in the underlying transaction."
218 J McDonnell, and J Menzies, 'Undermining the Certainty of International Trade Finance' (2015) <http://www.kwm.com/en/au/knowledge/insights/undermining-the-certainty-of-international-trade-finance-20151109>.
219 *Loi*, n131, 512.
220 W Baker, 'Qingdao Metals: Is It Fraud If No One is Being Defrauded?' (2015) Jul/Aug *Documentary Credit World* 36. Also UNCITRAL Secretariat, *Recognizing and Preventing Commercial Fraud: Indicators of Commercial Fraud* (2014).
221 *Explanatory Note by the UNCITRAL Secretariat on the UN-CIGSLC* (1995) [45].
222 *United(No.4)*, n145, 183.

against a letter of credit restrained on the basis that the beneficiary presented documents in support of their claim for payment which fraudulently misrepresented the content of the actual goods delivered.[223] The issuing bank was alerted to the fraud prior to making payment against the demand. The Court held:

> [W]here 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.[224]

The issue of independent instrument fraud was addressed by the English court as early as 1765.[225] In the modern era, fraud was mentioned by the English court in 1958 by Sellers LJ who noted in relation to the Court's jurisdiction that "the court would exercise jurisdiction…in a case where there is a fraudulent transaction."[226] In 1977, this was affirmed in *Edward Owen Engineering* where the Court of Appeal held:

> [A] performance bond stood on a similar footing to a letter of credit and a bank giving such a guarantee must honour it according to its terms unless it had notice of clear fraud…The only exception is when there is a clear fraud of which the bank has notice.[227]

The following year, in the first of four hearings, the British Court considered an allegation of fraud in *United Merchants*[228] but distinguished the authorities on the facts. However, in doing so Diplock LJ held:

> 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* or, 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.[229]

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223 *Sztejn*, n133, 632.
224 Ibid 634.
225 *Pillans v Van Mierop* [1765] 97 Eng Rep 1035: "If there was any kind of fraud in this transaction, the collusion and *mala fides* would have vacated the contract."
226 *Hamzeh*, n134, 128.
227 *Edward Owen*, n25, 171[A-B].
228 *United City Merchants v Royal Bank of Canada* [1979] 1 Lloyd's Rep. 267 (*United*$^{(Nos.1~4)}$).
229 *United*$^{(No.4)}$, n145, 184. With respect, a direct translation would be "No action arises from an unworthy cause".

Earlier, the Privy Council in *Gian Singh* found that where a bank, in good faith, pays against fraudulent documents that for all purposes appeared to constitute a complying presentation, that bank is entitled to reimbursement from the applicant notwithstanding the fraud:

> [T]he fact that it [the bank] failed to detect that a document was a forgery did not prevent it from recovering from its customer.[230]

The bench in the English Supreme Court of Appeal in *Banco Santander* looked at the effect of independence when fraud was detected – and the issuing bank alerted – *after* presentation of complying documents and confirmation of compliance, but *before* payment was due under a deferred payment obligation. Meanwhile, the confirming bank had negotiated and paid the Credit before the fraud was detected.

The Court of first instance found that under the UCP500 "[t]he basic authority given by the Issuing Bank to the Confirming Bank in a deferred payment letter of credit is to pay at maturity".[231] This was affirmed on appeal.[232] Subsequently the UCP600 removed the effect of this ruling.[233]

The Supreme Court of New South Wales in *Inflatable Toy* followed the English authorities regarding fraud. While positing that *United*$^{(No.4)}$[234] was too narrow in one unstated sense, Young J held that "the concept of fraud must **not** be narrowly constrained."[235] The underlying question was whether documents that were technically incorrect to the knowledge of the applicant could be relied on as sufficiently fraudulent to ground an injunction to restrain payment.

His Honour took a more nuanced approach, holding that he could not find the beneficiary's uttering of the documents to be "a case of clear fraud" as the parties "were not too fussed that the documents might be contrary to what was actually happening, they both knew what the commercial reality was and were prepared to accept it."[236]

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230 *Gian Singh & Co. Ltd v Banque de l'Indochine* [1974] 1 WLR 1234, 1235.
231 *Banco Santander SA v Bayfern Ltd* [1999] 2 All E.R. (Comm) 18 [Conclusions].
232 *Banco Santander SA v Banque Paribas* [2000] 1 All E.R. (Comm) 776.
233 [Art.7(c)]: An issuing bank undertakes to reimburse a nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the issuing bank. Reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not the nominated bank prepaid or purchased before maturity. Also Arts.8(c)&12(b).
234 *United*$^{(No.4)}$, n145.
235 *Inflatable Toy Company Pty Ltd v State Bank of NSW* (1994) 34 NSWLR 243, 251 (*Inflatable Toy*). Emphasis added.
236 Ibid 252.

Courts have widely held that a mere *suspicion* or allegation of fraud by the bank is not a sufficient basis for the withholding of payment.[237] The fraud must be evident and sufficiently egregious to ground relief.[238]

Lee argues however that the fraud exception to the independence principle is no 'exception' at all:

> As the credit deals with the documents that would be subject to the alleged fraud, there is no need to venture outside the four corners of the credit and violate the autonomy principle in order to reject fraudulent documents. The fraud "exception" is really no more than the expression of the bank's general legal duty not to be part of any fraud on the applicant that it has knowledge thereof.[239]

This argument proposes that the bank carries a duty of care to its applicant-client to protect them from known fraud,[240] which is a duty that overwhelms any other. Whether the fraud 'exception' to the independence principle operates as is generally thought or in fact constitutes an entirely different obligation separate from consideration of the principle is arguable. However, the capacity to allege fraud-in-the-documents as a means to restrain the benefit of the instrument has been recognised across multiple jurisdictions.

Aitken says of fraud in this domain:

> The exception of obtaining injunctive relief by invoking "fraud" is a narrow one – it is difficult to make out on the facts, and at the level of balance of convenience an injunction against the financial institution to restrain it from paying on the obligation will likely be refused.[241]

237 *Society of Lloyd's v Canadian Imperial Bank of Commerce* [1993] 2 Lloyd's Rep. 579, 581.
238 *Dolan*, n98, 486.
239 *Lee*, n213, 163.
240 For example: *Corporations Act* 2001 (Cth), Part 2D.1, Div.1.Gen.Duties, sections 180-190. See A Herzberg, and H Anderson, 'Stepping Stones - From Corporate Fault to Director's Personal Civil Liability' (2012) 40(2) *Federal Law Review* 181
241 L Aitken, 'The "fraud" exception, and other good reasons not to pay on a letter of credit or performance bond' (2014) 30(10) *Australian Banking & Finance Law Bulletin* 1 [Conclusion]. The assumption that the court is likely to restrain payment by the bank is difficult to understand as almost invariably, it is the beneficiary who is restrained from making a demand and thereby not to disturb the independence principle.

2.0 Illegality in Brief

Enonchong states that "the illegality exception has the same juristic basis as the fraud exception".[242] In many cases where illegality has been discussed, the spectre of fraud has been closely examined as well.[243] The case law for this exception is sometimes conflicting[244] and where the exception has been broached before English courts, the law as to the exception remains, to some extent, inconclusive.[245] Illegality has also been canvassed by the court in Singapore,[246] Hong Kong,[247] and Canada.[248]

None of the rule sets governing letters of credit and demand guarantees addresses illegality directly. ISP98 specifically provides that "defences to honour based on fraud, abuse or similar matters…are left to the applicable law."[249] The degree of illegality that will render the documentary credit void must ultimately be decided on the facts.

In the US, Barnes has stated that "[t]he illegality defence is potentially more troublesome than the fraud defence" and expounds extensively on the very deliberate process of revising the UCC §5.0 in a manner that declines to countenance such an "extraordinary defence".[250] Elsewhere he states:

> U.S. banks recognize an "illegality" defense where a court or government agency with appropriate jurisdiction orders dishonor of an LC obligation, but not on the basis of mere declarations of illegality in the underlying transaction.[251]

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242 N Enonchong, 'The Autonomy Principle of Letters of Credit: An Illegality Exception?' (2006) *Lloyd's Maritime and Commercial Law Quarterly* 404, 405.

243 Similarly, academic discussions invariably include commentary on fraud and its relationship to illegality. This discussion is beyond the purview of this paper.

244 For example, the lower and upper Court decisions in *Mahonia,* n265 & n258 leave much unsaid and some clearly unresolved questions with regard to what was decided.

245 *Enonchong*, n242, 405, who states that despite the Court rulings to date, the response from the Court of Appeal has not been "authoritative" and points to similar misgivings in practitioner texts.

246 *Sinotani Pacific v Agricultural Bank of China* [1999] 4 SLR 34 (CA).

247 *Cooperative Centrale Raiffeisen-Boerenleenbank BA v Bank of China* [2004] HKCU 666.

248 *Standard Trust Co v Bank of Nova Scotia* (2001) NFCA 27 and *Meridian Developments Inc v Toronto Dominion Bank* (1984) 32 Alta LR (2d) 150.

249 Rule 1.05(c).

250 J Barnes, ''Illegality' as Excusing Dishonour of LC Obligations' (2005) 11(1) *DCInsight* republished in the IIBLP Annual 2006 Survey, n251, 23-24.

251 J Barnes, and J Byrne, 'Survey of US Letter of Credit Case Law: 2004' in J Byrne (ed), *2006 Annual Survey of Letter of Credit Law and Practice* (International Institute of Banking Law and Practice, Inc., 2006) 19, referring to *Mahonia(No.2)*, n258.

McLaughlin states that illegality as an exception to independence "has not yet been explicitly recognized in the United States."[252] McDonnell also notes:

> In North America, the prevailing view is that no illegality exception exists...In Canada, courts have emphasised that LCs are not tainted by illegality in the underlying transaction.[253]

However the English courts have signalled a willingness to allow illegality "as a defence to a payment of a letter of credit obligation"[254] should the factual matrix favour such an outcome.[255]

There are several possible scenarios[256] that would give rise to a general 'illegality exception' including:

- whether the underlying contract is illegal through fraudulent misrepresentation or non-disclosure or a similar ground;
- whether an otherwise lawful letter of credit issued pursuant to an illegal contract is thereby "tainted by illegality"[257] and therefore unenforceable.[258]

Also possible, the underlying contract may be legal but the letter of credit may contain terms providing for payment under unlawful conditions or for an illegal purpose, such as breaching international trade sanctions, and therefore be unenforceable.[259]

To complicate matters further, there are also jurisdictional issues to contend with. The contract may fall under one jurisdiction while the independent instrument falls under another – a determination of illegality and any cross-contamination will be relevant to the jurisdiction.[260] It may be that the terms of an independent instrument

252 *McLaughlin*, n89, 1197.
253 *McDonnell*, n218, "The Illegality Exception".
254 *Barnes*, n251, 19.
255 Examples include: *Mahonia(No.2)*, n258; *Royal Boskalis Westminster NV v Mountain* [1999] QB 674 (CA); *Regazzoni v KC Sethia (1944) Ltd* [1958] AC 301.
256 *Enonchong*, n242, 406.
257 *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 W.L.R. 1152, 1156 (*Group Josi*).
258 *Mahonia Ltd v JPMorgan Chase Bank* [2004] EWHC 1938, 428 (*Mahonia(No.2)*): "the doctrine of taint could be seen to apply inasmuch as the L/C is analogous to a form of security for the performance of ENAC's obligations and there is a stream of authority...where the courts have refused to enforce security given for an illegal contract."
259 Note: these scenarios are not concerned with whether the demand on a credit might be illegal for fraud; there is abundant case law to assist with determining such a situation.
260 For example, graft and corruption is normalised behaviour in many jurisdictions but is statutory criminal behaviour in others.

provide for payment that breaches law within a particular jurisdiction but the contract giving rise to that obligation is lawful in its own jurisdiction.[261]

UN-CIGSLC also arguably makes provision for an illegality exception. A cross-reading of Article 19 which deals with 'Exception to payment obligation', and Article 20(3) would suggest as much.

Art.19(1)(c) provides that the issuer has a right to refuse payment where the demand has "no conceivable basis", such as where "the underlying obligation…has been declared invalid by a court or tribunal". Art.20(3) provides that the "use of the undertaking for a criminal purpose" empowers the Court to issue an order to withhold payment.[262] Hence, a criminal purpose, being an 'illegal' one, is sufficient to restrain the receipt of any benefit from the independent instrument.

The jurisprudential core of the illegality exception lies with the accepted difficulty of proving 'egregious' fraud.[263] Where a contract is made unenforceable through its own illegality (being for the trade in illicit narcotics for example) then anything *dependent* on that contract is also unenforceable.[264]

The reasoning holds that there being no contract, no benefit can be drawn by any person from that contract.[265] However, McLaughlin reasons that the independence principle "cuts the credit loose" and therefore illegality in the underlying contract does not affect the payment obligation.[266]

It may be that, as has been suggested regarding fraud,[267] the bank simply owes a duty of care to its shareholders and other stakeholders not to facilitate illegal conduct of any kind, and this supersedes the independence principle.

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261 C Hugo, and K Marxen, 'Documentary Credits and Demand Guarantees' (Paper presented at the *Annual Banking Law Update*, South Africa, 2013) state that it is "unlikely that a South African court will be willing to entertain a defence or injunction based on fraud or illegality in the underlying agreement, in circumstances where the fraud or illegality concerned must be established with reference to foreign law due to a choice-of-law clause."

262 Art.20(1) states that a court may "Issue a provisional order to the effect that the beneficiary does not receive payment". This could mean either an order to restrain the beneficiary from making a demand or to restrain the issuer.

263 B Kozolchyk, 'Drafting Commercial Practices and the Growth of Commercial Contract Law' (2013) 30 *Arizona Journal of International and Comparitive Law* 423, [4-B]: "Only when the fraud perpetrated by the beneficiary is egregious enough to leave the banks with worthless paper are extraordinary or equitable remedies granted to the paying bank or its applicant, such as injunctions against payment".

264 This effect on any *dependent* obligations that fall out a contract is widely accepted under the Civil Law of Obligations and is reflected in statute. Whether this principle extends to independent instruments has not been tested in any significant case.

265 *Mahonia Ltd v JPMorgan Chase Bank* [2003] EWHC 1927 (*Mahonia*$^{(No.1)}$), [68].

266 *McLaughlin*, n29, 505.

267 See discussion at p.58.

Enonchong argues "the illegality exception has the same juristic basis as the fraud exception [and] it should have a similar effect on the autonomy principle."[268] Byrne however disagrees with this view, noting that "[t]he doctrinal source of illegality lies outside LC law, and illegality should be restricted in regards to its impact on LC independence."[269]

McLaughlin argues for illegality as an exception. He states that the fraud exception to the independence principle allows the Court to prevent a *private* injury from, for example, the supply of "worthless goods". What follows, he argues, is:

> *a fortiori*, it should be permissible to breach the independence principle to prevent a serious *public*, as opposed to a serious private injury.[270]

He cites the importation of dangerous drugs as an example of what might constitute a serious public injury.

A contract that provides for a bank to transfer funds in breach of international monetary sanctions that prohibit fund transfers to a specific country[271] may be shown as illegal and unenforceable, with the result that the obligations in the underlying letter of credit may also be unenforceable.[272] It can be argued that this does not offend the independence principle – there is no lawful contract and therefore nothing exists from which the credit instrument can be found 'independent'.

The 'illegal' behaviour required to ground a defence against the independence principle can be found in either the instrument itself and/or in the underlying contract.[273] In either case an underlying purpose must be proven which shows that the payment obligation under the instrument is intended to be used as a means to circumvent the law or to promote some illegal purpose[274] such that the Court is

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268 *Enonchong*, n242, 411.
269 *Barnes*, n251, 306[3].
270 *McLaughlin*, n29, 528.
271 D Smith, 'Sanctions Disclaimers in Letters of Credit' (2014) 5 *Journal of International Commercial Law* 2 [II-A-iii].
272 *Mahonia(No.1)*, n265, [10] where the issue for decision was "whether the principle that a letter of credit gave rise to an autonomous contract insulated from the underlying transaction in connection with which it was issued precludes the bank from declining to pay against presentation of a conforming document". Note however that as a matter of public policy the Court in this case would not enforce the letter of credit where the underlying contract of sale was entered into for unlawful purposes in a foreign jurisdiction.
273 *Enonchong*, n242 [406-II-A].
274 In *United(No.4)*, n145, 169: "the contract of sale and purchase was a disguise for exchanging currencies and therefore that contract and the letter of credit were unenforceable".

compelled to restrain the payment obligation.[275] Barnes however is not convinced, holding firm on the inviolability of the independence principle:

> Declarations that the underlying obligation is illegal and unenforceable will not do. In such cases, relief based on illegality must be sought after the bank pays.[276]

It is possible for a letter of credit to be 'legal', ie issued in compliance with the law affecting independent instruments but "being used to carry out an illegal transaction" thereby rendering it unenforceable.[277]

In *Group Josi*,[278] the applicant/plaintiff sought to have an injunction grounded on its *own* illegal behaviour,[279] prompting Staughton LJ to raise the question of whether "a letter of credit [can] be affected by illegality of the underlying transaction".[280] His Honour found that while "illegality is a separate ground for non-payment under a letter of credit"[281] the parties had not so acted in that case.

For illegality to affect the independence principle:

> [T]here must be an *illegality of such significance* that for public policy and morality reasons, the letter of credit should not be paid in derogation of the independence principle.[282]

The illegality exception may still be evolving and Courts continue to test its boundaries,[283] but one commentator argues that *Group Josi* acted to rule out illegality as an available defence, at least to reinsurers.[284]

However, seven years after *Group Josi* the Court in *Mahonia(No.1)* held:

> If a beneficiary should as a matter of public policy (*ex turpi causa*) be precluded from utilising a letter of credit to benefit from his own fraud, it is hard to see why he should be permitted to use the courts

275 *United City Merchants v Royal Bank of Canada* [1981] 1 Lloyd's Rep 604, *United(No3)*, 633, where Griffiths LJ held that 'when the issuer of a letter of credit knows that a document, although correct in form, is, in point of fact, false or illegal, he cannot be called upon to recognise such a document as complying with the terms of the letter of credit.'.

276 *Barnes*, n250, 24.

277 J Reed, and R Enoch, 'Illegality Is No Longer A Defence' (1995) 3(12) *International Insurance Law Review* 436, 436.

278 *Group Josi*, n257.

279 The plaintiff, Group Josi, alleged that it was not legally able to enter into reinsurance contracts under the *Insurance Companies Act (Repealed)* 1974 (UK) and therefore the letters of credit raised under those contracts were "tainted with illegality by reason of the illegality of the insurance contracts": *Reed*, n277, 436.

280 *Group Josi*, n257, 1159.

281 Ibid 1163.

282 *Johns*, n128, 330. Emphasis added.

283 For example the South African case *Dormell Properties v Renasa Insurance NNO* 2011 (1) SA 70 (SCA).

284 *Reed*, n277, 436.

to enforce part of an underlying transaction which would have been unenforceable on grounds of its illegality.[285]

There has also been discussion as to whether from a public policy perspective there should be an illegality exception to autonomy outside of the fraud exception.[286]

In the final analysis, the existence and development of an "illegality exception" remains uncertain with a considerable resistance in many jurisdictions to allowing behaviours in the underlying contract to penetrate the veil of autonomy.

Section C. Summary of the Independence Principle and Exceptions

The veil of autonomy which separates the underlying contracts from the independent instrument obligation has been tested in new and creative ways,[287] but has proved resilient. The veil of autonomy has largely been left intact by the courts as judges across all jurisdictions have consistently seen the perils of tampering with the agreed-to risk allocation embodied in the independence of the payment obligation.[288]

Independence, as one of the elements that supports "the original allocation of transaction risk agreed to by the parties",[289] assists with making the relevant trade instruments attractive to rational buyers.[290]

Ellinger has posed the question whether a forum [court] "should apply the autonomy principle as a mandatory rule or fundamental public policy". While suggesting that to do so might enhance the reputation of the forum in question "as an important centre for international trade", he dismisses the idea on the basis that:

(a) it is not an important enough principle; and

285 *Mahonia(No.1)*, n265 [68] and *Mahonia(No.2)*, n258.

286 *Enonchong*, n242, 405-406 discusses whether the 'illegality' exception should go the way of the 'nullity' exception in British law which was declared untenable in *Montrod Ltd v Grundkotter Fleischvertriebs GmbH* [2001] EWCA Civ 1954.

287 See the decision to grant a new exception to autonomy in *Dormell*, n283 as described in *Kelly-Louw*, n300, 204[III].

288 *Dolan*, n98, 485.

289 *Johns*, n128, 306.

290 B Horrigan, 'New Directions in How Legislators, Courts, and Legal Practitioners Approach Unconscionable Conduct and Good Faith' (2012) *Monash University Faculty of Law Legal Studies Research Paper No. 2013/38* 30 "What commercial parties seek to avoid is uncertainty or risk that cannot be priced or otherwise factored into contractual negotiations and drafting measures."

(b) contracting parties have sufficient access to rule systems which provide for the independence principle.[291]

Fraud is the only widely agreed-to exception to independence, albeit with different standards applied across jurisdictions.[292] However, it is also argued that there is no 'exception' where there is fraud. Regardless of where the fraud arises, the entire transaction is a nullity and therefore there is no contract upon which the independence principle can operate.[293]

One argument provides that the right to make a demand arises out of the underlying contract. If a fraud will set aside the contract either *ab initio* or from the time of the fraud, then the timing of the fraud event is highly relevant to whether the independent instrument was, at least, issued while the underlying contract was still on foot.

This consideration then lends support for arguments for 'procedural fraud' and 'substantive fraud'.[294] The former would be found in the corruption of the contract's formation; the latter in its execution. Procedural fraud might arise from either knowingly deceitful or reckless misrepresentations being made during negotiations. Substantive fraud might be fraud in the underlying contract[295] or fraud in the documents comprising the presentation portfolio. Each occur at significantly different times and places, and can be complicated by fraud arising from third parties.[296]

However, the reverse is true also. If the fraud is procedural and the contract is consequently void *ab initio*, then any financial instrument raised pursuant to that nullity contract ought not have a demand made against it.[297]

That is, if the demand-right arises out of the underlying contract then, where that contract has been voided at law, no demand-right ought to arise.[298] The

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291 *Ellinger*, n14, 356.

292 X Gao, 'The Fraud Rule Under The U.N. Convention On Independent Guarantees And Standby Letters Of Credit' (2010) 1 *Journal of International Commercial Law* 48, 58. Also *Enonchong*, n242, 405.

293 *Lee*, n239. There is also the question of procedural fraud and substantive fraud and whether the instrument was raised after or before the fraudulent event.

294 These categorisations have not been mooted elsewhere and are suggested here after consultations with Dr A Davidson. *Ellinger*, n14, 142-143, discusses "Documentary Fraud versus Fraud in the Underlying Contract" but does not categorise them. The nature of each category mirrors that of 'procedural' and 'substantive' unconscionability, which are recognised categories of equitable fraud. See discussion in Chapter 3.B.1.2 below.

295 *Themehelp Ltd v West* [1996] QB 84 (CA) (*Themehelp*).

296 *United(No.4), n145*.

297 See *UN-CIGSLC* [Art.19(2)(b)]. This has not been tested but is arguable. This is not to be confused with the 'Doctrine of Nullity' that has been proposed but rejected by the Court in the UK: *Montrod*, n286.

298 This clearly defies an independence principle that "cuts [the instrument] loose" from the underlying contract and to which no retrospectivity will apply.

independence principle is not offended nor is the bank's obligation compromised because the bank has a primary duty of care to ensure that a fraudster does not benefit from their fraud.

The difficulty that arises with this all-or-nothing approach is where there is partial or 'immaterial' fraud, ie where the fraud exists but is insufficiently material to restrain the benefit of the instrument.[299]

Illegality has been acknowledged by the Court in the United Kingdom but, given the paucity of case law, the exception has not as yet developed any guiding principles as to what constitutes 'illegality' and how far its scope extends in that jurisdiction. It is broadly resisted by academics and lawyers in most jurisdictions.

The independence principle will always suffer stress from those who see its strict liability as an affront to 'fairness'. As Kelly-Louw put the tension between the independence principle and the unjust enrichment of those who would game the system:

> [P]ublic-policy considerations in favour of the fraud and illegality exception require that in certain cases the principle of autonomy give way to the broader purpose of making sure that parties who engage in illegal or fraudulent transactions do not use the judicial process in furtherance of their unlawful or fraudulent purpose.[300]

This reflects Enonchong's view that it would not be wise for "the [independence] principle [to] be allowed to become so rigid and inflexible that it undermines other important policy concerns of the law."[301]

Also in this vein, in *Mahonia(No.1)* Colman J held that it would "be wrong in principle to invest letters of credit with a rigid inflexibility in the face of strong countervailing public policy considerations." Again, the public policy under consideration (*ex turpi causa*) is whether a fraudster "should be precluded from utilising a letter of credit to benefit from his own fraud"[302] by allowing the fraudster's right to make a demand hide behind the veil of autonomy. To this end the Court has consistently attempted to ensure that such is not the case.

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299 Refer to *Byrne*, n4, p.247. The "Official Comment" to *UCC-Revd.5*, n11, §5-109 provides that "an insubstantial and immaterial breach of the underlying contract…would not justify an injunction." A full examination of fraud in independent instruments is beyond the scope of this thesis.

300 *Kelly-Louw*, n186, 216.

301 *Enonchong*, n242, 405.

302 *Mahonia(No.1)*, n265 [68].

McLaughlin argues for the extension of the independence principle, stating:

> Although by its own terms, the independence principle is not effective outside the one overall commercial or financial transaction that spawned it, still from a policy perspective, the independence principle should be extended to prevent applicants from seeking to block payment of the letter of credit by raising claims unrelated to the letter of credit.[303]

The Courts have enforced recognised few exceptions to autonomy, and those few reluctantly and cautiously. They have generally taken a narrow view of the principle, even going so far as to disallow "the intervention of [an] applicant in proceedings between a beneficiary and a confirming bank."[304]

Fraud is a well-established basis; illegality remains unsettled. It is however, unconscionable conduct with which this paper is concerned.

The above analysis of the independence principle demonstrates the general points of consensus around it:

- its integrity is essential to the product;
- it is universally recognised by commercial parties, academia and the judiciary;
- it is not absolute[305] but transcends many fundamental contract law doctrine.

In order to establish the legal basis for using unconscionable conduct as a ground to push aside the veil of autonomy, a full understanding is necessary on the history and character of the types of conduct being considered by the courts as 'unconscionable' for that purpose. The next chapter will examine unconscionable conduct generally and proceed to identify the specific categories that may affect the independence of independent instruments.

303 *McLaughlin*, n29, 553.

304 *European Asian Bank AG v Punjab And Sind Bank* [1982] 2 Lloyd's Rep 356 (CA) cited by *Ellinger*, n14, 357[fn22].

305 It does not transcend the doctrine of fraud, for example. It is trite that independence is also subject to the Doctrine of Sovereignty and can be pierced under statute or in the course of acting pursuant to a statute.

This discussion will result in an understanding of why certain categories of unconscionable conduct can reasonably be asserted to be sufficient to ground an injunction restraining a demand-right, and the common characteristics of those categories. Using that information, a jurisprudential framework to describe a category of unconscionable conduct specific to independent instruments can be described and founded.[306]

[306] See Chapter 6, p.221.

Chapter 3. Unconscionable Conduct and The Unconscionability Exception

Section A. Introduction to Unconscionable Conduct

In conjunction with the dictates of the independence principle, the law dealing with unconscionability or unconscionable conduct must be examined to ascertain how a grant of relief can be grounded to restrain the benefit of an independent instrument. Equitable fraud, from which contemporary unconscionable conduct in part descends, has a long history and a broad ambit.[307] The elements and categories of unconscionable conduct have been widely studied and critiqued, and courts throughout the world have contributed to the understanding of the doctrines that have developed.

In this thesis, a new category of unconscionable conduct specific to independent instruments is proposed and described.[308] The elements of this category of unconscionability are extrapolated from both the commentariat and the judicial pronouncements made in the resolution of disputes relating to these instruments. This chapter reviews the significant findings from the case law across multiple jurisdictions and draws out the fundamental elements to inform the description of independent instrument unconscionable conduct proposed in Chapter Six.

The behaviour of commercial parties with respect to their contractual obligations can be fraudulent in the sense of tortious fraud or criminal fraud, or fraud in equity.[309] Fraud in equity does not require the element of intent to be proved and "[m]any activities regarded as fraudulent were not done with an intention to cheat or deceive."[310]

The Court's equitable jurisdiction extends to past acts done without "actual evil design or contrivance to perpetuate a positive fraud or injury"[311] and accounts for those actions that are unconscientious but lacking malice. Some independent

307 See generally: *Vout*, n15; and G Dal Pont, *Equity and Trusts - Commentary and Materials* (Lawbook Co. - Thompson-Reuters, 5 ed, 2011), Pt.3.

308 See Chapter 6, p.221.

309 J Heydon, M Leeming, and P Turner, *Equity - Doctrines and Remedies* (LexisNexus, 5th ed, 2015), Ch.12 for a full dissertation on the species of fraud.

310 *Heydon*, n309, 435[12-005].

311 *Heydon*, n309, 435[12-005]. The authorities relating to unauthorised profits by fiduciaries is an example of "situations where there has been no conscious deception or sharp practice."

instrument matters where demands were made with a *bona fide* belief that the demand-right could be exercised might be thus described.[312]

The law dealing with unconscionable conduct broadly is well understood, although it's inter-relationship with commercial undertakings has not been settled in some respects. In particular, *where unconscionable conduct impinges onto the law of independent instruments and challenges the independence of these instruments, the doctrinal basis for intervention becomes opaque*.

This chapter reviews the relevant law of unconscionable conduct with emphasis on independent instruments and, from that, develops a view on how the law of unconscionability affects the 'independence' of independent instruments. Specifically, Section B of this chapter limits its analysis to the fundamentals of common law unconscionable conduct, but also makes passing reference to the elements of American[313] and English[314] 'good faith' in commercial contracts.

The relevant case law provides context, practical application and explanation of the principles.[315] The associated principles of equity, contract law and the Australian statute are reviewed and contextualised within the broader legal framework of independent instrument law. It also looks at the elements of procedural and substantive unconscionability and how the *timing* of conduct can affect its applicability to allegations of unconscionability.

Section C of this Chapter looks at the application of the doctrines of unconscionability to independent instruments (primarily in Singapore and Australia) and the lifting of the veil of autonomy. Referred to as the "unconscionability exception", much criticism has been directed at this incursion of equity into the law of contract, and some confusion remains as to the scope and effect of the doctrine. This discussion also includes the *application* of the relevant statutory prohibitions.

Finally, this chapter looks at whether there should be a special 'category' of unconscionable conduct that accommodates the unique milieu in which independent instruments operate. This requires consideration of how such an exception might be framed in law. This thesis supports an argument **that posits the existence of a category of unconscionable conduct specific to**

312 *Renard Constructions v Minister for Public Works* (1992) 26 NSWLR 234, 275[D].
313 *UCC-Revd.5*, n11, §5-102(a)(7).
314 See *TTI Team*, n211, 46[3].
315 See Ch's.4&5 for full case analyses.

independent instruments that defines equitable intervention in Australia and Singapore.

Also for discussion is the vexing contradiction that arises when the veil of autonomy must be lifted to consider whether the underlying issues support an allegation of unconscionable conduct – how a *review* of alleged behaviours does not constitute any determination of any issues that may arise.[316] How the Courts have dealt with this is discussed in advance of a review in Chapters Four and Five of the specific case authority where relief from unconscionable conduct has been sought in both Singapore[317] and Australia.[318]

There is also the issue of how to accommodate and apply 'substantive' unconscionability, as opposed to procedural unconscionability, into commercial transactions.[319]

It is discussed to the extent possible given the relative paucity of authority on the issue. Much of the case law appears to be a misapplication of procedural unconscionability principles to substantive issues.

This discipline uses a range of vocabulary relating to the law and to the behaviours it governs. These include 'equitable fraud', 'unconscionability', 'unconscionable', 'unconscionability exception', 'unconscionable conduct', and 'unconscionable dealing'. The use of the term 'unconscionable' may be interchanged with 'unconscientious'.[320]

Many of these terms can only be described in context, or by using broad principles that describe the general *effect* of certain behaviours. Court have consistently avoided any attempt to circumscribe what specific behaviours fall within these broad categorisations so to avoid unnecessarily restraining the equity. It is this restraint that allows a new category of independent instrument unconscionability to be found.

Narrow definitions of unconscionable conduct have also been avoided by courts over many years, and there is general judicial agreement that no definition is likely to capture all possible miscreant behaviours brought before it. Courts tend to

316 *Mount Sophia*, n39 [47].
317 See Chapter 4.
318 See Chapter 5.
319 See §B1.2 below.
320 *Commonwealth v Verwayen* (1990) 170 CLR 394 per Deane, J [22].

'describe', rather than 'define', and typically use inclusive language or examples.[321] As Mahoney J indicated in *Antonovic*, guidance in equity comes from "very wide general expressions",[322] noting also that unconscionability is "better described than defined."[323]

It is necessary to note that the *timing* of alleged unconscionable conduct in a specific transaction cycle may be as relevant to proving the allegation as the nature of the conduct itself. Timing of the conduct determines whether it is procedurally or substantively unconscionable in nature.

Nowhere is this element more significant than when considering allegations of abusive demands on independent instruments. Substantive unconscionable conduct occurring *after* an independent instrument has been issued could not be argued as a basis to set aside that instrument itself.

Unconscionability needs to be framed within a set of judicial parameters that have been laid down in the courts and the commentary provided from the academic community to enable a consistent doctrinal approach to be taken to matters alleging unconscionable conduct. This then informs the law of unconscionable conduct as it affects independent instruments – the unconscionability 'exception'.

The following sections address each of these in turn with a view to grounding a firm understanding of the law driving the unconscionability exception to independent instruments.

Section B. Theoretical Foundations of Unconscionable Conduct

1.0. Equity and the Development of Unconscionability

"The common law principle of 'freedom to contract' gives little scope to redress imbalances in bargaining power between parties to a contract."[324] The lack of *égalité* between transacting parties often gives rise to inequality in bargaining power and consequently, the inequity in contractual relations can lead to an injustice suffered by the weaker party.

321 For an extensive list of conduct the court has found *not* to be unconscionable, see p.251.
322 *Blomley v Ryan* (1956) HCA 81, 401.
323 *Antonovic v Volker* (1986) 7 NSWLR 151, 165[A].
324 T Ciro, V Goldwasser, and R Verma, *Law and Business* (Oxford University Press, 2014), 311.

Recognition of this has contributed to the rise in common law jurisdictions of ameliorating doctrine[325] which "qualifies, moderates and reforms the rigour, hardness and edge of the law".[326] Equity does not however "arm the courts with a general power to set aside bargains simply for being unfair, unjust, onerous or harsh."[327]

The original unconscionability jurisdiction arose in part from a British judicial policy[328] of protecting well-born heirs-apparent from the effects of their own excesses, paid for by using their future estate as collateral for loans taken before they were invested with the property.[329] The authorities for this are generally referred to as the "catching bargains" cases.[330]

The loans received in these matters were required to be 'unconscientious' to set aside the agreement, ie "financial need *by itself* [was] unlikely to constitute special disadvantage" and without more, was insufficient to set aside the contract.[331] While the Court of Chancery has allowed itself the right to review "unconscionable bargains", these do **not** include "voluntary foolish bargains".[332]

In one seminal British case, *Earl of Chesterfield*,[333] the Court held that "where a bargain has become oppressive, it is in the discretion of the Court to relieve"[334] the harshness of the bargain.

Lord Hardwicke famously described 'unconscionable contracts' as "such as no man in his senses and not under delusion would make on one hand, and as no honest and fair man would accept on the other" and then found the Court "has an

325 *Dal Pont*, n307, 1[P.05-P.30]: "equity means fairness in the resolution of disputes through the application of good conscience…Equity grew…as a response to the inadequacies of the common law."
326 *Lord Dudley v Lady Dudley* (1705) Prec Ch 241, 244 per Lord Cowper.
327 *Dal Pont*, n307, 293[9.05].
328 E Ellinger, and A Angelo, 'Unconscionable Contracts: A Comparative Study of the Approaches in England, France, Germany, and the United States' (1991) 14 *Loy. L.A. Int'l & Comp. L.J.* 455, 461: "These cases involved more than the granting of a remedy against an oppressive bargain; they involved an attempt to protect the estates of the landed classes."
329 C Rickett, 'Unconscionability and Commercial Law' (2005) 24 *University of Queensland Law Journal* 73, 75. As the great wealth of the English nobility started to drastically decline toward the end of the 19th century, this issue became so entrenched and difficult that it required Parliamentary intervention, resulting in the *Sale of Reversions Act* (1867) (UK).
330 *Dziedzic & Lindgren*, in *Vout*, n15, 435[35.9.170]. See also *Heydon*, n309, 398.
331 *Dal Pont*, n307, 293[fn1] and 297[9.35]: "Financial need may seriously affect a person's ability to judge her or his best interests." *Dal Pont*, 295[9.25]: Special disadvantage concerns a "weaker party's ability to make an informed judgement as to her or his interests."
332 *Pawlett v Pleydell* (1679) 79 Selden Society 739. Cited by *Fletcher*, n339, 49.
333 *Earl of Chesterfield v Janssen* (1750-1) 2 Ves Sen 125 (*Chesterfield*).
334 Cited in *Adams*, n408, 567-568. *Chesterfield*, n333, 126: "Oppression of this kind is almost of as ancient date as the use of money as a medium of trade".

undoubted jurisdiction to relieve against every species of fraud",[335] including equitable fraud.[336]

In *Evans*, the Court attempted to frame the conduct in question by stating "though there was no actual fraud, it is something like fraud, for an undue advantage was taken of his [*the plaintiff's*] situation."[337] From this statement the Court was apparently looking at alternatives to common law fraud and attempting to scope those alternatives.

It was however from the 'disabilities' of the 'expectant' British nobility[338] that other sufferers of disadvantage, such as the elderly, the young and the uneducated, ultimately found relief under the doctrines of unconscionability.[339]

In *Fry v Lane*, Kay J considered commercial 'unconscionable bargains' holding:

> [W]here a purchase is made from a poor and ignorant man at a considerable undervalue, the vendor having no independent advice, a Court of Equity will set aside the transaction.[340]

The spirit of this equitable intervention was, much later, echoed again in the UK and also Australia, in *Bundy*[341] and *Amadio*[342] respectively.[343]

The expansion of the application of unconscionability principles to *general* commercial matters is a relatively recent development. Prior to the early 20th century, "the pursuance of self-interest [was] encouraged as a virtue"[344] in contractual matters. As Kessler notes "[t]he most striking feature of nineteenth century contract theory is the narrow scope of social duty which it implicitly assumed."[345]

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335 *Chesterfield*, n333, 155. Cited in *Blomley*, n322, 385.

336 A Davidson, 'Fraud and the UN Convention' (2010) 1(1) *George Mason Journal of International Commercial Law* 25, 41: "In equity, the term "fraud" not only embraces actual fraud, but also other conduct that falls below the standard demanded in equity." See p.112 for a discussion on Lord Hardwicke's categories of unconscionable conduct."

337 *Evans v Llewellin* (1787) 1 Cox 333, 340. Cited in *Blomley*, n322, 429.

338 *Blomley*, n322 [11]: McTiernan J, discussing unconscionability, stated that "[t]his principle of relief is not limited to transactions with expectants." His Honour also cited *White and Tudor's Equity Cases*, 7th ed. (1897) vol.1, p.313, affirming that relief "has been extended to all cases in which the parties to a contract have not met upon equal terms".

339 K Fletcher, 'Review of Unconscionable Transactions' (1973) 8 *University of Queensland Law Journal* 45, 48-49.

340 *Fry v Lane* (1888) 40 Ch.D. 312, 322.

341 *Lloyds Bank Ltd v Bundy* [1975] QB 326 (*Bundy*).

342 *Commercial Bank of Australia Ltd v Amadio* [1983] HCA 18 (*Amadio*).

343 All three cases bear striking similarity in their facts.

344 *Vout*, n15, 114.

345 F Kessler, G Gilmore, and A Kronman (ed), *Contract Cases and Materials* (Little, Brown & Co., 3rd ed, 1986), 1118.

The High Court of Australia also acknowledged this but pointed out:

> [I]n the early part of this century overriding importance attached to the concept of freedom of contract and to the need to hold parties to their bargains. These considerations, though still important, should not be allowed to override competing claims based on long standing heads of justice and equity.[346]

Kozlina describes this same period as experiencing a "decline in [the] ameliorative role" of equity, but points to a 20th century "equitable revival within the law of contract" given the "frequent invocation of unconscionability as a basis for equitable relief".[347]

Hard-line Victorian-era British judicial policy with respect to commercial unconscionable conduct was succinctly expressed by Wills J, when defending the sanctity of contract:

> Any right given by contract may be exercised against the giver…no matter how wicked, cruel or mean the motive may be which determines the enforcement of the right.[348]

Historically, neither the common law nor equity have entertained a role in 'fixing a bad bargain'. In 1676, the English High Court Court held that "the Chancery mends no man's bargain"[349] and this has generally remained the position in courts of equity since.

In *Bridge*, Radcliffe LJ said:

> 'Unconscionable' must not be taken to be a panacea for adjusting any contract between competent persons when it shows a rough edge to one side or the other.[350]

This view of unconscionable conduct becomes significant when considering independent instruments because of the character of the parties involved. They are, almost invariably, commercially sophisticated parties with access to appropriate advice and would therefore be unlikely to be able to make out a case under special disadvantage rules.

346 *Legione v Hateley* [1983] HCA 11 [40] (*Legione*).
347 S Kozlina, *Contract Law: Principles, Cases and Legislation* (Thomson Reuters, 2014), 27[1.160].
348 *Allen v Flood* [1898] AC 1, 46.
349 *Maynard v Moseley* (1676) 3 Swan 651, 655.
350 *Bridge v Campbell Discount Co* [1962] AC 600, 626.

The Australian Parliament considered such circumstances could arise in relation to the *TPA*, with the Minister stating:

> In the vast majority of commercial transactions neither party would be likely to be in a position of special disability or special disadvantage, and no question of unconscionable conduct would arise.[351]

The law relating to unconscionability in commercial matters in Australia has evolved into a unique blend of traditional equity and legislative guidance interpreted through a plethora of significant case law. Brennan J (dissenting) in the High Court stated in *Stern* that "[t]he courts have not sought a power to destroy the rights and obligations which the parties to a contract create." His Honour noted that "the concept of unconscionability is not a charter for judicial reformation of contracts".[352]

In the 1956 Australian 'special disadvantage' case *Blomley*, the full bench of the High Court addressed the scope and effect of commercial unconscionable conduct in detail. Kitto J described it as:

> [A] well-known head of equity. It applies whenever one party to a transaction is at a special disadvantage in dealing with the other party because illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affect his ability to conserve his own interests, and the other party unconscientiously takes advantage of the opportunity.[353]

Judicial focus in *Blomley* concerned the *procedural* elements of the contract, with the court only looking at the terms of the contract for evidence of special disadvantage unconscionability.[354]

In disputes concerning independent instruments, unconscionable conduct is invariably averred to occur in relation to the substantive terms of the contract or in the circumstance surrounding the making of the demand. A different approach to

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351 Commonwealth, *Parliamentary Debates*, House of Representatives, 03 November, 1992, 2408 (John Button). The Honourable Minister appears to have only been considering procedural unconscionability with this provision. A consolidated discussion of Unconscionable Conduct under the statutes can be found on p. 80.

352 *Stern v McArthur* (1988) 81 ALR 463, 479 (*Stern*).

353 *Blomley*, n322, 415.

354 See discussion "Procedural and Substantive Unconscionability", Ch.3, p.83.

unconscionable conduct in respect of independent instruments is therefore necessary.

In 1992, the Australian Parliament amended[355] the *TPA* to include the first two sections of *Part IVA*. With this, the Commonwealth statutorily prohibited unconscionable conduct in relation to commercial matters without restraining the court to equitable principles.[356] Commentators at the time expressed concern about the reach of the provisions,[357] and were dubious as to the court's capacity to properly interpret the legislation.[358]

The rules of equity for unconscionable conduct are not prohibitive; they are remedial, ie the rules are applied *post hoc* to provide relief against the harm done from such conduct. Equity does not prohibit unconscionable conduct; it provides relief from the *effects* of unconscionable behaviour.[359]

This is not the case with statutory unconscionability, which is prohibitive. In *Berbatis(No.1)*, French J held:

> There is no rule of equity which prohibits unconscionable conduct. Rather there are remedies available to relieve against or prevent such conduct in certain classes of case. **The Act, however, creates a prohibition**…[i]t prohibits conduct in respect of which a judge in equity would have been prepared to grant relief. The imposition of the prohibition precedes any actual or notional judicial decision.[360]

To determine whether relief should be available under the Act, his Honour suggests that when asked to do so, his fellow judges ask themselves whether, under the same circumstances, relief would be granted under equity.[361] This solution might have been available with respect to s51AA(1) *TPA* but the law is not similarly restrained in applying s51AC *TPA* and a wider ambit might be applicable.[362]

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355 *Trade Practices Legislation Amendment Act* 1992 (Cth), s51AA and s51AB (to replace s52A). See §2.0 below.

356 A consolidated discussion of Unconscionable Conduct under the *TPA/ACL* can be found on p. 80, including a summary of the legislation introducing and amending the Acts.

357 R Baxt, and J Mahemoff, 'Unconscionable Conduct Under The Trade Practices Act' (1998) 26 *Australian Business Law Review* 5, 24 (*Baxt*).

358 *Rickett*, n329, 74-75.

359 *Hill v Van Erp* [1997] HCA 9, 748: "In a sense it is true that much of equity is concerned with the prevention, or unravelling of the consequences, of unconscionable conduct."

360 *ACCC v CG Berbatis Holdings Pty Ltd* [2000] FCA 2 (*Berbatis(No.1)*), [42]. Emphasis added.

361 "The judge deciding a case under s51AA will be asking himself or herself whether he or she would have been prepared to grant relief at equity on the basis of an assessment of the conduct in question as unconscionable."

362 *Dziedzic & Lindgren*, in *Vout*, n15, 475[35.9.590] refers to the *TPA*. Applies equally to ss20/21 *ACL*.

The doctrines of equity are advancing into previously sacrosanct areas of commercial activity. This was acknowledged by Batt J in 1996 when he stated that there had been "considerable growth in [the] importance of unconscionability as a sword and a shield in Australian jurisprudence of late". In passing, his Honour also acknowledged that unconscionability is not an absolute but a continuum, referring to "gross unconscionability falling short of actual fraud". He then cast doubt whether it exists as a ground for injunction.[363]

Where a party alleges unconscionable conduct under the *ACL*, that party will be "required to to establish that such conduct [will] support the grant of relief under specific equitable criteria."[364]

In Australia, many extensively-reasoned High Court cases over a twenty-year period formed a clear judicial view of unconscionable conduct in commerce, including *Amadio (1983)*, *Legione* (*1983*), *Waltons Stores (1988)*, *Verwayan (1990)*, *Samton (2002)*, and *Berbatis (2003)*.[365]

In the UK, the somewhat controversial 1975 case of *Bundy*, Denning MR looked at five categories of case where something other than fraud, misrepresentation or mistake apparently underlay the reasoning and sought "to find a principle to unite"[366] them. He declared that all the reviewed cases rested on an inequality of bargaining power and that this then was to be a sufficient ground for relief.[367] This position was largely refuted in a later Court of Appeal matter.[368]

However, despite that unconscionable conduct *is* recognised by the British court for *some* purposes, "it has not accepted that unconscionable conduct may be a defence to payment in respect of autonomous payment obligations."[369]

In Australia, the majority of the High Court in *Bridgewater* discussed the similarities between unconscionable conduct and undue influence, much as was done in *Bundy*.[370] The High Court noted:

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363 *Olex(No.1)*, n38, 400.
364 *Rodrigo*, n169, 499.
365 *Amadio*, n342; *Legione*, n346; *Waltons*, n1020; *Verwayan*, n320; *Samton(No.2)*, n383; *Berbatis(No.3)*, n382, respectively. Unconscionability cases relating to independent instruments specifically are discussed in Section B2.1. and Chapters 4 and 5 below.
366 *Bundy*, n341 [15].
367 Ibid [24]. It should also be noted that Denning MR's view was a minority finding.
368 *Alec Lobb (Garages) v Total Oil (GB)* [1985] 1 W.L.R. 173 (CA), 181[H] (*Lobb*).
369 D Horowitz, *Letters of Credit and Demand Guarantees - Defences to Payment* (Oxford University Press, 2010), 130[6.01] (*D.Horowitz*).
370 *Bundy*, n341 [19].

> Each doctrine may be seen as a species of that genus of equitable intervention to refuse enforcement of or to set aside transactions which, if allowed to stand, would offend equity and good conscience.[371]

Somewhat incongruously, *Bundy* found favour many years later with the Malaysian Supreme Court of Appeal which stated that "[t]he principle concerning 'unconscionability' was *initially propounded* by Lord Denning in…Bundy".[372] With respect, this is true only in the broadest sense – the words "unconscionable" or "unconscionability" do not appear in either of opinions handed down, nor was Denning MR in the majority.[373]

The Malaysian court in *Sumatec(No.2)* also mentioned *Bundy*, holding:

> This "unconscionable" category [outlined in *Bundy*] is said to extend to all cases where unfair advantage has been gained by an unconscientious use of power by a stronger party against a weaker [party].[374]

With respect, this does not appear to be an accurate characterisation of the finding in *Bundy*.

The doctrine dealing with 'Catching Bargains' or 'Sale of Reversions' cases developed into the Doctrine of Unconscionable Dealing[375] has continued to develop different classes of complaint. Different categories of unconscionability have emerged[376] including recognition of the categories of procedural and substantive unconscionability.

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371 *Bridgewater v Leahy* [1998] HCA 66 [73].

372 *Sumatec Engineering and Construction v Malaysian Refining Company* [2011] 7 CLJ 21, [25] (*Sumatec(No.2)*). Emphasis added.

373 Cairns LJ agreed with Sir Eric Sachs that the appeal should be allowed on the basis of undue influence and pointedly disregarded Denning MR's view entirely.

374 *Sumatec(No.2)*, n372 [25]. If an imbalance of bargaining power were indeed a basis for unconscionable conduct affecting independent instruments, it might be argued that the very insistence on the supply of an unconditional, independent demand guarantee is unfair and procedurally unconscionable.

375 *Rodrigo*, n169, 483: "the concept of unconscionable dealing has typically been used to determine whether there was some form of procedural unfairness in the bargaining process." *Heydon*, n309, 506[16-040]. The equity has since been replaced in statute in the UK and Australia: n329.

376 In *Blomley*, n322, it is stated: "The jurisdiction to set aside unconscientious bargains is one which has not been limited by equity to cases where there is a relationship of influence. It is an old established ground for equitable relief", citing *Chesterfield*, n333.

Of the 'genus' categories other than Unconscionability,[377] perhaps only 'Undue Influence'[378] could be imagined as a possible grounds for injunction in relation to independent instruments – a procedural defect in the contract.

The application of the principles of equity and equity-under-statute to independent instruments will continue to be plead, especially in Australia. As the above primer shows, unconscionability has developed significantly over time to address different categories of cases and, it is posited here, should be encouraged to continue doing so.

2.0. Australian Statutory Unconscionability

The Australian *Trade Practices Act* (*TPA*) was introduced in 1974, replacing its largely ineffective predecessor.[379] Certain provisions prohibiting unconscionable conduct in trade or commerce were introduced into the *TPA* and amended over time, finally resulting in *Part IVA – Unconscionable conduct*.[380]

Sections 51AA and 51AB, set out prohibitions against unconscionable conduct in trade or commerce *within the meaning of the unwritten law* and "identifie[d] a range of matters that the court may take into account when determining if conduct is unconscionable."[381]

The Second Reading speech introduced the unconscionability provisions. The Minister stated:

> Unconscionability is a well understood equitable doctrine...It involves a party who suffers from some special disability or is placed in some special situation of disadvantage and an 'unconscionable' taking advantage of that disability or disadvantage by another. The doctrine does not apply simply because one party has made a poor bargain.[382]

377 See p.119.

378 There is some question as to whether using the threat of a demand against a documentary credit is unconscionable on the grounds that it amounts to undue influence. In Singapore, it has been held unconscionable; in Australia, it has been expressly ruled out. See *Samwoh*$^{(No.2)}$, n760 and *Olex*$^{(No.1)}$, n38. Also *TTI Team*, n211, 46[3]: "A breach of faith can arise in such situations as...a threatened call by the beneficiary for an unconscionable ulterior motive."

379 *Restrictive Trade Practices Act 1971* (Cth)

380 s52A was introduced in 1986; s51AA and s51AB (to replace s52A) were introduced in 1992; s51AC was not introduced until 1997. Section 51AC was introduced per the *Trade Practices Amendment (Fair Trading) Act* 1998 (Cth). Section 51ACAA was added per the *Trade Practices Amendment Act (No.1)* 2001 (Cth).

381 ACCC, *Guide to Unconscionable Conduct* (2004) 2nd Ed. Commonwealth of Australia, 1.

382 Commonwealth, *Parliamentary Debates*, House of Representatives, 03 November, 1992, 2408 (John Button). Cited in *ACCC v CG Berbatis Holdings Pty Ltd* [2003] HCA 18 (*Berbatis*$^{(No.3)}$) [5]. Emphasis added.

However, in *Samton*[(No.2)], the full Federal Court (despite the Reading) rejected the defendant's submission to the effect that the *TPA* was limited to the 'special disadvantage' doctrine of unconscionable conduct. It held:

> [T]he terms of the section are not limited to those categories. Although the section is confined by the parameters of the "unwritten law ", it is the unwritten law "from time to time". Neither the Explanatory Memorandum nor the Second Reading Speech can be treated as imposing qualifications which are not found in the words of s51AA.[383]

The *Competition and Consumer Act* (*CCA*)[384] superseded the *TPA* in 2010.[385] Part IVA *TPA*, containing the unconscionability prohibitions, was removed to *Schedule 2 CCL: The Australian Consumer Law*. A revised numbering protocol was implemented. There were many policy reasons given for the transition but the fundamental driver was to provide consistency and clarity to consumer and other laws Australia-wide, given the plethora of state and federal consumer regulations which existed prior to then.[386]

It is important to note that despite its name, the 'consumer law' applies not only to business-to-consumer transactions but also to transactions with and between certain businesses.[387] It is within this jurisdiction that the legislation captures allegations of unconscionable conduct in independent instruments.

The changes to the Australian trade practices regime in the 2010 amendment included:

> [A] range of new enforcement powers, penalties and redress options…[and] introduces important new regimes dealing with unfair contract terms and consumer guarantees.[388]

383 *ACCC v Samton Holdings* [2002] FCA 62, [50] (*Samton*[(No.2)]). The issue was finally resolved in 2011 when s21 *ACL* was amended to instruct the Court to expressly consider substantive unconscionability. See discussion p.82.

384 J Paterson, 'Introducing the New, National Australian Consumer Law' (2011) 36 *Alternative Law Journal* 50, 50-51 describes the "Competition and Consumer Act" as the "new name for the Trade Practices Act".

385 Two Acts were instrumental in the transition: *Trade Practices Amendment (Australian Consumer Law) Act (No.1) 2010* (Cth) and *Trade Practices Amendment (Australian Consumer Law) Act (No.2) 2010* (Cth). These are supported by the *Trade Practices (Australian Consumer Law) Amendment Regulations* 2010 (No.1) (Cth).

386 *Baxt*, n357, 7.

387 Ibid 7.

388 *Paterson*, n384, 50.

Because neither the underlying principles nor the legislative intent with respect to unconscionable conduct has changed, "the case law accordingly is not broken by the amendments over the years", including the re-badging of the *TPA*.[389] Therefore the case analysis in Chapter 5 below[390] comprises an unbroken line of authority on independent instrument unconscionability.

The provisions relevant to independent instrument unconscionability are:

> **Section 21 Unconscionable conduct in connection with goods or services**
>
> (1) A person must not, in trade or commerce, in connection with:
>
> (a) the supply or possible supply of goods or services to a person…;
>
> (b) the acquisition or possible acquisition of goods or services from a person…;
>
> engage in conduct that is, in all the circumstances, unconscionable.

In 2011 the Parliament amended the *ACL*,[391] inserting three express interpretive principles:

> (4) It is the intention of the Parliament that:
>
> (a) this section is **not limited by the unwritten law** relating to unconscionable conduct; and
>
> (b) this section is capable of applying to a system of conduct or pattern of behaviour, whether or not a particular individual is identified as having been disadvantaged by the conduct or behaviour; and
>
> (c) in considering whether conduct to which a contract relates is unconscionable, a court's consideration of the contract may include consideration of:
>
> (i) the terms of the contract; and
>
> (ii) **the manner in which and the extent to which the contract is carried out**;

389 S McLeod, 'Statutory Unconscionable Conduct Under The ACL: The Case Against a Requirement for 'Moral Obloquy'' (2015) 23(2) *Competition and Consumer Law Journal* 123, 124 (*McLeod*).

390 See p.184.

391 *Competition and Consumer Legislation Amendment Act 2011* (Cth). It is also this amendment that directly provides for Australian substantive unconscionability in commercial matters.

These provisions expressly widen the scope of s21 beyond equitable principles and empower to the Court to include substantive unconscionability, in the terms and the performance of the contract, in their considerations. All of these are relevant to independent instrument unconscionability. S22 enumerates a range of "matters the court may have regard to for the purposes of s21".

McLeod states:

> The effect of the [above] principles was to expressly state what had long been understood — that courts cannot solely rely on established equitable principles to inform the content of statutory unconscionable conduct.[392]

However, the presence of the matters described is not necessarily indicative of unconscionable conduct. It has been held that the evidence of one – or even more than one – of those enunciated circumstances will "not be determinative in considering whether conduct has been 'in all of the circumstances, unconscionable'".[393]

This thesis proposes development of a separate, new category of independent instrument unconscionability. If this is to be viable, it must accord with the parliamentary intent of the *TPA/ACL* unconscionability regime and the courts' interpretations of that statutory regime.[394] The expression of category's characteristics in Chapter Six relies on the case law where the *TPA/ACL* has been plead.

The line of authority for independent instrument unconscionability in Australia[395] considers both the original *TPA* and the more-recent *ACL* while acknowledging the independence principle, the veil of autonomy,[396] independent instrument rules of practice, and the obligations of the parties to the underlying contract.

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392 *McLeod*, n389, 125.

393 *Director of Consumer Affairs Victoria v Scully* (2013) 303 ALR 168, 181: "The presence of one or more of those matters, without more, does not mean that conduct has been unconscionable."

394 These provisions are reflected in a range of other statutes including s62B of the *Retail Leases Act 1994* (NSW); s12CB and s12CC of the *Australian Securities and Investments Commission Act 2001* (Cth); s77 and s78 of the Retail Leases Act 2003 (Vic); and s46A and s46B of the Retail Shop Leases Act 1994 (Qld).

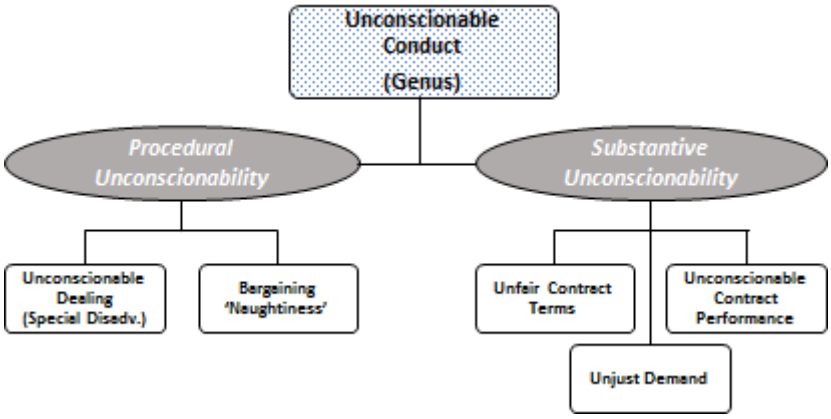
395 See Ch.5 below.

396 Not in those words.

3.0. Procedural and Substantive Unconscionability

When considering unconscionable conduct to ground judicial interference in the receipt of the benefit from an independent instrument, the *timing* of disputed conduct in the transaction cycle may be relevant. It is possible for unconscionable conduct to be found at various points in a commercial transaction cycle – formation, content/execution, or completion/termination[397] – and it will be necessary for courts to determine how conduct timing might affect which equitable doctrines apply. Simply, the *timing* of the conduct affects the *categories* of conduct that might apply to independent instruments.[398]

Apropos of the timing of the unconscionable conduct will be its classification as either 'procedural' or 'substantive'.[399] These classifications were coined originally by Leff in 1967 as a means by which he could "distinguish the two interests…bargaining naughtiness [and the] evils in the resulting contract".[400]



Procedural unconscionability concerns the *formation* of the underlying contract from whence the dispute has arisen and "has been the traditional focus of legal doctrine, both at common law and in equity."[401]

397 This third distinction may be unnecessary depending on whether a demand against an independent instrument is seen as separate from the content and application of the terms or an extension of them.

398 For example, procedural unconscionability would look to the doctrines of duress and undue influence; substantive unconscionability might look to relief from harsh insistence on a right or wilful misconduct. The importance of this is that, in order to prove the beneficiary's conduct unconscionable, a plaintiff must show how the alleged conduct satisfies the elements of one of these "established categories" and which it is ultimately depends on the timing of the conduct.

399 Despite extensive research, no court in any jurisdiction dealing with an independent instrument matter has acknowledged this academic distinction or made mention of it in its reasoning. According to Vout, when considering unconscionable conduct, Courts historically have tended to focus on procedural doctrines such as unconscionable dealing.

400 A Leff, 'Unconscionability and the Code' (1967) 115 *University of Pennsylvania Law Review* 485, 487. This coinage takes place in context with *UCC* §2-302.

401 *Vout*, n15, 117[35.5.200].

Substantive unconscionability deals with the *content* of the bargain, "the fairness or otherwise of its terms"[402] and how they are implemented[403] to determine if the joint effect is an unconscionable outcome. However, in Australia unfair content or outcomes *alone* will not suffice to restrain an undertaking.[404] Substantive unconscionability is concerned with the unconscientiousness of the *outcome* from a transaction, such as the unjust enrichment of the beneficiary or another party.

Procedurally speaking, the Court might consider that, if a debtor is at a significant disadvantage with respect to a lender, the *formation* of the loan agreement may be unconscientious. Consideration of such a disadvantage might address any of a range of personal circumstances in context with the formation of the agreement, including such matters as the debtor's age, education or health.[405]

Substantively speaking, a term of exorbitant interest on the loan, or contractual terms that concern the title, valuation and/or disposition of the underlying assets might be regarded as unconscionable.

The Court will determine whether a term is construed against one party to an extent that is unfair, eg a term which provides for rights to one party or an obligation on another for which there is no consideration, reciprocation, or appeal against.[406] Again however, unfairness *of itself* is insufficient to find unconscionability.[407]

Early courts did not use the term 'procedural unconscionability' but that was their sole focus. Thurlow LC in *Adams* held that to determine whether a contractual obligation is unconscionable, regard is only given to the formation of the contract and not to any events that arise during the life of the contract, especially where an event alters the character of the agreement. In line with many similar judicial pronouncements his Honour also affirmed that "[w]here a bargain is good at the

402 *Dal Pont*, n307, 294[9.10].

403 *Vout*, n15, 116[35.5.190]: Substantive unconscionability refers to "cases in which the rationale for judicial intervention is founded upon the unconscionability of the outcome which would otherwise prevail".

404 *Axelson v O'Brien* (1949) 80 CLR 219 [13]: "…where parties have agreed on the terms the court will not refuse a decree of specific performance on the ground of unfairness." Also *Dal Pont*, n307, 294[9.10].

405 *Vout*, n15, 117[35.5.200]: "The doctrines of undue influence, unconscionable dealing (or relief from 'catching bargains'), unilateral mistake, relief from fraud, misrepresentation and duress may all be explained on [this] basis."

406 It is possible that in some jurisdictions an argument could be made that an 'Asplenium Clause' [see p.176] is inherently unfair if indeed the account party had no choice but to accept the condition. The syllogism would be circumlocutive: A term that sets aside the defence to unconscionable conduct behind the demand is in itself unconscionable because it is unfair to one party on the grounds that they felt they had no choice but to accept it and therefore, there was no freedom of contract.

407 *Eltraco International Pte Ltd v CGH Developments Pte Ltd* [2000] 4 SLR 290 (*Eltraco)*, 299[30].

commencement, but turns out a hard one afterwards, the Court will not decree a performance."[408]

McHugh JA referred to both forms of unconscionability in relation to unjust contracts, stating:

> a contract may be unjust under the Act because its terms, consequences or effects are unjust. This is **substantive injustice**. Or a contract may be unjust because of the unfairness of the methods used to make it. This is **procedural injustice**. Most unjust contracts will be the product of both procedural and substantive injustice.[409]

Unconscionability is therefore found on either a procedural basis, wherein the borrower's position at the time of contract formation is considered (eg unconscientious exploitation of a 'special disability'), or on a substantive basis related to the unconscionable prosecution of the contract or transaction.[410]

On either basis, in independent instrument disputes alleging unconscionability, the Court has to decide whether the beneficiary's demand should be restrained due to unconscionable behaviour.

Much of the case law and the explanations and descriptions of 'unconscientiousness', 'unconscionability' and 'unconscionable conduct' from the Bench either does not acknowledge the bifurcation or focusses on *procedural* unconscionability, where the formation of the contract is alleged to be in doubt.[411] Independent instrument matters have given no judicial discussion to substantive unconscionability. Neither term is mentioned even in those independent instrument cases where it is clearly substantive matters that are being alleged as unconscionable.

Early in the US history of contractual unconscionability, Wright J in *Williams* held "in an oft-cited opinion"[412] which has been widely followed:

> Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties [*procedural unconscionability*] together with contract terms which

408 *Adams v Weare* (1784) 1 Bro. C.C. 567, 568.
409 *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610, 620[G]. Emphasis added.
410 *Dal Pont*, n307, 294[9.10].
411 This follows naturally from the doctrine of unconscionable dealing.
412 C Horowitz, 'Reviving the Law of Substantive Unconscionability' (1986) 33 *UCLA Law Review* 940, 941.

> are unreasonably unfavorable to the other party [*substantive unconscionability*].[413]

However, this conjunction of 'unconscionabilities' laid out in the *Williams* test was disregarded in a "significant minority of courts" during the 1960s where contracts were set aside purely on issues of substantive unconscionability such as "excessive price".[414] Legal enthusiasm for the doctrine waned thereafter; according to Horowitz, between 1971 and 1986, "no [US] court…declared a contract unconscionable solely on substantive unconscionability grounds."[415]

In Australia Vout notes that with respect to substantive unconscionability, "courts have proceeded cautiously in this area…since without a focus on specific acts of wrongful conduct *the notion of unconscionability can become too subjective.*"[416] It is posited that his concern reflects an insufficient development of the necessary doctrine by which an allegation of *substantive* unconscionable conduct can be tested.[417]

Perhaps part of the issue is that substantive unconscionability lacks a legal pedigree – it is a relatively recent legal development in response to shifting societal views. It is not founded on any historical doctrine of common law or equitable fraud. The question becomes the extent to which courts are willing to accommodate new developments in this area of law. The ramifications of such developments, as seen with independent instruments, can be significant.

Dal Pont states that the Australian statutory unconscionability provision allows the Court to deal with both procedural and substantive unconscionability:

> Thus s51AB relates to unconscionability *both* in the process of effecting the contract (termed "procedural" unconscionability and typified by the equitable doctrine of unconscionability) and regarding the nature of its terms (what is called "substantive" unconscionability).[418]

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413 *Williams v Walker-Thomas Furniture Co.* (1965) 350 F.2d 445 (D.C.Cir.), 449 (*C.Horowitz*).
414 *C.Horowitz*, n412, 942.
415 Ibid 942[fn14].
416 *Vout*, n15, 117[35.5.210]. Emphasis added.
417 His view echoes Mason J's concern regarding subjective interpretation of this area of law. See p.106. See discussion "Procedural and Substantive Unconscionability", Ch.3, p.83.
418 G Dal Pont, 'The Varying Shades of Unconscionable Conduct - Same Term, Different Meaning' (2000) 19 *Australian Bar Review* 135 [75]. Emphasis added.

Note here that Dal Pont does not 'typify' substantive unconscionability. That is to say, while procedural unconscionability is "typified by…unconscionability", no indication is provided as to the jurisdiction for substantive unconscionability. This is problematic as:

> protection in equity will usually depend on finding an established head of the jurisdiction. These established heads evolved as responses to their current needs by application of a general principle.[419]

This distinction aside, coverage under *TPA* was no accident – the Act was amended specifically to include both categories of unconscionability. In response to a Senate Committee Inquiry into the definition of unconscionable conduct,[420] the Government acknowledged "the belief among some stakeholders that the courts have not been willing to tackle what is called 'substantive unconscionability'". It concluded as a result that "there are many more unfair contract terms operating" than is desirable.[421]

Substantive unconscionability is also given express recognition in Section 21(4)(c) *ACL:*

> It is the intention of the Parliament that:
>
> (c) in considering whether conduct to which a contract relates is unconscionable, a court's consideration of the contract may include consideration of:
>
> (i) the **terms** of the contract; and
> (ii) the **manner** in which and the **extent** to which the contract is carried out;
>
> and is **not limited to** consideration of the circumstances relating to **formation** of the contract.

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419 *Heydon*, n309, 441[12-045].

420 An attempt by the Senate Committee to have a definition of unconscionable conduct inserted into the Act failed, as did attempts to have a statutory duty of good faith included.

421 Australian Senate Standing Committee on Economics, '*The Need, Scope and Content of a Definition of Unconscionable Conduct for the Purposes of Part IVA of the Trade Practices Act 1974*' (2008), 3-5.

Dal Pont states:

> The statute empowers the court to consider not only the *process* whereby a contract was effected but also whether the *terms* of such contract generate an unconscionable result.[422]

The statute does not provide specific guidance on how the 'terms', 'manner' or 'extent' can be tested for unconscionability, leaving it to the court to determine on first principles. However the lack of historical jurisprudence to underpin substantive unconscionability may be slowing judicial expression leaving abusive calls on independent instruments unaddressed.

Tests for procedural unconscionability exist by examining the status of the victim or the behaviour of the defendant, or both. Development of a test for substantive unconscionability is now required for independent instruments because all such matters rest on substantive issues.

No reported case in this domain has sought to have the underlying contract set aside on the grounds of 'unconscionable dealing' or its common law descendant – substantive unconscionability must be found to restrain a beneficiary's demand-right.

It would therefore assist for the judiciary to discover a philosophical foundation for the encroachment of substantive unconscionability on the contractually-agreed-to rights of parties. As Deane J stated with respect to estoppel, but which applies equally to substantive unconscionability:

> [T]he conceptual foundations of a legal doctrine constitute an essential basis of judicial decision...Those conceptual foundations can only be identified by reference to the essential content and operation of the doctrine.[423]

Dziedzic and Lindgren have questioned "to what extent this bifurcation [*between procedural and substantive unconscionability*] is desirable"[424] given that substantive unfairness is dealt with in the equitable doctrines of relief against penalties and forfeitures. They do not however discuss the basis for their apprehension.

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422 *Dal Pont*, n418 [75]. Emphasis added. It is difficult to ascertain from the authorities the character of an "unconscionable result". An 'unjust enrichment' is likely to be one possibility.

423 *Verwayen*, n320 [21].

424 *Dziedzic & Lindgren*, in *Vout*, n15, 441[35.9.220].

There is no clear answer to the question of the applicability of substantive unconscionability in either the case law or the academic literature. The widening scope of the doctrine of unconscionability into the substantive terms of commercial transactions is taking place with a paucity of jurisprudence to underpin the case law. It is equity by stealth.

What has so far been provided as guidance is descriptive, often accomplished by exclusion – describing what unconscionable conduct is *not*, eg it is *not* unfairness alone or it is *not* insufficient value alone, rather than how conduct might be tested to determine if it is substantively unconscionable.

Furthermore, 'defining' unconscionability as 'unfair' is circumlocutive – it is akin to testing 'big' by asking whether it is 'large'. Both terms are relative, subjective and synonymic.

Interestingly, the unconscionability section of the *UCC*, §2-302, has been said to suffer the same fate. The official comment to the Code has been criticised because it "continues the so-called 'basic test' which, in view of its definition of unconscionability *in terms of itself*, is an unhelpful tautology."[425]

The issue with formulating a test for substantive unconscionability was succinctly put by Samuels JA (with which Kirby P agreed) in *Antonovic*:

> Both "unfair" and "unjust" assert failure to satisfy a standard of some sort and, unless the standard is itself defined, the nature and effect of the alleged departure may be difficult to gather.[426]

When a reliable standard is developed to evaluate the presence of substantive unconscionability, the Court will be able to lift the veil of autonomy to ascertain with greater consistency whether the demand on an instrument is abusive or the outcome unjust.

The delineation between procedural and substantive unconscionability needs to be considered when developing a special category of independent instrument unconscionability. Allegations of unconscionable conduct will be required to

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425 JHA, 'Unconscionable Contracts Under the Commercial Code' (1961) 109 *University of Pennsylvania Law Review* 401, 404 (*JHA*). Emphasis added. [NB: The author's full name is not provided in the article or in the Contents of the journal.] "The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be **unconscionable** under the circumstances existing at the time of the making of the contract." In other words, unconscionability is tested by reference to whether it is unconscionable. This is also a classic example of using substantive material to establish a procedural breach.

426 *Antonovic*, n323, 157[C].

consider almost exclusively substantive matters – either alone or in conjunction with procedural matters.

Procedural matters can have probative value for establishing substantive unconscionability.[427] For example, evidence that the beneficiary put the applicant under duress as a means to gain leverage during negotiations might help establish the unconscionability of a later demand.[428]

A special category of unconscionability for independent instruments will, it is posited, necessarily involve a court review of substantive matters surrounding the underlying contract to evaluate them for unfairness, harshness, or oppression, possibly in context with any outcome that would involve one party being unjustly enriched.[429]

In Chapter Six a framework of elements for independent instrument unconscionability is provided. It includes a requirement to determine where unconscionable conduct is found in independent instrument transactions, i.e. whether it is procedural or substantive unconscionability. This distinction is important because the equitable relief available differs for each.[430]

4.0. Framing the Doctrine of Unconscionable Conduct

This section sets out a range of judicial and academic opinions on behavioural unconscionable conduct to establish some view on the boundaries of the doctrine. The 'mapping' of these boundaries is vital to gaining an understanding of the doctrine's application to independent instruments, given the added complexity afforded by the independence principle. An understanding of unconscionability, particularly the jurisprudence of substantive unconscionability, is essential to properly formulate a specific category of 'independent instrument unconscionability' as this paper puts forward in Chapter Six.

427 *Dal Pont*, n307, 294[9.10].

428 *Crescendo Management v Westpac Banking Corp* (1988) 19 NSWLR 40 [44-45] (*Crescendo*): McHugh JA considered what is called "economic duress", stating that pressure will be illegitimate "if it consists of unlawful threats **or amounts to unconscionable conduct**".

429 The term 'unjust enrichment' is used in its ordinary sense – the formal legal doctrine remains controversial in the Australian jurisdiction. See: J Edelman, 'Australian Challenges for the Law of Unjust Enrichment' (2012) *Speech to UWA Summer School*.

430 For example, procedural unconscionability attracts contractual avoidance and severance. Substantive unconscionability will attract relief by injunction, constructive trust, or damages. See Ch.6: 'A New Category of Unconscionable Conduct', p.221.

4.1. Describing Unconscionability

'Unconscionable conduct' is not homogenous; the term is used variously and its meaning can only be drawn from context.[431] There can be no single, definitive description of unconscionable conduct that encompasses all varieties of behaviour that fall under the broad doctrine. "Unconscionability [is] an arcane, nebulous concept in contract law that courts had used to avoid enforcing contracts that 'shock the conscience.'"[432]

Unconscionability can be framed in part by the many descriptions of exclusion; describing what unconscionability is *not* by reference to specific behaviours.[433] There can be no 'unified theory' of unconscionable conduct any more than there can be a unified theory of torts.[434]

In many jurisdictions where equitable concepts of fairness do not encroach on the principles of contractual freedom, there is often a doctrine of 'good faith', which superficially bears many of the same hallmarks.[435] In *Renard*, Meagher J noted "the considerable degree of interchangeability between the expressions 'fairness' and 'good faith'", going on to note that "there is a close association of ideas between the terms unreasonableness, lack of good faith, and unconscionability."[436]

The terms 'unconscionability' and 'good faith' are widely used in relation to a diverse and disconnected range of legal disciplines, the effect of which has perhaps "masked rather than illuminated the underlying principles at stake".[437]

The very term 'unconscionable conduct' is used in different senses as Mason J explained in the seminal case of *Amadio*:

> Historically, courts have exercised jurisdiction to set aside contracts and other dealings on a variety of equitable grounds. They include fraud, misrepresentation, breach of fiduciary duty, undue influence and unconscionable conduct. In one sense *they all constitute species of unconscionable conduct*.[438]

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431 *Rickett*, n329, 90, states that "the notion of unconscionability in the unwritten law is itself uncertain."
432 C McCullough, 'Unconscionability As A Coherent Legal Concept' (2016) 164(3) *University of Pennsylvania Law Review* 779, 781.
433 See list p.251.
434 S Hershovitz, 'The Search for a Grand Unified Theory of Tort Law (Review)' (2017) 130 *Harvard Law Review* 942, 943-944.
435 *Kuehne*, n45, 64-67.
436 *Renard*, n312, 265[B] and 265[C].
437 J McGhee (ed), *Snell's Equity* (Sweet & Maxwell, 30th ed, 2000), Preface. Cited in *Berbatis(No.3)*, n382 [43].
438 *Amadio*, n342, 460. Emphasis added.

The term 'unconscionable conduct' therefore is used as both:

1. a generic term that sweeps up the range of 'unconscionable' doctrine in equity,[439] and
2. as a specialised term to describe types of specific behaviours that respond to further categorisation.[440]

The first might be called 'doctrinal-type unconscionability'; the second, 'behavioural-type unconscionability'. It is the second of these that the Court must identify and, to some extent, quantify in terms of its materiality. To accomplish this in independent instrument matters, the court will lift the veil of autonomy and look to the substantive matters to ground a restraint.

Dal Pont describes equitable fraud as "conduct of a nature sufficient to invoke the intervention of a court of conscience". It is also "the basis for relief for…undue influence and unconscionable dealing" but points out that these have "flourished into a 'separate' equitable doctrine" and no longer fall strictly under the banner of 'equitable fraud'.[441]

Traditionally, equity was called upon to curtail rights where those rights were "exercised unreasonably or in bad faith".[442] In *Amadio*, Gibbs CJ looked at the relative power positions of the parties, finding in the context of procedural 'unconscionable dealing':

> A transaction will be unconscientious within the meaning of the relevant equitable principles only if the party seeking to enforce the transaction has taken unfair advantage of his own superior bargaining power, or of the position of disadvantage in which the other party was placed.[443]

This is notable for the bifurcation between the behaviour of the beneficiary ("bargaining naughtiness"[444]) and the characteristics of the plaintiff (special disadvantage). This binary approach has been integrated into contemporary procedural unconscionability.

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439 *Berbatis(No.1)*, n360 [42]: "The term ['*unconscionability*'] is used across a broad range of the equity jurisdiction." *Vout*, n15, includes in this range Mistake, Misrepresentation, Duress, Undue Influence and Unconscionable Dealing.

440 This echoes the multiple uses for the term "common law" as a generic and a specific term to describe different jurisdictions in different contexts.

441 *Dal Pont*, n307, 267.

442 *Clough Engineering v Oil and Natural Gas Corporation* [2007] FCA 881 [80(a)] (*Clough(No.1)*).

443 *Amadio*, n342, 460.

444 *Leff*, n400, 487.

The "exceptional" jurisdiction of 'unconscionable dealing', descendant doctrine of 'catching bargains', has three elements. It arises from the concatenation of three elements:

1. a relationship that places one party at a special disadvantage to the other;
2. a knowledge of that special disadvantage in the stronger party; and
3. unconscientious exploitation of the special disadvantage by the stronger party".[445]

None of these typically exist in independent instrument matters.

Unconscionable dealing "focuses on unconscionability of a 'procedural' nature, namely on the conduct of the parties...leading to a transaction."[446] Unconscionable dealing is not concerned with substantive matters other than to the extent that they might be "probative of procedural unconscionability."[447] It has not historically been a ground to restrain a demand on an independent instrument.

Twenty years after *Amadio*, in *Berbatis(No.3)*, the majority opinion of Gummow and Hayne JJ described "unconscionable" as:

> a description of various grounds of equitable intervention to refuse enforcement of or to set aside transactions which offend equity and good conscience.[448]

Looking at the interpretation of the Australian statutory prohibition in s51AA *TPA*, Dal Pont advises that the better view is a narrow one, stating:

> Where there is a choice between ascribing to a word in legislation a narrow precise definition from case law or a broader loose one, the former should ideally be preferred. Had the legislature intended the term "unconscionable" to attract a wide definition, it would have included a list of factors such as those appearing in s51AB.[449]

Independent instrument unconscionability matters heard in Australia under these provisions have generally taken a narrow view of the legislation.

445 *Dal Pont*, n307, 293[9.05].
446 Ibid 294[9.10].
447 Ibid 294[9.10].
448 *Berbatis(No.3)*, n382 [42].
449 *Dal Pont*, n418 [79].

Determining unconscionability is "inherently fact-specific".[450] The factual matrix upon which any alleged unconscionable conduct is founded malleates the doctrine.[451] "In each situation equity inquires into the conduct of the defendant, and, by the remedies at its disposal, will deny the defendant the right to obtain or retain any benefit from their unconscionable conduct."[452]

Various scholars have identified a range of recognised categories of unconscionability that reflect, to some extent, clusters of behaviours with common unconscionable objectives.[453] However, these categories are not universally agreed upon nor applied, and any attempt to totally reconcile the different categorisations would be problematic.[454]

For the purposes of finding substantive independent instrument unconscionability, some acknowledged categories of unconscionable conduct will not suit because the required conduct is not possible in the transaction.[455] For example, a substantive inequitable denial of legal obligations is unlikely to arise within the context of independent instruments.

Procedurally, *Amadio*-type "special disability" unconscionable conduct would be unlikely to be alleged in a dispute involving "a major commercial transaction negotiated at arm's length between between parties who have access to financial and legal expertise."[456] This is because commercial parties are unlikely to suffer 'special disadvantage' infirmities likely to trigger accusations of procedural unconscionable conduct in the formation of any of the three relationships in the transaction.[457]

Sir Anthony Mason stated in 1985 "there exists strong resistance in this country to the exposure of commercial transactions to equitable remedies".[458] Four years later, his Honour described the Australian judicial mood toward more recent developments:

450 *McLeod*, n389, 124.
451 It is because the range of possible factual scenarios is infinite that unconscionability defies succinct definition.
452 *Dal Pont*, n418 [81].
453 *Vout*, n15, 121.
454 See 'Categorising Unconscionable Conduct', §1.4 below. Some of the categories appear repeatedly, albeit using different phrasing.
455 The 'categories' of unconscionability are discussed in detail below, commencing *Parkinson*, n559.
456 *Dal Pont*, n307, 297[9.35].
457 Seller/Buyer; Buyer/Bank; Bank/Beneficiary.
458 P Finn (ed), *Essays in Equity - Ch.12: A Mason, Themes and Prospects* (Sweet & Maxwell, 1985), 243. This statement however was made prior to the advent of Part IVA *TPA*.

> The development in doctrines based on unconscionability is partly explained by the fact that our sense of what is unconscionable conduct is today much more comprehensive than it used to be. We – and I suppose I am speaking of judges – are more easily shocked than we used to be by harsh conduct.[459]

Despite a broad shift in common law jurisdictions toward a more equitable view of commercial relationships, the sterner, 19th century view could be found in some quarters until relatively recently. For example, in *Renard*, Meagher JA in discussing an imputation of reasonableness into a contract affirmed that "there is no reason why the principal should have regard to any interests except his own." His Honour noted with approbation the Plaintiff's acceptance of the position that "the principal [need] not [be] burdened by any element of altruism."[460]

In Australia and abroad, judicial notions of fairness and equity and conscientiousness have expanded gradually into commercial matters to an extent previously unknown.[461] This expanded view has also been reflected in Australian statutory regimes at State[462] and Commonwealth level that have incrementally brought equitable doctrine to bear on commercial transactions.[463]

Priestly J considered the rise in allegations of unconscionable conduct generally in the context of international comparative law:

> An important factor, in my opinion, in the growing willingness to use old unconscionability rules more freely, has been the steadily increasing use in Australia this century of expansive definitions of unconscionability in both state and Commonwealth statutes. These have authorised courts to interfere with contractual relations in a way almost scandalous to adherents of nineteenth century Anglo-Australian doctrine.[464]

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459 *Mason*, n196, 2.
460 *Renard*, n312, 275[G] and 276[A].
461 *Vout*, n15, 107[35.5.10]: "It is an emerging preoccupation of the judiciary in the common law world, not only in Australia".
462 See for example the *Contracts Review Act 1980* (NSW).
463 For example the extension of the unfair consumer contracts regime to incorporate protection for small business in the *Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015* (Cth).
464 L Priestley, 'A Guide to a Comparison of Australian and United States Contract Law' (1989) 12(1) *University of NSW Law Journal* 4, 10.

The doctrine has its proponents. Defending the incursion of fraud and unconscionable conduct into the sanctity of the independent instruments. Loi states:

> Whatever commercial value might be attached to the autonomy principle, just as the courts will not countenance the law and the court's own offices being perverted into instruments of fraud, the courts will likewise not allow the law or its offices to become instruments of unconscionable conduct.[465]

It is Loi's view that where unconscionable conduct is alleged, it is the manifest duty of the Court to ensure the allegation is properly heard, the independence principle notwithstanding. Anything otherwise "flies in the face of the court's duty to ensure justice is done…autonomy will not shield truly unconscionable conduct."[466]

In *Dynamics*, the Court noted "there is as much a public interest in discouraging fraud as in encouraging the use of letters of credit."[467] The conundrum however, is how to properly and consistently identify the behaviours which must *not* be shielded, given that identification and accurate description of behaviours that constitute unconscionable conduct remains "notoriously difficult to define with any precision".[468]

This has not stopped attempts being made. Finn sought to describe it in [he admits] very generic terms that might allow the Court to identify unconscionable behaviour:

> Unconscionable conduct can be said to be synonymous with the use of a manipulative power to induce or produce a course of conduct, in a way which offends the fundamental assumptions on which the making of a binding contract are premised.[469]

Looking at one refined view of the doctrine, the Federal Court of Australia in *Berbatis(No.1)*, affirming *Legione*,[470] addressed the category of substantive unconscionable conduct in which most independent instrument cases would tend to fall if they were argued in equity.

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465 *Loi*, n131, 511.
466 Ibid 511.
467 *Dynamics*, n43, 1000.
468 *Dal Pont*, n418 [79].
469 P Finn, 'Unconscionable Conduct' (1994) 8(1) *Journal of Contract Law* 37, 49.
470 *Legione*, n346.

French J stated:

> The fundamental principle according to which equity acts is that a party having a legal right shall not be permitted to exercise it in such a way that the exercise amounts to unconscionable conduct.[471]

This is a rewording of the category of substantive unconscionability which prohibits the harsh or oppressive insistence on the exercise of a right.[472]

In Singapore, Hoo JC in *JKI* recognised that unconscionability presents difficulty with categorisation, describing it as "easily identifiable, but difficult to define".[473] The Singapore Court of Appeal in *Mount Sophia* also noted that unconscionability:

> is a concept that has proven impossible to comprehensively define, and previous case law has instead preferred to indicate the elements of behaviour that would be caught by the label of unconscionability.[474]

In the United States, the *UCC* addresses unconscionable conduct in a number of places,[475] albeit not specifically in relation to independent instruments. Leff discusses the history of unconscionability in the *UCC* in some detail, specifically in reference to the current version of §2-302, noting that early versions of the section provided that "substantive imbalance" in the contract *as a whole* was the target of the unconscionability provision.

Leff notes that "[t]his idea, that 'unconscionability' meant something like overall contractual imbalance" was ultimately replaced.[476] Revisions and draft releases took place throughout the 1940s and early 1950s.[477]

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471 *Berbatis(No.1)*, n360 [14].

472 See *UN-CIGSLC Explanatory Note*, n221 [46] "abuse of right". See also *PBS(No.2)*, n985, 587: "Broadly it may be said that the vendor will not be allowed to use his contractual right if it would be unconscionable in the circumstances to do so."

473 *JKI*, n185 [23].

474 *Mount Sophia*, n39 [41].

475 *UCC-Revd.5*, n11, §2-302 – Unconscionable Contracts; §2A-108 – Dealing with Unconscionable Leases; §2-719 – Contractual Modification or Limitation of Remedy.

476 *Leff*, n400, 513.

477 *Uniform Law Commission* <www.uniformlaws.org>: Due to the federalist nature of the law in the United States, "uniform laws" are drafted and released by the Uniform Law Commission which provides the states with "non-partisan, well conceived, and well drafted legislation that brings clarity and stability to critical areas of state statutory law."

The current version states:

> §2-302 Unconscionable Contract or Clause
>
> (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

Under this section the court is empowered to address both procedural *and* substantive unconscionability, and indicates that both the circumstances surrounding formation and the consequences are subject to wide powers of rescission and severance.

Leff complains:

> [O]ne cannot tell from the statute whether the key concept [*unconscionability*] is something to be predicated on the bargaining process or on the bargain or on some combination of the two, that is, to use our terminology, whether it is procedural or substantive.[478]

Leff's view is valid: the section is *de*scriptive and not *pre*scriptive. It does not provide for any sort of test for unconscionability, leaving to the courts the identification of the doctrine's elements.[479]

The "Official Comment" to the section provides a purpose statement followed by a basic test to guide the court's considerations:

> §2-302: This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable…This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the light of…[everything], *the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract*.[480]

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478 *Leff*, n400, 488.
479 *McLeod*, n389, 125.
480 *UCC-Revd.5*, n11, §5-109 Official Text With Comments. Emphasis added.

The expression “under the circumstances” equates to “given the factual matrix”, implying that there needs to be something more than just a bad bargain; there needs to be behaviour from which equity will provide relief.

In order to find unconscionability it appears from the “basic test” that the Court must be informed as to how the clauses are “one-sided”. Unfortunately, no reference is made to the substantive issue of “any unconscionable result” in the Comment, with the court only directed to consider the procedural circumstances at formation.

Elsewhere, the law of unconscionability has been addressed twice by the full Court of Appeal in Malaysia in *Sumatec*.[481] For the most part, the Court found Singaporean and Australian precedent persuasive. In the first appeal, the Court found unconscionable conduct as a separate ground from fraud for the purposes of restraining the benefit of an independent instrument. The Court provided a test for the standard of proof carried by the plaintiff, finding:

> [T]o establish “unconscionability” there must be placed before the court manifest or strong evidence of source degree in respect of the alleged unconscionable conduct complained of, not a bare assertion.[482]

To ground an injunction the appellate court went on to find that “this additional ground of ‘unconscionability’ should only be allowed with circumspect where events or conduct are of such degree such as to prick the conscience of a reasonable and sensible man.”[483]

In the second appeal, the full bench of the Federal Court of Malaysia addressed the “sole question” of “whether ‘unconscionable conduct’ on the part of a beneficiary of a bank guarantee or a performance bond was a distinct ground, apart from 'fraud'”.[484] This was the first time Malaysia’s “apex court”[485] dealt with the question directly and in so doing, held as it had a year earlier, albeit with different judges on the bench, that unconscionable conduct is a separate ground for injunction.

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481 *Sumatec*$^{(No.3)}$, n170, 402, was an appeal confined to the question of unconscionability.
482 *Sumatec*$^{(No.2)}$, n372, [24]. This phraseology echoes the “strong *prima facie* case” requirement in Singapore and Australia.
483 Ibid [24].
484 *Sumatec*$^{(No.3)}$, n170, 410[11].
485 Ibid 410[12].

While doing so, the Court framed the approach cautiously, first stating:

> [T]here is no simple formula that would enable the court to ascertain whether a party had acted unconscionably in making a call on an on-demand performance bond.

The Court went on:

> [W]hether or not "unconscionability" has been made out is largely dependent on the facts of each case. In every case where "unconscionability" is made out, there would always be an element of unfairness or some form of conduct which appears to be performed in bad faith.[486]

The bench noted that "abuses arising out of the contract"[487] justified an injunction and proposed that the purpose of the doctrine of unconscionability is to prevent "oppression and unfair conduct". The issue of what constitutes subjective 'unfair conduct' was not addressed. The Bench also affirmed that determining unconscionability is "fact specific" and that a restraint would follow where "[a]ll the facts and circumstances surrounding the demands…were so lacking in good faith and amounted to unconscionable conduct that it warranted court intervention."

Civil law jurisdictions do not countenance *equitable* notions of 'unfairness'. However, their doctrines of 'good faith' struggle with similar issues of assessing standards of behaviour. In 2016 the Court of Amsterdam heard jurisdictional arguments regarding the "standard for exceptions to the principle of abstraction" in *CKT*.[488] The parties "disagreed on whether the standard was that the drawing was [per Danish law] '*disloyal* and *unfounded* or – as the equivalent in Dutch law…obviously *fraudulent* or *arbitrary*.'"[489]

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486 Ibid 413[17-v]. It must also be noted that, as shown in *Clough(No.3)* the Plaintiff may only seek equity's relief with 'clean hands'.

487 Ibid 421[40]. This also supports the postulation that the demand-right arises out of the contract and must be restrained there.

488 *CKT Marine Services BV v NV Nationale Borg-Maatschappij* C13/601449/KG ZA 16-85 MW/EB (Court of Amsterdam, February 17, 2016)[Neth.].

489 J Byrne, and C Byrnes (ed), *Institute of International Banking Law & Practice Annual Survey* (Institute of International Banking Law & Practice, 2017), 481.

4.2. Framing and Testing Unconscionability

The above judicial and academic commentary reflects one common theme: a general reluctance to attempt to constrain the boundaries of unconscionable conduct with any form of concise definition. Procedural unfairness can be tested, but it is no nearer being defined than substantive unconscionability for which there are few tests.

It is posited here that a lack of an agreed-upon definition does not preclude a capacity to develop an elemental test for the presence of substantive unconscionability. There are many legal concepts that defy singular definition but tests have evolved to identify them.[490]

While the available generic explanations and descriptions provide guidance on the character of unconscionable conduct, they also demonstrate a range of views as to the scope of the doctrine. Similarly, there are a range of views as to how unconscionable conduct should be *categorised*[491] and whether such categories assist with understanding unconscionability.

Categorisation enables the Court to cluster behaviours more generally and thereby make links and draw "parallels between related forms of unconscionable conduct."[492] Identifying common elements is difficult to achieve. As Hutley JA held in *Logue*, "[t]here is no simple formula for determining when conduct or facts constitute equitable (constructive) fraud".[493] Loi also succinctly states:

> [T]he real difficulty…[lies] in *formulating* what *"unconscionability" means* in this context and *how* a case of unconscionability is to be sufficiently proved in evidential terms to trigger interlocutory intervention.[494]

In *Blomley*, Fullagar J looked for commonality between the circumstances *surrounding* the transaction as a method to identify procedural unconscionability:

> The circumstances adversely affecting a party, which may induce a court of equity either to refuse its aid or to set a transaction aside, are of great variety and can hardly be satisfactorily classified. Among them are poverty or need of any kind, sickness, age, sex,

490 The existence of a constructive trust, for example. See *Finn*, n469, 37.
491 See 'Categorising Unconscionable Conduct', §5.0. below.
492 *Parkinson*, 'Notion of Unconscionability', in *Vout*, n15, 110.
493 *Logue v Shoalhaven Shire Council* [1979] 1 NSWLR 537, 553.
494 *Loi*, n131, 511.

> infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary. The common characteristic seems to be that they have the effect of placing one party at a serious disadvantage vis-a-vis the other.[495]

Gleeson CJ stated in *Berbatis(No.3)* that "[t]he common characteristic of such circumstances is that they place one party at a serious disadvantage in dealing with the other."[496]

His Honour recognised commercial realities, stating:

> [A] person is not in a position of relevant [*sic*] disadvantage, constitutional, situational, or otherwise, simply because of inequality of bargaining power. **Many, perhaps even most, contracts are made between parties of unequal bargaining power**, and good conscience does not require parties to contractual negotiations to forfeit their advantages, or neglect their own interests.[497]

The description here frames by exclusion – it describes what unconscionability is *not*, ie an inequality of bargaining power, and what the parties are *not* required to do, ie forfeit any advantage. This contributes to the doctrine but more is required for consistency on what unconscionability *is* and what identifies it as such.

Dziedzic and Lindgren frame the scope of unconscionability broadly by dealing with more general principles. They provide "four aspects to the scope of unconscionability" that indicate matters for the court to consider:

1. The inequitable doctrine of unconscionability is tied to the requirement of special disability;[498]
2. The improvidence or rashness of a transaction does not warrant equity's intervention;
3. Inadequacy of consideration, will not of itself, establish unconscionable dealing;

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495 *Blomley*, n322, 406.

496 *Berbatis(No.3)*, n382 [8]. More than this is required however to gain an understanding of the intended scope of the doctrine. The quantum by which to measure 'serious', and the extent of 'disadvantage', will acquire further clarification only through application to different factual matrices.

497 *Berbatis(No.3)*, n382 [11]. Emphasis added. See discussion on 'unequal bargaining power' in *Bundy*, p.113.

498 Again, referencing only *procedural* unconscionability.

4. Unconscionable conduct **does not depend on substantive unfairness**.[499]

Again, the issues of *extent* arise. An examination of most contractual arrangements would invariably reveal one party to be at some disadvantage. It is the dynamic of business. Finding the point at which monetising that advantage/disadvantage becomes unconscionable is the problematic aspect.[500] As McLeod points out:

> [T]he difficulty [is] in determining when commercial practices cease to be 'tough but fair' and become, instead, unconscionable.[501]

For courts, the core issue is dealing with the infinite range of human behaviours associated with the full gamut of commercial transactions, and to class some behaviours as inequitable while other quite similar behaviours as fair commercial practice. Looking at findings across jurisdictions over time, some appear anomalous. It is a given that neither unfairness itself, nor an inequality of bargaining power alone are sufficient to ground unconscionable conduct.[502]

It has been held that where a genuine dispute is on foot regarding the damages owing to a beneficiary, making a demand on the independent instrument does not constitute unconscionable conduct.[503] Yet a *force majeure* clause disputably operating in the underlying contract was sufficient to find a demand unconscionable.[504]

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499 *Dziedzic & Lindgren*, in *Vout*, n15, 440[35.9.220]. Emphasis added, recognising substantive unconscionability as a consideration. They do not say however whether it is their view that while unconscionability does not *depend* on substantive unfairness, whether substantive unfairness should be taken into consideration, whether it should only act probatively to substantiate procedural unconscionability, or whether substantive unconscionability can stand alone to ground an injunction. That unconscionable conduct ***does*** not depend on substantive unfairness is not to say that it ***can***-not so depend.

500 *Lobb*, n368, 183: "Inequality of bargaining power must anyhow be a relative concept. It is seldom in any negotiation that the bargaining powers of the parties are absolutely equal."

501 *McLeod*, n389, 124.

502 *Vout*, n15, 118-119[35.5.220]: "Taking advantage of an inequality of bargaining power, without more, will not be regarded as unconscionable." and [35.5.230] "Unfairness in trade and commerce, without more, will not constitute unconscionable conduct."

503 *Minson Constructions Pty Ltd v Aquatec-Maxon Pty Ltd* [1999] VSC 17 [23] (*Minson)*: "the defendant was entitled to call on the security at the time it did, notwithstanding that there may be a genuine dispute between it and the plaintiff concerning responsibility for the defects".

504 See *Min Thai* analysis, p.150.

Equitable fraud or unconscionable conduct[505] remains stubbornly "amorphous and ambiguous".[506] The Court is restricted to applying general principles to specific conduct but Finn points out that a lack of definition is common in legal concepts, citing Trusts, Fiduciary Duty, and Agency as examples of where the Court is left to its own devices.[507] This lack however has not constrained the Court from developing tests to establish their existence.

It might be argued that the lack of specificity regarding the elements and character of unconscionable conduct provides opportunity for each Court to define the term as broadly or narrowly as it sees fit, robustly responding to each factual matrix. Deane J supported this approach in *Verwayen*, stating:

> Ultimately...the question [of what is] unconscionable must be resolved not by reference to some pre-conceived formula framed to serve as a universal yardstick but by reference to all of the circumstances of the case, including the reasonableness of the conduct of the other party…and the nature and extent of the detriment which he would sustain.[508]

Insofar as unconscionability equates to good faith in independent instrument matters,[509] a lack of *bona fide* belief in the exercise of a right has been found to constitute a 'breach of faith' in contract.

In England, Thornton QC stated:

> The basis for a contention of a breach of faith must be established by clear evidence even for the purposes of interim relief. A breach of faith can arise in such situations as...a lack of an honest or *bona fide* belief by the beneficiary that the circumstances, such as poor performance, against which a performance bond has been provided, actually exist.[510]

505 *Vout*, n15, 111: "Unconscionability is otherwise known as 'equitable fraud' or 'constructive fraud'…found particularly in older cases...[and] is a much wider concept than the ordinary meaning of the word 'fraud'." Also G Wooler, 'The 'New Asplenium Clause' - Unconscionability Unwound?' (2016) (Mar) *Singapore Journal of Legal Studies* 169, 171.

506 *Attorney-General of NSW v World Best Holdings* [2005] NSWCA 261 [118] (*World Best*)

507 *Finn*, n469, 37.

508 *Verwayen*, n320 [21(4)].

509 Given the international nature of independent instruments, such comparisons are helpful to develop a more complete view of how such conduct is proscribed.

510 *TTI Team*, n211 [46].

If there is "a considerable degree of interchangeability between the expressions 'fairness' and 'good faith'",[511] this statement would indicate that a beneficiary's *bona fide* belief in the exercise of a demand-right might be sufficient to avoid an allegation of unconscionability.

In *Kvaerner*, Selvam J stated:

> In circumstances where it can be said that the buyer had **no honest belief** that the seller has failed or refused to perform his obligation, a demand by the defendants/buyers in my view is a dishonest act which would justify a restraint order.[512]

The implication from this may be that where an honest belief in the right to make a demand is genuinely held, no restraint order will follow unless other circumstances exist to ground one. Certain issues arise with this 'innocence defence' however. The presence of *mala fides* has never been an essential element of either form of unconscionable conduct[513] and the court should be largely unconcerned with the beliefs or intentions of the defendant. Where it can be shown the beneficiary could have no honest belief, this can support a finding of unconscionable conduct. However, the holding of an *honest* belief (or the *lack* of 'no honest belief') does not on its own mean a demand is conscionable.

4.3. Issues with Assessing Unconscionability

Given the "inherently unstable" character of unconscionability,[514] some commentators have expressed concern about the consistency of judicial findings in this domain.[515] Not all judges are familiar with the nuance of equitable principles and the lack of clarity in the written law exacerbates uncertainty.[516] Individual judges will interpret the law according to their own specialities, especially given the complexity of the equitable doctrines at play. This possibility is viewed with some caution.[517] Brennan J stated in *Stern*:

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511 *Renard*, n312, 265[B] and 265[C].

512 *Kvaerner Singapore Pte Ltd v UDL Shipping Pte Ltd* [1993] SGHC 146 [20] (*Kvaerner*). Emphasis added. This also begs the question on what constitutes a 'dishonest act' – what standard of dishonesty would apply to ground a restraint?

513 *Nocton v Lord Ashburton* [1914] AC 932, 954: "…it is a mistake to suppose that an actual intention to cheat must always be proved."

514 *Rickett*, n329, 74-75.

515 *Leff*, n400, 497; *Baxt*, n524, 396.

516 *Rickett*, n329, 89: "[L]egislatures might be excused for thinking that the increased use of the term by the judges meant that the latter actually knew what the term [*unconscionability*] meant!".

517 *Mason*, n196. "There is the objection that if contracts are to be set aside on the ground that they are unfair judges would run some risk of deciding cases by reference to personal and subjective opinions rather than by reference to acceptable standards."

> If unconscionability were regarded as synonymous with the judge's sense of what is fair between the parties, the beneficial administration of the broad principles of equity would degenerate into an idiosyncratic intervention in conveyancing transactions.[518]

Similar fears have been expressed with respect to the unconscionability provisions in *UCC* §2-302. Given that 'unconscionability' is not *defined* in the Code, Shulkin states that it "leaves the applicability of the section solely to the discretion of the individual court, a factor, it is feared, which will lead to abuse, inconsistency and carelessness in decision making."[519]

The development and application of unconscionable conduct to commercial transactions is symbiotic with a general shift in western societal mores dealing with commercial conduct.[520] Courts are now "increasingly curtailing the pursuance of self-interest" that once was seen as a commercial virtue which would not have been interfered with.[521]

Some commentators however have expressed reservations. One believes that the lack of specificity around definitions of unconscionable conduct has seeped into the Australian statutory regime as well. Rickett is vociferous in condemning the relevant sections of the *TPA* for their imprecision. His view is unequivocal:

> That legislation should push judges into such an imponderable situation is…quite unacceptable of the legislature. Legislatures may well be able to do what they want, but they do not act constitutionally…if they merely foist onto judges the application of categories of meaningless reference.[522]

The full bench in *World Best* was firm with respect to the legislation varying substantive rights under the auspices of an ambiguous concept of unconscionability, stating:

> Over recent decades legislatures have authorised courts to rearrange the legal rights of persons on the basis of vague general standards which are clearly capable of misuse unless their

518 *Stern*, n352, 479.
519 M Shulkin, 'Unconscionability - The Code the Court and the Consumer' (1968) 9(2) *Boston College Law Review* 367, 369.
520 *Rickett*, n329, 87.
521 *Vout*, n15, 114.
522 *Rickett*, n329, 88-89.

> application is carefully confined. *Unconscionability is such a standard.*[523]

4.4. The Issue of Moral Obloquy

Australian unconscionability has recently seen the introduction of a new element of 'moral obloquy'. It originally arose as a result of "Spigelman CJ… evaluating the concept of statutory unconscionability as used in the *Retail Leases Act*."[524] His Honour held that the application of the *statutory* prohibition could only be conducted where "highly unethical" circumstances existed bearing "a high level of moral obloquy".[525] This view was expressly adopted by the Federal Court[526] and by Gageler J in the High Court.[527] This new element has given rise to much discussion in judicial circles.

As McLeod states:

> The first problem with any requirement for 'moral obloquy' or a variation thereof, then, is that the phrases themselves are arguably so ambiguous as to be unable to practically serve as a useful benchmark for what it means for conduct to be 'unconscionable'.[528]

The adoption of this doctrine is a genuine issue for independent instrument unconscionability. Since *World Best*,[529] a "weight of authority…has adopted the requirement for 'moral obloquy'" in unconscionability matters.[530] If there is a requirement to prove moral obloquy, despite no mention of it in the statute whatsoever,[531] then the provision would not extend to independent instrument matters and plaintiffs would be denied access to relief under the statute.

One recent Australian case provided that unconscionability must be measured "against conscience by reference to the norms of society that is in question", disregarding any need to evidence moral obloquy.[532] This position, if widely

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523 *World Best*, n506 [119]. Emphasis added.
524 R Baxt, 'What place does moral obloquy have in the evaluation of statutory unconscionable conduct?' (2014) 88 *Australian Law Journal* 396, 396.
525 *World Best*, n506, [121]. P Vout, 'Unconscionability and Good Faith in Business Transactions' (2013) *National Commercial Law Seminar Series (Online),* [18]: maintains that 'moral obloquy' has "rapidly become part of an accepted judicial definition of the phrase "unconscionable conduct" where no statutory definition exists".
526 *ACCC v Woolworths Limited* [2016] FCA 1472 [131].
527 *Paciocco v ANZ Banking Group* [2016] HCA 28 [188].
528 *McLeod*, n389, 129.
529 *World Best*, n506.
530 *McLeod*, n389, 126.
531 In *Paciocco*, n108 [305], Allsop CJ made clear that the normative enquiry into unconscionability is "tied to the words of the statute."
532 *ACCC v Lux Distributors* [2013] FCAFC 90, 41.

adopted, would remove the need to develop a subjective test for moral obloquy.[533] Certainly it will be fatal to any independent instrument matters hoping to fall under the *ACL*'s unconscionability provisions if an element of moral obloquy needs to be satisfied.

This thesis argues that the presence of 'moral obloquy', whatever that might be, may be probative but should not be definitive. In that way, the relief available under the *ACL* will extend to independent instrument plaintiffs facing abusive demands which, it is argued here with respect, was the intention of the Parliament.

4.5. Summary

The above demonstrates that framing the doctrine of unconscionable conduct can only be accomplished in the broadest of senses. Unconscionability and bad faith are said to have much in common and the authorities demonstrate that this is so to some extent. The term 'unconscionable conduct' has been found to mean different things in different contexts.

The doctrines of 'unconscionable conduct' are being applied to an ever-widening field of commercial matters.[534] Much of this widening has been in the expansion in the application of substantive unconscionability. Unfortunately, this wider application has not been accompanied by a commensurate judicial clarification on the philosophical underpinnings to substantive unfairness. This has the potential to result in misapplication of the doctrine. It is possible that the lack of an historic jurisprudence might be the reason why a test has not yet been developed for substantive unconscionability.

533 *McLeod*, n389, 127.
534 *McCullough*, n432, 785-86, '*The Recent Rise in the Use of Unconscionability*'.

5.0. Categorising Unconscionable Conduct

5.1. Rationale

Categorisation provides the capacity to look at like cases, provides a vocabulary for conduct and relief, and allows hierarchical structures to be developed to aid with contextualisation. The following section addresses each of these. Categorisation enables counsel to explain *how* certain behaviours are 'unconscionable', ie how they offend good conscience. Both courts and legislatures have categorically refused to define 'unconscionability' because of the risk of exclusion by definition.

However, as actual, unique factual matrices are examined, similarities between specific behaviours become evident, and it becomes easier to define and identify individual characteristics of the different categories of unconscionable conduct. It also allows visibility on what conduct is *not* considered unconscionable.

By categorising the different *types* of matters alleging unconscionability which have been addressed by the court, categorisation of new matters is eased. The facts of those matters can be better viewed in light of specific unconscionable outcomes.[535]

Categorisation ought to provide the plaintiff with a context against which to assess their likelihood of success. From the context comes the language to connect their specific argument with the authorities, but this opportunity often appears missed. For example, analysis of independent instrument disputes often finds that the demand complained of as 'unconscionable' (in a generic sense) is more akin to 'harsh or oppressive insistence on a right'.[536]

However, the opinions published by the Court rarely mention any attempt by counsel to categorise the conduct on which they hope to ground an injunction but complain of the conduct itself, leaving the court to determine whether it falls within an established category.[537] It appears at least that Counsel typically attempts to show why the alleged behaviour is vaguely 'unconscionable', rather than

535 *Vout*, n15, 111[35.5.40].
536 This has rarely been plead directly in independent instrument disputes.
537 One exception is *Clough(No.1)* [78] which argued *inter alia* the demand was a harsh insistence on a right, which the Court defined as a right "used arbitrarily, or capriciously or unreasonably or in bad faith".

specifically why it is 'harsh or oppressive'. To succeed, a plaintiff's argument must specifically identify the established category of unconscionability into which it fits.

Categorisation provides a more concise view of a narrower band of behaviours and the easier it becomes to match actual conduct with doctrinal markers. The elements of proof required, distilled from the authorities, would consequently be narrowed and focussed to guide the court's reasoning and the relief available.

For example, 'substantive unconscionability' can be evidenced from the substantive terms of, operation of, or outcomes from a contract and what would reasonably be expected from that contract. 'Oppressive rights enforcement' might be evidenced by showing that a demand against an independent instrument will cause such an unconscionably harsh effect as to attract equity's intervention. An 'exploitation' or 'exploitative situation' can be demonstrated by means of the showing a significant differential between the bargaining position of the parties. Alternately, these could all be referred to generically as 'unconscionable' and left to the court to categorise, which it may decline to do.

So vocabulary then becomes strategically important for plaintiff's counsel. Through categorisation and consequent concise identification of unconscionability's elements, it becomes easier to articulate how specific behaviours fit into categories of unconscionability. There are issues with vocabulary however. Matters that may once have been simply 'equitable fraud' might today be called 'procedural unconscionability'.[538] (These are "cases that, although classified as fraud, did not require proof of an intention to deceive".[539]) Many cases of this type are now broadly characterised under the doctrine of 'unconscionability'. Meanwhile the term 'equitable fraud' is still used in some specific contexts.[540]

538 For example *Nevill v Snelling* (1880) 15 ChD 679 where a moneylender was relying on the threat of public humiliation to protect him from loss after extending excessive credit to a young gentleman.

539 *Dal Pont*, n307, 267[8.05].

540 Equitable duress and fraud on a power for example.

5.2. Historical Categorisation

At the most abstract level of categorisation, 'unconscionable conduct' or 'unconscionability' arguably sweeps up all the various doctrine of fraud, estoppel,[541] and equitable fraud, which includes 'unconscionable dealing',[542] unilateral mistake, duress, undue influence, and misrepresentation.[543]

The 'catching bargains' cases are an early example of a categorisation of unconscionable conduct cases[544] and this contributed significantly to the early development of the wider doctrine. In one seminal case, *Chesterfield v Janssen (1750)*, Lord Hardwicke listed and discussed five types of fraud. It is from these that much understanding of the nature and variety of fraud and equitable fraud has devolved.

The first two of the five provide that fraud is:

1. *dolus malus*…actual, arising from the facts and circumstances of imposition;
2. apparent *from the intrinsic nature and subject of the bargain itself*; such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other, which are unequitable and unconscientious bargains.[545]

The first of these is egregious fraud much as is applied today. The second-listed is the most likely basis for contemporary *substantive* unconscionability,[546] as it provides for:

> intrinsic fraud, that is, fraud which can be presumed from the grossly unfair nature of the terms of the contract.[547]

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541 *Vout*, n15, 161[35.6.190] points out that estoppel itself suffers from a range of sub-categorisations, such as common law and equitable estoppel; promissory estoppel; etc; and categorisations that reflect "the manner by which the estoppel is created, such as by record, by deed". It is beyond the scope of this paper to investigate these in any detail.

542 *Dziedzic & Lindgren*, in *Vout*, n15, 429.

543 For the purposes of this thesis, the historical category of 'unconscionable dealing' will be treated as the parent of 'unconscionable conduct' only in its procedural sense as it is also constrained to procedural unconscionability, ie where there is 'special disadvantage'. The other categories in this list are supported by a body of law relating to quite distinct behaviours from those concerned with demands against independent instruments. See p.84.

544 See p.79.

545 *Chesterfield*, n333, 155-56. Emphasis added.

546 "If substantive unconscionability exists then that may be the head of power on which it is grounded.": Professor R Grantham, personal discussions with the author 08/02/2017, University of Queensland.

547 J Murray, *Contracts: Cases and Materials* (LexisNexis, 6th ed, 2006), 503-504[17].

What is apparent from the literature is that much academic and judicial effort has been given to the question of where the doctrine of unconscionability arose, and how it affects our understanding of unconscionability today. Much however remains unclear including the judicial basis for contemporary substantive unconscionable conduct, under which all independent instrument disputes to date have fallen.

Lord Hardwicke also provided an indication of a unifying doctrine for these various categories of fraud:

> The principle, on which the court has gone in these cases, is an unconscionable bargain, and it being contrary to public convenience to encourage it. Such contracts are generally founded in oppression by taking advantage of the borrower's necessity.[548]

This is reflected to some extent in Lord Denning's judgement in *Bundy* wherein, after looking at a number of unconscionability cases, his Honour stated:

> Gathering all together, I would suggest that through all these instances there runs a single thread. They rest on 'inequality of bargaining power'.[549]

In this somewhat anomalous finding, Denning LJ held – contrary to the authorities at the time – an "inequality of bargaining power to be a sufficient and independent ground of relief."[550] In 1985 the Court of Appeal in *obiter* narrowed the finding in *Bundy* stating:

> In fact Lord Denning M.R.'s judgement in *Lloyds Bank v Bundy* merely laid down the proposition that where there was unequal bargaining power the contract could not stand if the weaker did not have separate legal advice.[551]

This view of the plaintiff's access to legal advice when considering the defendant's conduct remains good law.

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548 *Chesterfield*, n333, 129.

549 *Bundy*, n341. It should be noted that these 'unifying themes' have largely been rejected in most jurisdictions: see *Berbatis(No.3)*, n382. Also Lord Denning's was a minority view on the bench.

550 *Dziedzic & Lindgren*, in *Vout*, n15, 435[35.9.230]. It is no doubt decisions of this kind that led Harman LJ in *Campbell Discount Company v Bridge* [1961] 1 QB 445,459, to say: "...the system of equity for good or evil has been a very precise one, and equitable jurisdiction is exercised only on well-known principles. There are some who would have it otherwise and I think Lord Denning is one of them." (Cited in *Heydon*, n309, 441[fn49]).

551 *Lobb*, n368, 181[H].

From the legal scholar's perspective, *Bundy* is valuable for Lord Denning's dissertation on unconscionability. His Lordship provided a general view of the law of unconscionable conduct, discussing the doctrine and commenting on its similarity with other forms of equitable relief. His Honour discussed the following five categories of conduct based on an extensive review of the authorities:

1. Duress of Goods;
2. Expectant Heir;
3. Undue Influence;
4. Undue Pressure;
5. Salvage Agreements.[552]

Since *Bundy*, the High Court of Australia has categorically denied any jurisdiction to unequal bargaining power, holding that leveraging unequal bargaining power does not equate to benefitting from a "special disadvantage" and therefore does not constitute unconscionable conduct.[553]

Much work has been done both in the courts and in academia to structure unconscionable conduct and to provide certainty and coherence to the doctrine.

Before discussing the scope of unconscionable conduct, the Singapore Court of Appeal in *Dauphin* echoed many similar judicial statements to the effect that it does:

> [N]ot think it is possible to define 'unconscionability' other than to give some very broad indications such as a lack of bona fides. What kind of situation would constitute unconscionability would have to depend on the facts of each case…**There is no pre-determined categorisation.**[554]

Concern regarding the categorisation of unconscionable conduct was also expressed by the court when Gleeson CJ stated:

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552 *Bundy*, n341, [III.Categories]. Lord Denning provides authorities with *ratio* in English jurisprudence for each of these categories of conduct. ***Bundy's*** factual matrix is remarkably similar to the Australian case *Amadio*, n342.

553 *Berbatis(No.3)*, n382 [5]: "The doctrine [of unconscionability] does not apply simply because one party has made a poor bargain."

554 *Dauphin Offshore Engineering Pte Ltd v HRH Sheikh Sultan bin Khalifa bin Zayed* [2000] 1 SLR 657 (*Dauphin)* [42]. Emphasis added. This statement would appear to contradict the plethora of opinion to substantiate the established categories of unconscionable conduct.

> There is a risk that categories, adopted as a convenient method of exposition of an underlying principle, might be misunderstood, and come to supplant the principle.[555]

Despite this risk, categorisation does allow clustering of behaviours deemed unconscionable and ultimately makes newly alleged conduct easier to test.

Wells' attempt at categorisation drew from authorities relating to consumer law in the US and listed eight "circumstances in which a merchant or supplier might be deemed to have committed an unconscionable act or practice":

1. Taking advantage of the inability of a consumer to protect his interests;
2. Charging a price which, at the time of the transaction, grossly exceeds either the supplier's cost or the price at which similar property or services are readily obtainable;
3. Entering into a consumer contract from which…the consumer will be unable to receive a substantial benefit;
4. Entering into a consumer transaction in which…there is no reasonable probability of payment of the contract in full by the consumer;
5. Inducing a consumer to enter into a transaction which is excessively one-sided against the consumer;
6. Making a misleading statement of opinion on which the consumer is likely to rely;
7. Coercing the consumer…so as to cause him to act contrary to his own free will or to submit to a situation or condition against his own volition and interest;
8. Breaching a confidential or fiduciary relationship in a consumer transaction.[556]

555 *Berbatis(No.3)*, n382 [10].
556 *Wells*, n81, 315-321.

Conveniently, this list takes the broadest possible scope of 'unconscionable conduct', drawing on the full tableau of unconscionable behaviours, albeit from a consumer context.[557]

Parkinson and Vout takes a different approach by referring to the "notion of unconscionability" being given specificity through a number of doctrines:[558]

1. Exploitation of vulnerability or weakness;
2. Abuse of position of trust or confidence;
3. Insistence upon legal rights in circumstances which make that insistence harsh or oppressive;
4. Inequitable denial of legal obligations;
5. Unjust retention of property.[559]

In addition to these, a final category is suggested by Gilmour J in *Clough(No.1)*, affirming *Legione,*[560] that "a party, having caused or contributed to the other party's breach…cannot now purport to exercise its rights."[561] If such causative behaviour can be argued as another doctrine of unconscionability, it adds another category to the above list, suggested as:

6. Exercise of a right arising from a breach caused by the right-holder so as to trigger the exercise of that right.

This suggested category reflects the doctrine of *ex turpi causa non oritur actio*.[562] *UN-CIGSLC* Art.19(2)(d)] also provides support for it, stating:

> A demand has no conceivable basis when…fulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary.

Juridical foundations for this category can be found in *Royal Design* where unconscionability was "based on delays in construction that were *caused by the beneficiary's own default* in failing to make timely payments".[563]

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557 Australian statutory unconscionability is also founded in Consumer Law.
558 Four of these are listed and referred to as "classes of case" in *Samton(No.2)*, n383 [47].
559 *Parkinson*, 'Notion of Unconscionability', in *Vout*, n15, 109-110.
560 *Legione*, n346 [20] "equity does not intervene to grant specific performance...where the party seeking specific performance is in default."
561 *Clough(No.1)*, n442.
562 *Holman v Johnson*, (1775) 98 Eng. Rep. 1120, 1121: *From a dishonourable cause an action does not arise.* A court will not assist a plaintiff to pursue any legal remedy if the right to it arises in connection with the plaintiff's own unlawful act.
563 *Royal Design*, n148, described thus in *Dauphin*, n554, [46]. Emphasis added.

In *Kvaerner*, the Court held that an attempt by a beneficiary to take advantage of a performance guarantee after failing to fulfil a condition precedent was unconscionable where their failure provided the justification for making the demand.[564]

So this additional category is a valid contribution to framing the unconscionability doctrine and has implications for independent instrument unconscionability.

In *Samton(No.2)*, the full Federal Court of Australia, referring to a specific text,[565] provided that categories 1-4 above can be supported by the following "broad standards" of behaviour:

1. That those in positions of strength or influence should not take advantage of another's relative weakness.
2. That people should not, by appeal to strict legal rights, cause hardship to others by violating their reasonable expectations.
3. That those in fiduciary positions should act only in the interests of those to whom those fiduciary duties are owed.[566]

The Bench went on to describe the equitable responses to breaches of these standards, which includes setting aside or rescinding contracts (procedural unconscionability), and preventing parties from exercising their legal rights harshly (substantive unconscionability).

Flagging the relevance of materiality, the Court emphasised that "[t]here are different thresholds of conduct in [the] various categories, all of which may be described as unconscionable."[567] Calibrating these different thresholds with consistency is where the challenge lies.

Getzler acknowledges that the array of contractual and non-contractual behaviours described as 'unconscionable' "cannot comprehensively be classified" but nevertheless proposes four categories:

1. procuring an unconscionable bargain;
2. exercising harsh or oppressive remedial rights;

564 *Kvaerner*, n512. The Court held at 344[6] that "it was eminently just and convenient to restrain a party from taking advantage of his own wrong."
565 Law Book Company, Laws of Australia, Vol.35.
566 *Samton(No.2)*, n383 [47]. With respect, these three 'broad standards' appear to be little more than a descriptive re-statement of the first three categories (nothing on the fourth), and do not advance the general understanding of the doctrine.
567 *Samton(No.2)*, n383 [48]. See discussion on Materiality below p.249.

3. causing detrimental reliance by representation or conduct;
4. abusing a consensual relationship.[568]

In *TTI Team*, the English Court of Appeal summarised the law with respect to establishing a 'breach of faith' sufficient to restrain a demand on an independent instrument. 'Bad faith' and 'unconscionable conduct' are considered jurisprudentially similar, although the bifurcation of 'procedural' and 'substantive' does not apply to the doctrine of good faith in contracts.[569]

The English authorities, as summarised in *TTI Team* amidst a broader "Summary of the Law",[570] provide that to establish such a breach, clear evidence must be adduced to show:

1. a failure by the beneficiary to provide an essential element of the underlying contract on which the bond depends; or
2. a misuse by the beneficiary of the guarantee by failing to act in accordance with the purpose for which it was given; or
3. a total failure of consideration in the underlying contract; or
4. a threatened call by the beneficiary for an unconscionable ulterior motive; or
5. a lack of an honest or *bona fide* belief by the beneficiary that the circumstances, such as poor performance, against which a performance bond has been provided, actually exist.[571]

While this law does not apply in those jurisdictions where unconscionability has been applied to independent instruments, it demonstrates the desirability for cases to be classified. It also assists with comparative law efforts to distinguish between bad faith and unconscionable conduct.

The attempt to rationalise the doctrine of unconscionability by means of case categorisation is so that the facts might be tested against a narrower range of like cases. For example, categorisation of 'unconscionable conduct' cases enable courts to better distinguish between 'species' applicable to independent

568 J Getzler, 'Unconscionable Conduct and Unjust Enrichment as Grounds for Judicial Intervention' (1990) 16(2) *Monash University Law Review* 283, 284.
569 The spirit and intent of these categories of 'bad faith' are widely reflected in the law of unconscionability.
570 *TTI Team*, n211, 5.3.[46].
571 *TTI Team*, n211, 5.3.[46(3)].

instruments: the harsh insistence on a right, inappropriate conduct during formation, and beneficiary wilful misconduct. If argued in more general terms, these distinctions become harder to find and the behaviours more difficult to describe and prove.

For example, it has been found that neither 'loss of reputation'[572] nor consequent financial difficulty is sufficient to found harsh or oppressive conduct in relation to a demand on an independent instrument. To begin, these are not behaviours – they are outcomes and cannot therefore be categorised as a type of conduct. They are descriptions of effects and the plaintiff must either show how the the behaviour that led to that result is unconscionable or how the outcome itself is unconscionable.

It is posited here that plaintiffs might see an improved rate of successful appeals for relief from unconscionability if the multi-layered view of the doctrine were more widely understood. To this end, a model of unconscionability is offered below with a vocabulary to describe the relationship of the elements to each other.

5.3. The 'Family' of Unconscionability

This thesis proposes a categorisation of 'unconscionability' into three levels[573] – 'family', 'genus', and 'species' – to assist with designing the doctrine so it can be better understood and the law consistently found.[574]

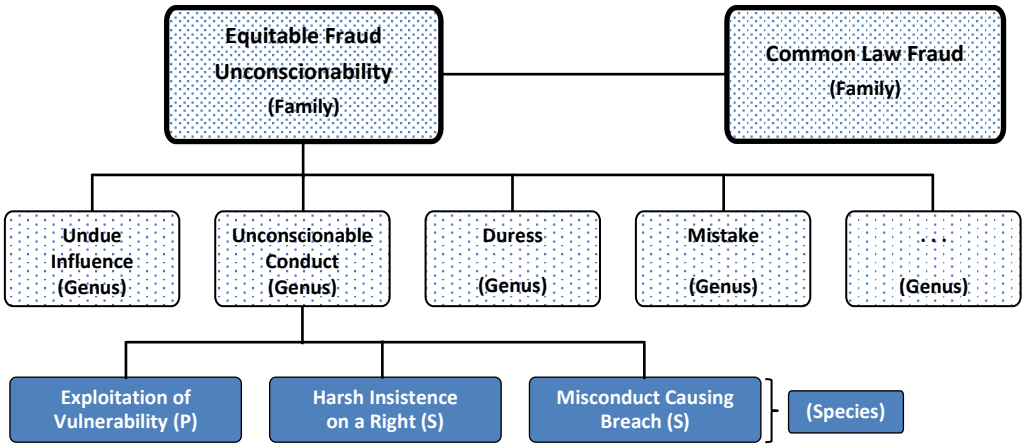
At the peak of the hierarchy is the 'Family' of generic '*Unconscionability*' which is the broadest categorisation. The 'Family' sits alongside the range of equitable grounds for remedy in commercial situations. 'Fraud' as a 'doctrinal family' sits at this level.

'Genus' sub-categories are the broad doctrinal realms of unconscionability such as 'Undue Influence', 'Mistake', 'Duress' and 'Unconscionable Conduct'. 'Species' categories would be the sub-categories of the doctrine of Unconscionable Conduct such as 'exploitation of vulnerability or weakness' and 'harsh or oppressive insistence on a right'. The 'species' categories are best plead as grounds for restraint because the elements to be evidenced have clearer lines of authority and this lack of recognition of the grounds is what appears lacking from the authorities.

572 *Bocotra*, n149 [49].
573 The lowest three biological major taxonomic ranks.
574 These terms are used throughout this thesis.

It is at this level that specific behaviour can be identified, described and determined as unconscionable or not. Words such as 'exploitation' and 'oppressive' have better-defined meanings in law and common usage, with strong lines of judicial authority to support them. Applying those definitions to actual behaviours becomes more pedestrian within a specific context such as independent instruments.

Importantly, not all 'genus' or 'species' of *unconscionability* will apply to independent instruments.



This taxonomy[575] provides a depiction of the family of conduct described under the umbrella term '*Unconscionability*'. This 'laminating'of unconscionability has judicial support. In *Berbatis*$^{(No.1)}$, French J noted:

> The concept of unconscionability is arguably to be found at two levels in the unwritten law. There is a generic level which informs the fundamental principle according to which equity acts. There is the specific level at which the usage of "unconscionability" is limited to particular categories of case.[576]

This structure echoes the High Court of Australia:

> Each doctrine may be seen as a species of that genus of equitable intervention to refuse enforcement of or to set aside transactions which, if allowed to stand, would offend equity and good conscience. [577]

[575] P=Procedural; S=Substantive
[576] *Berbatis*$^{(No.1)}$, n360 [23].
[577] *Bridgewater*, n371 [73]

Finally, Mason J in *Amadio*, supports such a categorisation, saying "fraud…undue influence and unconscionable conduct…all constitute species of unconscionable conduct".[578]

6.0. Independent Instruments and Unconscionability Law: Issues

Unconscionability jurisprudence remains partly unsettled, despite the plethora of case law. This injects further uncertainty into the law of independent instruments. It is posited here that the primary reason for much of the instability and uncertainty surrounding unconscionable conduct, especially in relation to independent instruments, is the lack of recognition for, and application of the different doctrines of procedural and substantive unconscionability. This appears uniform across jurisdictions.

Historically, "[t]he equitable doctrine of unconscionable dealing confers no power on courts to set aside bargains merely on the basis of their content."[579] Because independent instrument matters are all content-based disputes,[580] it follows that the power used to ground injunctions in Singapore, Malaysia and Australia could not have been grounded on the tenets of unconscionable dealing. This is also evident from the lack of special disadvantage and a general paucity of bargaining naughtiness where sophisticated commercial parties are involved. It must therefore be dealt with substantively but this has not to date been expressly recognised and refined.

In Australia, "it is statute that confers upon the court the power to set aside a bargain on the ground that its terms are unconscionable."[581] It is well settled that the Doctrine of Parliamentary Sovereignty[582] prevails against the independence principle.[583]

Consideration of both procedural and substantive issues is provided for in ss20~21 *ACL*.[584] Both sections are directed to equity for guidance on unconscionable conduct but s21 *ACL* is expressly not constrained to those principles.[585] However in

578 *Amadio*, n342, 460.
579 *Dal Pont*, n307, 294[9.10].
580 See Chs.4&5 below.
581 *Dal Pont*, n307, 294[9.10].
582 French, R, 2012, *The Courts and the Parliament* (Qld Supreme Court Seminar 04/08/12), 2.
583 *Boral(No.2)*, n61 [74]. Emphasis added.
584 See discussion on *TPA/ACL*, p.184.
585 *Vout*, n15, 430[35.9.30]. Also see Section B-1.2 above. Commentators like Rickett have expressed concern about the basis upon which the court is meant to ground an injunction for unconscionability beyond the boundaries of the unwritten law.

no independent instrument matter has the court taken the opportunity to coherently explain how procedural and substantive unconscionability should be differentiated within that jurisdiction.

As the majority of independent instrument matters are seeking interlocutory injunctions, which are an equitable relief, they are typically heard in the court's equitable jurisdiction in Singapore and Malaysia.[586] It is therefore in equity that the jurisprudential basis for the intervention provided in Singapore/Malaysia must be found. However, other than acknowledging the departure from the English position,[587] no Singaporean court has provided an analysis of the *elements* of unconscionability used to prove the conduct found unfair. The Singaporean court has therefore acknowledged a different position but has not yet taken the opportunity to explain the jurisprudential basis for the new ground.

Such detail is vital for the purposes of laying down precedent. Without established, enunciated elements to put to proof, the classification of conduct as 'unconscionable' might become increasingly arbitrary and subjective, which gives rise to the above-mentioned judicial concern.[588]

The lack of specificity on the constructive elements required to prompt judicial intervention for breaches of *substantive* unconscionability is of concern. No Singaporean case[589] addresses the fundamental question:

> If *substantive* unconscionability can ground in equity a restraint on an otherwise lawful demand, what elements must be shown *prima facie* to exist to establish it?

In both *Raymond*[590] and *Min Thai* Chai J ventured to elaborate on the parameters of the notion of 'unconscionability', stating it:

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586 In Australia, independent instrument matters are heard under the court's civil jurisdiction and the power of injunction is provided pursuant to the s232 *ACL*.

587 *GHL*, n21, [16]: "We accept that to that extent, Bocotra is a departure, and if we may respectfully say so, a conscious departure, from the English position." This departure from the English position equates to a reworking of the equitable doctrine of unconscionable conduct without a considered justification, explanation or detailed analysis of the new doctrine being provided, ie why substantive unconscionable conduct is now sufficient; how such conduct affects contractual rights; and what elements have to be put to proof to find a *prima facie* case.

588 See comment by Brennan J, p.107.

589 *GHL*, n21; *Eltraco*, n407; *Samwoh*$^{(No.2)}$, n763 respectively.

590 *Raymond Construction Pte Ltd v Low Yang Tong and AGF Insurance (Singapore) Pte Ltd* [1996] SGHC 136 (*Raymond*). In both these cases the beneficiary was restrained from making a demand against the independent instrument in question. Chai J might be described as the 'Father of the Unconscionability Exception' in Singapore and Malaysia as both these cases were persuasive in subsequent unconscionability cases concerning independent instruments. However, Thean JA might also claim this title as he was on the bench in *Royal Design*, *Bocotra*, *GHL*, *Dauphin*, *Eltraco*, and *Samwoh*, all but one of which (*Dauphin*) ultimately restrained the demand against the instrument.

> involves unfairness, as distinct from dishonesty or fraud, or conduct so reprehensible or lacking in good faith that a court of conscience would either restrain the party or refuse to assist.[591]

With respect however, while this may be *descriptive*, it is not *prescriptive*. The terms used are vague and subjective for generic application, giving rise to the possibility of misinterpretation and misapplication. This is common among many of the authorities – the Bench describes behaviour as 'unconscionable' but does not indicate *why* it is unconscionable, other than by reference to itself.[592]

The legal stability of independent instrument is essential to their inherent integrity. This was noted in *Civilbuild*$^{(No.1)}$[593] where Kin JC, discussing unconscionability, stated:

> It is important that the law in relation to such bonds be placed on a clear and unambiguous footing in order that they continue to be accepted by beneficiary parties whether in Singapore or abroad.[594]

The law of unconscionability in relation to independent instruments cannot yet be said to have clarity. This is especially so with respect to the identification and application of the elements required to prove the conduct, despite an extensive line of authority. With the advent of the 'Asplenium Clause',[595] it may never get the opportunity in Singapore. With the increasingly higher bar set to prove unconscionability in Australia under the statute, plaintiffs might seek future redress in other jurisdictions.

7.0. Findings on Unconscionability

Despite the commentary and depth of authority, 'unconscionable conduct' continues to defy accurate scoping by definition. It cannot be stated with certainty what behaviours will constitute unconscionable conduct, although an extensive list of exclusions exists.[596] This lack of clarity is part of the "fundamentally messy character of the common law legal system".[597] The market however requires certainty and it can be argued that the parameters of those 'species' of

591 *Min Thai Holdings Pte Ltd v Sunlabel Pte Ltd* [1998] SGHC 395 [20].
592 For example, stating that unconscionable conduct is behaviour that is 'unconscientious' is tautological.
593 The findings from this court were mostly overturned on appeal.
594 *New Civilbuild Pte Ltd v Guobena Sdn Bhd* [1999] 1 SLR 374 (*Civilbuild*$^{(No.1)}$) [45].
595 *Asplenium*$^{(No.2)}$, n212. Also *Wooler*, n505.
596 See p.251.
597 M Kirby, *Foreword to the Second Edition*, *Vout*, n15, vii.

unconscionability which might affect independent instruments need further clarification.

The common law is far from finding any universality with regard to unconscionability, or how to test its presence, or whether it is sufficiently egregious to attract equity's attention. Denning MR's view of a unifying concept of unequal bargaining power has not found favour.

Insofar as the English authorities more broadly are concerned, while a contractual good faith doctrine exists, the concept of substantive unconscionability being allowed to contaminate commercial undertakings is an anathema to judicial policy.[598]

Horowitz notes:

> one defence still lies beyond England's borders: unconscionable conduct…[the UK]…has not accepted that unconscionable conduct may be a defence to payment in respect of autonomous payment obligations.[599]

Unconscionable conduct in the UK is founded on unconscionable dealing, and unconscionable dealing only provides relief to procedural unconscionability – there must be special disability or 'bargaining naughtiness'. It is difficult to conceive of either circumstance arising in independent instrument disputes.

Therefore the English courts have indicated a willingness to accept 'bad faith' as a defence to autonomous payment obligations given the right circumstances but not an unconscionability defence.[600]

The behaviours that are alleged to be unconscionable in independent instrument disputes are substantive in nature and strictly speaking, in line with the authorities, cannot fall under the doctrine of unconscionable dealing. They do not apparently fall under any other contemporary category of unconscionability. It is for this reason that a special category of unconscionable conduct needs development to accommodate the characteristics of independent instruments.[601]

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598 *D.Horowitz*, n369, 130[6.02].

599 *D.Horowitz*, n369, 131[6.03].

600 The early cases are imprecisely expressed, referring to 'breach of faith', 'bad faith', "no honest belief (in the demand)" and similar phrases indicating an undefined form of unconscionable conduct. See *inter alia*, *Cargill International SA v Bangladesh Sugar and Food Industries Group* [1996] 4 All ER 563 (QB), 568: "The court will not grant an injunction…unless there has been a lack of good faith."

601 See 'A New Category of Unconscionable Conduct', Ch.6 below.

On the widening of the application of equity in commercial transactions, Kirby J (that "blackest of black-letter lawyers"),[602] stated in *Austotel*:

> in particular circumstances protection from unconscionable conduct will be entirely appropriate. But courts should, in my view, be wary lest they distort the relationship of substantial, well-advised corporations in commercial transactions by subjecting them to the overly tender consciences of judges.[603]

This may be in part because unconscionable conduct will always retain an element of subjectivity that cannot be eliminated by any amount of precedent or legislative guidance. Dziedzic and Lindgren states:

> [I]t must be accepted that whether particular conduct constitutes unconscionable dealing will be largely a matter of opinion, that the scope for the operation of precedent and principle is limited and that much will depend on the facts of the individual case.[604]

Dal Pont notes that the issues outlined here are unlikely to become redundant any time soon and also notes his concern with the effect of these developments:

> [T]he impact of the concept of unconscionability in contract has been substantial to say the least, and shows little sign of receding. It marks a new flexibility, which no doubt brings justice to the individual, and may function to generate substantial uncertainty in contracting.[605]

Developing a consistent and encompassing framework for unconscionability is complex and at times counter-intuitive, especially in relation to independent instruments, given the effect of their idiosyncratic character. The growth of substantive unconscionability alongside the doctrine of unconscionable dealing is difficult to accommodate within traditional equitable principles or to reconcile with categories of contemporary unconscionable conduct. As Rickett exclaims, "Standing alone, 'unconscionability' is a very slippery notion indeed."[606]

602 M Kirby, *Foreword to the First Edition*, *Vout*, n15, vii.
603 *Austotel v Franklins Self Serve* (1989) 16 NSWLR 582, 585-586.
604 *Dziedzic & Lindgren*, in *Vout*, n15, 441[35.9.220].
605 *Dal Pont*, n418 [83].
606 *Rickett*, n329,74.

Section C. Theoretical Foundations of the Unconscionability Exception

This section reviews authorities governing and analysing the unconscionability exception to the independence principle of independent instruments. Consideration here is given to the judicial observations of courts in Australia, Singapore and other jurisdictions with respect to the exception. Academic discussion that describes and questions the existence and value of the exception is discussed with examples from the authorities to illustrate the development and parameters of independent instrument unconscionability.

Application of the unconscionability exception is not complex *per se*. However the consistent identification of behaviour that is sufficiently unconscionable is problematic. This difficulty is burdened by the lack of clear jurisprudence by which the doctrine might develop, including consideration of the effects of substantive unconscionability. In addition, the unique and somewhat counter-intuitive nature of the independence principle itself adds difficulty.

Only in Singapore has the Court expressly developed the unconscionability exception from within its equitable jurisdiction. Australian courts are required to exercise both their laws of statutory interpretation and the rules of equity to find unconscionable conduct.

The remainder of this chapter reviews the global judicial and academic view of the exception and examines the lines of authority that have considered it. Matters considering the unconscionability exception heard in England, Canada, Malaysia, the US, and South Africa are also relied upon.

1.0. Analysis of the Exception

1.1 Introduction to the Unconscionability Exception

This thesis does not engage in an extended analysis of the genesis of the unconscionability exception in Singapore as this has been completed elsewhere.[607] An abbreviated review of the early case law is provided for contextual purposes. Of more salient interest are the later cases in the Singapore High Court which incontrovertibly established and refined the unconscionability exception, leading to *Asplenium*$^{(No.2)}$[608] and judicial affirmation of the 'Asplenium Clause'.[609] It is this line

607 See *D.Horowitz*, n369, 162-169. See also Ch.4 below.
608 *Asplenium*$^{(No.2)}$, n212.
609 *Wooler*, n505.

of cases that pollinated the Malaysian cases and threatened to spread further, a possibility probably arrested by the finding in *Asplenium(No.2)*.

Development of unconscionable conduct as an exception to the independence principle might be considered a jurisprudential progression from the fraud exception. Equitable fraud, which includes special disadvantage procedural unconscionability,[610] has been widened in Singapore, Malaysia, and Australia to incorporate substantive unconscionability in commercial matters.

This thesis proposes the effect of unconscionability needs to be understood in terms of where the contractual rights and obligations lie. Again, these independent instruments are unique and do not obey the usual principles of contract law, or equity, or even necessarily Hohfeldian reasoning.[611]

Both the fraud exception and the unconscionability exception are predicated on the independence principle. Immediately an independent instrument is issued, for most purposes it becomes independent of the contractual agreement that gave rise to it. No substantive dispute between the primary parties disturbs the obligation to honour.

In its broadest context, the 'exception' to the independence principle (fraud, illegality, unconscionability, nullity) is a term by which to describe the Court's use of a legal doctrine to ground an injunction. The injunction will restrain the agreed-to demand-right held by the beneficiary of an independent instrument.

To find the grounds upon which to found the doctrine, courts must lift the Veil of Autonomy. It looks to the contract and conduct beneath to determine whether the matters involved provide the necessary proof to satisfy the elements of a doctrine (such as unconscionable conduct) upon which to ground relief.

One argument against this is that demand guarantees are so like letters of credit that the underlying contract should be similarly independent. However, the Court in *Potton* disagreed:

610 *Dziedzic & Lindgren*, in *Vout*, n15, 436[35.9.190].

611 See p.22. Hohfeldian reasoning holds that an obligation that arises on one party will automatically give rise to a right in another person. This may not apply with independent instruments – the issuer undertakes an obligation to pay independent of the beneficiary (which is one basis for the argument that independent instruments are not contracts *per se*). This is one identified area of post-doctoral research.

> [I]t would seem wrong to me if the court was not entitled to have regard to the terms of underlying contract…by a mere assertion that a performance bond is like a letter of credit.[612]

Horowitz believes the instruments' abstraction becomes threatened as a result.[613] She reasons that if the instruments are truly independent, neither lifting the veil nor any findings from that process should have any probative value with respect to determining the obligation to honour.

However, the argument to this is that the process of considering the substantive issues through the veil of autonomy does not imply a determination of those issues.[614] A strong *prima facie* case or its equivalent is the standard required; not incontrovertible evidence. The substantive issues are therefore leveraged for their probative value to ground a doctrine and consequently found an injunction. Whether this process offends the independence principle is arguable.

It is proposed here that if the Court must look into the terms of the underlying contract and conduct, or their application or effect, to determine whether the demand-right should be restrained, it follows that, as provided in *Sumatec(No.3)*,[615] *the right to make a demand must arise expressly or impliedly from the underlying contract* and not from the instrument itself. The independent instrument itself only gives rise to a Liberty[616] to make a presentation and the right to sue for wrongful dishonour, ie the beneficiary is not *obliged* to do anything.[617]

The following section outlines the judicial and academic support for the view that where an injunction restrains a beneficiary but does *not* curtail the issuer's capacity to pay, the independence of the instrument is not affected. It follows that the 'exception' to the independence principle may be a fiction except where an issuer's obligation to pay is restrained.

612 *Potton*, n709, 28. Emphasis added.
613 *D.Horowitz*, n369, 1-3.
614 *Mount Sophia*, n39 [47]: "a consideration of the disputes between the parties does not necessitate a substantive determination of them."
615 *Sumatec(No.3)*, n170 [40(iii)]: "unconscionability is a doctrine which allows courts to deny enforcement of a contract because of abuses arising out of the contract".
616 This is equivalent to the Hohfeldian 'incident' of 'Privilege'. Between the two instruments, the beneficiary has a right to make a complying demand, and ***no duty not to*** make a demand, and also the privilege **not** to make a demand should they so choose. See L Wenar, 'The Nature of Rights' (2005) 33(3) *Online Journal of Philosophy and Public Affairs* 223 <http://onlinelibrary.wiley.com/doi/10.1111/j.1088-4963.2005.00032.x/full>, 224-228.
617 See discussion on the source of demand-rights: p.22.

1.2. Restraint of Demand-Right and Honour Obligation

It could be argued that an injunction restraining the beneficiary's demand-right does not offend the independence principle because the issuer's obligation to honour, which lies with the instrument, remains unaffected. The argument provides that only where the *issuer* is restrained that the question arises on piercing the veil of autonomy.

Writing in the context of 'breach of faith' in the British jurisdiction, Horowitz said:

> [the injunction] did not involve any problem for the autonomy principle, as the injunction was to restrain the beneficiary from calling on the guarantee; it was *not to restrain the bank from paying*.[618]

Early Singaporean cases do not accord with the view. In *Brody, White*[619] and *Bocotra*, the Court "bestowed judicial imprimatur"[620] on the principle that "[t]here is no distinction between cases where an injunction is to restrain a bank or the beneficiary under the guarantee."[621]

In *Bocotra* Karthigesu JA held:

> [i]t was irrelevant that the injunction in the present case was one which prevented the appellants from encashing the letter of credit, rather than one which restrained the bank from honouring the credit. *The consequence would have been the same*: the documentary credit contract between the bank and the appellants, which should be independent of the underlying contract between the appellants and the respondents, was in effect being frozen by the injunction obtained by the appellants.[622]

This view has become controversial. In the Victorian Court of Appeal Callaway J disagreed with a statement made by the English court in *Group Josi*[623] which supports the view that there is no difference between restraining the bank and the beneficiary:

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618 *D.Horowitz*, n369, 133[6.05].
619 *Brody, White & Co v Chemet Handel Trading* (1993) 1 SLR 65 (CA).
620 A Wong, 'Restraining A Call On A Performance Bond: Should 'Fraud Or Unconscionability' Be The New Orthodoxy' (2000) 12 *Singapore Academy of Law Journal* 132, 136.
621 *Bocotra*, n149 [33(d)].
622 Ibid [34].
623 *Group Josi*, n257.

> There is nevertheless an important difference between restraining a bank from honouring a guarantee and restraining the beneficiary from calling upon it. In the former case the moving party seeks to prevent the bank from performing its contract; in the latter case the moving party seeks to prevent the beneficiary from breaching a provision of the underlying contract.[624]

In *Themehelp* the Court went further, holding:

> [I]t does not seem…that the slightest threat is involved to the autonomy of the performance guarantee if the beneficiary is injuncted from enforcing it in proceedings to which the guarantor is not a party.[625]

More recently in *Boral(No.2)*, Austin J reviewed the authorities relating to the lifting of the veil of autonomy and found:

> [A]n injunction to restrain the beneficiary from breaching the underlying contract *does not directly interfere with the autonomy of the payment obligation.*[626]

This view of an autonomy principle that only applies to the issuer's obligation to honour was supported in the Malaysian Supreme Court of Appeal where Yusof JC stated:

> As between the immediate parties…[i]f there is clear evidence of fraud in the underlying contract, or unconscionability, the Court can interfere. In these two situations, *the integrity and autonomy of the document will not be compromised, since the paying bank will not be directly prevented from acting on the document*. It is the beneficiary that is prevented from making a call on the document on these grounds.[627]

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624 *Fletcher*, n943, 27.
625 *Themehelp*, n295, 99.
626 *Boral(No.2)*, n61 [41]. Emphasis added. His Honour added, somewhat contrarily, "the effect of intervening in this way is to break down the separation between the underlying contract and the independent financing contract". The nature of this "break down" was not elaborated upon but superficially this description reads like a breach of independence.
627 *Focal Asia & Chye Heng v Raja Noraini Binti* [2009] 1 LNS 913 [11: Conclusion]. Emphasis added.

Three years later, in *Sumatec*[(No.3)], the full bench of the Malaysian Supreme Court of Appeal held:

> [D]istinction must be drawn between an injunction to restrain a bank/issuer from making payment out on a performance bond (which is governed by the performance guarantee agreement) and an injunction to restrain a beneficiary from making a demand on the bond (*which is governed by the underlying contract between the parties*).[628]

This statement implies that the *right* to make a demand arises out of the underlying contract. It will therefore be any unconscionable behaviour in relation to that underlying contract that the court will consider to answer a plea to restrain that right.

The *UN-CIGSLC* has not provided significant guidance. It is worded such that either the issuer or the beneficiary can be restrained. Given a demand which has "no conceivable basis", the *UN-CIGSLC* provides for a court to:

> issue an order to the effect that the beneficiary does not receive payment, including an order that the guarantor/issuer hold the amount of the undertaking.[629]

The *UN-CIGSLC* therefore takes no position on the question of whether the independence principle is compromised by restraints against the issuer.

1.3. Abstraction

Another demonstrated means by which to determine the effect of various 'defences' to payment such as 'unconscionability' is to evaluate the 'degree of abstraction' between the independent instrument and the underlying contract.[630] Horowitz maps various exceptions to autonomy onto a "spectrum of abstraction" that plots the degree of abstraction between the instruments and the underlying contract.[631]

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628 *Sumatec*[(No.3)], n170 [40(iii)]. Emphasis added.
629 *UN-CIGSLC* [Art.20(1)(a)]
630 This terminology is used widely in Europe. See *CKT*, n488.
631 *D.Horowitz*, n369, 4[1.08]. The degree of abstraction represents the legal separation between the rights and obligations under one contract with those of another.

According to her theory, the degree of abstraction between the instruments decays as the inquiry becomes more substantive. That is, the more the court is required to inquire into the terms and conditions or outcomes from the operation of the underlying contract, the lesser the degree of abstraction, and therefore the more *inter*dependent the two contracts become.

Horowitz' theory holds that the unconscionability exception requires too great a diminution of the level of abstraction, and therefore:

> English law…should not adopt a defence of unconscionable conduct in respect of [independent instruments]…because it would involve too much reference to the underlying contract."[632]

She emphasises that it is the degree of abstraction that protects independent instruments:

> If the undertaking were interlinked with the underlying contract, there would be no protection [for the instrument] against defences arising under that contract, and the obligation would no longer be abstract.[633]

In relation to the spectrum of abstraction she discusses an "ideal cut-off point [that is] movable for policy reasons".[634] This 'point' represents the perfect degree of abstraction that allows for an egregious fraud defence[635] but refuses to admit investigations of a substantive nature.[636] This mooted "cut-off point" appears to be decided on the basis of an assessment of the "degree of abstraction".[637] It may also be analogous to what is referred to in this thesis as the 'Veil of Autonomy', which reflects the legal separation between the independent instrument and the underlying contract/conduct.

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632 Ibid 131[6.03]. Interestingly, Horowitz does not make a case for *why* the abstraction is important.

633 Ibid 1[1.02]. With respect, the logic here does not follow. It might be better to say that 'if the undertaking were interlinked, the obligation would no longer be abstract and *therefore*, there would be no protection against defences under the contract.'

634 See the Spectrum of Abstraction in *D.Horowitz*, n369, 13-14[1.20].

635 'Fraud in the documents' or 'fraud as no honest belief', but holds that 'fraud in the transaction' degrades the degree of abstraction too greatly to be an acceptable defence to payment.

636 This pre-supposes that a perfect degree of abstraction is always optimal.

637 *D.Horowitz*, n369, 5[1.09]: "The aim is to indicate this range broadly, rather than attempt to plot these defences on the spectrum as though this were an exact science."

1.4. Singapore – Exception Jurisprudence

The unconscionability exception in Singapore had an inauspicious beginning. Former Chief Justice Keong has stated without explanation that the doctrine was introduced into Singapore from Australia.[638] It is however, difficult to see how this view can be sustained given that *Bocotra*, the case widely held as seeding the exception, predates any significant Australian case pleading this cause of action.[639] Also, Australian case law has rarely been referred to by the Singaporean court in any major unconscionability case in the line of authority.[640]

The case law indicates that the real influence in early Singaporean cases was two British cases *Potton Homes*[641] and *Edward Owen*[642] which were both mentioned in Singapore's earliest successful "implicit unconscionability"[643] cases, *Royal Design*[644] and *Kvaerner*.[645]

Potton Homes is widely accepted as seeding the exception,[646] although unconscionability was neither found nor mentioned. Its reputed role in the development of the exception devolved from the following widely-quoted excerpt:

> As between buyer and seller the underlying contract cannot be disregarded so readily…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*…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…the seller should not be unable to prevent a call upon the bond.[647]

However, this link might be considered specious given that neither British case is seen in its own jurisdiction as either establishing unconscionability as an exception to independence or even as acknowledging that one exists.

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638 C. Keong, 'Developments in Singapore Law 2006–2010: Trends and Perspectives' (Speech delivered at the Singapore Academy of Law Conference 2011, Singapore, 24 February 2011).

639 S51AB and s51AC *TPA* were not introduced until 1992, one year prior to *Kvaerner* and just three years prior to *Bocotra*, which refers obliquely to "fraud and unconscionability" as exceptions to autonomy.

640 *Johns*, n128, 312: "From Singapore, unconscionability has migrated to Australia and Malaysia, and its existence appears to have been acknowledged in Hong Kong."

641 *Potton*, n709.

642 *Edward Owen*, n25.

643 *Johns*, n128, 311. The 'implicit cases' are those wherein unconscionability was an implied ground for the injunction.

644 *Royal Design*, n148.

645 *Kvaerner*, n512.

646 *Johns*, n128, 312.

647 *Potton*, n709, 28. Emphasis added.

The line of precedent in Singapore can be bifurcated into the 'pre-*GHL*' cases and those found since where unconscionability was expressly endorsed by the Court. Johns and Blodgett separate the case law on the basis of whether unconscionability was "implicit" or "explicit" in the findings, further dividing "explicit" by jurisdiction.[648]

In two cases immediately before *GHL* – *Raymond Construction* and *Min Thai* – there is no discussion of the autonomy of the independent instrument involved, and no reference to procedural or substantive unconscionability. However both were restrained on the basis that the demand was unconscionable. It is not until *GHL* that the Court gives prescriptive weight to the doctrine.

GHL was a strongly worded judgement – it left no room for doubt whether the unconscionability exception exists in that jurisdiction.[649] The exactitude with which the bench dealt with a range of matters relating to unconscionability established characteristics of the exception. *GHL* is referenced frequently in subsequent independent instrument cases seeking to ground an injunction on unconscionable conduct in both Singapore and Malaysia.[650]

Soon after *GHL*, Tin and Thean JJA in *Dauphin*, devoted an entire section to the question "Is there a separate 'unconscionability' exception?"[651]

While discussing *Bocotra*, the Court went further than *GHL*, stating:

> the court in that case [*Bocotra*] was clearly conscious that fraud as a ground was quite distinct from that where you had to examine the circumstances surrounding the underlying contract.[652]

Ultimately *Dauphin* did not find the demand on the instrument unconscionable but provided:

> we would reaffirm…*GHL v Unitrack* that in Singapore 'unconscionability' has been accepted as and is a separate ground in itself for granting injunctive relief insofar as a performance guarantee is concerned.[653]

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648 *Johns*, n128, 311-320. This also reflects an equity/statute jurisdictional division in the head of power.
649 Given its importance the case findings have been dealt with extensively elsewhere in this paper. See *GHL*, n168; n21, and case analysis, p.151.
650 Malaysia has developed its own line of authority on unconscionability affecting independent instruments that mirrors the Singaporean line.
651 *Dauphin*, n554 [34].
652 Ibid [37].
653 Ibid [42].

The line of authority in Singapore from that point forward until *Asplenium*$^{(No.2)}$[654] remained firmly grounded on these early cases. Other than needing to deal with a range of factual variables, the development of the unconscionability exception jurisprudence was straightforward; *Bocotra*, *GHL* and *Dauphin* provided sufficient certainty for the exception to develop organically and to be robust enough to deal with any variables.[655]

Before *Asplenium*$^{(No.2)}$ however, the Court heard *Mount Sophia* which provided an exhaustive review of the line of authority. As this author has stated previously:

> If it can be said that a line of authority has a denouement, a single seminal case that puts to rest any notion of doubt as to the existence and scope of a doctrine, then BS Mount Sophia is such a case. The full bench of the Court of Appeal addressed virtually every aspect of the unconscionability exception, quoted from a wide variety of domestic and non-Singaporean case law, statute and juridical commentary, and produced the *magnum opus* on the Singaporean Unconscionability Exception to the Autonomy Principle in Demand Guarantees and Letters of Credit.[656]

In *Mount Sophia*, Leong JA summarised the following seven "applicable principles" of the exception found previously by Pillai J:[657]

1. Whether there is unconscionability depends on the facts of each case. There is no pre-determined categorisation.
2. In determining whether a call on a bond is unconscionable, the entire picture must be viewed, taking into account all the relevant factors.
3. The concept of unconscionability involves unfairness, as distinct from dishonesty or fraud, or conduct of a kind so reprehensible or lacking in good faith that a court of conscience would either restrain the party or refuse to assist the party.

654 *Asplenium*$^{(No.2)}$, n212. It is essential to note that *Asplenium*$^{(No.2)}$ did **not** set aside the unconscionability exception; it provided a means by which to contractually restrain appeal to the exception.
655 See the case analyses in Chapter 4 below.
656 *Wooler*, n505, 173.
657 *Astrata (Singapore) Pte Ltd v Tridex Technologies Pte Ltd* [2010] SGHC 250, [73] (*Astrata*).

4. While in every instance of unconscionability there would be an element of unfairness, the reverse is not necessarily true. Unfairness *per se* does not constitute unconscionability.

5. In intervening in a call on an on-demand bond/guarantee, the court is concerned with abusive calls on the bonds.

6. Mere breaches of contract by the party in question would not by themselves be unconscionable.

7. It is important that the courts guard against unnecessarily interfering with contractual arrangements freely entered into by the parties. The parties must abide by the deal they have struck.[658]

With respect to unconscionability itself, Leong JA held:

> [A] finding of unconscionability is a conclusion applied to conduct which the court finds to be so lacking in *bona fides* such that an injunction restraining the beneficiary's substantive rights is warranted. Sufficient reasons must be given to the court…and it is necessary that these reasons are drawn from a thorough consideration of the relevant facts…*taking into account the parties' conduct leading up to the call on the bond*.[659]

This is judicial support for lifting the veil of autonomy and for consideration of substantive unconscionability when determining whether a demand is abusive.

The Singaporean courts have adhered to a *standard* of proof whereby the applicant must make a "strong *prima facie* case", a threshold which the court has admitted is deliberately high.[660]

This in effect limits the risk-shift away from the account party. When the plaintiff prays for relief, the court is acutely aware that it is being asked to restrain a party "from enforcing a substantive right which he had contracted for."[661]

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658 The first two principles are strikingly similar. Neither Court in *Astrata* or *Mount Sophia* provided additional explanation regarding how they found each principle nor have they provided any kind of comparative analysis. The first principle is almost identical to a statement in *Dauphin*, n554 [42]. The second is from *Eltraco*, n407 [31]. The court in *Eltraco* also references and affirms the finding in *Dauphin*.

659 *Mount Sophia*, n39 [45].

660 *Dauphin*, n554 [57].

661 *Mount Sophia*, n39 [22].

1.5. Australia – Exception Jurisprudence

Unconscionable conduct in Australia took on judicial life in the early 1980s[662] and has widened continuously since. The head of power for the unconscionability exception in Australia is provided by the statute, not the general law. The statute requires the court to look to the general law for guidance on the nature of unconscionability and unconscionable conduct generally and to apply the principles to specific behaviours relating to a demand on an independent instrument.

The possible use of unconscionable conduct to ground an injunction was first mentioned in *Hortico* where it was said "it may be that in some cases…the unconscionable conduct may be so *gross* as to lead to" exercise of the Court's "discretionary power".[663]

More than ten years after *Hortico* unconscionable conduct as a grounds to restrain an independent instrument was addressed by Batt J in *Olex(No.1)*,[664] the first of three Australian cases to find the exception. At first instance, counsel for the Plaintiff plead unconscionable conduct *under the general law* relying on judicial pronouncements in *Hortico* and *Logue*.[665]

His Honour was unconvinced, finding that there was no authority for equity to intervene.[666] If such a power existed, the Court held, "one would expect it to have been mentioned in the cases much earlier."[667]

When the Court considered unconscionability under s51AA *TPA*, Batt J laid down both a general *and* a specific principle. His Honour held in *general* that the making of a demand, ie the "insistence" on a right "in circumstances which make that harsh and oppressive", satisfied the requirements of s51AA and could ground an injunction under s80(1) *TPA.* This was substantive unconscionability, dealing as it does with the *outcome* of a contract, and was within the ambit of the Act.[668]

662 *Finn*, n469, 37.
663 *Hortico (Australia) Pty Ltd v Energy Equipment Co (Australia) Pty Ltd* (1985) 1 NSWLR 545, 554 (*Hortico*). No unconscionable conduct was found.
664 See p.189, Case Analysis for further discussion on *Olex(No.1)*.
665 *Logue*, n493.
666 While not expressly saying so, his Honour's reasoning suggests that of the British courts – substantive matters are not addressed under the general law. To date, all independent instrument unconscionability has been substantive.
667 *Olex(No.1)*, n38, 400.
668 *Dal Pont*, n418 [75].

The guarantees in question in *Olex* allowed part drawings. The beneficiary drew down the full amount of the instruments despite knowing that the liability guaranteed had largely been met. This was found sufficient to ground an injunction and is authority for the *specific* principle that *making a demand for a sum greater than that which is owed, where the credit allows for partial drawings, is unconscionable*. Neither of these were overturned in the High Court and remain good law.[669]

Batt J famously stated:

> The effect of the statute, applying as it does to international trade and commerce, is to work a substantial inroad into the well-established common law autonomy of letters of credit and performance bonds and other bank guarantees.[670]

However it was six years, in *Boral*$^{(No.1)}$, before another demand on an independent instrument was restrained under s51AA for unconscionability.[671] While the question properly was "whether the making of demand for the full invoice value constitutes unconscionable conduct",[672] this was not addressed in this matter possibly due to the interlocutory nature of the proceedings.

On appeal Austin J decided that the demand for a "disputed amount" was unconscionable. This was based on two circumstances: first, that the certification giving effect to the demand was false; and second, the judicial policy that "*the principle of autonomy…cannot override the statute*."[673]

This last statement is taken to mean that unconscionable behaviour, if sufficiently egregious, is sufficient for the purposes of the unconscionability provisions in the *TPA*/*ACL* to lift the veil of autonomy.

The Court also finalised any discussion in relation to autonomy and its capacity to consider the underlying contract when it said:

> The terms of the irrevocable instrument and the underlying contract, properly construed, are highly relevant to the decision whether

669 *Olex*$^{(No.3)}$, n207: The High Court refused Olex Focas leave to appeal.
670 *Olex*$^{(No.1)}$, n38, 404. The line of authority is overwhelmingly populated with cases alleging unconscionable conduct under the *TPA* which have failed to meet the standard of proof required.
671 See case analysis: p.193.
672 *Boral Formwork and Scaffolding v Action Makers* [2003] NSWSC 557, [13] (*Boral*$^{(No.1)}$).
673 *Boral*$^{(No.2)}$, n61 [74]. Emphasis added.

> conduct in connection with those arrangements is unconscionable for statutory or equitable purposes.[674]

In *Boral(No.2)* the Court of Appeal referred to two equitable doctrines relied upon by the successful applicant. Unfortunately Austin J does not provide which influenced his Honour's final determination. The two "traditional doctrines" relied upon were:

1. Unconscientious reliance on strict legal rights;
2. Unconscionable benefit arising from their own breach where they were aware of their breach.[675]

It was another six years before an Australian court, in *Board Solutions*,[676] had the opportunity to review the exception. This matter is also the last occasion in Australia where such an injunction was granted. With respect, the reasoning provided in the matter is confused and inconsistent with the authorities and provides little new.[677] The applicant was successful however, which makes it noteworthy in that jurisdiction.

In *Board Solutions*, the Court held that to enjoin the demand it should consider "whichever course appears to carry the lower risk of *injustice* if it should turn out to have been wrong."[678] Forrest J confirmed that the general law in Australia does not provide for the unconscionability exception and relief must be sought from the statute.[679] However, his Honour notes that the "reach of s51AA" has not been determined by the High Court and that different views have been expressed with regard to it.[680] This remains the case at time of writing.

In summary, *Board Solutions* advances understanding of the unconscionability exception in no material way other than to confirm a number of matters from prior cases with respect to the application of the *TPA*.

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674 Ibid [94].
675 The Court relied on *Wilkinson v Feldworth Financial Services* (1998) 29 ACSR 642.
676 *Board Solutions Australia Pty Ltd v Westpac Banking* [2009] VSC 474 (*Board Solutions*).
677 See the case analysis at p.207.
678 Ibid [27(d)]. With respect, this element introduces a completely random variable into the consideration of the unconscionability exception and suggests the intervention (per Kirby J in *Austotel*) of the "overly tender consciences of judges". See p.125 above.
679 Ibid [37].
680 Ibid [47].

The Australian line of authority on the unconscionability exception rests on the *ACL*; the unconscionability provisions therein have been applied relatively narrowly in independent instrument matters.[681]

It is possible to suggest that the Australian exception typically relies on equitable doctrines relating to the harsh or oppressive insistence on legal rights, and the avoidance of unjust enrichment arising from the beneficiary's own breach or misconduct. It has also been found that the head of power under which an unconscionable demand can be enjoined is provided under s232(1) *ACL*.

1.6. The Exception Under UN-CIGSLC

A view of the broad international position is provided by the *UN-CIGSLC*. It does not mention unconscionable conduct *per se*. It does however deal very effectively with abusive demands in terms that are, for all intents, analogous to contemporary contractual unconscionability in common law jurisdictions.

Under Art.19, injunctive relief is available in the absence of fraud or forgery where there is "no conceivable basis" for the demand, a wonderfully drafted catch-all that encapsulates the spirit of the equitable doctrine:

> **Article 19**
>
> (1) If it is manifest and clear that:
>
> (a) Any document is not genuine or has been falsified;
>
> (b) No payment is due on the basis asserted in the demand and the supporting documents; or
>
> (c) Judging by the type and purpose of the undertaking, the demand has no conceivable basis,
>
> the guarantor/issuer, acting in good faith, has a right, as against the beneficiary, to withhold payment.

The effect of this last clause appears to provide the issuer with a role in assessing when a demand has "no conceivable basis" which is likely to be seen as being wide of their role as an evaluator of documents.

681 Only three matters have succeeded to restrain payment of an independent instrument in a final determination over a thirty-year period.

Art.19(2) also provides five examples of when a demand may fall under the first provision and these are discussed in detail below in relation to the legal construct of independent instrument unconscionability.[682] As Loi points out, the examples in Art.19(2) "clearly extend beyond fraud"[683] and deal with both procedural and substantive unconscionability.

1.7. The Exception – Overview and Analysis

In the three 'unconscionability jurisdictions', it has been found unconscionable for a beneficiary to make a demand:[684]

- for an amount greater than that which is owed: *GHL*[685] and *Olex*$^{(No.1)}$[686]
- to acquire some form of advantage by devious means: *Bains Harding*[687]
- where a contractual dispute settled within the terms of the underlying contract estopped the Beneficiary from making the claim: *Boral*[688]
- despite being unable to meet their own fiscal responsibilities under the contract: *Raymond*[689]
- despite engaging in *abus de droit*: acting to obstruct the performance of the underlying contract and thereby to enable a claim against the instrument: *Royal Design*[690]
- despite there being an outstanding dispute whether the contract is still on foot, eg whether a *force majeure* provision might be held to operate: *Min Thai*[691]

682 See p.229 and p.246.
683 *Loi*, n131, 510.
684 This paragraph and the following list, with redactions/amendments, is excerpted from this author's published work. See *Wooler*, n505, 175-6.
685 *GHL*, n21.
686 *Olex*$^{(No.1)}$, n38.
687 *Bains Harding (Malaysia) Sdn Bhd v Arab-Malaysian Merchant Bank Bhd* [1996] 1 MLJ 425, 426-427.
688 *Boral*$^{(No.2)}$, n61.
689 *Raymond*, n590.
690 *Royal Design*, n148. Also J Byrne, and C Byrnes (ed), *Institute of International Banking Law & Practice Annual Survey* (Institute of International Banking Law & Practice, 2008), 243: "Although the doctrinal origins of this aspect of LC fraud have not been explored, most courts have assumed that such an action is fraudulent even where the beneficiary's action constitutes a breach of contract and not fraud with respect to the underlying transaction."
691 *Min Thai*, n591.

- ❖ despite failing to meet a major obligation under the contract terms, causing the performing party to default and triggering a capacity to make the claim - usually a failure to make or guarantee interim payments: *Kvaerner*[692]

However, in the major jurisdictions of the UK and the US, unconscionability remains a pariah doctrine. In England, *TTI Team* came closest to acknowledging a role for unconscionability in restraining the beneficiary to an independent instrument. Thornton QC, after noting that a 'breach of faith' is sufficient to ground equitable relief, held:

> A breach of faith can arise in such situations as…a threatened call by the beneficiary for an unconscionable ulterior motive; or a lack of an honest or bona fide belief by the beneficiary that the circumstances, such as poor performance, against which a performance bond has been provided, actually exist.[693]

However, while the English Courts do not appear ready to adopt an unconscionability exception any time soon,[694] the similarity between unconscionable conduct (which is not recognised) and contractual good faith (which is), may deliver much the same result. Thornton QC's grounds are similar in some aspects to those grounds found unconscionable in some Singaporean cases.

Loi addresses the criticism that the unconscionability exception is likely to 'undermine the commercial viability' of independent instruments. Loi takes an inverted view of the matter, excoriating any defence of independence in the face of unconscionable conduct, pointing out:

> [C]onfidence in, and utility of, commercial instruments such as performance guarantees cannot possibly be promoted by habitual judicial enforcement of unconscionable payment demands made under oppressive circumstances.[695]

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692 *Kvaerner*, n512. Characterised succinctly in *Star-Trans Far East v Norske-Tech Ltd* [1995] SGHC 168; [1995] 2 SLR(R) [36]: "The applicants induced the breach and relied on it to call on the performance bond. There was clear and unrefuted evidence that the applicants relied on their own wrong."

693 *TTI Team*, n211, 46[3]. Emphasis added. The reference here to unconscionability to describe a breach of faith creates an interesting judicial link.

694 This author suggests that the British adherence to a narrow view of the doctrines of unconscionable dealing and equitable fraud whereby historically only *procedural* unconscionability can be enjoined, could well be responsible for this judicial reluctance.

695 *Loi*, n131, 509. This view was noted with approbation in *Mount Sophia*, n39 [33]. See *Dynamics* quote, p.97.

The Malaysian Court in *Focal Asia* stated expressly that consideration of unconscionability "accord[s] with good commercial sense"[696] and this view was specifically endorsed three years later in *Sumatec*$^{(No.3)}$.[697]

The sanctity of the independence principle has to be weighed against other considerations in the market – victims of an abusive demand enforced by the judicature are unlikely to trust such instruments again.Where the Court is seen to be aiding an abuse its own integrity may come under attack. It was in fact *because* of this very issue – the black-letter law of contract producing unfair outcomes – that the Courts of Chancery and ultimately, equity, first found favour.

The heart of the argument in support of the unconscionability exception stems from recognition of the *unequal risk* being shouldered by the parties once an independent instrument obligation arises. At all times the bearer of a demand instrument carries a capacity to impact significantly the financial resources of the applicant, which could even be fatal to their organisation if realised.

While it is a reasonable argument to state that the parties, especially legally advised, well-resourced and sophisticated firms, enter into the transaction with their eyes open, it is of little comfort where an abuse materialises.

It is arguable that a significant inequity in bargaining position is created where the value of the underlying contract is large relative to the operational size of the contractor providing the demand guarantee. In these conditions the contractor adopts a level of risk disproportionate to the likely return and carries little or no negotiating leverage.[698]

As found in *GHL* with respect to both unconscionable oppressive behaviour and inequitable risk:

> It should not be forgotten that a performance bond can operate as an oppressive instrument, and in the event that a beneficiary calls on the bond in circumstances, where there is *prima facie* evidence of fraud *or unconscionability*, the court should step in to intervene... It should also not be forgotten that a performance bond is basically a security for the performance of the main contract, and as such we see *no reason*, in principle, *why it should be so sacrosanct and*

696 *Focal Asia*, n627 [10: *Fraud In The Underlying Contract*].
697 *Sumatec*$^{(No.3)}$, n170 [40].
698 It is unlikely that this on its own would suffice to find procedural unconscionability.

> *inviolate* as not to be subject to the court's intervention except on the ground of fraud.[699]

With this statement, the Court provided justification for equitable intervention (oppression); outlined the grounds for the injunction (unconscionability); indicated the standard of proof (strong *prima facie* case); and advocated for lifting the veil of autonomy based on the functionality of the instrument (security, not cash equivalent).

In independent instrument disputes, the courts are asked to determine on the facts the presence of substantive unconscionability and whether it is sufficiently egregious to restrain the benefit of the instrument. This is, on occasion, an onerous task but the courts are far better placed to make such a determination than the issuer.[700]

Much has been written for and against the unconscionability exception and there are sound arguments for and against its continued application. Loi reasonably argues that 'successful' abusive calls which sometimes do irreparable harm to contractor applicant parties can only harm the reputation of independent instruments.[701] Wunnicke however takes the common position that widening the range of exceptions to autonomy only weakens the product.[702] Whether there is evidence to support that assertion is unkown. It is more probable that the true position lies somewhere between the two points and users must rely on the courts to get the balance right.[703]

If unconscionable conduct continues to be plead as a "defence to payment",[704] it is imperative that the required proof is clarified and substantiated to provide confidence.

699 *GHL*, n21 [24]. Emphasis added.
700 *Ellinger*, n14, 325[vi]: "This leaves to the courts the responsibility for assessing the presence of [unconscionability], a task which, though uncertain, the courts are more equipped to perform than the issuer."
701 *Loi*, n131, 509.
702 *Ellinger*, n14, 325[vi].
703 This is why clauses agreeing to jurisdiction over arbitration and settlement of disputes are so important.
704 *D.Horowitz*, n369.

1.8. Table of Cross-Jurisdictional Independent Instrument Unconscionability Case Law

Case List: Injunctions Issued Grounded on *Prima Facie* Unconscionability

Singapore	*Malaysia*	*Australia*
Royal Design Studio Pte Ltd v Chang Development Pte Ltd [1990] SLR 1116	*Bains Harding (Malaysia) Sdn Bhd v Arab-Malaysian Merchant Bank Bhd* [1996] 1 MLJ 425	*Boral Formwork and Scaffolding v Action Makers Ltd* [2003] NSWSC 713
Kvaerner Singapore Pte Ltd v UDL Shipping Pte Ltd [1993] SGHC 146	*The Radio & General Trading Co Sdn Bhd v Wayss & Freytag* [1997] MLJU 462	*Olex Focas Pty Ltd v Skodaexport Company Ltd* [1998] 3 VR 380
Raymond Construction Pte Ltd v Low Yang Tong and AGF Insurance (Singapore) Pte Ltd [1996] SGHC 136	*Focal Asia & Chye Heng v Raja Noraini Binti* [2009] 1 LNS 913	*Board Solutions Australia Pty Ltd v Westpac Banking* [2009] VSC 474
Min Thai Holdings Pte Ltd v Sunlabel Pte Ltd [1998] SGHC 395	*Nam Fatt Corporation Berhad v Petrodar Operating Co* [2010] 9 CLJ 732	
GHL Pte Ltd v Unitrack Building Construction Pte Ltd [1999] 4 SLR 604	*Kejuruteraan Bintai Kindenko Sdn Bhd v Nam Fatt Construction Sdn Bhd* [2011] 7 CLJ 442	
Eltraco International Pte Ltd v CGH Developments Pte Ltd [2000] 4 SLR 290	*Sumatec Engineering and Construction v Malaysian Refining Company* [2012] 3 CLJ 401	
Samwoh Asphalt Premix Pte Ltd v Sum Cheong Piling Private Ltd [2002] 1 SLR 1	*Malaysian Reinsurance Berhad v Syarikat Weifong Industries Snd Bhd* [2014] MLJU 498	
Hiap Tian Soon Construction Pte Ltd v Hola Developments Pte Ltd (2003) 1 SLR 667	*Bina Jaya Mantap Sdn Bhd v Institute of Technology Petronas Sdn Bhd* [2014] MLJU 223	
Newtech Engineering Constructions Pte Ltd v BKB Engineering Constructions Pte Ltd (2003) 4 SLR 73		
Econ Piling Pte Ltd v Aviva General Insurance Pte Ltd and Another [2006] 4 SLR 501 (SGCA 32)		
JBE Properties Pte Ltd v Gammon Pte Ltd [2010] SGCA 46		
BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd [2012] SGCA 28		
Arab Banking Corporation v Boustead Singapore Ltd [2016] SGCA 26		

Chapter 4. Case Law – Unconscionability Exception: Singapore

Section A. The Unconscionability Exception in Singapore

1.0 Introduction

In 1990 the Singapore judiciary took a "conscious departure"[705] from the English courts on the applicability of unconscionable conduct on the integrity of the independence principle. When it did so, Singapore became the first common law jurisdiction to expand the scope of equitable fraud into independent instruments.

The Singapore doctrine of independent instrument unconscionability has progressively developed until the decision in *Asplenium(No.2)* put the efficacy of unconscionability as a defence to abusive demands on independent instruments into doubt.[706]

What follows is a review, in approximate calendar order, of all Singaporean cases dealing with allegations of unconscionable conduct in relation to demands on independent instruments. Some matters overlap in time.

Section B. The Unconscionability Exception in Singapore's Courts

1.0 Case Analyses – Singapore[707]

The case analyses that follow focus on development of the unconscionability exception and therefore detailed explanations of the facts are avoided unless necessary.

705 *GHL*, n21 [16]: The Singapore position is "a conscious departure, from the English position."
706 See case analysis p.177.
707 Presented broadly in date order as handed down. In this section, any dollar amounts referred to are Singaporean Dollars unless otherwise specifically noted.

Royal Design Studio v Chang Development[708]

The Singaporean line of authority identified with the unconscionability exception to the principle of autonomy in letters of credit and demand guarantees commonly commences with *Royal Design*. The matter concerned a building contractor who initially provided a $165,000 bond (reduced to $120,000) to assure performance. After protracted disagreements between the parties, the defendant threatened to call on the bond but an interim injunction restrained them from doing so. The Court sustained the injunction, finding:

1. while the plaintiff had substantially met its obligations, further progress was not possible due to the defendant's refusal to make agreed-upon interim payments;
2. the defendant held a considerable amount of money from sale of properties to which the plaintiff likely had equitable title under the contract and might therefore either be able to make claim to or, should the plaintiff been found in breach of contract, could be offset against any liability to the defendant. This, in the mind of the Court, therefore vitiated the defendant's claim to the performance bond;
3. a Director of the plaintiff company had put forward a personal guarantee to the amount of $1 million.

Despite that there was no allegation or finding of fraud the Court agreed with Everleigh J in *Potton Homes*[709] and that the bond was **not** to be considered the same as an irrevocable letter of credit and further held that payment could be enjoined until settlement of the dispute in the underlying contract.

The Court offered as explanation for its intervention:

> In innumerable cases, courts have, in appropriate circumstances, in exercise of their equitable jurisdiction granted interim injunctions restraining parties from enforcing their contractual provisions until the resolution of their disputes then pending.[710]

708 *Royal Design*, n148.
709 *Potton Homes Ltd v Coleman Contractors Ltd* [1984] 28 BLR 19.
710 *Royal Design*, n148 [22].

Kvaerner Singapore v UDL Shipbuilding[711]

UDL Shipbuilding, the defendant, contracted to purchase a pumping control system from the plaintiff for $1,000,000. The defendant paid the agreed-upon deposit of $300,000 but failed to provide a required letter of credit for the balance of the purchase price.

Simultaneously, the plaintiff provided a performance guarantee valued at 30% of the contract price to the defendant to secure its performance. When the plaintiff refused to ship the goods without the letter of credit, the defendant demanded payment under the performance bond. Maintaining the injunction, Selvam JC stated:

> The credit was also a condition precedent to the right to call on the performance bond. And it failed to fulfil the condition precedent. Accordingly it was eminently just and convenient to restrain a party from taking advantage of his own wrong.[712]

Also referencing Eveleigh LJ's obiter in *Potton Homes*, Selvam JC agreed that the fraud exception to autonomy is "not an immutable principle of universal application", nor does it have any "application where the injunction is sought against a party to the underlying contract who seeks to take advantage of the performance guarantee where, by his own violation, he fails to perform a condition precedent."[713]

Bocotra Construction v Attorney-General[714]

Bocotra is often cited as the first case to explicitly establish unconscionable conduct as a basis to enjoin a beneficiary from making claim on a demand guarantee or letter of credit. The basis for this belief is the several mentions made by the Court that "whether there is fraud or unconscionability is the sole consideration in applications for injunctions restraining payment or calls on bonds to be granted".[715] However:

1. *Bocotra* was a failed application to restrain; and
2. unconscionability was neither discussed nor defined in *obiter*;

711 *Kvaerner*, n512.
712 Ibid 344[6].
713 Ibid 344[8].
714 *Bocotra*, n149.
715 Ibid [45].

3. unconscionability was never mentioned as distinct from fraud; and
4. it was (later) stated in *GHL* that the case of *Kvaerner*[716] – which predates *Bocotra* – was in part successfully founded on the unconscionability exception. The Court said: "*Kvaerner Singapore* was decided partly on the ground of unconscionability and did not strictly follow the 'fraud' exception laid down in the English cases."[717]

Bocotra's role in the line of authority was discussed by the Court of Appeal in *GHL* where it stated its view that *Bocotra* was the genesis of unconscionability in this domain:

> There is nothing in that judgment which can be said to indicate or suggest that the court did not decide that 'unconscionability' alone is not a separate ground as distinct from fraud.[718]

However, in *Civilbuild(No.1)*,[719] Lee JC appeared to contradict this by rightly stating with reference to *Bocotra* that "[a]t no point did the court discuss the scope of this concept of 'unconscionability'...I do not understand the court as having changed the law without a discussion of the basis for it."[720]

Bocotra made a contribution with regard to how future courts are to consider applications to restrain demands. The Court in *Bocotra* held that "the sole consideration in applications for injunctions restraining payment or calls on bonds was whether there is fraud or unconscionability"[721] and not the balance of convenience test as laid down by the House of Lords in *American Cyanamid*.[722] The Court also noted that, with respect to the standard of proof, "mere allegations are insufficient".[723]

716 *Kvaerner*, n512.
717 *GHL,* n21 [20].
718 Ibid [16].
719 *Civilbuild(No.1)*, n594.
720 Ibid [33-35].
721 *Bocotra*, n149 [45].
722 *American Cyanamid Co v Ethicon Limited* [1975] AC 396.
723 *Bocotra*, n149 [47].

Raymond Construction v Low Yang Tong[724]

The line of authority was further refined in Singapore by Justice Lai Kew Chai who heard both *Raymond* and the only other non-construction independent instrument case pleading unconscionability in the Supreme Court, *Min Thai*.[725]

Raymond's importance, and the reason for the Court upholding the injunction based on unconscionability, stemmed from the fact that the defendant beneficiary who had contracted with Raymond Construction to build a house, withheld payment for the final stages of the construction process, which amounted to a considerable amount of money. While this constituted a breach of contract, such a breach, on its own, does not constitute unconscionability.

The Court found that the money being withheld, but also due under the contract, was sufficient to offset the value of alleged defects in construction until such time as those substantive matters were arbitrated. Therefore, a successful claim against the performance bond, in addition to the monies withheld would amount to unconscionable conduct.

In other words, the defendant could not both receive payment under the bond and simultaneously refuse to make payment for work already completed because, in effect this would amount to a double indemnity not originally contemplated by the parties.

Min Thai Holdings v Sunlabel[726]

This is the only case in the line of authority centred around a commercial letter of credit for the supply of perishable goods: rice from China. The claim of unconscionable conduct arose from a demand made on the letter of credit despite the alleged operation of a *force majeure* clause in the underlying contract that had been triggered as a result of flooding in China that wiped out the supply crop.

While the unconscionability exception was not yet firmly established, Chai J refers specifically in his judgement to it being “unconscionable” for the beneficiary to receive payment given that there were a number of pending disputes in the underlying contract. His Honour also proffered that Sunlabel was:

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724 *Raymond*, n590.

725 M Aijaz, 'Unconscionability As An Exception To The Independence Principle: A Study of Singapore Caselaw' (2011) 1 *Annual Review of International Law and Practice* 19, 10, posits that the death of Chai J is likely to have the effect of constraining the scope of the exception, given the late Justice’s very wide view of it.

726 *Min Thai*, n591.

> perfectly entitled to make a call on the guarantee…but they should have in all good conscience offered to let the money remain in the Allied Irish Banks plc…pending the resolution of disputes.[727]

This suggestion was unlikely to be entertained by the beneficiary unless ordered to do so by the Court.

Sin Kian Contractor Pte Ltd v Lian Kok Hong[728]

Finally in the 'pre-GHL' case line, the High Court also specifically contemplated unconscionability in *Sin Kian Contractor v Lian Kok Hong* but refused to accept the plaintiff's view of the beneficiary's behaviour, holding that they had "fallen far short of establishing that it would be unconscionable for the employer [beneficiary] to call on the guarantee".[729]

It has been argued that this case stands as the foremost precursor to the position now fully adopted by the Singaporean courts whereby a plaintiff must demonstrate a "strong *prima facie* case" to establish unconscionability.[730]

GHL Pte Ltd v Unitrack Building Construction[731]

This the first case to specifically establish unconscionability as grounds to restrain the benefit of an independent instrument. The Court considered the established grounds upon which injunctions restraining claims on bank guarantees could be founded.[732] The Court examined several major fraud and unconscionability cases in Singapore and made further mention of several influential English cases.

In *GHL* the Court of Appeal restrained the beneficiary "from seeking or claiming any payment"[733] from a demand guarantee, on the basis that the beneficiary was making claim for an amount to which it had no claim.

The value of the performance bond was based on 10% of the original contract price of $5,781,400.00. This price had been revised down significantly but the

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727 Ibid [28].
728 *Sin Kian Contractor Pte Ltd v Lian Kok Hong* (1999) 3 SLR 732 (*Sin Kian*).
729 Ibid 741.
730 *Loi*, n131, 514. While both the Court in *Dauphin*, n554, and *Chartered*, n24, laid down the '*strong prima facie*' standard, *Chartered* is not generally considered an unconscionability case but rather provides guidance on the standard of proof required to establish fraud. It should also be noted that while *Chartered* was only reported in 1999, it was in fact heard in 1992, therefore pre-dating all unconscionability cases except *Royal Design,* n148.
731 *GHL*, n21.
732 See *Bocotra*, n149 and *Kvaerner*, n512.
733 *GHL*, n21 [1].

agreed downward variations to the contract were not reflected in the amount guaranteed under the performance bond.

The court held that it was reasonable for the parties to expect that with the reduction in the value of the underlying contract, the value of the guarantee would be reduced accordingly, and when *GHL* attempted to draw down the guarantee for the whole *original* amount, its behaviour was deemed unconscionable.

Given that this equitable ground had only developed over a relatively short period, Thean and Chai JJ laid to rest the question of whether unconscionability existed as a separate ground.

Referring specifically to *Bocotra* they stated:

> the concept of 'unconscionability' was adopted after deliberation, and was not inadvertently inserted as a result of a slip; nor was it intended to be used synonymously or interchangeably with 'fraud'.[734]

The Court thereby made clear its judicial policy position.

New Civilbuild v Guobena [735]

The High Court twice heard arguments from Civilbuild who sought to enjoin Guobena from seeking payment under a performance bond from The Tai Ping Insurance Company. Both cases were heard in the High Court by a single (albeit different) judge, two years apart, but each made quite different findings regarding the unconscionability exception. This has confused some subsequent commentary.[736] Relevantly however, the two matters were heard on either side of the *GHL* decision in which the Court expressly took issue with the finding in the earlier *Civilbuild* case.[737]

Civilbuild(No.1) was brought by Guobena under summons and sought to have a previously granted *ex parte* interlocutory injunction discharged first on the basis that it should have been granted *inter partes*, and also because:

1. there was a lack of full and frank disclosure on the part of the plaintiff account party, Civilbuild, when seeking the injunction;
2. there was no disclosed cause of action in the writ; and

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734 *GHL*, n21 [16].
735 *New Civilbuild Pte Ltd v Guobena Sdn Bhd* [2000] 2 SLR 378 (*Civilbuild(No.2)*).
736 Some commentators after the event appear to have missed the later appeal, eg *Johns*, n128, 317.
737 *GHL*, n21 [20]. "…we are unable to agree with the learned judge that this court did not in Bocotra decide that 'unconscionability' is a separate exception permitting injunctive relief."

3. there was no fraud alleged.

This last point is indicative of the fact that it was heard before *GHL*, the case widely accredited with establishing unconscionability in Singaporean jurisprudence. Civilbuild did not plead fraud because, they claimed, the facts showed that it was unconscionable for Guobena to make a claim, relying on *Royal Design*[738] and *Potton Homes*[739] as authority. Guobena submitted *Bocotra*[740] as the authority upon which a claim of unconscionability could be dismissed, and the Court agreed after an extensive review of both British and Singaporean case law. Kin JC held:

> unconscionability on the part of the first defendants in calling for the performance bond was not a defence to upholding the injunction. The case of Bocotra…did not suggest that apart from fraud, unconscionability on the part of a party was an established reason for upholding an injunction. It was well established that banks could not be restrained other than for fraud, and Bocotra did not seek to extend this principle further. Insofar as the court in Bocotra referred to unconscionability, it was used interchangeably with fraud.[741]

The plaintiff's failure in *Civilbuild(No.1)* brought about its financial collapse with the consequence that its original appeal, lodged against that finding, ultimately lapsed and the issuer met the demand on the instrument.

However, Civilbuild later brought another action praying to the Court for repayment of the monies already paid to Guobena by Tai Ping Insurance, among other interpretative and compensatory matters.[742]

In *Civilbuild(No.2)* the High Court was asked to revisit the question of unconscionability in a quite different jurisprudential environment. *GHL* had been decided earlier and unconscionability was now firmly established as a basis for enjoining a claim on a bond; a fact to which the Court directly referred. Civilbuild's only basis for its allegation of unconscionability was an assertion that "there was no delay on their part in the completion of the project and [therefore]…Guobena's

738 *Royal Design*, n148.
739 *Potton*, n709.
740 *Bocotra*, n149.
741 *Civilbuild(No.1)*, n594, 376.
742 *Civilbuild(No.2)*, n735. It is unclear from the judgement whether the company emerged from liquidation or the action was brought by the liquidator on behalf of Civilbuild's creditors.

demand under the bond was fraudulent and unconscionable."[743] This argument was clearly not going to be sustainable even in the development days of the unconscionability exception given that the alleged behaviour did not fall into any category of behaviour previously held as unconscionable and could not be found to establish a new category. Chiu J therefore denied the declaration sought.

In what might appear as an attempt to justify the Court's departure from its position two years earlier on the existence of unconscionability as a ground, Chiu J stated:

> It is pertinent to note that the issue of whether the call on the bond was…unconscionable on the facts *did not feature in either of the grounds* on which Lee Seiu Kin JC discharged the injunction. In the light of his decision that…unconscionability alone could not be a ground for upholding the injunction, it was not necessary…to decide on whether there was indeed… unconscionability on the facts of the case. In this regard, it **cannot** be said that the issue of whether Guobena's call on the bond was…unconscionable was already determined.[744]

With respect, it is unclear to which two grounds Chiu J is referring. Regardless, *Civilbuild(No.2)* reaffirmed unconscionability as a ground, although it was not found on the facts.

Dauphin Offshore Engineering v Bin Zayed[745]

Dauphin contributes to the understanding of equitable unconscionability by:

1. being the first case to provide substantial guidance on the standard of proof the Court would require to be satisfied before interfering with the undertakings of the parties to a demand guarantee; and
2. providing some indication as to the nature of the cause of action.[746]

743 Ibid 379.
744 *Civilbuild(No.2)*, n735, 401-402. Emphasis added.
745 *Dauphin*, n554.
746 Ibid [42].

The Court specifically addressed the question of whether unconscionability could ground an injunction, effectively extinguishing the view of the lower court judge that no such ground existed.[747]

The finding in *Dauphin* was the first to posit that a "strong *prima facie* case of unconscionability had to be shown",[748] which is the standard of proof all plaintiffs thereafter pleading unconscionable conduct have been required to meet. Subsequent courts have interpreted this standard of proof to mean that a movant is obliged to produce sufficient evidence to establish conclusively a fact which makes a contested call on a letter of credit or demand guarantee unconscionable.

With regard to the elements of unconscionability, the Court would not be drawn into specifics. It noted that a finding of unconscionability is made on the facts and it lacks "pre-determined categorisation", *inter alia* alluding to – by reference to the case law – oppression, abuse, unfairness and unjust enrichment as behaviours proscribed under this head.[749]

Subsequent Singaporean case law where unconscionability was plead drew heavily on the *Dauphin* reasoning, as do cases in neighbouring Malaysia.[750] *Dauphin* is however listed among the superior court cases where the plaintiff *failed* to have the beneficiary restrained for unconscionable conduct.

Eltraco International v CGH Developments[751]

This case is difficult in part to reconcile with related case law and can be characterised as an example where the Singaporean Justices have taken a distinctly nuanced approach to the unconscionability exception. The appellate Court demonstrated that, insofar as the credit instrument itself will allow partial drawings, the all-or-nothing approach to what constitutes unconscionability may be gradated.

This will depend on the factual scenario; their Honours found favour with *Dauphin*, stating:

747 Ibid [34].
748 Ibid [57].
749 Ibid [42-47].
750 For example: *Kejuruteraan Bintai Kindenko Sdn Bhd v Nam Fatt Construction Sdn Bhd* [2011] 7 CLJ 442.
751 *Eltraco*, n407.

> In determining whether a call on a bond is unconscionable, the entire picture must be viewed, taking into account all the relevant factors.[752]

The case also saw the higher court over-ruling the original decision refusing an injunction on any basis. Eltraco sought to restrain the beneficiary on two grounds. First, that CGH was required to demonstrate a breach of the underlying contract; and second, that CGH's claim was unconscionable.

Eltraco submitted that:

- CGH was holding significant 'retention monies', and
- there was a genuine dispute as to what works had been completed, and
- the value of works left undone or in need of rectification was not established.

The Court found CGH owed no duty to prove a breach given the nature of the on-demand ('independent') guarantee, but then opted to exercise its equitable jurisdiction.[753]

Rather than simply refuse the injunction, as is the usual approach, Thean and Chao JJA arrived at a compromise sum that would provide sufficient security to CGH without acting in a manner that would reasonably be unconscionable to the applicant. While the Court provided explanation vis-à-vis how it arrived at the amount at which the claim became "clearly excessive"[754] it was at pains to point out that they were not "involved in an exercise in quantifying damages but only in ensuring that the amount of the bond called for is not unconscionable."[755]

Again, the Court recognised that while unconscionability always involves unfairness, it is not the case that every instance of unfairness gives rise to a finding of unconscionable conduct. It held that, in its equitable jurisdiction, the Court was empowered to "limit the restraint to only that part which is clearly excessive and allow the other part which would not be unconscionable."[756] In other words, *Eltraco* provided (for the first time) that a call on a bond can be *partially*

752 *Eltraco*, n407, 299[31].
753 Ibid 300[36].
754 Ibid 291. The amount decided on was $600,000.
755 Ibid 301.
756 Ibid 300.

unconscionable, at least to the extent of claims for amounts beyond that which can be demonstrated as positively owed.

Chew Pin Pin v AGF Insurance[757]

Chew Pin is an unusual case largely ignored in the literature wherein the account party was not a party to the proceedings, having gone into liquidation. The guarantor (AGF Insurance) resisted a complying call on the 'clean' performance bond,[758] and sought to rely upon an allegation of fraud and unconscionability in the underlying contract to ground their dishonour.

However the Court viewed it as an attempt by a guarantor to avoid payment on an unsecured guarantee in the knowledge that it was unlikely to see any return from the winding up of the account party. It agreed with the lower court that under the rules of privity, "the bondsman is a stranger to the underlying contract" and any alleged unconscionable conduct on the part of the plaintiff could be pursued by the Official Receiver.

Choo JC said:

> The foremost question…is whether the bondsman is entitled to refer to the underlying contract and the alleged unconscionable conduct on the part of the plaintiff…I agree entirely with the district judge, that the defendant as bondsman has no recourse to the underlying contract between the employer and the contractor.[759]

The Court held that AGF was required to meet its obligations and could not rely on any other matter to set aside that obligation.

Samwoh Asphalt Premix v Sum Cheong Piling[760]

Samwoh contributed to the development of the unconscionability exception by suggesting yet another type of unconscionable conduct – the threat of calling on the guarantee to bring "pressure" to bear on the account party during unrelated negotiations.[761]

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757 *Chew Pin Pin v AGF Insurance (Sing) Pte Ltd* (2000) 2 SLR 152 (*Chew Pin*).

758 E Laryea, *Paperless Trade: Opportunities, Challenges and Solutions* (Kluwer Law International, 2003), 136. A 'clean' or 'open' performance bond can be either a demand bond or conditioned on a breach of the underlying contract.

759 *Chew Pin*, n757, 154.

760 *Samwoh Asphalt Premix Pte Ltd v Sum Cheong Piling Private Ltd* [2002] 1 SLR 1 (*Samwoh*$^{(No.2)}$).

761 Such behaviour has been expressly ruled out in Australian courts as being unconscionable. See *Olex*$^{(No.1)}$, n38, 403.

The facts in *Samwoh* are complex, involving a primary employer (the Ministry of Defence) conducting works at Changi Airport; a primary contractor (Sum Cheong Piling – SCP); and a major sub-contractor (Gim Chuan – GC). Samwoh was a minor sub-contractor and the account party who requested Ecics-Coface Guarantee Company issue the performance guarantee in question. It was provided to the primary contractor to indemnify Samwoh's component of the contracting work, distinct from any other party's obligations. However, a demand made by SCP against Samwoh's guarantee sought to use that undertaking to assure a range of other works that were GC's responsibility – not Samwoh's – but were ultimately left uncompleted or faulty.

Implied from the judgement is a rancorous project environment in which disputes arose at various times between all three contracting parties, with GC ultimately being excluded from the site. The relationship between SCP and Samwoh then failed, with the former attempting to coerce the latter into accepting onerous contractual terms relating to the works left uncompleted or poorly completed by GC.

The Court of Appeal found that the call on the guarantee was made in an attempt to force Samwoh into accepting the terms and not on the basis that there was any failure by Samwoh to meet their contractual obligations. As such, the claim was ruled unconscionable. This followed *Kvaerner* where it was held that "a demand under [a] performance guarantee can be made only when the seller has failed or refused to fulfil his obligations under the contract".[762]

Samwoh was also unusual insofar as the Court of Appeal overturned the ruling of the High Court[763] *in favour of* the plaintiff account party. It found that "there was no evidence that Samwoh had failed to discharge their obligations" and that the claim on the credit was "utterly lacking in bona fides".[764] Thean JA said:

> the call for payment by SC Piling under the performance guarantee was not based on any bona fide claim they had against Samwoh. The clear inference is that they invoked the performance guarantee as a bargaining chip to compel Samwoh to agree to their terms. It was an abusive call on the performance guarantee…SC Piling…acted

762 *Samwoh*$^{(No.2)}$, n760 [21] citing *Kvaerner*, n512, 154.
763 *Samwoh Asphalt Premix Pte Ltd v Sum Cheong Piling Private Ltd* [2001] 3 SLR 447 (*Samwoh*$^{(No.1)}$).
764 *Samwoh*$^{(No.2)}$, n760 [21].

> unconscionably in calling for payment under the performance guarantee and should have been restrained from so doing.[765]

McConnell Dowell v Sembcorp Engineers[766]

By the time the High Court of Singapore heard *McConnell*, the unconscionability exception was fully established, as was the standard of proof required to ground the exception. The bank guarantee procured by the plaintiff was intended to co-underwrite the financial risk incurred by Sembcorp Engineers (SE) during a tortured process to secure funds for a massive development project in India. In order to facilitate the raising of several hundreds of millions of dollars in funding, SE was obliged to deposit $125 million into a term deposit that would attract penalties should the money be withdrawn before its maturity date. The bank guarantee McConnell provided to SE was held to have been, in essence, an underwriting of half any potential loss in relation to those funds.[767]

However, in the underlying contract, which was a 'Pre-Bid Agreement', no provision was made to limit any claim under the guarantee to any *actual* loss.

Further, no term was introduced in either the agreement or the guarantee to provide that the defendant had to *demonstrate* a loss before making a claim under the guarantee. The suit put to the Court that any claim made in the absence of any *actual* loss would be unconscionable.

Given the lack of contractual terms with regard to losses, Li JC determined that, despite no loss, nor any certainty that there would ever be any loss, it was not unconscionable for the claim to be made for the full amount of the guarantee. To support this, the Court strongly affirmed the autonomy principle in saying:

> the right of SE to make a call and receive money under the BG [*bank guarantee*] depends on the terms of the BG itself and not the underlying contract pursuant to which the BG was issued, unless the terms of the BG stipulated otherwise.[768]

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765 Ibid [18]. It is doubtful at time of writing whether this would constitute unconscionable conduct in Australia.

766 *McConnell Dowell Constructors (Aust) Pty Ltd v Sembcorp Engineers and Constructors Pte Ltd* [2002] 1 SLR 199 (*McConnell*).

767 Ibid 211[69]. The other (anonymous) party did not contest the claim against their guarantee.

768 Ibid 208[47].

Li JC then disclaimed any inequity by pointing out that "it was open to the parties…to agree that SE should only be compensated…for its loss up to a maximum of US$1.25m."[769] That McConnell had not done so was fatal to their appeal.

One difficulty extended from the fact that the bank guarantee was used more in the nature of a chip in a high-stakes poker game than as a method to underpin some performance or other promise. By providing the guarantee McConnell gambled on SE's funding process being realised in order to secure a large sub-contract in the final development but lost when the funding failed to materialise. It was found that McConnell did not adequately protect itself within the terms of the guarantee or the underlying agreement. The absence of any term requiring SE to prove a loss before being able to make a successful demand proved fatal to their application.

Li JC confirmed Justice Chai's position in *Raymond*[770] that while the claim may be unfair, that by itself does not constitute unconscionability.[771]

Seng Hock Heng Contractor v Hup Seng Bee Construction[772]

*T*he defendant HSB called on a performance bond for an amount the plaintiff claimed was far in excess of any outstanding work or potential liquidated damages under the contract. The plaintiff limited his pleading to the precedents set by *Raymond* and *Sin Kian*,[773] proposing to the Court that *Raymond* suggests that such an exaggeration should be taken into account when considering the scope of the exception, while *Sin Kian* allows the Court to order part payment where there is any doubt as to the quantum.[774]

Teck JC held that the plaintiff had provided "no exceptional feature" that would "permit [the Court] to stray from the established principles", meaning instrument independence. The Court was also of the view that it was not in its purview to determine the validity of the claims made by the plaintiff and that the evidence was "inconclusive and difficult to evaluate". The applicant therefore had failed to discharge the onus of proof.[775]

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769 *McConnell*, n766, 211[69].
770 *Raymond*, n590.
771 *McConnell*, n766, 212[75].
772 *Seng Hock Heng Contractor Pte Ltd. v Hup Seng Bee Constructions Pte Ltd.* (2002) 4 SLR 612 (*Seng Hock*)
773 *Sin Kian*, n728.
774 This is a perplexing reference as the Court in *Sin Kian* did not overtly consider partial payment under a bond at all. Partial payment was considered, and applied, in *Eltraco*, n407 however, as it was in the subsequent case of *Hiap Tian Soon*, n776.
775 *Seng Hock*, n772, 614[6].

The Court did not discuss the nature of unconscionability nor conduct any review of other case law relating to it. The dismissal of the application was based entirely on the documentary evidence before the Court, leaving the facts of the dispute to be considered at trial.

Hiap Tian Soon Construction v Hola Development[776]

The *Hiap Tian* judgement largely considers contractual matters and damages. The Court looked briefly at whether the claim on the performance bond by the beneficiary was unconscionable on the basis that the value of the underlying contract had, by mutual agreement, been revised downwards.

The defendant, Hola, maintained their claim to 10% of the *original* contract value. The Court in *GHL* had already found similar business behaviour unconscionable four years earlier but Hola sought to have this element of the suit distinguished on the basis that the quantum of change in the contract value under consideration was considerably less than that considered in *GHL*.[777]

The Court found however that the principle laid down in *GHL* remained applicable regardless of the amount of the reduction in the underlying contract sum.[778] Chui J addressed the issue of whether revision of the performance bond needed to be contemplated by the parties in advance. Drawing on the reasoning in *GHL*, His Honour provided certainty with regard to such variations in value by stating:

> [T]he sum payable under the performance bond is subject to revision unless the parties have agreed that that amount is to be unaffected by any changes to the original contract sum.[779]

This finding was in response to an argument by the beneficiary/respondent that, because none of the parties had expressly considered a downward revision of the guaranteed 10% of the primary contract, then it placed the guaranteed sum beyond revision.

The Court found this reasoning to be specious and in conflict with the case law. The principle decided therefore provides that parties must expressly fix the sum *against* revision in order for that amount to be redeemable in all circumstances.[780]

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776 *Hiap Tian Soon Construction Pte Ltd v Hola Developments Pte Ltd* (2003) 1 SLR 667 (*Hiap Tian*).
777 Ibid 684[61].
778 Ibid 684[65].
779 Ibid 685[66]. Original emphasis.
780 Ibid 685[60].

The Court found that the value of the guarantee is relative rather than actual, and unless otherwise agreed to expressly, can only be determined by reference to the agreed-upon value of the underlying contract as it stands from time to time. Unless specifically stated to the contrary, contractual value is not a quantum fixed against the original contract value but adjusts as the value of the underlying contract adjusts:

> The revision of the contract sum represents a reduction of the contractor's responsibility towards the developer…[and]…the security held by the developer in the form of a performance bond must similarly be reduced.[781]

The Court affirmed *Dauphin* and others by stating that unconscionability could not be defined in precise terms, reliant instead on the facts of each matter. By following *GHL*, the Court allowed that claiming an amount greater than that which is owed should be found unconscionable.

Anwar Siraj v Teo Hee Lai Building Construction[782]

This case is only included here for the purposes of completeness. An *ex parte* interim injunction had been issued to enjoin the claimant from receiving money under the performance bond, which was subsequently set aside only to be reinstated by a judicial commissioner.[783] This particular appeal was by the beneficiary claimant to have that decision reversed.

The Court read down the terms of the bond narrowly, followed a conservative reading of the case law, and could find no behaviour on the part of the claimant that could be made out as unconscionable.

Newtech Engineering v BKB Engineering[784]

The dispute in this case revolved around a claim on two performance bonds issued by the plaintiff sub-contractor to a general contractor, BKB Engineering, as guarantees for the construction of certain culvert and road works for the Singaporean Ministry of Defence.

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781 Ibid 684[62].

782 *Anwar Siraj v Teo Hee Lai Building Construction Pte Ltd* (2003) 1 SLR 394 (*Anwar*).

783 Singaporean "Judicial Commissioners" are persons appointed to the Supreme Court by the President of Singapore on the advice of the Prime Minister. JC's have the powers of a judge in that jurisdiction and are appointed to "facilitate the disposal of business in the Supreme Court." See <http://www.supremecourt.gov.sg>

784 *Newtech Engineering Constructions Pte Ltd v BKB Engineering Constructions Pte Ltd* (2003) 4 SLR 73 (*Newtech*).

Newtech successfully sought relief in part because they "produced cogent evidence to support their contention that they were not in default of their contractual obligations", therefore demonstrating that there was "no reason to call on the bonds".[785] On the basis of the documentary evidence, it was contended that BKB could not have a belief that their claim was *bona fide*.

BKB made the claim on the bonds based on a range of allegations that they could not support with evidence. They could not demonstrate either any breach of the underlying contract by the plaintiff or that certain alleged delays were caused by the plaintiff.

Nor BKB could provide evidence to support an otherwise inexplicable rise in the cost of certain work incurred rectifying an alleged fault in the plaintiff's work.

By the time the claims were made, the works had "long been completed and the defects liability period had expired."[786] To support this, the plaintiff established that all contractual obligations were satisfied by November 2000, in line with agreed-to extensions that were not caused by the plaintiff.

The claim on the bonds was made some 26 months later. Also relevant to the unconscionability of the demand was that neither BKB, the project consultants, nor the Ministry of Defence made any complaint to the plaintiff about their work in the intervening period.

The Court was concerned at the veracity of the claims made by BKB in support of their demand. The Court questioned a cost disparity for the removal of certain residue earth, noting that it "was difficult to see how [BKB] could have made such a blunder in their accounts". The difference between the two amounts was "suspiciously close to the total amount payable under the bonds."[787]

The Court appears to imply that BKB had committed a fraud in making the claim, stating:

> The entire circumstances of the case suggested strongly that the first defendants had an ulterior motive in calling on the bonds. It did not appear to be based on any *bona fide* claim they had against the

785 Ibid 80[27].
786 Ibid 78[18].
787 Ibid 79-80. The claimed costs ballooned from $137,000 in August 2002 to about $287,000 in January the following year but BKB could not produce any evidence to support the claimed increase.

> plaintiffs…The calls on the bonds appeared to have been made to ameliorate their cash flow problems.[788]

The Court granted the applications for injunctions against BKB on the grounds of unconscionability.

Econ Piling v Aviva General Insurance[789]

Econ is mentioned in the literature in relation to unconscionability because the District Court initially granted an injunction based on its view of unconscionable behaviour. The High Court overturned the injunction. The Court of Appeal ordered that the bond's beneficiary, Jurong Town Corporation, was time barred from making a claim under the relevant legislation.

So, the case may assist with determining the effect of Statute of Limitations legislation[790] as it applies to the operation of performance bonds. It does not assist with understanding the unconscionability exception. It is included here for completeness.

Leighton Contractors (Sing) v J-Power Systems Corp[791]

This case follows the established line of authority closely and contributes little to the development of the exception. The Court affirmed the strong *prima facie* case rule, and supported the view that no evidence of default was necessary, stating that "the Performance Bond was an "on demand" one and no actual proof of breach was required on the part of JPS."[792]

The plaintiff Leighton Contractors (LCS) attempted to demonstrate that the defendant (JPS) was not a "fair and honest contractor", but the basis for the allegation left the Court unmoved. The fact that several adjudications as to costs had gone against the defendant previously did not substantiate the plaintiff's claim to unconscionability in the current circumstance in the Court's view.

The defendant JPS claimed that multiple breaches of contract by the plaintiff had caused the expenditure of monies which nearly totalled the quantum of the bond. In addition, JPS claimed a significant (although unstated) amount for liquidated damages extending from the late completion of the contract by the plaintiff. The

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788 Ibid 80[27].
789 *Econ Piling Pte Ltd v Aviva General Insurance Pte Ltd and Another* [2006] 4 SLR 501 (SGCA 32) (*Econ*).
790 *Limitation Act* (SGA) 1996 (Cap 163 Rev Ed).
791 *Leighton Contractors (Sing) Pte Ltd v J-Power Systems Corporations* [2009] SGHC 7 (*Leighton*).
792 Ibid [9]

Court interpreted the Contract completion terms narrowly, holding that LCS had not completed the contract as agreed despite that a Certificate of Substantial Completion had been issued to LCS and that "JPS's claim that liquidated damages are payable was not *mala fide*."[793]

The Court determined not to follow *GHL*[794] or *Hiap Tian*[795] by finding unconscionability in an excessive claim. In the final analysis the Court decided that "LCS fell short of demonstrating a strong *prima facie* case of unconscionability on JPS's part…[given the]…limited evidence and the nature of the application."[796]

Shanghai Electric Group v PT Merak Energi[797]

In *Shanghai*, Kin J stated that, despite making the jurisdictional finding that British law applies, His Honour would "for the sake of completeness"[798] discuss whether the defendant would have been found to have acted unconscionably in making the demand if Singaporean law had applied. However, it is doubtful whether *Shanghai* should be included in the line of authority, as issues relevant to both the advance payment bond and underlying contract were decided under British law. It is included here for completeness.

In its deliberations, the Singaporean Court noted that British law does not allow for unconscionability as a basis "upon which the court would restrain a call on an on-demand bond"[799] and therefore did not need to address the issue of alleged unconscionability. Kin J reiterated the difficulty of determining "what constitutes "unconscionability"…[despite the]…various expositions on the concept of unconscionability found in the authorities."[800]

In the Court's view, the call was no more than the defendant, PTM, attempting to affect the return of the moneys it had advanced to Shanghai Electric, as it was lawfully required to do.[801]

793 Ibid [11].
794 *GHL*, n21.
795 *Hiap Tian,* n776.
796 *Leighton*, n791 [12].
797 *Shanghai Electric Group Co. Ltd v PT Merak Energi Indonesia & Anor* [2010] SGHC 2; 2 SLR 329 (*Shanghai*).
798 Ibid [35].
799 Ibid [14]. The Court noted that English and Singaporean law "diverge" on this point.
800 Ibid [38].
801 Ibid [47].

JBE Properties v Gammon[802]

In the first instance, the High Court in *Gammon v JBE*[803] restrained JBE from receiving the benefit of what it deemed to be an on-demand performance bond issued by BNP Paribas, finding the demand unconscionable given that the beneficiary had "grossly inflated"[804] the costs of rectification for certain defects in the account party's work, possibly in collusion with another sub-contractor.

In the final appeal, the Court restated the Singaporean position that "unconscionability is a separate and independent ground for the court to grant an interim injunction restraining a beneficiary from making a call on a performance bond".[805] It also addressed the question whether, in relation to unconscionability claims, the various types of guarantees (on-demand bonds, indemnity performance bonds etc) should be treated with the same consideration as commercial letters of credit.

The Court looked briefly at the history of the two instrument types, and their role in the allocation of risk. Specifically, the Court looked at whether it "would be entitled to interpret the performance bond as being conditioned upon facts rather than upon documents or upon a mere demand",[806] noting:

> The Singapore courts' rationale in applying unconscionability as a separate and independent ground for restraining a call on a performance bond…is that *a performance bond serves a different function from a letter of credit*. The latter performs the role of payment by the obligor for goods shipped to it by the beneficiary.[807]

The Court's discussion of the development of the Singaporean exception is notable.

The different functions referred to were explained as the *primary* obligation under a commercial letter of credit to make payment for goods shipped as opposed to the *secondary* obligation under a bond to held by the obligor "to pay damages if it breaches its primary contractual obligations to the beneficiary."[808] The Court specifically refuted the idea that a bond is the 'lifeblood of commerce'.

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802 *JBE(No.2)*, n19.
803 *Gammon Pte Limited v JBE Properties Pte Ltd* [2010] SGHC 130 (*JBE(No.1)*).
804 Ibid [11].
805 *JBE(No.2)*, n19 [6].
806 Ibid [10].
807 Ibid [10]. Emphasis added.
808 Ibid [10-12].

The Court looked at Ellinger and Neo's discussion on the different treatment of guarantees and letters of credit and disagreed with the authors' view that where the employer-beneficiary has sacrificed a stronger position for a weaker one,[809] it would be justifiable to apply the autonomy principle to the performance bond and treat it as though it were a letter of credit.[810]

Citing the case before them where the employer-beneficiary had accepted a performance bond in substitution for security in the form of a cash deposit, the Court stated:

> (a) a cash deposit is no different in principle to a guarantee (albeit more difficult or impossible to enjoin use of); and
>
> (b) the greater ease of injunction must be taken to be "a factor which the employer-beneficiary must…have considered and accepted in preferring a performance bond to a cash deposit".[811]

To remove any doubt, the Court held:

> [T]he Singapore position on the circumstances in which the court may restrain a call on a performance bond is justified…The juridical basis for adopting unconscionability as a relevant ground…lies in the equitable nature of the injunction. Considerations of conscionability are applicable…and there is no reason why these considerations should not be applied for the purposes of determining whether a call on a performance bond should be restrained to achieve a fair balance between the interests of the beneficiary and those of the obligor.[812]

Another aspect of the case related to clause 7.6 in the underlying "Building Contract". This term provided:

> Save in the case of fraud or *unconscionability*, the Management Contractor accepts that the Employer may call upon the banker's undertaking or any other security held by it at any time and the

809 That is, accepting the weaker secondary obligation instrument as opposed to the stronger cash position.
810 *Ellinger*, n14, 326.
811 Ibid [12].
812 Ibid [13].

> Management Contractor *shall not seek an injunction* against the Employer.[813]

The effect of this clause was to provide Gammon with the specific right to intervene where an allegation of unconscionable conduct arose.

The Court ultimately shied away from unconscionability as the ground for restraining the beneficiary's claim. It ruled that the bond in question was a "true indemnity performance bond"[814] and therefore the only basis upon which JBE could draw down on it was to demonstrate that it had suffered actual loss.

It is unclear to what extent the findings of the lower court remain applicable law. The Court did provide that in different circumstances the demand would have been unconscionable "for the reasons given [in the lower court]."[815]

Astrata (Singapore) v Tridex Technologies[816]

Astrata's contribution to the unconscionability exception is unremarkable, except for two relatively minor points.

First, *Astrata* is one of the few cases in the line where the substantive issues are not concerned with construction law. The performance bond in this case relates to the development and delivery of technology for the purposes of tracking individuals and vehicles by an unnamed "state".

Second is Justice Pillai's review in the lower court of the case law from *Bocotra*[817] to *Eltraco*[818] and his compilation of "applicable principles" harvested from those cases.[819] This distillation was referred to in the subsequent Court of Appeal case of *Mount Sophia*[820] and serves as a useful summary of principles to act as guideposts for the Court when considering an application to enjoin a claim on a bond on the basis of unconscionable behaviour by the claimant.

On appeal, the obligor Astrata did not seek leave on the decision that Tridex's demand on the performance bond was not unconscionable.[821]

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813 Ibid [15]. Emphasis added. Contrast this with the 'Asplenium Clause', p.176.
814 Ibid [20].
815 Ibid [30].
816 *Astrata*, n657.
817 *Bocotra*, n149.
818 *Eltraco*, n407.
819 *Astrata*, n657 [73].
820 *Mount Sophia*, n39.
821 *Astrata (Singapore) Pte Ltd v Portcullis Escrow Pte Ltd* [2011] SGCA 20

BS Mount Sophia v Join-Aim[822]

Being among the few recent cases in this line of authority where unconscionability was successfully argued, *Mount Sophia* is profoundly interesting to the development of the exception and both the High Court and Court of Appeal contribute to the law – indeed, both judgements must be read in conjunction to fully appreciate the contribution they make.

The appeal provides a comprehensive analysis of the full body of case law relating to the unconscionability exception and described the exception. While the Court of Appeal affirmed the High Court's decision to restrain the claim on the on-demand performance bond, it found unconscionability on more complex grounds and provided an extensive and, with respect, wonderfully written exposition as to why it did so, in a manner that echoes an exhaustive academic treatise on the subject.

Factually, the case differs little from many of those preceding it, being a claim on a performance bond under circumstances where some doubt exists over the *bona fides* of the claimant beneficiary. Much of the doubt surrounded the timing of certain events leading to the claim, including differences of view regarding work-completion and work-certification dates.

Justice Kwang in the High Court refused to be drawn into the "myriad of other matters" with which the parties attempted to distract the Court, finding no cause to address these "run of the mill construction disputes which were properly the subject of arbitration".[823] His Honour's role was to determine whether the call on the bond was unconscionable and this responsibility was echoed again in the appellate court which affirmed that it "was not required to decide on the substantive entitlements of the parties…[or]…engage in protracted consideration of the merits of the case."[824]

However, it is arguable whether Kwang J gave sufficient consideration to the cause of action, despite providing a full restatement of the unconscionability case principles from *Astrata*.[825]

His Honour particularly noticed in evidence an email which provided a 'Practical Completion Date' for the contracted works that was later inexplicably pushed back,

822 *Mount Sophia*, n39.
823 *Join-Aim Pte Ltd v BS Mount Sophia Pte Ltd and Another* [2012] SGHC 3 [28-29].
824 *Mount Sophia*, n39 [40].
825 *Astrata*, n657 [31].

thereby creating significantly higher liquidation damages for the beneficiary (and therefore a basis for calling on the bond). This also invited a suspicion of collusion between the architect and his client and therefore possible abusive behaviour in making the call on the performance bond.

However, on appeal, this email was held to be insufficient in itself, with the Court implying that such a basis was too narrow and that the email, "no matter how robust a peg it was, was not...sufficient to establish a finding of unconscionability."[826]

The Court of Appeal followed the dictum in *Eltraco*[827] which provided that in order to determine unconscionability, all relevant factors must be taken into account. The Court defined unconscionability in the context of performance bonds and looked at the *entire* chronology of events leading up to the call on the bond. It is, they held, "only if the entire context of the case is particularly malodorous that such an injunction should be granted."[828]

Tin, Leong and Rajah JA also contributed to the developing definition of unconscionability, stating:

> Unconscionability in the context of performance bonds is **a conclusion applied to describe certain types of conduct in certain contexts in the execution of a contract**. It is not a formulaic doctrine with definite elements and must be distinguished from the *general contract law doctrine* of unconscionability, which is concerned with conduct at the time of the formation of the contract, and which can vitiate consent to a contract on the grounds that the terms of the contract are unfair and the contract was entered into in an unfair manner.[829]

This is the first occasion where the Court has clearly made out that unconscionable conduct in independent instruments is substantive and is not to be confused with the general contract law doctrine of unconscionability, which is procedural.

826 *Mount Sophia*, n39 [40].
827 *Eltraco*, n407, 299.
828 *Mount Sophia*, n39 [21].
829 Ibid [41]. Original italics. Bold added.

During the appeal, the Court identified three "strands" to be addressed and was assiduous in teasing two of these out and addressing them individually with regard to the unconscionability question.[830]

The first strand related to the aforementioned completion dates, ie the delayed issuance of the Delay Certificate[831] and the chronology of events leading to the claim. The second strand related to the beneficiary refusing to honour a Progress Claim. The third strand concerned the fact that it was given to the architect to demand under threat that the bond be extended on the verge of its expiry.

While explicitly stating that "no single factor was conclusive", in finding the claim unconscionable, the Court first found "the complete absence of allegations of delay by [BS Mount Sophia] odd and, indeed, troubling", holding that "the Appellant's silence spoke volumes."[832] This silence also extended to responses by the contractor to proposals put by the architect which the Court believed "had, at very least, misled the respondent".[833] This, it felt, amounted to a lack of *bona fides* because it indicated a lack of belief in the contractor's responsibility for the delays.[834]

The Court also held as improper the claimant's threat to call on the bond if the contractor did not extend its validity[835] and took particular exception to the fact that it was given to the Architect to make this demand in an Architect's Direction.

While holding firm that their "consideration of the disputes between the parties does not necessitate a substantive determination of them",[836] the final view of the entire matter gave the Court sufficient reason to dismiss the appeal.

Several other highly salient points were also entered that clarify the scope of the unconscionability exception. Discussing the determination of a claimant's *bona fides*, the judgement noted:

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830 For unknown reasons, the Court disregarded the matter of the beneficiary's failure to honour the final progress payment.

831 The Delay Certificate is issued by the architect to certify the extent to which the project completion was retarded by reference to any extensions that have been granted; the date by which the works were due for completion; and declares the contractor in default where this date has not been met. This certification is a condition precedent to claims for liquidated damages. In this case, the Delay Certificate was not issued until almost eleven months after the stated date of completion, which the Court also addressed.

832 *Mount Sophia*, n39 [48].

833 Ibid [49]. The Court's reasoning is interesting given the principles of contract relating to silence on the part of the offeree, saying: "The appellant's silence on this point also seemed to us to constitute its acquiescence to those conditions." See, *inter alia*, *Felthouse v Bindley* (1862) 142 ER 1037.

834 Ibid [52].

835 Ibid [53].

836 Ibid [47].

> Even if the Appellant was mistaken in adopting this position [that the respondent was in breach], the call could still be legitimate if this position was genuinely adopted and the Appellant honestly believed that the respondent was in breach.[837]

This demonstrates the Court's commitment to witnessing the claimant's *bona fides* and being prepared to allow what may *prima facie* appear an unfair claim where it is made with an honest belief.

The justices also discussed the need to "strike the appropriate balance between the conflicting positions of the obligor and beneficiary", and connected this with the conflict existing between the "underlying need to preserve the *raison d'être* of performance bonds" and the use of bonds as instruments of oppression.[838] The Court coined the term "perennial tension" to describe the nature of this conflict and dedicated considerable discursive effort to it. Indicating policy, the justices stated that "courts should be slow to upset the status quo and disrupt the allocation of risk".[839]

To resolve this tension, the Court put forward the view that "unconscionability must be *applied in a nuanced manner*". To support this, their Honours noted with approbation Loi's view that:

> confidence in, and utility of, commercial instruments such as performance guarantees cannot possibly be promoted by habitual judicial enforcement of unconscionable payment demands made under oppressive circumstances.[840]

It therefore followed that the Court was obliged to intervene where there was "unsatisfactory conduct tainted by bad faith."[841] In so saying the justices rejected the idea that unconscionable conduct cannot be found simply because "a neat and tidy definition of the same is not forthcoming."[842]

837 Ibid [52].
838 Ibid [24].
839 Ibid [25].
840 *Loi*, n131, 508-509 cited in *Mount Sophia*, n39 [33]. This reflects the view in *Dynamics*, n467.
841 *Mount Sophia*, n39 [36].
842 Ibid [35].

York International v Voltas Limited[843]

The plaintiff's action in York did not seek to take "the more far-reaching step of seeking a declaration that the defendant's call on the Guarantee is invalid", but rather only to restrain the defendant's claim "pending the outcome of arbitral proceedings". The Court considered this with approbation by stating that the plaintiff had "taken a position that was eminently reasonable."[844] This is an otherwise fairly pedestrian case.

In a well-reasoned decision, the Court set out to determine three limbs of the dispute:

1. the nature of the Guarantee (being conditional or not);
2. whether the demand was defective; and
3. whether the defendant's claim comprised unconscionable behaviour.

Unfortunately, the Court despatched the allegation of unconscionable conduct on the part of the defendant with alacrity, finding that the 'strong *prima facie* case' standard had not been met, and dismissed an implied proof that the defendant did not have a *bona fide* belief that their claim was valid.

The majority of the Court's judgement addressed the matter of conditionality of the Guarantee, ie whether the beneficiary could claim against the bond with a simple demand, or whether the claim was contingent upon there being a factual basis for it – actual breach of the purchase agreement *and* a consequent actual loss.

Of interest are two points of law not previously seen in this line of authority. First is the Court's specific coinage of a new principle to describe the *role* of performance bond – the 'Expediency Principle"[845] – which is provided in conjunction with the established (and rule-based) independence principle as a basis for the broad view that "performance bonds are a type of document where the court should be restrained in its examination of the external context and intrinsic evidence."[846]

Ang J stated:

> The primary role of a performance bond in commerce is to ensure expediency in payment. When a call is made, both the beneficiary

843 *York International Pte Ltd v Voltas Limited* [2013] SGHC 124 (*York*).
844 Ibid [15].
845 Ibid [19(a)].
846 Ibid [19].

> and the bank need to be able to determine quickly if the demand is valid simply by looking at the bond instrument itself, without having to cross-refer to the underlying contract…(hereinafter "the expediency principle").[847]

Second, the Court invoked a variation on the *contra preferentem* rule by providing that, where there is ambiguity as to whether a bond or guarantee is independent, the "court is entitled to construe any ambiguity against the beneficiary".[848] The application of such a rule is unique in this line of authority.

Ultimately however, the Court ordered the beneficiary restrained, but on the basis that:

1. "the Guarantee was conditional [*sic*] and premised on there in fact having been a breach of the underlying contract leading to loss";[849] and
2. the demand presented by the beneficiary was faulty.

The Court found that the defendant "could not be said to have engaged in unconscionable conduct"[850] based on the facts adduced.

Tech-System Design and Contract v WYWY Investments[851]

In its reasoning the Court in *Tech-System* relied heavily on *Mount Sophia.*[852] It reaffirmed the authority that a legitimate demand against a bond or guarantee is not unconscionable, even if it has a seriously deleterious effect on the obligor.[853] Even where there is doubt, such a call, "would still be legitimate so long as the position was genuinely adopted and the beneficiary honestly believed that the obligor was in breach of its obligations."[854]

The application for an injunction grounded on unconscionable conduct followed contractual disputes between the parties relating to delays and defects in a construction project. It sought to restrain the call on the bond until such time as the substantive contractual issues could be resolved in arbitration.[855] There was no

847 Ibid [19(a)]. Emphasis added.
848 Ibid [27].
849 Ibid [38].
850 Ibid [46].
851 *Tech-System Design & Contract (S) Pte Ltd v WYWY Investments Pte Ltd* [2014] SGHC 57 (*Tech-System*).
852 *Mount Sophia*, n39.
853 *Tech-System*, n851 [39].
854 Ibid [37].
855 Ibid [2].

argument made by the plaintiff to the effect that the performance bonds were not payable on demand.[856]

The plaintiff's case however, lacked sufficient evidentiary support to found a *prima facie* case of unconscionable conduct, largely relying as it did on specious arguments relating to personnel appointments, and hearsay evidence relating to inadmissible statements and conversations.[857] The plaintiff also failed to establish that any of the substantive contractual issues underlying the claims and counter-claims of the parties, which the Court left to be determined in arbitration or litigation, constituted a strong *prima facie* case of unconscionable conduct.[858] Finally, the plaintiff also failed to defend the claim that the beneficiary's accounts were "false or fraudulent or so obviously wrong…as to constitute unconscionable conduct."[859]

The plaintiff stated that a successful call against the performance bond would effectively ruin the company but the Court was indifferent. It stated that "a situation such as the present would be precisely the kind of situation envisaged when the parties contracted for performance bonds to be provided."[860]

While the Court held that it was "not persuaded that the plaintiff had brought [the] application in bad faith",[861] it reminded the parties that any inquiry into unconscionable conduct must focus "on the *beneficiary's* alleged unconscionable conduct rather than the effect on the *obligor*."[862]

Tech-System serves to reinforce some of the basic legal guidelines for restraining a demand grounded in unconscionable conduct, ie that a strong *prima facie* case must be made out in its entirety, without resort to "mere allegations and hearsay".[863] Further, any hardship brought about by a demand "could not be relevant"[864] in relation to determining the presence of unconscionable conduct.

856 Ibid [18].
857 Ibid [22].
858 Ibid [23].
859 Ibid [33].
860 Ibid [36].
861 Ibid [43].
862 Ibid [41]. Original emphasis.
863 Ibid [2].
864 Ibid [39].

CCM Industrial v 70 Shenton[865]

This is a pedestrian case that was quickly settled on established principles and unfortunately lends support to the statement made by Leow JC in *Asplenium*$^{(No.1)}$ that it "is apparent from the authorities that the ground of unconscionability is the primary port of call used by parties seeking an injunction to restrain the calling of a performance bond."[866]

The actual basis upon which the plaintiff alleged unconscionable conduct is unstated. However, only the most optimistic counsel would have sought to have the beneficiary enjoined for unconscionability given the factual matrix, and the Court swiftly despatched the matter accordingly. The matter is included here for completeness.

CKR Contract Services v Asplenium Land[867]

The *Asplenium Land* case will have a profound and enduring effect on the unconscionability exception given the treatment by the Court of Appeal on exclusion clauses. The Court of Appeal disagreed with the findings of the lower court and the ultimate result strengthened the defendant's position.

The primary dispute rested on the existence within the underlying contract of Clause 3.5.8, a term agreed to as part of the main contract. It was alleged by the plaintiff that this clause ousted the jurisdiction of the Court by limiting to fraud alone the grounds upon which the account holder was able to seek to have the beneficiary restrained from making a demand against the performance bond.

The relevant clause provides:

> *3.5.8 In keeping with the intent that the performance bond is provided by the Contractor in lieu of a cash deposit, the Contractor agrees that except in the case of fraud, the Contractor shall not for any reason whatsoever be entitled to enjoin or restrain:*
>
> *(a) the Employer from making any call or demand on the performance bond or receiving any cash proceeds under the performance bond; or*

865 *CCM Industrial Pte Ltd v 70 Shenton Pte Ltd* [2014] SGHC 75 (*CCM*).
866 *CKR Contract Services Pte Ltd v Asplenium Land Pte Ltd* [2014] SGHC 266 [20] (*Asplenium*$^{(No.1)}$).
867 *Asplenium*$^{(No.2)}$, n212.

> *(b) the obligor under the performance bond from paying any cash proceeds under the performance bond*
>
> *on any ground including the ground of unconscionability.*[868]

In the first instance, the High Court held that any attempt under a contract to limit the grounds for an injunction was unenforceable on three grounds:

1. That clause 3.5.8 was an attempt to oust the jurisdiction of the court;
2. The court's equitable jurisdiction provided the necessary authority for the grant of an injunction and this authority cannot be "circumscribed or curtailed by contract"; and
3. The use of unconscionable conduct to ground an injunction was legal policy that could not be disregarded by agreement between private parties.

While this effective severance of the exclusion clause did not help the plaintiff's case in the lower court, they could not make out a strong *prima facie* case of unconscionability in any event. The grounds upon which they attempted to anchor their allegations that the demand was unconscionable were uniformly rejected by the Court and demonstrated that counsel for the plaintiff was truly optimistic that the Court would overturn itself.

Leow JC in the High Court cited the finding in *Eltraco* that unfairness *per se* does not constitute unconscionability any more than a mere breach of contract constitutes such behaviour.[869] Neither the plaintiff's assertion of a lack of fiscal need on the part of the beneficiary[870] nor the financial devastation that would be delivered on the person of the plaintiff swayed the Court toward a finding of unconscionable conduct for the demand.[871]

Both parties appealed the decision:

> CKR appealed against the Judge's finding that Asplenium did not make the call unconscionably. Asplenium cross-appealed against the Judge's holding that the clause was unenforceable.[872]

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868 *Asplenium*$^{(No.2)}$, n212 [5].
869 *Asplenium*$^{(No.1)}$, n866 [27] citing *Eltraco*, n407, 298-299[30-32].
870 Such a need is not a condition precedent for making a demand on the bond.
871 The court in *Tech-Systems*, n851 [39-41] made it clear that the fiscal consequences to the obligor are not to be considered when examining the beneficiary's right to demand payment.
872 *Asplenium*$^{(No.2)}$, n212 [2].

The bench took an unfavourable view of the reasoning of the High Court, reviewing all three grounds for severing the exclusion clause and holding that Clause 3.5.8. was valid and enforceable.[873] This finding is now essential business knowledge and will almost certainly guarantee the inclusion of such clauses in those contracts requiring one party to furnish an on-demand guarantee.

The appellate Court first found the nature of the clause "to be more in the nature of an *exclusion or exception clause* (*as opposed to* a clause seeking to *oust the jurisdiction of the court*)" which "seeks to *limit* the *right* to an *equitable remedy*".[874] The clause does not, in other words, deny either party access to the Court as such and therefore does not conflict with public policy.

The Court also distinguished the authorities relied on given that the clauses dealt with therein differed in a key respect – they sought to oblige the Court to act in a manner dictated by the parties' contractual agreement:

> The court cannot be obliged to exercise its discretion in a way that gives effect to an agreement between parties in a manner that is contrary to principles it would ordinarily apply to the grant of injunctive relief. That, however, does not preclude parties from agreeing to limit their right to seek certain remedies or reliefs from the court, which is the effect of cl.3.5.8.[875]

The Court did "not think that cl 3.5.8 represents an ousting of the jurisdiction of the court"[876] nor that the policy considerations cited by Leow JC of the lower court "really support[ed] his conclusion to the effect that [cl 3.5.8] is contrary to public policy".[877]

The Court's clarification of the use of exclusion clauses contributes significantly toward the decay of the unconscionability exception by providing the means by which parties can agree to exempt themselves from the remedies available for an unconscionable demand. It is posited here that this finding has for most purposes rendered unconscionability, as a defence to abusive calls, nugatory.

873 *Wooler*, n505, 178.
874 *Asplenium*$^{(No.2)}$, n212 [21-24]. Original emphasis.
875 Ibid [29].
876 Ibid [36].
877 Ibid [41].

JK Integrated v 50 Robinson[878]

In response to the grant of an *ex parte* injunction, the defendant beneficiary sought to have the order set aside in the High Court preventing it from making a demand for the full amount of a $4.7 million independent performance bond. The terms of the bond allowed for partial payments and its independence was not disputed.

From the factual matrix, it is apparent that the parties were in dispute from very early in the construction project over a range of issues; some further exacerbated by the plaintiff's alleged precarious financial position. Despite the defendant's continued financial support and the implementation of additional agreements to assist the plaintiff, ultimately the defendant issued a "Termination Certificate" and made a demand against the bond.[879]

The basis for the plaintiff's claim that the demand against the bond was unconscionable rested on three grounds, specifically that the defendant:

1. engaged in conduct that caused both delays to the works and "financial and other difficulties";
2. applied "unjustified" pressure on the plaintiff to meet its obligations; and
3. resorted to threats of non-payment to "control" the plaintiff.[880]

The plaintiff did not attempt to allocate any of these behaviours to any of the established categories of unconscionable conduct. It is apparent that the plaintiff was attempting to frame what were "genuine contractual disputes between the parties"[881] as the defendant's 'unconscionable conduct'.

In its defence, 50 Robinson alleged *inter alia* that the "plaintiff did not make full and frank disclosure of material facts during the *ex parte* hearing" and sought to have the injunction set aside on that basis as well.[882]

The Court reviewed some of the basic tenets of unconscionability from the authorities, flagging the established principles on evidence and independent instruments, affirming neither breaches of contract nor genuine contractual disputes can constitute unconscionable conduct. It also affirmed that a protracted

878 *JKI*, n185.
879 Ibid [16].
880 Ibid [18].
881 Ibid [19].
882 Ibid [21].

consideration of the substantive issues of the case was not required to establish whether an injunction could be granted grounded in unconscionability.[883]

Throughout its examination of the minutia of the claims put forward by the plaintiff, the Court consistently found the defendant (and its agents) had acted appropriately, had met its obligations under the contract, and had done more than was reasonably necessary to assist the plaintiff meet their obligations.

Relying on reasoning in *Mount Sophia*[884] the Court stated that "so long as the First defendant had the honest but mistaken belief that the plaintiff [was in breach], the First defendant's call on the Performance Bond would still have been legitimate."[885] Accordingly the Court held that there could be no unconscionable conduct.[886]

The Court also looked to the extent of the plaintiff's indebtedness to the defendant, likely rectification costs, and possible liquidated damages to find that the demand for "the full amount of the Performance Bond was [also] not unconscionable."[887]

Therefore, grounds (1) and (2) above were found to be wanting as they constituted ordinary contractual disputes conducted in a manner that fell short of being unconscionable. With regard to ground (3) above, the Court found there to be insufficient evidence to conclude that the defendant had acted other than in a normal commercial manner, which it said cannot be unconscionable.

Boustead Singapore v Arab Banking Corporation[888]
Arab Banking Corporation v Boustead Singapore[889]

At first instance it appeared that *Boustead* would contribute significantly to the unconscionability exception in Singapore. However the matter was decided on different grounds in the Court of Appeal.

The matter was factually complex but in essence, Boustead Singapore plead that demands against a bank "Facility Agreement" were unconscionable on the basis that the underlying contract was frustrated and the guarantees and counter-guarantees they were meant to indemnify had not been paid and could not be honoured. The High Court agreed.

883 Ibid [27].
884 *Mount Sophia*, n39.
885 *JKI*, n185 [72].
886 Ibid [71].
887 Ibid [76].
888 *Boustead(No.1)*, n160.
889 *Boustead(No.2)*, n159.

One finding by Woo J that perhaps survived appeal is the decision to broaden the scope of the unconscionability exception to include Financial Agreements under the unconscionability exception. The Agreement was not what would usually be termed 'the underlying contract', which was a contract of sale frustrated by war. It was contractual in nature but the Court saw no reason to differentiate it.

Ultimately unconscionability (equitable considerations) did not feature in the Court of Appeal's decision. The Court did not disturb any of the High Court's reasoning directly. It simply discounted the need to decide the matter on the basis of unconscionability once it found in the plaintiff's favour on the ground of fraud in the reckless sense.[890]

2.0 Conclusion to Singaporean Case Analyses

Singapore was the first jurisdiction to comprehensively canvass and develop an unconscionability exception to the principle of autonomy in letters of credit and demand guarantees. The Singapore superior courts have heard more than twenty-eight cases where unconscionable conduct has been plead to ground an action and, as a result, the scope of the exception has been widened and its application refined. The types of behaviours that have been regarded as unconscionable have been carefully considered and both the standard and burden of proof have been clarified.

Unconscionable conduct has been found in relation to a broad range of behaviours relating to demands on letters of credit and demand guarantees. Many allegations of unconscionable conduct have been held to lack merit. Those cases where the applicant was successful provide guidance on how the Singaporean court is likely to view similar behaviours in future. Behaviours proscribed by the Court include where the beneficiary makes a demand:[891]

- ❖ despite having acted to obstruct the performance of the underlying contract (*abus de droit*) and thereby to enable a claim against the independent instrument: *Royal Design*;[892]

890 *Boustead(No.2)*, n159 [58]. *Dal Pont*, n307, 267[8.05] points out that such reckless misrepresentations constitute 'common law' fraud on the contract which is decided in that jurisdiction before the court considers matters under its equitable jurisdiction.

891 *Wooler*, n505, 175-176. This paragraph and a substantial part of the following list are excerpted in part or full from this journal article.

892 *Royal Design*, n148.

- ❖ despite its failure to meet a major obligation under the contract terms, thereby causing the performing party to default and triggering a capacity to make the claim—usually a failure to make or guarantee interim payments: *Kvaerner*;[893]
- ❖ despite being unable or unwilling to meet their own fiscal responsibilities under the contract: *Raymond Construction*;[894]
- ❖ despite there being an outstanding dispute as to whether the contract is still on foot, eg whether a *force majeure* provision might be held to operate: *Min Thai Holdings*;[895]
- ❖ for an amount greater than that which is owed: *GHL*[896] and *Hiap Tian*;[897]
- ❖ despite holding sufficient monies to mitigate their losses *and* despite an incapacity to quantify actual damage: *Eltraco*;[898]
- ❖ in order to bring pressure to bear on the account party in unrelated negotiations: *Samwoh*$^{(No.2)}$;[899]
- ❖ despite the complete absence of a *bona fide* claim nor any factual basis upon which to ground a demand: *Newtech*;[900]
- ❖ despite being unable to demonstrate a *bona fide* belief in factual matrix alleged to underpin that demand: *Mount Sophia*;[901]

Despite Singapore pioneering the unconscionability exception in relation to letters of credit and demand guarantees, the finding of the Court of Appeal in *Asplenium*$^{(No.2)}$[902] (which establishes the Asplenium Clause[903]) may cause unconscionability as a ground for an injunction to be taken out of play. This partially depends on the speed at which template Asplenium clauses are adopted into demand guarantees and other financial services' contracts.[904]

893 *Kvaerner*, n512.
894 *Raymond*, n590.
895 *Min Thai*, n591.
896 *GHL*, n21.
897 *Hiap Tian,* n776.
898 *Eltraco*, n407.
899 *Samwoh*$^{(No.2)}$, n760.
900 *Newtech*, n784.
901 *Mount Sophia*, n39.
902 *Asplenium*$^{(No.2)}$, n212.
903 *Wooler*, n505.
904 Given the finding in *Boustead*$^{(No.2)}$, n159 the adoption may need to be considered in such contracts as the 'Facility Agreement' at issue in that matter.

Given that the rational user of these instruments will seek always to mitigate risk,[905] it is less likely as a result of *Asplenium*[(No.2)] that any party requiring an independent instrument will contract without an exclusion clause that will allow even abusive calls (short of fraud) to go unchallenged.

[905] J Linarelli, 'The Economics of Uniform Laws and Uniform Lawmaking' (2002) 49(1) *The Wayne Law Review* 1, 11: The strategic choices that rational (or boundedly rational) parties make are in part determined by the information that they have on the possible outcomes of any legal dispute arising from a failure to perform by the other party.

Chapter 5. Case Law – Unconscionability Exception: Australia

Section A. The Unconscionability Exception in Australia

1.0 Introduction and Context

The original head of power in Australia the veil of autonomy to be lifted was the statutory prohibition against unconscionable conduct in trade or commerce under the now-superseded *Trade Practices Act*.[906] The *Australian Consumer Law*,[907] has replaced the relevant consumer provisions in the earlier Act.

The Act provides that the Court should look to the meaning of the unwritten law for guidance.[908] It also allows the Court to consider other matters, and it is here that some of the difficulty and confusion arises with understanding the application of the Act to independent instruments. The Australian line of authority lacks the consistency of the Singapore authorities analysed in the previous chapter. No case that addresses directly the question of unconscionability in relation to abusive demands on guarantees or bonds has been heard in the High Court of Australia.

Both s20 and s21 *ACL* incorporate the words "in trade or commerce". This has given the Courts scope to consider whether demands on bank guarantees or letters of credit could amount to unconscionable conduct. The wording of the section requires in practice, that the plaintiff demonstrate to the Court that a demand [conduct] is unconscionable as provided in the unwritten law.

However, in the absence of a clear definition for unconscionability it falls to the Court to frame the scope and determine the elements of proof for the doctrine. It is the case law therefore which must be analysed to inform the effect of the unconscionability exception in Australia.

What emerges from the following analyses is that the use of statute to ground unconscionability in commercial matters brings its own set of judicial challenges.

906 A consolidated discussion of Unconscionable Conduct under the statutes can be found on p. 80.
907 *Competition and Consumer Act 2010* (Cth), Schedule 2 - The Australian Consumer Law, Ch.2, Pt. 2.2.
908 S20(1): "A person must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law from time to time."

Section B. The Unconscionability Exception in Australia

1.0 Case Analyses – Australia

As with the analysis of the Singaporean line of authority, the following discussion focuses purely on the Australian development of the unconscionability exception to the principle of autonomy and does not detail factual matrices unless essential to explaining the law.

Typically, the cases reveal that the plaintiff or applicant attempts to ground their application for relief on a range of grounds, including fraud and the existence of an implied or express negative stipulation in the underlying contract. No attempt has been made here to examine these grounds as they are unrelated to the development of the unconscionability exception or the understanding of unconscionable conduct with respect to letters of credit and demand guarantees.

Wood Hall Ltd v Pipeline Authority[909]

This is the first decision from the High Court of Australia that examined the nature of the *autonomy* of credit instruments.[910]

The plaintiff Wood Hall did not raise unconscionable conduct as ground for an injunction to restrain the demand under equity. Unconscionable conduct was not possible under the *Trade Practices Act* given that this ground was not introduced for another seven years.[911]

Looking at the independence of the instrument, Barwick CJ stated:

> there is no basis whatever upon which the unconditional nature of the bank's promise to pay on demand can be qualified by reference to the terms of the contract between the contractor and the owner.[912]

Murphy J noted that, should the Court require that the bank must inquire into the "rights and liabilities arising from the performance of a contract", then:

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909 *Wood Hall*, n138.

910 *Boral*[(No.2)], n28 [37]: [*Wood Hall* is] "The leading statement of the principle of autonomy in Australian law". Autonomy is not addressed by the High Court again until *Simic v New South Wales Land and Housing Corporation* [2016] HCA 47.

911 *Trade Practices Revision Act No.17 of 1986* (Cth), s22, Insertion of s52A.

912 *Wood Hall*, n138, 387.

> [A]ll the legal and factual complexities of a building dispute would be injected into an otherwise straightforward unconditional undertaking.[913]

Meanwhile, of interest to courts in future unconscionability cases is the mention by the High Court:

> There is evidence that suggests that the Authority, in making the demands, was acting pursuant to what it described as a "strategy" to put pressure on the contractor in the hope that the dispute between the parties might be settled more advantageously to the Authority.[914]

Despite the mention, the Court did not clarify its view on whether such conduct is unconscionable. Later, in *Olex(No.1)*, Batt J pondered the High Court's restraint in not finding this behaviour unconscionable.

His Honour stated there that the High Court in *Wood Hall* had allowed:

> with apparent equanimity that…in making the demands the Authority was acting pursuant to what it described as a "strategy" to put pressure on the contractor.[915]

Wood Hall importantly serves to describe and entrench the principle of autonomy. Otherwise the case only marginally advances the general development of the law in relation to unconscionable demands on guarantees.

Hortico (Australia) v Energy Equipment Co[916]

It is in *Hortico* that an Australian superior court first considers the idea that *equitable* principles of unconscionable conduct might be brought to bear on disputes over demands made on bank 'guarantees'.[917]

The Court discusses the jurisprudence surrounding letters of credit, bank guarantees and bank bonds, and the obligational differences between them. Specifically, the Court sought to clarify the legal difference between a 'guarantee'

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913 Ibid 400.

914 Ibid 391. Notably the later Singaporean case of of *Samwoh(No.2)*, n760 [21] considered use of an almost identical 'strategy' by a beneficiary and held that use of such a "strategy" is unconscionable. It cites the Court's finding in *Kvaerner*, n512, 354 that demands on *performance guarantees* can only be made where there is clear evidence that the account party is in breach of its contractual obligations.

915 *Olex(No.1)*, n38, 403. Batt J appears to imply a view that such conduct should be deemed unconscionable.

916 *Hortico*, n663.

917 For context, *Hortico* was heard in the same year that the *Trade Practices Act* was amended to include section 52A, statutorily proscribing unconscionable conduct in business practice.

and a 'bond', and discussed how the usage-in-trade terminology differs from the legal definitions for those same products.

Young J affirmed:

> [T]he wide general principle of equity that whenever a person unconscionably makes use of a statutory or contractual power for an improper purpose, that equity may step in and restrain the exercise of that power.[918]

His Honour broadly discussed an exception to autonomy grounded on unconscionable conduct and propounded that "it may be that in some cases…the unconscionable conduct may be so gross as to lead to exercise of the discretionary power".[919]

Unconscionability was not argued by the plaintiff so the Court only dealt with it vicariously. Ultimately, the plaintiff failed on all counts to have the demand restrained. *Hortico* was the first time a superior court demonstrated an inclination to widen the application of unconscionable conduct principles in commercial matters.

Stern v McArthur[920]

Stern is an important unconscionable conduct case unrelated to financial instruments specifically but concerns contracts more broadly. It deals with the circumstance of unconscionable conduct within a contractual relationship at or after its termination and consequent to a dispute, much as occurs with letter of credit and demand guarantee matters. *Stern* is included here for its affirmation of a category of unconscionable conduct later associated with unconscionable demands against letters of credit and demand guarantees: *the harsh insistence on strict legal rights*.[921]

Reflecting on the earlier case of *Legione,*[922] the Court held that "equity will relieve against an unconscionable exercise of legal rights".[923] This principle becomes important for letters of credit and demand guarantees later when Batt J in

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918 *Hortico*, n663, 554. This is a re-statement of "oppressive or harsh enforcement of a right".
919 Ibid 554.
920 *Stern*, n352.
921 See the categorisation of unconscionable conduct in Ch.3, p.109.
922 *Legione*, n346.
923 *Stern*, n352, 469.

Olex[(No.1)][924] cites *Stern* to include harsh insistence on strict legal rights to be unconscionable conduct under s51AA *TPA*. Given that this section has been held to apply to demands on credits and guarantees, it follows that unconscionable conduct grounded on the insistence on strict legal rights also applies to those instruments.

Stern does not relate directly to independent instruments; it contributes to the line of authority by linking an equitable remedy to the equitable prohibition against harsh insistence on legal rights, a doctrine discussed as grounds for relief in subsequent decisions.

Inflatable Toy Company v State Bank of NSW[925]

Much as the early Singaporean cases prior to *GHL* flirted with the "idea" or "notion" of unconscionable conduct as a ground to enjoin an abusive demand, *Inflatable Toy* (primarily addressing issues of fraud in relation to a demand on a commercial letter of credit) also provides judicial framework for the subsequent unconscionable conduct cases.

Former Chief Judge and renown equity jurist, Young J, heard both *Hortico*[926] and *Inflatable Toy*, and used both to flag the possibility that unconscionable conduct would be considered as a ground should an application be made to the Court.

It had been nine years since section 52A *TPA* had come into effect, and two years since the amendments to replace it with sections 51AA, 51AB and 51AC. Unconscionable conduct however was not alleged by the plaintiff. Young J nonetheless took advantage of the opportunity to state:

> [I]t is still wise to keep open the possibility that *unconscionable conduct may be an exception*.[927]

Consequently, *Inflatable Toy* contributed to the development of the independent instrument unconscionability by signalling a willingness by the Court to address an injunction application based on unconscionable conduct.

924 *Olex*[(No.1)], n38, 402.
925 *Inflatable Toy*, n235.
926 *Hortico*, n663, 554.
927 *Inflatable Toy*, n235, 251. Emphasis added.

Olex Focas v Skodaexport Co(No.1) [928]

Much as *GHL*[929] contributed to the unconscionability exception in Singapore, its development in Australia was given a significant stimulus by *Olex(No.1)*, heard in Supreme Court of Victoria.[930] The matter concerned a contract for supply of services to a contractor involved in a major construction project in India. The demand against a number of 'mobilisation guarantees' was made after the parties failed to resolve prolonged disputes.

Much of the legal consideration in *Olex Focas* was done in the lower court where Batt J took the opportunity to address:

- the nature of the guarantees;
- the character of "unconscionable or unconscientious behaviour";[931] and
- the application of section 51AA *TPA* to the autonomy of independent guarantees.

Batt J affirmed the autonomy principle stating "the underlying contract is separate and, for this purpose, irrelevant."[932] His Honour differentiated between two different credit instruments on foot, their purpose, and the obligations undertaken by the parties. The 'guarantees' (which were both independent) sought to protect two quite separate eventualities:

1. 'mobilisation guarantees' to allocate the risk of non-repayment of 'procurement advances'; and
2. 'performance bonds' to allocate the risk of non-performance of substantive contractual obligations.

They were not intended to be used to interchangeably enforce the owner's rights[933] and therefore the Court was required to make a determination in relation to both, separately, as to whether the claims on them were abusive.

This bifurcation led to quite different outcomes for each and contributed to clarification of the Australian unconscionability exception by laying down the general principle that it is unconscionable to claim a greater amount than is owed

928 *Olex(No.1)*, n38.
929 *GHL*, n21.
930 The basis for the successful claims of unconscionable behaviour in both the *Olex* cases and *GHL* was found due to both beneficiaries making demands for greater amounts than was owed.
931 *Olex(No.1)*, n38, 403.
932 Ibid 394.
933 *Olex(No.1)*, n38, 385: "the guarantees relate to those advances and not to performance of the work".

under a financial guarantee. This breach may be aggravated by whether there is a capacity to make partial demands against the credit instrument and the beneficiary does not avail itself of that capacity,[934] demanding instead the full amount of the guarantee.

Batt J found that the beneficiary was acting unconscionably, not by making a claim against the procurement guarantees *per se*, but by demanding money that had already been repaid, ie money no longer owed. His Honour held that this behaviour was not fatal to the demand-right and went on to say:

> [H]ad the first defendant simply called up an amount not exceeding the balance still outstanding on the advances, I do not consider that its conduct could have been said to be open to a serious question that it was unconscionable.[935]

The treatment of the performance bonds on the other hand was textbook application of the autonomy principle and the unconscionable conduct above was not found to extend to them. The instruments were independent demand guarantees and the Court refused to disturb the risk allocation agreed to freely by the parties.

His Honour stated:

> The principle is clearly established that payment by a bank and a demand therefore by a beneficiary under an unconditional performance bond or guarantee, as under a confirmed irrevocable letter of credit, will not be restrained except in a clear case of fraud, of which the bank is clearly aware at the time.[936]

Of particular interest for the examination of Australian unconscionability was Batt J's discussion of unconscionable conduct under the general law, as opposed to that under the statute:

> With regard to the passing reference in *Hortico* to gross unconscionability in an extreme case, *I would not… treat gross unconscionability falling short of actual fraud as a ground for an*

934 Ibid 403.
935 Ibid 405.
936 Ibid 395. This appears to remove unconscionable demands from the *TPA/ACL* unconscionability provisions.

> *injunction*. If it were a ground…one would expect it to have been mentioned in the cases much earlier.[937]

The long-term impact of this on the general law of independent instrument unconscionability is unknown. However, subsequent Australian cases generally consider unconscionable conduct in relation to statutory consumer protection provisions.

Olex Focas v Skodaexport Co(No.2)[938]

The Victorian Court of Appeal refused to disturb the findings of the lower court, holding that "the plaintiffs here have not established any evidentiary basis…for any further injunctions beyond those granted by the primary judge".[939]

It did however accept from the respondents an undertaking not to "assign, transfer or otherwise dispose of any moneys paid in response to demands made pursuant to all or any of the guarantees"[940] until such time as the appeal was heard in the High Court.

Olex Focas v Skodaexport Co(No.3)[941]

Olex Focas applied for special leave to appeal to the High Court, but was refused. This was despite a strident appeal to the principle in *Wilson v Church*[942] which provides that it is the paramount duty of the Court to which an application for stay of execution pending appeal is made to see that the appeal, if successful, is not nugatory.

However, the Court found that the *status quo* was best protected by not disturbing the beneficiary's right to make a demand for payment. It disagreed with counsel's proposition that the *status quo* was to be found in ensuring that the beneficiary should be disallowed access to the benefit of the guarantees under consideration until such time as the substantive issues could be determined at trial.

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937 Ibid 400. Emphasis added.
938 *Olex Focas Pty Ltd v Skodaexport Company Ltd* (1996) VicSCA BC9604384 (Unrept) (*Olex (No.2)*).
939 Ibid 3, per Charles JA.
940 Ibid 5.
941 *Olex(No.3)*, n207.
942 *Wilson v Church (No.2)* (1879) 12 Ch D 454, 458-459.

Fletcher Construction Australia v Varnsdorf[943]

Fletcher is notable for the courageous basis upon which the plaintiff sought to ground an injunction in unconscionability and the Court's example of a type of behaviour not considered unconscionable.

The plaintiff alleged that the claim against the guarantees – two A$2.5 million standby letters of credit – was unconscionable because, given the lengthy procedural delays leading up to the demands being made:

> [I]t would be unconscionable for the Owner to call upon the security at a time when the dispute would, but for its conduct, have [already] been determined.[944]

No mention of the *Trade Practices Act* was made and unconscionability must be presumed to have been argued under the general law.

Describing the claim as "doomed to fail", Byrne J rejected outright any suggestion that the time required to complete negotiations and mediation, being to both parties' benefit, could constitute unconscionable conduct.

Fletcher is therefore authority for the principle that *causing a delay arising from the conduct of procedures in which the interests of both parties are represented cannot be taken as unconscionable conduct for the purpose of grounding an injunction*.

The plea to consider unconscionable conduct was abandoned in the Court of Appeal.

Minson Constructions v Aquatec-Maxon[945]

In *Minson*, Beach J refused to part from strict adherence to the law of independent instruments, affirming the decision in *Olex Focas*[946] that the *status quo* was best left undisturbed. His Honour took the position because the guarantees had already been called up and the plaintiff's application was in fact seeking redress rather than restraint. Minson's strategy was desperate and poorly-considered, failing to show any behaviour as unconscionable conduct.

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943 *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* (1997) VSC BC9705048 (*Fletcher*$^{(No.1)}$) and *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd* (1997) VSCA BC9706712 (*Fletcher*$^{(No.2)}$).

944 Ibid 15.

945 *Minson*, n503.

946 *Olex*$^{(No.1)}$, n38.

The plaintiff put to the Court that, by virtue of the beneficiary/respondent exercising its demand-right under the performance guarantees without informing the plaintiff of its intention, the beneficiary had acted unconscionably. No mention of the *Trade Practices Act* was made so it is assumed that they sought to ground this in the general law. It failed.

It is settled that the exercise of a valid right in the common law will not be found unconscionable unless strict enforcement of the right would be "harsh and oppressive".[947] The Court reinforced the autonomy principle by steadfastly refusing to order the return of the funds "notwithstanding that there may be a genuine dispute between [the defendant] and the plaintiff".[948]

Boral Formwork & Scaffolding v Action Makers(No.1)[949]

Boral(No.1) was the first Australian case to consider the full effect of sections 51AA and 51AC *TPA* on the independence of irrevocable standby letters of credit. Austin J considered a range of case law in this line of authority which provided a succinct judicial summary of the precedents. The case has some unusual characteristics.

First, the credit instrument involved is a standby letter of credit,[950] issued to assure against a failure to pay cash for commercial goods received by the account holder Boral Formwork, rather than the more straightforward commercial letter of credit which is more commonly used in purchase-of-goods transactions.

Second, while the parties were still under contract the beneficiary went into liquidation. The demand on the letter of credit was made by the liquidators, whose solicitors advised Boral prior to the *ex tempore* hearing that from the liquidation process "there will be a nil dividend to unsecured creditors."[951]

Third, the substantive issue rested entirely in the common law of contract, being wholly concerned with a warranty claim for defective goods. In order to determine whether the demand on the standby was unconscionable, the Court needed to lift

947 *Berbatis(No.1)*, n360, [14(iii)] citing Parkinson, *The Notion of Unconscionability* Laws of Australia 35.5, 8.
948 *Minson*, n503 [23].
949 *Boral(No.1)*, n672.
950 Quite likely a "Commercial Standby" letter of credit. See *Byrne*, n4, 31, 'Preface to ISP98': "A 'Commercial Standby' supports the obligations of an applicant to pay for goods or services in the event of non-payment by other methods."
951 *Boral(No.1)*, n672 [15].

the veil of autonomy and look to the terms of the underlying contract and the rights that arose with respect to the rectification of defective goods.

The matter commenced on urgent application to the Court's equity division for an interlocutory injunction. Campbell J reviewed matters briefly and, given the "circumstances of pressing urgency",[952] found that a serious question existed as to whether the demand constituted unconscionable conduct and granted injunctions.

Boral Formwork & Scaffolding v Action Makers ***(No.2)***[953]

In the Supreme Court before Austin J, the plaintiff sought orders requiring Action Makers to countermand the demand for payment of the disputed amount on three grounds:

- First, in contract, that the respondent was bound by a negative stipulation in the underlying contract circumscribing any demand;
- Second and Third, that the demand was unconscionable in breach of sections 51AA and 51AC *TPA*.

Early in the judgement on the credit instruments in question, the Court appeared mistaken by describing standby letters of credit generally as requiring "documents which evidence money owing but unpaid by the account party to the beneficiary".[954] (The provision of such documents was a condition of the Boral standby.)

However, the Court clarified this, stating that the "required documentation depends upon the terms of the instrument",[955] thereby recognising the effect of the conditions within the instrument on the payment obligation, affirming independence.

The Court noted that the payment obligation under a standby may require only a "written demand"[956] for payment *without reference to any breach of obligation* to support that demand.

Austin J examined the legal character of independence and the relevant provisions of the *TPA*. Much as *GHL*[957] provided confirmation of the existence of the unconscionability exception in Singapore, *Boral* framed the exception in Australia

952 *Boral*$^{(No.1)}$, n672 [16].
953 *Boral*$^{(No.2)}$, n61 [34].
954 Ibid [34].
955 *Boral*$^{(No.2)}$, n61 [34].
956 *Ellinger*, n14, 300.
957 *GHL*, n21.

within the confines of the *TPA*. His Honour reviewed both sections 51AA and 51AC *TPA* and considered them in light of the facts. His Honour found that the elements of both were satisfied, but then found that section 51AA(2) exempts application of that section where 51AC can be found. Holding therefore that the "conduct impugned accompanies, goes with, or is involved with the supply of goods",[958] as required by the section, the Court ultimately grounded the section 80(1)(d) injunction[959] on section 51AC.

Austin J also pronounced that "[t]he principle of autonomy, applicable to a standby letter of credit, *cannot override the statute*."[960]

The Court's rationale was this:

- First, the autonomy principle provides that the "unconditional payment obligation"[961] under the letter of credit is separate from the terms of the underlying contract. Therefore the payment obligation must be left untouched by any events affecting the operation of that underlying contract.
- Next, the statute provides *inter alia* that a person cannot act unconscionably in trade or commerce. This means that even where the conditions of the standby *allow* the beneficiary to make a demand, still that beneficiary cannot under any circumstances act unconscionably when making the demand.

To determine whether the beneficiary is in fact acting unconscionably the Court must look to the construction of the underlying supply agreement, which requires the court to lift the veil of autonomy. Specifically, the Court looked at the terms of payment and the terms providing the Buyer's right to offset their costs for rectification work to the defective product supplied. It was the fact that Action Makers claimed the amount Boral could offset that led to a finding of unconscionability.

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958 *Boral(No.2)*, n61 [85].

959 The Court may…(c)…grant an injunction restraining a person from engaging in conduct that constitutes or would constitute (d) a contravention of a provision of Part IV or V.

960 *Boral(No.2)*, n61 [74]. Emphasis added.

961 *Boral(No.2)*, n61 [32]. In fact, the payment obligation is not "unconditional" but actually 'independent' of the underlying contract. There are always 'conditions' to payment of a credit and therefore technically they are all 'conditional'.

The Court grounded its power to interfere with the commercial relationship between the parties in the statute. It thereby subjugated autonomy to the necessity to investigate whether the demand was unconscionable.

Philosophically, Austin J accepted that more than one doctrine of unconscionable conduct exists to characterise behaviours. His Honour specifically ruled out the application of the perhaps better-known, *Amadio*-like 'special disadvantage' unconscionable conduct[962] in preference to the equitable doctrine prohibiting the assertion or exercise of "a legal right in circumstances where the particular assertion or exercise of it would constitute unconscionable conduct".[963] Referring to the case law, Austin J held:

> [T]he word "unconscionable" in s51AC is not limited to conduct that would be unconscionable according to equitable principles.[964]

There were two specific behaviours by Action Makers that the Court *appeared* to find unconscionable. The first was found as evident – the beneficiary claimed an amount in excess of the amount owed. Although not specifically stated by the Court, it can be inferred that this behaviour satisfied the requirements of the *TPA*.

The Court held that Action Makers:

> [B]y making a call on the letter of credit for amounts greater than was in fact due…and certifying incorrectly for that purpose, the administrative receivers caused Action Makers to act unconscionably for the purposes of s51AA.[965]

The second related to the timing of the demands given the construction of the credit instrument – the demand on the guarantee was made simultaneously with a demand for payment from Boral.

The Court found no negative stipulation but was persuaded that the demand constituted unconscionable conduct under both sections 51AA and 51AC *TPA* and the demand by Action Makers to be unconscionable.

In its view the dispute was already resolved when the demand was made; no monies were owed based on the fact that the claimant's solicitors had provided in

962 *Amadio*, n342.
963 *Boral(No.2)*, n61 [77].
964 Ibid [90].
965 Ibid [79].

writing that the offsets for defective product claimed by Boral were in fact valid. Therefore, the later demand on the standby, which included a sum of monies already paid and for the value of the already agreed-to offsets, was unconscionable.

What emerges is the principle that *a demand on a credit instrument that includes sums that are not owing is the unconscionable assertion of a legal right in breach of the unconscionability provisions of sections 51AA and 51AC of the Trade Practices Act.*

Finally, Austin J attempted to reconcile equitable principles via the *TPA* in the workings of commercial undertakings with the general theory of autonomy, giving "anxious consideration"[966] to the contrary logic of the two. Ultimately, *Boral* established that **the Court may look to the underlying contract for assistance with determining whether the beneficiary has acted unconscionably**, regardless of the tenets of the doctrine of autonomy, finding:

> The terms of the irrevocable instrument and the underlying contract, properly construed, are highly relevant to the decision whether conduct in connection with those arrangements is unconscionable for statutory or equitable purposes.[967]

The importance of *Boral* cannot be overstated, given its overview of the doctrine of autonomy and unconscionability, the legislation, and the confluence between them.

Ideas Plus Investments v National Australia Bank[968]

The factually-convoluted allegations raised here included several causes of action. Among them, whether a demand on a standby letter of credit was unconscionable in breach of section 51AA *TPA* and therefore of direct (if not immediate) relevance to the development of the unconscionability exception.

The credit had been honoured and paid, and the bank had "deducted from the plaintiff's account"[969] the full value of the instrument. The plaintiff was suing to have the monies paid repatriated, in part on the basis that the demand was unconscionable, grounded in three causes of action.[970]

966 Ibid [94].
967 Ibid [94].
968 *Ideas Plus Investments Ltd v National Australia Bank Ltd* [2005] WASC 51 (*Ideas Plus(No.1)*).
969 *Ideas Plus(No.1)*, n968 [42].
970 The plaintiff also alleged breach of contract, and misleading or deceptive conduct.

The plaintiff alleged *inter alia* that when the beneficiary "issued the certificate and made demand under the letter of credit…[it]…knew that it had not satisfied the conditions of draw down."[971] The veracity of that allegation relied on a construction of the credit terms which the beneficiary's legal advice indicated was likely to fail. It was the receipt of this advice that proved influential on the Court's.

The other grounds claimed included that the beneficiary knew that the plaintiff would suffer loss if the demand was made. However, it was not stated how this constituted unconscionable conduct.

Much case law had already found unconscionable conduct could restrain a demand. However, Commissioner Siopis did not give significant weight to this cause of action. He rightly rejected outright the proposition that Ideas Plus was under any special disadvantage given the "ordinary commercial" nature of the transaction.[972]

The Court also found that the plaintiff's allegation that the beneficiary knew it did not have the right to make a demand, and had therefore acted unconscionably, could not be upheld."[973] The call on the instrument was made based on legal advice properly received with regard to the construction of the instrument.[974]

The Court indicated (but did not state explicitly) that receipt of legal advice supporting such an interpretation is a sufficient defence to an allegation of unconscionable conduct.

The plaintiff attempted to ground a separate unconscionability action[975] founded in the "special disability" category of unconscionable conduct.[976] The court is generally reluctant to find one-party disadvantage in corporate matters, given the sophisticated character of the parties, and this position prevailed. Commissioner Siopis stated that the "knowing exploitation by one party of the disadvantage of another"[977] is a difficult case to make involving commercial parties. No appeal was lodged against his finding that there was nothing unconscionable in making the demand on the credit.[978]

971 *Ideas Plus*$^{(No.1)}$, n968 [48].
972 Ibid [85]. The Commissioner does not speculate on whether any other categories of unconscionable conduct might be applicable.
973 Ibid [84].
974 Ibid [83].
975 Introduced as a late amendment to their pleadings and therefore apparently treated as a separate claim.
976 *Dziedzic & Lindgren*, in *Vout*, n15, 437-438;441.
977 *Samton*$^{(No.2)}$, n383 [48].
978 *Ideas Plus Investments Ltd v National Australia Bank Ltd* [2006] WASCA 215 (*Ideas Plus*$^{(No.2)}$) [26].

It is not entirely clear whether *Ideal Plus Investments* added to the development of the unconscionability exception. However, it can reasonably be argued that it lays down a defence to allegations of unconscionable conduct where a demand is made subsequent to receipt of legal advice that supports such a demand.

Clough Engineering v Oil and Natural Gas Corporation(No.1)[979]

The matter of *Clough* involves four cases, all in the Federal Court of Australia, culminating in a hearing by the full bench of French, Jacobson and Graham JJ. As a whole, *Clough* is problematic insofar as the development of the unconscionability exception is concerned. The early single-bench *ex parte* hearings twice applied section 51AA *TPA* to ground injunctive relief but these findings were later convincingly overturned by the full bench of the Federal Court.

The law in relation to the application of section 51AA *TPA* and unconscionable conduct generally on performance guarantees was extensively canvassed throughout.

In the first *ex parte* application hearing for an injunction under section 80(d) *TPA*, Gilmour J reviewed the precedents in conjunction with the relevant sections of the *TPA* to support his reasons for granting interlocutory injunctions. His Honour set out the arguable matters which he felt supported Clough's pleas, albeit with the caveat that the Court had no proper contradictor, which later proved significant.[980] Holding the threshold to be "not high",[981] the Court found that Clough had made out a *prima facie* case which, if supported by the facts, would support the relief claimed.

Much of Gilmour J's reasoning was overturned by the full bench of the Court. Clough claimed two causes of action:

1. unconscionable conduct under section 51AA *TPA*, and
2. breach of contract that was "closely related to the cause of action based on unconscionable conduct".[982]

979 *Clough(No.1)*, n442.
980 Ibid [71].
981 Ibid [36].
982 Ibid [27].

Granting the interlocutory injunctions, Gilmour J ordered that the first respondent be restrained from demanding or obtaining payment finding that the demand was "an improper exercise of power by ONGC to take advantage of the banks' propensity to pay."[983]

His Honour recognised an established category of unconscionable conduct by pointing out:

> [E]quity has traditionally exercised its jurisdiction to curtail an exercise of a right to terminate if that right is sought to be used arbitrarily, or capriciously or unreasonably or in bad faith.[984]

This specifically joined the oppressive insistence on one's rights with unconscionable conduct within the context of a demand guarantee matter. Relying on *Pierce Bell*,[985] his Honour stated that "[e]quity operates to prevent this conduct on the basis that it is unconscionable conduct."[986]

Clough Engineering v Oil and Natural Gas Corporation(No.2)[987]

Heard 12 days after the original injunctions were granted, *Clough(No.2)* was heard by the same judge in response to an application by the issuing banks to set aside the injunctions staying them from honouring their obligations under the performance guarantees. This case does not advance the development of the unconscionability exception in any meaningful way.

It is not entirely clear from the judgement why the banks brought this action on their own behalf, ie not in conjunction with the beneficiary. The plaintiff's bank made no submission in relation to any unconscionable conduct on the part of the beneficiary.[988]

In denying any change to the "status quo",[989] the Court restated its reasons from the original hearing, including its belief that Clough was not in breach of its contractual obligations and therefore the beneficiary was not entitled to make a demand against the guarantees. Otherwise, Gilmour J was content for the parties to await a final outcome on the substantive issues.

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983 Ibid [80].
984 Ibid [78].
985 *Pierce Bell Sales Pty Ltd v Frazer* [1973] HCA 13 (*PBS(No.2)*).
986 *Clough(No.1)*, n442 [78].
987 *Clough Engineering v Oil and Natural Gas Corporation* [2007] FCA 927(*Clough(No.2)*).
988 Ibid [18].
989 Ibid [52-53].

Clough Engineering v Oil and Natural Gas Corporation(No.3)[990]

For this hearing Gilmour J had the benefit of hearing the beneficiary's submissions – the previous hearings both being held *ex parte* – and the resultant finding was significantly different in almost every respect.

Clough was asking the Court to consider (a) the construction of the negative stipulation; (b) that ONGC caused the problem from which it sought relief; and (c) that ONGC's demand was unconscionable.[991]

The onus remained on Clough to establish the existence of a serious issue to be tried in order for there to be a "continuation of the injunction".[992]

The Court referred specifically to the construction of a term that constrained claims against the provided guarantees, except "in the event of the Contractor failing to honour any of the commitments entered into".[993] The question then arose whether the breach only needed to be merely *asserted* or whether it needed to be *proven*. It found:

> [O]n the proper construction of the Construction Contract, the performance guarantees could be invoked upon the basis *merely of an asserted failure* on the part of Clough to honour its commitments under the Construction Contract.[994]

Affidavits from the beneficiary/respondent demonstrated that, contrary to submissions made in the previous hearings, Clough was itself in breach of the underlying contract in "two important respects".[995] With the benefit of the additional evidence provided by ONGC, the Court overturned its previous *ex parte* finding.

While not mentioned specifically, it is well settled that equity will not assist where a party has caused the problem from which it seeks relief[996] and Clough had failed to inform the Court fully as to the true position of the contract.

While Clough could only allege breaches that could only be determined at a later time, ONGC immediately demonstrated actual breaches already committed with regard to (i) the obligation to extend the guarantees; and (ii) the obligation to

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990 *Clough Engineering v Oil and Natural Gas Corporation* [2007] FCA 2082 (*Clough(No.3)*).
991 Ibid [4].
992 Ibid [15].
993 Ibid [23].
994 Ibid [53]. Emphasis added.
995 Ibid [91].
996 H Gibson, *Gibson's Suits in Chancery* (Gaut-Ogden, 1837), 36[§42].

provide various insurance certificates – two fundamental terms.[997] For this reason the Court refused to intervene on Clough's behalf.

The Court found that there was:

> [N]o…*prima facie* case or serious issues to be tried in respect to the alleged contraventions of s 51AA of the TPA…[and]…[i]t is of no consequence that a *prima facie* case and serious issues to be tried arose in other respects.[998]

Clough Engineering v Oil and Natural Gas Corporation(No.4)[999]

The full Federal Court was emphatic and unanimous in its rejection of Clough's appeal holding that "[t]he area of contest was not beset by difficulty or novelty."[1000] The Court reviewed the relevant facts and the reasoning of the primary court, addressed each of Clough's pleas, and affirmed Gilmour J's opinion at every point.

Finding that (a) the guarantees were "unconditioned on any actual breach"; (b) Clough was in breach of contract; and (c) Gilmour J was correct to find section 51AA to be inapplicable in this case, the Court went into some detail to explain its reasons.

Their Honours found:

> ONGC was entitled to call upon the performance guarantees where it had a "*bona fide* belief" in its claim that Clough was in breach of the contract.[1001]

The Court also held that it was correct for ONGC to hold such a belief[1002] given Clough's breaches of the Construction Contract.

With respect to the development of any unconscionability exception to autonomy, *Clough* does not advance matters. The principle applied was 'equity will not come to a supplicant's aid when that aid has become necessary through the supplicant's own fault'.[1003] Clough was in breach of its contractual obligations and it could not apply for relief from the consequences of that breach.

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997 *Clough(No.3)*, n990 [60].
998 Ibid [96].
999 *Clough(No.4)*, n180.
1000 Ibid 471.
1001 Ibid 472.
1002 Ibid 481.
1003 See discussion at p.560.

The Court held that "none of the categories of unconscionable conduct…apply in this case."[1004]

Clough Engineering – Summary and Analysis

Clough is often discussed as authority on independent instrument unconscionability. However, *Clough* is not in fact authority for the exception. If it is authority for anything, it is for the equitable principle of needing 'clean hands' to seek relief.

The early single-bench findings can be largely disregarded on the basis that they were *ex parte*, which subsequently proved significant. Neither the original judge nor the full bench of the Federal Court found any breach of section 51AA *TPA* once ONGC had the opportunity to respond.

In the latter's reasons, the justices affirmed that "the primary judge was right to reject the contention that there was a serious question to be tried as to whether there was unconscionable conduct on the part of ONGC in calling upon the performance bank guarantees".[1005]

Orrcon Operations v Capital Steel & Pipe[1006]

To the line of authority the contribution of *Orrcon* is significant. The case itself bears all the factual hallmarks of textbook letter of credit theory, including:

- a single, multiple-draw, commercial letter of credit expressly issued subject to the UCP500;
- a narrow, substantive dispute in relation to supplied defective product;
- allegations of misleading and deceptive conduct, unconscionable conduct, and breach of a negative stipulation;
- an Assignment of Proceeds, the 'proceeds' being remittances from the letter of credit; an Advising Bank which had advanced monies to the first defendant Capital Steel at a discount in reliance on the payments guaranteed by the letter of credit it held from the plaintiff, Orrcon; and

1004 *Clough(No.4)*, n180, 478.
1005 Ibid 459.
1006 *Orrcon Operations Pty Ltd v Capital Steel and Pipe Pty Ltd* [2007] FCA 1319 (*Orrcon*).

- ❖ international supplier-manufacturers holding Australian letters of credit for product of contested quality that appears to be the genesis of the entire issue.

Orrcon alleged unconscionable conduct. The "category" of unconscionable conduct that they sought to rely on asserts that the harsh or oppressive insistence on the strict application of legal rights is unconscientious and unfair,[1007] and was also "in bad faith".[1008]

The account holder, Orrcon Steel, sought injunctions on multiple grounds to require the beneficiary to countermand their demand for payment under a letter of credit, including that of unconscionable conduct, stating in their plea:

> [B]y its knowing failure to deliver pipe that complied with the specification…in breach of its obligations under the contract but nevertheless making and seeking to rely on the…drawings down on the letter of credit…in circumstances where it lacks the financial capacity to repay those drawings down, **Capital Steel has engaged and is engaging in unconscionable conduct** within the meaning of s51AA of the *Trade Practices Act.*[1009]

Orrcon alleged that, given Capital Steel knew or ought to have known that the product was delivered defective, any demand against a letter of credit as compensation for that product was unconscionable, aggravated by the beneficiary not being in a position to repay the drawings should the demand for those funds be found unconscionable at trial.

To determine whether there was a question to be tried, his Honour looked to the provisions of the *TPA* and at *Olex*[1010] and *Boral*,[1011] concluding there to be four issues. The "factual elements" underpinning Orrcon's claim concerned Capital Steel's knowing supply of defective product and, as a consequence of that knowledge, that their claim against the confirmed letter of credit as payment for that product was unconscionable.[1012]

1007 Ibid [52].
1008 Ibid [59].
1009 Ibid [25]. *Emphasis added.*
1010 *Olex*$^{(No.1)}$, n38.
1011 *Boral*$^{(No.2)}$, n61.
1012 *Orrcon*, n1006 [51].

Examining the relationship between the instrument and the contract that initiated it, Besanko J referred to UCP500 Art.3,[1013] which sets out the principle of autonomy, and then looked to the case law to establish how the autonomy principle had been purposed and applied previously. His Honour focussed on Lord Diplock's reasoning in *United City Merchants*[1014] wherein similarly, the beneficiary had already committed a fundamental breach of the underlying contract.

The Court did not seem predisposed toward the unconscionability exception, referring to the majority view in *Tanwar*[1015] in which the Justices describe the very phrase "unconscionable conduct" as misleading.

Besanko J considered that grounding exercise of the Court's discretion in a claim of unconscionable conduct was the position of last resort, referring again to the finding in *Tanwar*:

> It is wrong to suggest that "sufficient foundation for the existence of the necessary 'equity' to interfere in relationships established by, for example, the law of contract, is supplied by an element of hardship or unfairness in the terms of the transaction in question, or in the manner of its performance."[1016]

Looking to *Samton Holdings*,[1017] an influential unconscionable conduct case unrelated to financial instruments, his Honour reiterated the five categories of unconscionable conduct identified in that case "in which equity will intervene under the rubric of unconscionable conduct",[1018] including *Amadio*-like[1019] exploitation of a special disadvantage, and unconscionable departure from a representation as in *Waltons Stores*.[1020]

1013 [Art.3A]: "Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the Credit."

1014 *Orrcon*, n1006 [57] and *United(No.4), n145*.

1015 *Tanwar Enterprises Pty Ltd v Cauchi* [2003] HCA 57.

1016 *Orrcon*, n1006 [60] referring to *Tanwar*, n1015, 365-366.

1017 *Samton(No.2)*, n383.

1018 *Orrcon*, n1006 [61].

1019 *Amadio*, n342.

1020 *Waltons Stores (Interstate) Ltd v Maher* [1988] HCA 7. A leading Australian contract law case wherein unconscionable conduct gave rise to an estoppel restraining the defendant from refusing to honour undertakings made to the plaintiff who reasonably acted on them to their detriment. Per Mason CJ and Wilson J: "Equity will come to the relief of a plaintiff who has acted to his detriment on the basis of a basic assumption in relation to which the other party to the transaction has played such a part in the adoption of the assumption that it would be unconscionable conduct on the part of that other party to ignore the assumption."

The oppressive insistence on one's "strict legal rights"[1021] was not included which is unfortunate as this may have directly linked demand guarantees to this specific category of unconscionable conduct. Besanko J did however allow that the list provided "may not be exhaustive".[1022] His Honour considered this not to be a case in which equity should intervene.

The Court posited:

> In one sense one can say that it is unconscionable or unconscientious to enforce legal rights oppressively or in bad faith but on one view of the authorities **the real question is whether there is oppression or bad faith because the circumstances fall within one of the well-known cases** in which equity will intervene on the ground that the conduct is unconscionable or unconscientious.[1023]

The Court did not indicate what "circumstances" might be applicable. It did not state whether the demand by Capital Steel fell within one of the "well-known cases". Besanko J reviewed *Olex*,[1024] *Boral*[1025] and *Clough*[1026] before forgoing further analysis by declaring himself:

> prepared to proceed on the basis that such unconscionable conduct [non-compliance with the underlying contract] could found an order restraining payment under the letter of credit.[1027]

However, as Orrcon alleged that Capital's unconscionable conduct was pursuant to its knowledge of the defective product, their burden was to demonstrate that Capital did indeed have that knowledge at the time they submitted their complying presentations. This Orrcon could not do and therefore could not demonstrate unconscionable conduct at the relevant times.

Orrcon's final allegation of unconscionable conduct, that Capital's inability to repay drawdowns in the unlikely case that they should have to, was dealt with brusquely by the Court. Expressing doubt as to whether Orrcon's assessment of the beneficiary's financial health could possibly be an element for consideration,

1021 *Stern*, n352, 500.
1022 *Orrcon*, n1006 [63].
1023 Ibid [64]. Emphasis added.
1024 *Olex*$^{(No.1)}$, n38.
1025 *Boral*$^{(No.2)}$, n61 [81].
1026 *Clough*$^{(No.4)}$, n180.
1027 *Orrcon*, n1006 [70].

Besanko J concluded that even if such behaviour might be considered when assessing conduct, "it cannot be sufficient of itself."[1028]

His Honour also pointed out that it would not be wise for him to "attempt to determine the boundaries of unconscionable conduct in s51AA of the TPA on this interlocutory application".[1029]

Orrcon does not provide significant guidance with relation to whether or not the harsh or oppressive enforcement of one's legal rights in relation to bank instruments fits into the general doctrine of unconscionable conduct as a separate category in which equity will intervene.

The Court purposely determined the chain of events necessary to establish Capital's level of knowledge. It thereby established that one element for determining whether behaviour falls within the unconscionability exception is that, *at the time of making a demand, the beneficiary must not have any knowledge of any breach of any fundamental terms of the underlying contract*.

Board Solutions Australia v Westpac Banking Corporation[1030]

Board Solutions was an unusual and complex interlocutory hearing of an appeal against injunctions already in place. The first respondent was the account party's own bank and issuer of the subject "banker's undertaking".[1031] The beneficiary of the guarantee was Bendigo and Adelaide Bank Ltd (Bendigo), the contracted supplier's bank and principal creditor.[1032] The rights under the underlying Distribution Agreement had been subrogated from the original supplier (Multiboard) to its sister company (Arden Way).

The matter involved the wording of an independent, on-demand bank guarantee raised by Westpac Bank as issuing bank and Bendigo Bank as the 'beneficiary bank'.

To determine whether the demand was, *inter alia*, unconscionable, the Court raised the veil of autonomy and examined whether the conditions of the guarantee reflected the underlying formal 'Distribution Agreement' and representations made by the various parties in negotiations.

1028 Ibid [91].
1029 Ibid [70].
1030 *Board Solutions*, n676.
1031 Ibid [1].
1032 Ibid [52]: In unusual circumstances, the named beneficiary was the banker for the supplier, a relationship which "places this case out of the norm."

The plaintiff succeeded in making out a *prima facie* case that the beneficiary's demand was unconscionable under ss51AA and 51AC *TPA.*

In the judgement the Court did not indicate which *specific* conduct by the respondent banks it held to be unconscionable. His Honour did however indicate *where* the conduct likely occurred, saying that there was "a case to be made out against **both** Arden Way and Bendigo on the basis of a potential breach of ss51AA or 51AC",[1033] thereby exonerating Westpac from liability vis-à-vis any unconscionable conduct.

These findings are at odds for two reasons: first, despite the case being "made out against them", the Court *lifted* the injunction against Arden Way, who was neither the beneficiary nor the issuer of the instrument. They submitted that "it was a dispute… between the bankers and BSA".[1034] Additionally, given that Arden Way was neither a party to the Distribution Agreement nor beneficiary to the guarantee, it was not possible for them to undertake any conduct with respect to the demand whatsoever, unconscionable or otherwise. Yet the Court felt a case could be made out against them.

Contrarily, Westpac (who made no submissions to the Court[1035]) was the issuer of the instrument. They were responsible for the conditions in the instrument and, ultimately, the injunction against them was *continued*, as it was against the beneficiary Bank.

However, no evidence was adduced to demonstrate any unconscionable conduct on Westpac's part and Forrest J, while specifically *excluding* Westpac from allegations of unconscionable conduct, *extended* the injunction against them.

It is possible that Bendigo's unconscionable conduct was the making of a demand against a guarantee which the bank knew to be non-compliant with the underlying Agreement and other undertakings. It allegedly did so to protect its risk position with the supplier.[1036] The Court intimated this by pointing out that both Bendigo and Multiboard had acknowledged BSA's repeated insistence during negotiations and

1033 Ibid [52]. Emphasis added.
1034 Ibid [31].
1035 Ibid [26].
1036 Ibid [39]. This was left to the trial to determine but the Court here alludes repeatedly to a possible conspiracy between John Spina at Bendigo Bank and Karl Vreko at Multiboard and is openly critical of the lack of information in Spina's affidavit. NB: 'Karl' was spelled incorrectly in the judgement as 'Carl'.

later their insistence that the conditions of the guarantee reflect the terms of the underlying Distribution Agreement.

Despite this, Bendigo convinced Westpac to issue the guarantee without regard for the agreement.[1037] Why this behaviour was found unconscionable the Court did not say, nor did Forrest J attempt to ascribe the behaviour to any of the established categories of unconscionable conduct. Again, no reference was made to the basis upon which the injunction against Westpac was continued.

It is submitted that the unconscionable conduct that grounded the continuation of the injunctions emerged from equitable principles related to unjust enrichment. BSA contended that "Bendigo now seeks to recover far more than any obligation BSA has pursuant to its agreement with Arden Way"[1038] or in other words, was making a demand for payment of monies that were not owed.[1039] The judge noted that "at the time of the demand, BSA was not (and had not been) in default of payments for orders placed with Arden Way".[1040]

There was nothing Arden Way could have done with respect to the design of, or demand on, the guarantee and therefore it was impossible for it to have acted unconscionably with respect to it. The conclusion then is that Arden's unconscionable conduct, alluded to twice by the Court,[1041] must be with respect to its undertakings to BSA in relation to its negotiations with its bank, which in any event is irrelevant to the demand against the guarantee.

In the final analysis, it remains unclear precisely what conduct was found sufficiently unconscionable to restrain the two banks from further action in respect of demands against the guarantee. *Board Solutions* again demonstrates that unconscionable conduct cannot be established without lifting the veil of autonomy and looking at the construction of the underlying contract – in this case a 'Distribution Agreement'.

While the plaintiff in *Board Solutions* successfully restrained the beneficiary's claim, the case does not advance understanding of the unconscionability exception significantly. This is partly because the Court did not advise much of its reasoning

1037 Ibid [52].
1038 Ibid [4].
1039 Such behaviour has been found unconscionable in Singapore in relation to demands on guarantees: *GHL*, n21.
1040 *Board Solutions*, n676 [24].
1041 Ibid [5] & [37].

on the types of conduct sufficiently material to ground an injunction to restrain a demand against an unconditional bank guarantee.

FMT Aircraft Gate Support Systems v Sydney Ports[1042]

Pembroke J followed a narrow common law approach to the application seeking to restrain the beneficiary from claiming against a guarantee. Counsel for the plaintiff attempted to ground part of FMT's application in unconscionable conduct.

No detail is given as to the legal nature of the claim, whether under the general law or the statute, but the Court was not of a mind to deviate far from the principles stemming from the freedom to contract held by "commercial parties with access to legal advice and resources [who] were able to look after themselves."[1043] FMT alleged that the failure by Sydney Ports to advise that a liquidated damages clause had commenced operation constituted unconscionable conduct – certainly a tenuous claim at best.

Pembroke J was concerned with the commercial efficacy of the guarantee instrument and would not consider the application of equitable principles where to do so would threaten the "policy and purpose behind unconditional undertakings and performance guarantees".[1044]

It is highly unlikely even the most thorough application of the unconscionability exception would have found the conduct alleged in this matter sufficient to restrain the demand-right. The Court rightly dismissed any suggestion of unconscionable conduct by the beneficiary because they failed to allude in correspondence to the commencement of a liquidated damages term well known to the plaintiff. *FMT* does not therefore advance the boundaries of the unconscionability exception.

Redline Contracting v MCC Mining (WA)

To fully understand *Redline* both cases must be read in conjunction. Many of the facts necessary to understand the reasons in *Redline*$^{(No.1)}$[1045] are provided and explained only in *Redline*$^{(No.2)}$.[1046]

The matter concerns "four unconditional undertakings",[1047] also described as "Unconditional Insurance Bonds" and "Performance Bonds". Howsoever named,

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1042 *FMT Aircraft Gate Support Systems v Sydney Ports Corporation* [2010] NSWSC 1108 (*FMT Aircraft*).
1043 Ibid [36] citing *Summer Hill Business Estate v Equititrus*t [2010] NSWSC 776 [36].
1044 Ibid [39].
1045 *Redline Contracting v MCC Mining (WA)* [2011] FCA 1337 (*Redline*$^{(No.1)}$)
1046 *Redline Contracting v MCC Mining (WA)* [2012] FCA 1 (*Redline*$^{(No.2)}$)
1047 *Redline*$^{(No.1)}$, n1045 [1].

the instruments were independent, on-demand guarantees to provide a risk offset to the principal to protect against imperfect performance by the contractor. Also, the undertakings acted as security against claims for unliquidated damages.

The substantive dispute concerned whether the beneficiary could resort to the benefit of the guarantees for the purposes of resolving an unliquidated damages claim under the primary contract arising from Redline's breach of contract. As a result, judicial focus was brought on the construction of the contract, unconcerned with equity.

In the first hearing, Redline sought to have alleged misleading and deceptive conduct by the respondent categorised analogously as a form of unconscionable conduct, which was a novel but ultimately overly optimistic approach by counsel.[1048] Siopis J unsurprisingly held that the claim did "not have sufficient prospects of success at trial to warrant granting the interlocutory injunction claimed"[1049] and dismissed it, along with all other claims and refused to impose any injunction against the right to claim under the 'security'.

However, in the second hearing, counsel for the plaintiff amended its claims with regard to unconscionable conduct. Redline claimed the beneficiary's demand to be unconscionable in contravention of section 51AA *TPA*, and "relied upon a number of grounds [four] in support of its contention".[1050] They were that the demand on the guarantee was unconscionable because:

1. damages were not as yet payable;
2. the beneficiary had no need of the funds;
3. Redline would suffer reputational harm as a result; and
4. the demand was made for an ulterior purpose.[1051]

After dealing extensively with claims relating to the contract's construction, the Court addressed the revised claims relating to "Unconscionability".[1052]

1. Damages were not as yet payable: The Court did not state it's view with regard to Redline's strongest claim – that the demand on the

1048 The specific grounds for the claim in *Redline*$^{(No.1)}$ was not provided – it was dealt with in passing. Section 51AA was only mentioned as part of a direct quote from *Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd* (1998) NSWSC BC9806316 (Unrept).
1049 *Redline*$^{(No.1)}$, n1045 [37].
1050 *Redline*$^{(No.2)}$, n1046 [57].
1051 Ibid [57-60].
1052 Ibid [56]. For clarity, these grounds will be addressed in the order that they are listed, not the order in which the Court addressed them.

instrument was unconscionable because, they alleged, damages had not been awarded and might never have become so.

2. The beneficiary had no need of the funds: The Court could find no merit either in the argument that the beneficiary's lack of need for funds made the demand unconscionable, stating that a lack of need "is not the point" but did not elaborate further.[1053]

3. Redline would suffer 'reputational harm' as a result: The Court dispatched reputational harm quickly, citing *Clough*[1054] where it was similarly dispatched. To succeed on this point the plaintiff must prove that the demand is harsh or oppressive because it would result in their suffering reputational harm for which damages would be an insufficient remedy. This was not a question the Court felt had merit.

4. The demand was made for an ulterior purpose (which was "not identified"): The Court mentions "evidence of a failed mediation between the parties" and indicates an implication "that MCC Mining is putting commercial pressure on Redline to settle its dispute with it".[1055] The argument that using the demand as "part of a stratagem to put pressure"[1056] on Redline was unconscionable also fell away given the authority in *Olex* where it was held that this exact behaviour was not unconscionable.[1057] Further, the Court could find no bad faith in the exercise of a contractually agreed-to right.[1058]

The Court did not provide any detailed analysis as to why it is not unconscionable to make a demand when there was a genuine dispute as to whether the amount was owed but made it clear that the default legal position was not to interfere with the *status quo*.[1059]

Whatever the Court's reasons, the outcome was correct – none of the relied-upon behaviours alleged by Redline fell into any of the categories of unconscionable conduct laid down in the authorities. Redline was unable to demonstrate a

1053 Ibid [67].
1054 *Clough*$^{(No.4)}$, n180, 494.
1055 Ibid [60].
1056 Ibid [63].
1057 *Olex*$^{(No.1)}$, n38, 403. This is not the case in Singapore.
1058 *Redline*$^{(No.2)}$, n1046 [65].
1059 The 'true' *status quo* holds autonomy to be non-negotiable. However, courts have been known, after *ex parte* interlocutory injunctions have been issued, to refer to the '*status quo*' as the position held *after* the beneficiary has been enjoined.

reasonable likelihood that they could prove MCC's demand to be harsh or oppressive or otherwise unfair.

Accordingly *Redline* is authority for the principle that *where the contract is thus constructed, the exercise of a right to claim against a security as payment for unliquidated damages arising from alleged breaches of the underlying contract does not constitute unconscionable conduct.*

Redline did not contribute further to the development of the unconscionability exception. It maintained the most constrained view of the application of the unconscionable provisions of the *TPA/ACL* and took the most conservative position *vis-à-vis* the application of the relevant equitable doctrines.

Fabtech Australia v Laing O'Rourke Australia[1060]

In *Fabtech* the Federal Court of Australia acknowledged unconscionability as "a well-recognised basis upon which an interlocutory injunction may be granted".[1061] The plaintiff "relie[d] on s20 of the Australian Consumer Law"[1062] but failed to explain how the behaviours complained of fell within the established categories of behaviour already laid down in the "unwritten law".[1063]

The applicant submitted to Besanko J that six actions by the beneficiary made the demand unconscionable and therefore grounds for an interlocutory injunction.[1064] Not all matters were addressed.

The matter revolves around a difficult factual matrix for the purposes of finding unconscionable conduct. Part of the underlying contractual dispute had already been decided in favour of the account party, Fabtech, and the beneficiary had already made payment pursuant to the adjudicator's finding. The demand on the two independent guarantees was therefore a claim for recovery of overpayment, plus damages grounded in specific contractual terms allowing for such claims.

The Court provided generally that "it would be clearly unfair and unreasonable and, therefore, unconscionable"[1065] for the beneficiary to receive payment. The Court did

1060 *Fabtech Australia Pty Ltd v Laing O'Rourke Australia Construction Pty Ltd* [2015] FCA 1371 (*Fabtech*).
1061 Ibid [39].
1062 Ibid [41].
1063 *ACCA*, Sch.2, n907 [20].
1064 *Fabtech*, n1060 [40]. There is some confusion in the case note here – the Court recognises five complaints but addresses six.
1065 Ibid [40].

not address the implied definition here, nor did it acknowledge that to say an action is unfair and/or unreasonable, is *not* to say it is *necessarily* unconscionable.

The six behaviours alleged as unconscionable were:

1. That the purpose of the guarantee was to "ensure performance" and not to "allocate risk pending resolution of a dispute".[1066] The Court found this to have little merit, preferring to find the guarantee completely independent irrespective of any contradictory definitional terms in the contract.[1067]

2. The plaintiff argued that it was in full compliance with its contractual obligations, especially given that the respondent had certified the complete performance of the contract. The Court did not address this claim and so it can be assumed that it lacked any jurisprudential foundation, which was fatal to its success.

3. The respondent had not, it was alleged, raised any claim for liquidated damages at any time prior to the actual demand being made. The Plaintiff claimed that the beneficiary's delay in making a damages claim was unconscionable. This was also rejected by the Court which refused to grant that the beneficiary's delay exercising their agreed-to rights under the guarantee was unconscionable behaviour. It cannot be unconscionable to reserve one's rights, nor to exercise them at any time it is lawful to do so.[1068]

4. Fabtech also submitted that the respondent had "abandoned its pursuit of judicial review proceedings."[1069] It is unclear from the judgement how this submission was reasoned to ground unconscionable conduct The lack of a jurisprudential base must be assumed to set the submission aside.

1066 Ibid [40].
1067 Ibid [9].
1068 Ibid [43].
1069 Ibid [40].

5. Re-visiting the liquidated damages claim, Fabtech claimed that Laing O'Rourke had waited to make the demand on the guarantee until the operation of a certain contractual preclusion from disputing the claim, or from claiming further (unexplained) "extensions of time". This was not addressed by the Court in the judgement.

6. The applicant tried to connect an earlier adjudication decided in their favour and the demand on the guarantee being unconscionable. Besanko J noted that there remained a dispute between the parties with regard the adjudication but otherwise did not explain further.

Fabtech does not advance the jurisprudence of independent instrument unconscionability except to support the principle that it cannot be unconscionable to exercise one's rights lawfully. Most of the claims and allegations of unconscionability made by the applicant were vague or specious, and never likely to succeed. It is unsurprising that the Court refused to allow the applicant to depend on s20 *ACL* to ground an injunction.

Swiss Re International v Eagle Downs Coal Management[1070]

Swiss was an attempt to have the Court find a demand on a guarantee unconscionable and thereby ground an application for preliminary discovery under Federal Court Rule 7.23. The rule provides that, in order to obtain an order from the Court, the applicant must demonstrate its "reasonable belief" that they may have a "right to obtain relief in the Court from a *prospective* respondent".[1071] The ultimate 'relief' sought was an order for the return of some or all of the funds paid to the beneficiary under the guarantee.

The account party, WDS Limited ('WDS'), was not the plaintiff; Swiss Re, the issuer of the guarantee, made the application for reasons which are not made clear.

Swiss Re alleged that they had a reasonable belief that the demand was, *inter alia*, unconscionable[1072] and this belief was sufficient to ground an order for the respondent, Eagle Downs, to release documents that it had refused to the applicant. These documents, it was further claimed, would provide a basis for their

1070 *Swiss Re International SE v Eagle Downs Coal Management* [2015] FCA 1479 (*Swiss*).
1071 *Federal Court Rules 2011* (Cth), r7.23. Emphasis added. Establishing a 'reasonable belief' may be akin to establishing a strong *prima facie* case.
1072 *Swiss*, n1070 [35]: Swiss Re also alleged fraud, misleading and deceptive conduct pursuant to s18 *ACL*, and the existence of a negative stipulation.

reasonable belief to obtain relief. The range of documents sought was vast, and it was in part due to this that the Court refused the application for access to them.[1073]

The applicant demonstrated a limited understanding of independent instrument unconscionability when relying on s21 *ACL* for relief. Neither WDS nor its administrators in insolvency were moved to suggest that the call on the guarantee was anything other than appropriate.

Swiss Re contended that the demand on the guarantee was unconscionable because:

1. a call on the guarantee could only be made conditioned upon the identification of "[c]osts, losses, expenses or damages which [Eagle Downs] claims it has incurred or might in the future incur as a consequence of any act or omission or negligence or default of WDS."[1074] This could only be proved by reference to the documents to which the respondent had refused the applicant access. Swiss Re alleged that the documents would show there were no defects of substance to remedy, nor any basis for claims of damages. The Court agreed that "[i]n some cases, a party may be required to explain or contradict something".[1075] This was not one of those cases and a lawful refusal to produce documents without a legal obligation to do so lends no weight to an allegation of misconduct.[1076]
2. WDS (not Swiss Re) was said to be "shocked and stunned" by the "suddenness" of the demand.[1077] The notion that this contributes to the defendant's unconscionable conduct demonstrated a complete lack of understanding as to the nature of unconscionable conduct. Gleeson J observed that such suddenness "does not say anything material about the legality of the demand".[1078]

1073 Ibid [87].
1074 Ibid [58].
1075 Ibid [73].
1076 Ibid [75].
1077 Ibid [56(d)]. Swiss Re was alleging this shock on WDS' part, not WDS.
1078 Ibid [70].

3. The beneficiary was in breach of its own obligations under the supply contract in relation to periodic payments owed to WDS. This was not held to "cast any doubt upon Eagle Downs' *bona fides*"[1079] in making the claim.

4. Negotiations between the contract parties being undertaken at the time of the demand contemplated a reduction in the contract price and consequently in the value of the guarantee. This claim was denied on the grounds of uncertainty; that no agreement had been reached (nor perhaps was likely to be) and that such negotiations did "not provide a reasonable basis for doubting Eagle Downs' *bona fides*".[1080]

5. During earlier negotiations the beneficiary had made a statement to the effect that it would not make a demand on the guarantee, on the basis that the negotiations were ongoing. The Court found that the implication of this statement was "that the bond might be called upon if the contract was not successfully renegotiated",[1081] as indeed it was, but held that this did not negative the beneficiary's right to make the demand.

The Court had no issue with the factual basis for any of these claims by Swiss Re but would not accede to the notion that any of the behaviours constituted unconscionable conduct.

Best Tech Engineering v Samsung C&T Corp[1082]

The two initial hearings in this matter both dealt predominantly with how the construction of a particular contractual term might ground an injunction restraining the beneficiary from being paid under a bank guarantee. The applicant/plaintiff was partly successful with the Court acceding to a temporary restraint.

The first matter[1083] was an *ex parte* interlocutory application in which Pritchard J granted an injunction until such time as the matter could be fully contested. In the second matter,[1084] Cheney J replaced the original injunction with a limited restraint requiring Samsung to provide appropriate notice to the applicant commensurate

1079 Ibid [69].
1080 Ibid [66].
1081 Ibid [68].
1082 *Best Tech & Engineering v Samsung C&T Corporation* [2015] WASC 459 (*Best Tech(No.3)*).
1083 *Best Tech & Engineering v Samsung C&T Corporation* [2015] WASC 355 (*Best Tech(No.1)*).
1084 *Best Tech & Engineering v Samsung C&T Corporation* [2015] WASC 447 (*Best Tech(No.2)*).

with its obligations under the contract. Having received the relevant notice, the plaintiff "applied for further orders including an interlocutory injunction, not materially different from that discharged by Chaney J…[and] also applied for orders for the urgent separate trial of an issue pursuant to…the *Rules of the Supreme Court 1971* (WA)."[1085]

Best Tech argued "that it would be unconscionable for Samsung to rely on its strict legal rights under the Contract".[1086] No mention of the consumer law was made; the claim was grounded in the common law.

In the final hearing, Allanson J held that the claim lacked credibility in its entirety, stating that "[n]o attempt had been made to date to properly identify a suitable issue" and that the application had "not properly been thought through".[1087] Samsung submitted that the attempt to re-litigate matters already settled constituted an "abuse of process"[1088] and sought immediate dismissal of the application. The Court agreed with the lower court that Best Tech's position was unlikely to be tenable at trial.

Allanson J held that a "claim for relief on the basis of unconscionable dealings calls for a close consideration of the facts…Best Tech put forward no additional evidence on the issue of unconscionability, but relied solely on the fact that Samsung had not responded" to a relevant letter. This left the Court "unsure on what basis this is, or could be, asserted to be unconscionable".[1089] Holding to the principles of contract, his Honour held that "the plaintiff will be prejudiced by any call on the guarantees. But that is the effect of the agreement it entered."[1090]

Best Tech did not expand further on the law already in place.

1085 *Best Tech(No.3)*, n1082 [10].
1086 Ibid [34].
1087 Ibid [13-14].
1088 Ibid [32].
1089 Ibid [36].
1090 Ibid [37].

2.0 Conclusion to Australian Case Analyses

The Australian position on unconscionable conduct in independent instrument matters remains in flux. Only three matters have ultimately been successful in pleading unconscionable conduct with respect to abusive demands: *Olex Focas* (in part); *Boral*; and *Board Solutions*.[1091]

The Australian Courts have never addressed substantive unconscionability in relation to independent instruments and have not acknowledged that the principles of procedural unconscionability cannot be applied to situations where substantive unconscionability is being alleged. These Courts have often considered unconscionability with the non-statutory element of 'moral obloquy'. The elements of unconscionability to be put to proof, and the standard of proof required to establish unconscionable conduct are far from satisfactorily laid down. Unconscionable conduct *per se* has never been fully defined and matters concerning it are adjudged on the facts of each case.

In addition, the guidance provided by s22 *ACL* struggles to provide clear direction, other than by isolated example, regarding the matters *not* related to equitable principles which the Court may take under consideration. "These guidelines are seen as helpful indicia for the court but they are not exhaustive."[1092]

Australian Courts have not yet been asked to consider whether the independence of primary obligation letters of credit should be treated differently to the secondary obligation demand guarantees and stand-by guarantees which "serve the different function of securing the account party's obligation to pay damages upon commission of a breach."[1093]

Finally, the Australian courts have not addressed, in the *absence* of a special disadvantage to be abused, if unconscionability is applicable to independent instruments at all. They appear to have found no issue with respect to considering matters on their facts as well as the documents, but have not acknowledged that this is contrary to the operation of the instruments themselves and in direct contradiction with the independence principle.

1091 *Olex*$^{(No.2)}$, n938941; *Boral*$^{(No.2)}$, n61; *Board Solutions*, n676.
1092 *Baxt*, n524, 396.
1093 *Loi*, n131, 506.

Therefore the Australian position on independent instrument unconscionability remains very much an incomplete jurisdiction. Many questions remain to be answered regarding whether the statutory protections afforded other commercial parties under the *ACL* will be, or can be, extended to victims of abusive demands against independent instruments. It is for this purpose that the framework proposed in Chapter Six looks to assist with understanding the variety of elements of independent instrument unconscionability that must be taken into consideration.

Chapter 6. The Doctrine of Independent Instrument Unconscionability

Section A. A New Category of Unconscionable Conduct

1.0 Theoretical Rationale for Independent Instrument Unconscionability

There is a case to be made for a special category of unconscionable conduct specific to independent instruments. These instruments have been referred to as "specialty contracts",[1094] with distinct rights and obligations. The effect of unconscionability in common law jurisdictions on independent instruments must be considered in light of their singularity. If equitable principles are to be used, those principles ought to be identified and refined to suit the purpose.

Such consideration should perforce lead to the development of a new, recognised category of unconscionability. No existing category adequately addresses the range of matters which must be decided to determine whether a demand on an independent instrument should be restrained.

The question then becomes: if the Court is to recognise a unique category of independent instrument unconscionable conduct to ground an injunction, what elements of 'conduct' are necessary?

To answer this, a doctrine is required that describes, in the independent instrument context, the behaviours which constitute conduct that is 'unconscionable', 'unfair', 'unconscientious', 'lacking in good faith', or 'having no conceivable basis',[1095] *and is sufficiently egregious* to attract judicial relief.

In Australia the court held that no power under the general law could assist with independent instrument matters, but that the legislative prohibition could apply to such disputes.[1096] Under the legislation the Court is directed to *inter alia* principles of equity to guide their considerations.[1097] In addition, a well-defined category of independent instrument unconscionability would assist with ensuring consistent findings.

1094 *McLaughlin*, n89, 1197.
1095 *Renard*, n312, 268[F].
1096 See p.189 discussion of *Olex(No.1)*.
1097 See discussion p.82. S20 *ACL* is strictly limited to equitable principles and is generally not applied to independent instrument matters. S21 *ACL* is **not** limited to the principles of equity.

Without a framework, the existence of independent instrument unconscionable conduct will fall to each Court to determine on an *ad hoc* basis, which may be problematic:

> If unconscionability were regarded as synonymous with the judge's sense of what is fair between the parties, the beneficial administration of the broad principles of equity would degenerate into an idiosyncratic intervention in conveyancing transactions.[1098]

Unconscionable conduct, because of its foundations in equity, has only been found sufficient to ground an injunction against an independent instrument in three common law jurisdictions to date.[1099] Civil law jurisdictions either have a legislated doctrine of contractual good faith or they reference such "soft law" as the UNIDROIT Principles or the Principles of European Contract Law for guidance.[1100] In some jurisdictions a principle of contractual good faith exists but "it is difficult to find a clear and comprehensive statement of it."[1101]

Contractual good faith and unconscionability have similar characteristics.[1102] Some jurisdictions, such as the US and Australia, utilise both.

The US is a common law jurisdiction with a robust court of equity[1103] but issuers of independent instruments governed by the *UCC* are subject to a duty of good faith under §5-109(a)(2).[1104] *UCC* §2-302 permits the Court to restrain the effect of an unconscionable term but only where the unconscionability is procedural, ie the conduct occurred when the contract was formed. Independent instrument matters have, based on extensive research, all been substantive disputes. An alternative claim is not inconceivable.

Australia also has an equity jurisdiction with commercial unconscionability proscribed under statute. This is complicated with an ambiguous bifurcation between "the unwritten law of the states…from time to time"[1105] and an unidentified head of power founded outside of equity.[1106] The matters to which the court *inter*

1098 *Stern*, n352, 479.
1099 Australia, Malaysia, Singapore.
1100 L Gorton, 08 June, 2017 correspondence with this author.
1101 H MacQueen, *Good Faith in the Scots Law of Contract: An Undisclosed Principle?,* Good Faith in Contract and Property Law (Hart, 1999), 5-37.
1102 *Kuehne*, n45, 64-67. *Renard*, n312, 268[F].
1103 *Shulkin*, n519, 367[fn2].
1104 §5-102(a)(7): "'Good faith' means honesty in fact in the conduct or transaction concerned." Also *Wunnicke*, n30, 6[5].
1105 S20(1) *ACL*.
1106 The grounds for this are disputed: *Boral(No.2)*, n61 [90]. Also *Rickett*, n329.

alia may consider are provided in s22 *ACL*.[1107] While the drafters of this guiding provision likely did not consider independent instruments, the section nevertheless assists with framing independent instrument unconscionability.[1108]

It is apposite to question why unconscionable conduct ought to interfere with rights, and risk allocations, agreed to in private contract. The 19th century view of black-letter law is discussed above[1109] and there remains strong judicial support for strict enforcement except in exceptional circumstances.[1110] However, "it is generally recognised that a performance guarantee can be an oppressive instrument if abused."[1111]

Abusive conduct can be premeditated or malicious and cause unforeseeable harm. It cannot however, be presumed. Risk of contractual failure is certainly an element of any risk calculation but harm from abusive behaviour cannot be easily quantified or offset in advance. Indemnity may be provided for an applicant's own failures, but unjustifiable enrichment of the beneficiary would be difficult to mitigate. Independent instrument unconscionability offsets this.

More broadly, it would serve no purpose for the integrity of independent instruments to be undermined by an excessively broad application of a doctrine of unconscionability. Loi suggests that it is a matter of balance.[1112] It is posited here that, given unconscionability is already being used to ground restraint of the benefit of independent instruments, the best course is to establish a doctrinal framework so it can be applied consistently.

When considering commercial matters courts are asked to balance commercial realities with the social values of a modern world. Justice Mason has highlighted the Court's shift to a state where relief from commercial abuse is balanced against the need to ensure that unscrupulous parties are not unjustly enriched.[1113]

The commercial and social need to guard against abusive demands is self-evident. Damages can only be awarded once the substantive issues have been litigated.[1114] A disputed demand against an independent instrument will generally be made long

1107 S22(1)(a) *ACL* describes eleven matters "the court may have regard to" but these are descriptive, not *pre*scriptive. *Baxt*, n1092, 369: "Helpful indicia…but not exhaustive." See discussion p.240.
1108 See §2.2. below.
1109 See p.75.
1110 *Kirby*, n602 [viii]: "I hold to the somewhat old-fashioned opinion that parties of full age, without any relevant legal disability, should ordinarily be held to the legal obligations they have assumed."
1111 *Chartered*, n24, 668[39].
1112 *Loi*, n131, 508-509.
1113 See discussion by *Mason*, p.96.
1114 If procedural unconscionability is found, different relief might follow.

before that point in the judicial process – usually immediately after the relationship between the parties has irretrievably broken down. It is in part this time gap between the two, and the consequent financial harm to the account party, that makes it imperative for there to be a reasonable, material alternative to common fraud as a basis for restraining an unconscientious demand.

Courts have also seen the need for clarification: the existence of a category of unconscionability in Singapore specifically tailored to independent instruments was described by the Court of Appeal in *Boustead*[(No.1)].

Li J stated:

> [U]nconscionability as an exception has been carved out specifically "in the context of performance bonds", and is not to be mistaken for the general contractual doctrine of unconscionability.[1115]

Unfortunately, his Honour did not elaborate on the characteristics or elements of that "carved out" unconscionable conduct. To address that, a framework of relevant matters that ought to be considered or proven is described below.

Rather than refer to an 'exception' to the independence principle however, this paper supports the view that a properly developed category of unconscionability "carved out" for independent instruments will negate the need for consideration of an 'exception'.

The autonomy principle, it is posited here, ought not be offended by an injunction restraining the beneficiary's demand-right, and further, offence only occurs where the issuer is restrained from meeting their obligation to honour.[1116] This author accepts that the distinction is a fine but sufficiently clear one.

The proposal therefore follows that one characteristic of the new category will be that the available relief will be limited to a restraint against the beneficiary's demand-right.[1117]

It has been famously said that the "categories of negligence are never closed."[1118] Less widely appreciated is the analogous position taken in the High Court of Australia where it was held "the categories of *unconscionable conduct* are not

1115 *Boustead*[(No.1)], n160 [185].
1116 See discussion on demand-rights p.36.
1117 See elements table below p.252.
1118 *Donoghue v Stevenson* [1932] A.C. 562, 619 per Macmillan LJ.

closed".[1119] His Honour qualified this strenuously, citing concerns as to the effect of an excessively-applied doctrine of unconscionability, but acknowledged the Court's willingness to consider additional categories.

It is proposed here that a category of unconscionability specifically designed for independent instruments is both relevant and necessary. There is no evidence to support the idea that a properly formed doctrine would open the floodgates to allegations of unconscionable conduct in independent instrument disputes.[1120] As Loi said, simply because "relief would be more readily available…is not to say that injunctive relief would be *easily* or *readily* available".[1121]

It is necessary that the doctrine is properly informed with regard to the unique elements of independent instrument unconscionability harvested from the case authorities. These elements assist to determine the nature of the actual unconscionable conduct alleged to taint a demand. This is not to say that the "matters the court may have regard to" provided in s22 *ACL*[1122] have nothing to offer independent instrument unconscionability – some matters mentioned could conceivably be found in independent instrument disputes and these are particularised below. Case law provides the richest source of definition for unconscionability.

There is broad recognition that unconscionability cannot and should not be defined with much specificity.[1123] However, within the more confined independent instrument context, it is possible to acquire a much clearer view of what is required to establish certain conduct as unconscionable. The context narrows the range of behaviours which need to be considered and compared.

For example, lacking a context it is not possible to answer the *general* question 'What is unconscionable?' with anything other than an equally general non-contextual answer: 'It is unfairness. Or bad faith. Or unconscientious conduct.' None of which assists with understanding the character of 'unconscionable'. To accomplish this it is necessary to witness conduct in context.

1119 *Stern*, n352, 479. Emphasis added.

1120 S Rajan, 'Restraining A Call On Performance Bonds' (2016) <http://www.skrine.com/publications/legal-insights/707-restraining-a-call-on-performance-bonds>

1121 *Loi*, n131, 508-509. Original emphasis.

1122 Listed p.242.

1123 *Venture Cotton Coop v Freeman* 435 S.W.3d 222 (Tex. 2014), 228: "unconscionability is not a concept, but a determination to be made in light of a variety of factors not unifiable into a formula."

The Court in *Mount Sophia* stated:

> Unconscionability in the context of performance bonds is a conclusion applied to describe certain types of conduct in certain contexts.[1124]

Context allows grouping of behaviours into 'species' of unconscionable conduct (such as the harsh insistence on a right). Once specific, complained-of conduct can be properly analysed and *described* with reference to the character of these species of behaviours it becomes possible to evaluate it for materiality. The framework for doing so is postulated below.[1125]

A specific category of unconscionable conduct will recognise the broad social policy shift toward circumscribing corporate unconscionability.[1126] It has been acknowledged by both the courts and distinguished jurists that ruthless and unconscientious mercantile behaviour runs counter to contemporary thinking. Priestly JA pointed out:

> "a very large area of everyday contract law is now directly affected by statutory unconscionability provisions carrying with them broad remedies"…the ideas of unconscionability, unfairness and lack of good faith have a great deal in common. The result is that people…have grown used to the courts applying standards of fairness to contract which are wholly consistent with the existence in all contracts of a duty upon the parties of good faith and fair dealing in its performance…this is…the expected standard, and **anything less is contrary to prevailing community expectations**.[1127]

Loi has argued that a system which allows abusive demands to go unchecked will have a far more deleterious effect on market perceptions of independent instruments than occasional findings that a demand is unconscionable following a well-thought-out doctrine of law.[1128] This view is more likely to find wider acceptance in a conservative user community if independent instrument unconscionability is

1124 *Mount Sophia*, n39 [41].
1125 See §2.4 below p.249.
1126 B Horrigan, D Lieberman, and R Steinwall (DIISR), 'Strengthening Statutory Unconscionable Conduct and the Franchising Code of Conduct' (Department of the Treasury, 2010), 1-5.
1127 *Renard*, n312, 268[F]. Emphasis added.
1128 *Loi*, p.142.

seen as a set of properly constructed elements framed around existing law and usage.

Universal agreement on independent instrument unconscionability is unlikely; UNCITRAL has been unable to achieve it. The ICC and IIBLP have left the prosecution of fraud matters to local law, despite widespread acceptance of the fraud exception, not including articles relating to fraud in any rule set. Agreement would be even more difficult to achieve if it were perceived as grounded in common law equitable principles, given the broad lack of understanding in civil law jurisdictions on how equitable principles operate.[1129] It will therefore fall to local law to provide relief from unconscionability.

It is proposed here that for independent instrument unconscionability to operate, where an underlying contract requires an independent instrument, an implied obligation of good faith should be presumed to bind the beneficiary's demand-right.[1130] This reflects *UN-CIGSLC* deeming provision Art.15(3):

> The beneficiary, when demanding payment, is deemed to certify that the demand is not in bad faith.

Given that neither of these events, (a) adoption of a global agreement on unconscionability; nor (b) widespread acceptance of an implied good faith obligation, is likely to occur, the law dealing with abusive demands on independent instruments will remain split along jurisdictional lines.

There are those jurisdictions which technically support the proscription of abusive demands; those which provide relief when it is proved; and those where, except for fraud, the independence principle is inviolate and the applicant party carries the risk until disputes can be resolved under contract law principles.

2.0 Independent Instrument Unconscionability: A Framework

To determine independent instrument unconscionability the facts of a matter need to be considered in light of a range of elements, chiefly:

1. the timing of the conduct (§2.1). This informs whether the conduct is **procedural** (§2.2) or **substantive** (§2.3) in nature.

1129 *Rickett*, n329, 81, implies that some Australian judges may not either.
1130 See §3.0(H)ii below p.254.

2. the materiality of the conduct. It must be sufficiently egregious to attract intervention (§2.4).

3. the limits of unconscionability. Drawn from the case law, it informs on conduct already determined as **not** being unconscionable.

Where the conduct is procedural, it will be occur during formation of the contract. Where the conduct is substantive, it will be found in either the terms, performance or demand. Analysis of the facts ought to determine whether the alleged unconscionable conduct falls under a recognised 'category/species' of unconscionability.

The following analysis discusses each of these, scoping independent instrument unconscionability by reference to the case law and statute.

The elements of the conduct and circumstances surrounding the demand are examined in light of the substantive *content* of the terms of the underlying contract or the independent instrument, or from the beneficiary's *performance* of the terms of those documents.

'Performance' can refer to the implementation or operation of the underlying contract, or the manner in which the demand is made.

2.1. Effect of Timing of Alleged Unconscionable Conduct – Procedural and Substantive Unconscionability

The first matter to frame alleged unconscionable conduct references the timing of that conduct. Specifically, it is relevant whether conduct alleged as being unconscionable occurs during the formation of the underlying contract, during its operation, or in the demand itself. That is, whether the conduct complained of is 'procedural' or 'substantive'.[1131]

Independent instrument unconscionability:

> must be distinguished from the general contract law doctrine of unconscionability, which is concerned with conduct at the time of the **formation** of the contract, and which can vitiate consent to a

[1131] *Leff*, n400, 487.

> contract on the grounds that the terms of the contract are unfair and the contract was entered into in an unfair manner.[1132]

This statement implies that independent instrument unconscionability is always something other than *procedural* unconscionability.[1133] To prove unconscionable conduct in the general law of contract – in consumer law for example – requires consideration of "special disadvantage" and/or exercise of an inequality between the parties from which an unconscionable outcome arises.[1134]

The relevance of timing is in the relief available for each type of unconscionability. If the Court so orders for *procedural* unconscionability, the parties may be restored to their original positions if the offended party elects to exercise its rights to rescission: "contracts induced by such factors [as unconscionable dealing, duress, and undue influence] are said to be voidable".[1135]

Where a *dependent* obligation arose from the contract, and the relevant term was severed from the underlying contract, it would in most circumstances be set aside as well.

Whether the avoidance of the underlying contract would automatically restrain the demand-right against an independent instrument has never been tested but the view among most lawyers is that it would not, given the judicial support for a strong independence principle.[1136] The *UN-CIGSLC* attempts to link the status of the underlying contract with the operation of independent instruments. Gorton writes:

> The problem with the UNCITRAL Convention on Independent Guarantees is that it contains a rule in Art.19.2 which opens up for a "loose" attitude to the firm understanding of such guarantees.[1137]

His concern refers specifically to Art.19(2)(b) discussed below.[1138]

It remains uncertain what effect procedural unconscionability would have on the demand-right but the view proposed here is that the demand-right ought to be restrained while the obligation held by the issuer to honour remains intact. This distinction maintains the independence of the instrument but it may be too fine a

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1132 *Mount Sophia*, n39 [41].
1133 Although it is posited here that it is quite conceivable that an allegation of procedural unconscionability could be brought in an independent instrument matter.
1134 See model: p.84.
1135 *Heffey*, n1139, 975. *Blomley*, n322, 402.
1136 *Davidson* numerous discussions; and *Lonegrass*, 13 March, 2017 correspondence, with this author.
1137 *Gorton*, 08 June, 2017 correspondence with this author.
1138 See p.245.

distinction for strict non-interventionists. The question whether procedural unconscionability can arise where the parties are sophisticated and legally-informed remains untested. All independent instrument unconscionability matters to date have concerned substantive matters.

In the situation where unconscionable conduct is found to exist in either the operation of the contract or in the ultimate demand, ie substantively, the underlying contract can be set aside *in futuro* "but not so as to discharge rights and obligations arising from partial performance or causes of action accruing from the breach."[1139]

That is, a contract set aside after breach of a fundamental term does not affect anything that came before the time of the breach.[1140]

In the case of independent instrument disputes, breach of a fundamental term would typically be *after* the issue of the instrument and therefore the existence of the obligation undertaken by the issuer would not be in contention.[1141]

2.2. Potential Application of Independent Instrument Procedural Unconscionability[1142]

Under the law, treatment of procedural and substantive unconscionability is significantly different, as is the relief afforded from each. Procedural unconscionability has evolved from the early doctrine of equitable fraud, through the doctrine of 'catching bargains', and subsequently broadened to create the doctrine of unconscionable dealings.[1143] These developments have resulted in the modern procedural unconscionability applied today.[1144]

Contemporary procedural unconscionability has two limbs; the first concerns the character of the person disadvantaged. The second has been referred to as "bargaining naughtiness";[1145] because it examines any 'bad' behaviour of the

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1139 P Heffey, J Paterson, and A Robertson, *Contract - Cases and Materials* (Thomson, 9th ed, 2003), 975. Rescission also requires that restoration to the *status quo* is possible.

1140 J Tarrant, 'Total Failure of Consideration' (2006) 33 *University of Western Australia Law Review* 132, 132: "Rights that accrue prior to termination of a contract survive termination and can therefore be enforced after termination." This point in time differs depending on the cause of contractual termination, eg fundamental breach, repudiation, delay.

1141 The issue of the independent instrument is often a condition precedent to the operation of the underlying contract. Where so, the instrument is typically issued soon after the contractual relationship commences and will pre-date any breach of a term by either party.

1142 See discussion "Procedural and Substantive Unconscionability", Ch.3, p.83.

1143 A Mason, 'The Impact of the Equitable Doctrine on the Law of Contract' (1998) 27 *Anglo-American Law Review* 1, 7.

1144 For a detailed discussion, see generally *Vout*, p.95, and *Dal Pont*, p.69.

1145 *Leff*, n400, 487.

defendant during the formation of the contract, such as use of unfair pressure tactics.[1146]

To evidence procedural unconscionability, courts look for evidence of “oppression” and “unfair surprise”:

> indicating that the transaction lacked meaningful choice on the part of the complaining party. The inquiry focuses on specific and objective indicia demonstrating that a consumer was unable to read and understand the terms of the agreement.[1147]

In Australia, the definitive case on the first limb of procedural unconscionability is *Amadio* wherein the age and English literacy of the plaintiffs, in conjunction with pressure and prevarication from a trusted son, precluded them from being able to protect their own interests.[1148]

The difficulty with procedural unconscionability within independent instrument disputes is that the parties to such disputes are sophisticated and legally-informed. Therefore ‘special disadvantage’, the core component of the first limb of procedural unconscionability (especially with any element of moral obloquy), would be a difficult to impute into the underlying contractual negotiations.

However *procedural* unconscionability necessitates behaviour on the part of the beneficiary anywhere in the *formation* of the underlying contract to be construed as unconscionable. Given that there is often a significant power differential between the parties, it is conceivable that a factual matrix could arise to support such an allegation.

Research has not revealed a case where procedural unconscionability has been argued in relation to independent instruments. In neither the Singapore nor Australian line of cases is there mention of either term specifically. However although at least one case alludes to a difference between special disadvantage (procedural) and harsh insistence on a right (substantive).

1146 M Lonegrass, 'Finding Room for Fairness in Formalism - Sliding Scale Approach to Unconscionability' (2012) 44 *Loyola University Chicago Law Journal* 1, 9: “Conversely, a merchant’s “good behaviour,” such as using simple and concise contractual language…militates against a finding of procedural unconscionability.”

1147 Ibid.

1148 *Amadio*, n342.

In *Boral*, without specifically naming it, Austin J appears to avoid use of procedural unconscionability principles in relation to Action Makers' demand, preferring to use the substantive doctrine proscribing oppressive assertion of a right[1149] to ground a finding of unconscionable conduct under s51AC *TPA*.

Some courts in independent instrument matters have inadvertently applied the edicts of procedural unconscionability to the substantive issues in the contract or demand. The subsequent confusion about the doctrine is hardly surprising. There has not been recognition in any independent instrument dispute to date that the two categories exist, and no recognition that independent instrument disputes are *substantive*. Despite the *ACL* specifically providing for consideration of substantive matters,[1150] Australian Courts have not acknowledged the different categories nor how they apply specifically to independent instrument unconscionable conduct.

Applying the autonomy principle strictly would suggest that neither category of unconscionability should affect the sovereignty of the demand-right – for those purposes it should not matter if the unconscionable conduct occurs in the formation, content, or performance of the contract, or in the making of the demand. In the absence of fraud, a complying demand must be honoured.

It is unlikely procedural unconscionability will be argued in relation to independent instruments. The following analysis is for completeness – to recognise the existence of both types of unconscionability and to demonstrate a judicial approach with respect to both of them.

2.3. Nature of Independent Instrument Procedural Unconscionability

This thesis argues that where material independent instrument unconscionability is *prima facie* found in the *formation* of the underlying contract (ie procedural), the court should *ipso facto* consider whether any termination or clausal severance ought to extend to the rights and obligations that arose from it, including the demand-right against an independent instrument provided pursuant to a term of the contract.

1149 *Boral(No.2)*, n61 [75]: "The present case is clearly not one where the "special disadvantage" principle would be attracted."

1150 S21 *ACL*: "It is the intention of Parliament that…[this section]…is **not** limited to consideration of the circumstances relating to **formation** of the contract." Emphasis added.

As noted, this view defies a strict interpretation of the independence principle which provides that, regardless of what happens to the underlying contract – even its *total* avoidance[1151] – once the bank issues an independent instrument, the benefit from it should not be interfered with; that the demand-right survives the fatality of the contract itself.[1152]

It is argued here that if the underlying contract (or relevant term thereof) is invalid for procedural unconscionability, this should be sufficient grounds for the demand-right to be restrained. With respect to this, Eveleigh LJ in *Potton Homes* provided:

> 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.[1153]

This is posited as not being a breach of the instrument's independence. The issuer's obligation to honour remains intact but any attempt to exercise a demand-right against it would be a fraud, common law or equitable, depending on the facts. There is support for this position under *UN-CIGSLC* Art.19(2)(b) which provides that a *demand* has "no conceivable basis" if:

> The underlying obligation of the principal/applicant has been declared invalid by a court or arbitral tribunal, unless the undertaking indicates that such contingency falls within the risk to be covered by the undertaking.[1154]

Notably, the *UN-CIGSLC* properly recognises that it is the *demand-right* affected by unconscientious conduct, *not* the obligation of the issuer to honour, where the underlying obligation is invalidated. This follows logically and provides support for the view that the demand-right arises in the underlying contract. Where a demand-right arises from a contract that is subsequently rescinded, that right ought also be interdicted.

1151 *Gao*, n41, 25: "Even if the underlying transaction has been cancelled…the issuer has to pay".

1152 *UN-CIGSLC Explanatory Note*, n221 [17] for example states that the definition provided for 'independence' "is phrased in terms of the undertaking not being dependent upon the existence or validity of the underlying transaction, or upon any other undertaking."

1153 *Potton*, n709, 28.

1154 *Gorton*, 08 June, 2017 correspondence with this author, implies that it is possibly the attempt to link the status of the underlying contract in [Art.19(2)(b)] with the efficacy of the demand-right that has resulted in a low adoption rate for the *UN-CIGSLC*.

This author acknowledges that this view is contrary to strict independence, problematic in law, and is yet to be resolved definitively. In 1965 Kozolchyk, discussing letters of credit, noted:

> [T]he nullity of the underlying agreement as it affects the validity of the letter of credit…[as one of four]…areas of…conflict created by the opposing rules arising from two or more countries, and by the inconsistencies between municipal statutory or case law and international banking customs.[1155]

Kozolchyk cites (contemporary) Belgian case law (denying any effect) and Mexican statute (allowing it) as examples of conflict in this area of civil law.[1156]

The judicial policy outside of the Singapore, Malaysian, and Australian jurisdictions remains that, in the absence of fraud, the Court will not look at whether the demand-right is being validly exercised relative to the underlying contract. Without specifically saying so, those courts refusing to allow the demand-right to be restrained by unconscionable conduct have implicitly recognised only the elements of *procedural* unconscionability to apply.

This requires the court to look for conduct such as special disadvantage unconscionably leveraged, fraud, duress, or incapacity. In practical terms, establishing such a want of proper formation would demand an extraordinary factual matrix in an independent instrument matter.

If procedural unconscionability was pleaded the applicant party would, in interlocutory proceedings, need to succeed in demonstrating a strong *prima facie* case of unconscionable conduct showing how the contract was formed in circumstances where they could not protect their own interests. A *review* of the substantive matters at the interlocutory stage is not to make a definitive determination of them – this will be accomplished in subsequent hearings.[1157]

At the interlocutory stage the court will lift the veil of autonomy sufficiently to make a determination as to the nature of the conduct complained of in the formation of the contract but will not determine whether the timing of the conduct voids the underlying contract or terminates it. It does, by implication, indicate whether such

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1155 *Kozolchyk*, n29, 420.
1156 The legal position in both jurisdictions would no doubt be significantly different today.
1157 *Mount Sophia*, n39 [47].

conduct is likely to be *sufficient* to have the contract interfered with in other proceedings. If the court so finds, a restraint against the beneficiary's demand-right will hold until final determination of all issues.

The court may also look to the substantive terms of the underlying contract to find whether they have any probative value in determining procedural unconscionability, ie whether the terms indicate that the defendant has taken advantage of any special disability claimed by the plaintiff or is otherwise guilty of moral obloquy in its dealings.[1158]

It could also eventuate that a court in an independent instrument dispute accepts that there has been unconscionable conduct at some point in the contract formation but then decides that it simply is not *sufficiently* harsh or oppressive. That is, the conduct is insufficiently *material* to ground an injunction.

2.4. Nature of Independent Instrument Substantive Unconscionability[1159]

The doctrine of substantive unconscionability provides that "a court may refuse to enforce a contract if its terms are deemed sufficiently unfair."[1160] It has its critics: Epstein, a strong advocate for abolishing substantive unconscionability, argues that "[t]he doctrine should not…allow courts to act as roving commissions to set aside those agreements whose substantive terms they find objectionable."[1161] His view is similar to that of the English courts: unconscionability can only occur during contractual formation as "duress, fraud or incompetence".[1162]

The doctrine of substantive unconscionability is applied widely. In Australia and the US, it is embedded in statute and therefore must be properly described where those statutes apply to independent instruments. Substantive unconscionability broadly "looks to the injustice which would result if relief were not granted, irrespective of the conduct of the parties".[1163]

Any attempt to find substantive unconscionability in independent instrument disputes *requires* the veil of autonomy to be lifted; the terms of the underlying

1158 *Dal Pont*, n307, 294[9.10].
1159 See discussion "Procedural and Substantive Unconscionability", Ch.3, p.83.
1160 N Cornell, 'A Complaint-Oriented Approach to Unconscionability and Contract Law' (2016) 164 *University of Pennsylvania Law Review* 1131, 1144.
1161 R Epstein, 'Unconscionability - A Critical Reappraisal' (1975) 18 *The Journal of Law and Economics* 293, 294.
1162 Ibid 295.
1163 *Vout*, n15, 117[35.5.210].

contract have to be examined, as does the implementation of those terms. It is not possible to establish the ground in any other way.

Lonegrass states:

> Whereas procedural unconscionability targets the quality of the consumer's assent to the contract, *substantive unconscionability* targets the content of the terms themselves by looking for unfairness in the contract's substantive provisions.[1164]

Procedural and substantive unconscionability can operate jointly or severally – either can be used as evidence for the other in the right circumstances.[1165] Courts in the US have found that a term or a contract can be set aside on the basis of substantive unconscionability alone, with one court affirming its sufficiency by stating:

> The superior court was mistaken in assuming that the presence of procedural unconscionability is required to void a contract based on it containing unconscionable terms.[1166]

One US commentator sees a growing judicial adoption of substantive unconscionability as the *sole* basis for finding contractual unconscionability.[1167] This trend has also been noticed in Australia, with Vout noting:

> Increasingly, there are signs that courts are justifying intervention on the basis of unconscionable outcomes, without requiring proof that the defendant has engaged in some form of unfair dealing.[1168]

1164 *Lonegrass*, n1146, 10. Emphasis added.

1165 A court can look at the effect of the substantive terms to support a finding of procedural unconscionability from exploitation, for example; alleged unconscionable conduct during formation might explain the inclusion of certain terms and support severance for unconscionability.

1166 *Glassford v BrickKicker* 35 A.3d 1044 (Vt.2011), 1048-49.

1167 *Lonegrass*, n1146, 19-22: "a minority of courts continue to utilize the conventional two-prong approach to unconscionability, even while an opposed, but growing, minority have embraced a single-prong approach to the doctrine."

1168 *Vout*, n15, 117[35.5.210].

A.1. Limbs to Substantive Independent Instrument Unconscionability:

Within independent instrument transactions, substantive unconscionability can be found in three limbs:

1. In the substantive terms of the contract;
2. In the performance of the underlying contract, ie the manner in which the parties meet their obligations under the terms of that contract;[1169]
3. From the nature of, or circumstances surrounding, the demand on the instrument.[1170]

There is also the question of whether an unjust enrichment might follow and whether that is a relevant consideration.

A.1.1. First Limb: Unconscionable Substantive Terms

The first limb looks to the terms of the underlying contract and reviews the substantive content therein.[1171] Unconscionability can be found in the terms by determining whether, for example, any terms are excessively onerous, lacking in mutuality, or perhaps unlawful.[1172] These characteristics can be probative of procedural unconscionability, if that is that claim, or can be substantively unconscionable of themselves.

It is likely that the plaintiff would need to show how the alleged unconscionable terms came to be included in the contract in additional to how they are *effectively* unconscionable.

A.1.2. Second Limb: Unconscionable Contract Performance

The Court might then examine the beneficiary's conduct in relation to their obligations under the terms, ie their performance of the contract. This is to determine whether that conduct might, for example, have unconscionably caused the account party to breach, thereby providing grounds for making the demand.[1173]

1169 For example, where the beneficiary fails to meet an obligation, thereby triggering the demand-right.
1170 For example, where the demand is used to bring unconscionable pressure on the account party.
1171 In *Clough(No.4)*, the Court stated that in *Wood Hall*, n138, 598-99, Stephen J held that "the provisions of the contract may qualify the right to call on the undertaking contained in a performance guarantee." This appears to be a stronger version of Stephen J's position in that matter.
1172 *Asplenium*, n212 where it was falsely alleged a term ousted the court's jurisdiction.
1173 See for example *Royal Design*, n148.

This process is not to make a determination of the substantive issues; it is to find probative evidence which establishes a strong *prima facie* case of unconscionable conduct to ground an injunction. In Singapore/Malaysia, the injunction is a function of equity; the Australian head of power is provided in the *ACL*.[1174]

The injunction, if against the beneficiary, suspends the right to make a demand until such time as the substantive issues are resolved – it does not invalidate the independent instrument but acts to postpone the benefit being realised.[1175]

The Court will need to determine that the plaintiff seeking equitable intervention comes with 'clean hands',[1176] including whether the beneficiary had any knowledge of a breach of a fundamental term of the underlying contract.[1177] The plaintiff must establish that the unconscionable performance falls within a recognised category of unconscionable conduct. This author's analysis indicates a lack of insight among counsel litigating independent instrument matters of the *deductive* nature of unconscionability in commercial matters, from general principles to specific cases.[1178]

A.1.3. Third Limb: Unconscionable Demands

With respect to the third limb of substantive unconscionability, the nature of or circumstances surrounding the demand, the court may determine substantive unconscionability from the character of the demand itself. Some case examples will serve to highlight the type of conduct that falls under this limb.

The first type of case is where there is "a call for payment of a sum well in excess of the quantum of the beneficiary's actual or potential loss, [and] the beneficiary will gain more than what it has bargained for."[1179] This type of

1174 S232.
1175 *Chartered*, n24, 668[A] per Chan J: "A temporary restraining order does not prejudice or adversely affect the security; it merely postpones the realisation of the security until the party concerned is given an opportunity to prove his case."
1176 *Heydon*, n309, 74[3-050]:"Those who seek equity must do equity." Also *Clough(No.4)*, n180 [5].
1177 *Orrcon*, n1006, [87].
1178 For example *Leighton*, n791, [12] Choo J implies the weakness of the plaintiff's case stating "My opinion here was made on the limited evidence and the nature of the application before me". Opinions in both jurisdictional lines of authority often imply that the nature of the application lacks perspicacity.
1179 *JBE(No.2)*, n19 [11].

abusive demand is reliant on the integrity of the independence principle to protect the beneficiary from allegations of impropriety.

A harsh demand was held unconscionable in Australia in *Olex Focas*, where full payment was sought under 'advance procurement guarantees' for debts that had largely been repaid.[1180] In these cases the beneficiary relies on a strict interpretation of the terms of the independent instrument to make a demand on the basis of a sum, the quantum of which is perhaps disputable. Injunctions grounded on this head provide relief against the harsh and unconscionable insistence on a legal right given in good faith by restraining the beneficiary from abusing it.

The second type of case under this head arises where the demand is made after the account party's contractual obligations have been completed and the beneficiary could have no reasonable belief in their claim. In *Newtech*, works were completed and the defects liability period had expired but the performance bonds were still on foot.[1181]

The beneficiary had cashflow problems and decided to revise their invoices *post hoc* to reflect the value of the bonds, then to make a demand based on questionable representations of fact. While this type of behaviour might be found fraudulent, fraud was not plead by the applicant.

This type of matter reflects some Court's inclination toward allowing substantive unconscionability to be sufficient on its own to set aside agreements where the demand is "utterly lacking in *bona fides*".[1182]

In *Boustead(No.2)* the court considered that there was possible collusion between the banking parties to a set of guarantees and counter-guarantees.[1183]

The purpose of the demand from the issuer of the counter-guarantee, as it appeared but was not established, was not to reimburse for payment of those counter-guarantees but to unjustly enrich the ultimate beneficiary at the innocent expense of the account party.[1184] To avoid a finding of unconscionable conduct the beneficiary was required to demonstrate that

1180 *Olex(No.3)*, n207.
1181 *Newtech*, n784.
1182 *Kvaerner*, n512 [10].
1183 See analysis of facts in *Boustead(No.2)* p.180.
1184 *Boustead(No.1)*, n160.

the ultimate beneficiary of the counter-guarantees had a legitimate claim and that they had been paid. For reasons unknown, neither could be made out.[1185]

This type of conduct also falls under the umbrella of oppression but, depending on the facts, might conceivably fall under the 'genus' of Duress, not Unconscionable Conduct. McHugh JA expressly joined the two holding "economic duress" to include conduct that "amounts to unconscionable conduct".[1186] *Boustead(No.2)* therefore demonstrates that the conduct of the *demand* itself can be unconscionable for the purposes of grounding an injunction.

For this limb, it is posited that to determine the character of a 'successful' demand would be to enquire whether an unjust enrichment would follow *but for* equity's intervention.[1187] If this is the case, the Court is justified in restraining the beneficiary's demand-right.

2.5. Identifying Substantive Independent Instrument Unconscionability

Depending on jurisdiction, independent instrument unconscionability must be found to satisfy either the requirements for equitable relief or the elements of a statutory prohibition. Australian courts applying s21 *ACL* are not restrained by the principles of equity.

Of the six recognised categories or 'species' of unconscionable conduct discussed above,[1188] only three are likely to arise in independent instrument disputes, with the first being procedural and unlikely. This limits the grounds available but also provides significantly more certainty identifying and categorising specific behaviours as unconscionable.

The following examines each 'species' in context with independent instruments:

1. Exploitation of vulnerability or weakness.
   - This is procedural unconscionability but could conceivably affect independent instrument matters.[1189]

1185 The independence principle was breached in this matter because of an extraordinary factual matrix where the issuer was the original defendant.

1186 *Crescendo*, n428 [45G]. His Honour is referring to the 'family' doctrine, not the 'genus' behavioural unconscionable conduct. Also see *Dal Pont*, n307, 268[8.10-8.20].

1187 Here the term 'unjust enrichment' is used in the common sense of the words and not in the doctrinal sense.

1188 See p.116.

1189 See p.84.

2. Abuse of position of trust or confidence.
   - This is procedural unconscionability and highly unlikely to arise as a matter of fact in independent instrument matters.
3. Insistence upon legal rights in circumstances which make that insistence harsh or oppressive.
   - This is substantive unconscionability and is a likely basis for restraining abusive demands on independent instruments.
4. Inequitable denial of legal obligations.
   - This is substantive unconscionability and is conceivably a basis for or element of independent instrument unconscionability.
5. Unjust retention of property.
   - This is substantive unconscionability and is unlikely to arise as a matter of fact in independent instrument matters.
6. Exercise of a right arising from a breach intentionally caused so as to give rise to that right (*abus de droit*).
   - This is substantive unconscionability and is a likely basis for restraining abusive demands on independent instruments.[1190]

Of these recognised categories only three might be alleged with respect to independent instrument disputes:

3. Harsh or oppressive insistence on a right;[1191]
6. *Abus de droit*;[1192]
4. Inequitable denial of legal obligations.[1193]

Equity's relief from the oppressive insistence on a right (3) is "defined through the law of estoppel, especially promissory estoppel as it affects the enforcement of rights under existing contracts". It follows from equity's jurisdiction to "ensure harsh and oppressive outcomes do not occur".[1194]

1190 See discussion p.141.
1191 *Berbatis(No.1)*, n360 [14]. See different aspects of this on p.73 & p.98.
1192 *Royal Design*, n148.
1193 This might arise as a matter of fact, but could also be probative for *abus de droit*.
1194 *Vout*, n15, 130[35.5.420]. It is beyond the scope of this thesis to examine this outside the operation of independent instruments.

Allowing a person to benefit from their own wrong per (6) offends public policy. Courts of equity have found it inequitable to allow a "a man to derive advantage from his own wrong."[1195] As Selvam JC noted in *Kvaerner*, "it was eminently just and convenient to restrain a party from taking advantage of his own wrong".[1196] This is the practical application of the equitable 'clean hands' doctrine but it should be noted that the doctrine is limited in its application.

Just as the plaintiff must show that it has met its contractual obligations before seeking relief, the defendant must show why its wrongdoing should not support a plaintiff's prayer for equitable relief in the form of a restraint on its demand-right.[1197]

With independent instrument disputes, this wrongdoing could involve a range of behaviours, such as failing to meet payment obligations[1198] or falsifying costs,[1199] but must be substantive in nature.

2.6. Procedural and Substantive Matters Under the ACL

Sub-sections 22(1)-(2) *ACL*, provide a range of matters to which the Court may have regard when determining unconscionable conduct. While not intended to be comprehensive, the twelve matters provide a broad set of indicia to find unconscionable conduct, of which the following six[1200] may facilitate finding unconscionability in independent instrument disputes:

> Without limiting the matters to which the court may have regard for the purpose of determining whether a person…has contravened section 21 in connection with the supply…of goods or services to a person…, the court may have regard to:
>
> *(a) the relative strengths of the bargaining positions of the acquirer and the supplier;*
>
> *(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the acquirer/supplier…*
>
> *(i) the extent to which [one party] unreasonably failed to disclose to the [other party]:*

1195 *Meyers v Casey* [1913] HCA 50, 124.
1196 *Kvaerner*, n512 [6].
1197 *Dal Pont*, n307, 923[30.170-172].
1198 *Raymond*, n590.
1199 *Board Solutions*, n676; *JBE(No.2)*, n19.
1200 Sections 22(1) and (2) are identical for these purposes, but distinguish between protecting the acquirer and the supplier. They are amalgamated here for brevity.

(i) any intended conduct…that might affect the interests of the [other party]; and

(ii) any risks to the acquirer/supplier arising from the acquirer/supplier's intended conduct (being risks that the acquirer/supplier should have foreseen would not be apparent to the acquirer/supplier);

(j) if there is a contract between the acquirer and the supplier for the acquisition of the goods or services:

(i) *the extent to which the acquirer/supplier was willing to negotiate the terms and conditions of the contract with the acquirer/supplier; and*

(ii) the terms and conditions of the contract; and

(iii) the conduct of the acquirer and the supplier in complying with the terms and conditions of the contract; and

(iv) any conduct that the acquirer or the supplier engaged in, in connection with their commercial relationship, after they entered into the contract;

(k) without limiting paragraph (j), whether the acquirer/supplier has a contractual right to vary unilaterally a term or condition of a contract between the acquirer and the supplier for the acquisition of the goods or services;

(l) the extent to which the acquirer and the supplier acted in good faith.

Note: (a), (d), (i), (j)(i), above are *procedural*; (j)(ii)-(iv), (k), and (l) are *substantive*.[1201] The likelihood of the former set ever being considered within independent instrument disputes is low. The focus here is on the latter set.

The *ACL* dictates that these matters are considered with respect to s21(3)(a) "any circumstances that were not reasonably foreseeable at the time of the alleged contravention"; s21(4)(a), that it "is not limited by the unwritten law relating to unconscionable conduct"; the substantive terms of the contract [s21(4)(c)(i)] and the manner and extent "to which the contract is carried out" [s21(4)(c)(ii)].

[1201] See discussion p.82.

Given this distillation of the matters provided in the *ACL*, independent instrument applicants can look to the underlying case law where the factual matrix has required the Court to consider the ambit of the legislation. From this, more certainty should emerge as to the range of conduct considered unconscionable under those particular sub-sections of the *ACL*.

2.7. Standard of Proof

It is moot that for an interlocutory injunction to be granted in either Australia, Malaysia, or Singapore, a strong *prima facie* case must be made out.[1202] The plaintiff must argue that the beneficiary's conduct in relation to its contractual obligations or the nature of the demand is such that allowing the independent instrument to be encashed would be inequitable.

Kathigesu J, in *Bocotra* held that "mere allegations are insufficient" given the higher degree of strictness applied for unconscionability-based interlocutory proceedings seeking injunctive relief.[1203]

In *Hortico*, the Court provided procedural guidance stating:

> Where an application for an interlocutory injunction raises questions of law the court will ordinarily decide those questions at the interlocutory stage unless they should be better left until later. The only exceptions to this general rule are...(b) *where the determination of the questions requires a factual matrix which is not available until the facts in the entire proceedings have been proved*.[1204]

At the interlocutory stage, to ground injunctive relief the Court seeks to determine whether "there is a serious question to be tried…that [the defendant's] conduct is shown to be unconscientious and unconscionable".[1205] The HCA full bench in *Beecham* held that the *first* of two tests was to ask:

> whether the plaintiff has made out a *prima facie* case, in the sense that if the evidence remains as it is there is a probability that at the trial of the action the plaintiff will be held entitled to relief.[1206]

1202 *Dauphin*, n554 [57]. Also n1208 below.
1203 *Bocotra*, n149 [47]. This parallels the fraud standard.
1204 *Hortico*, n663, 546.
1205 *Olex*$^{(No.1)}$, n38, 404.
1206 *Beecham Group v Bristol Laboratories* [1968] HCA 1 [4].

In relation to independent instruments, Gilmour J in *Clough(No.3)* referred to the Court Rules[1207] (which also reflect the *prima facie* standard), explaining:

> Clough needs to demonstrate a *prima facie* case for the relief claimed. The threshold for demonstrating a *prima facie* case is not high. It is whether on the material before the Court, inferences are open which, if translated into findings of fact, would support the relief claimed.[1208]

His Honour referred to a '*prima facie case*' nine times in his reasons, often in conjunction with the expression "or serious issue to be tried'.

This then constitutes the appropriate standard for independent instrument unconscionability: a strong *prima facie* case that there is a serious question to be tried which would support the relief claimed.

In 1996, Batt J agreed with the English authorities on the standard "in answer to the question of what level of proof is required for the grant of an interim injunction in a letter of credit case". Using the more descriptive test provided in *Group Josi*,[1209] his Honour asked:

> Have the plaintiffs established that it is seriously arguable that, on the material available, the only realistic inference is that [the beneficiary] could not honestly have believed in the validity of its demands on the [letter of credit].[1210]

It is apparent from the above that authorities across jurisdictions largely agree on the required standard.

2.8. UN-CIGSLC

This section examines the *UN-CIGSLC* acknowledging that neither Singapore, Malaysia or Australia have ratified it. This is not to say however that there is nothing of value in the *UN-CIGSLC* to assist with informing a new doctrine of unconscionable conduct. Analysis reveals how certain independent instrument matters align with Art.19(2).

1207 Federal Court Rules O8, r3(2)(c).
1208 *Clough(No.3)*, n990 [13].
1209 *Group Josi Re v Walbrook Insurance Co Ltd* [1996] 1 W.L.R. 1152, 1160.
1210 *Olex(No.1)*, n38, 398, affirming Staughton LJ's view in *Group Josi*.

Art.15(3) provides the good faith obligation on demands, holding "[t]he beneficiary…[is]…deemed to certify that the demand is not in bad faith", ie "that none of the circumstances exist that would justify non-payment".[1211]

Art.19 provides for the circumstances where the payment obligation might be restrained[1212] subject to "provisional court measures". An amalgamated application of Arts.19(1)(b-c) would provide that no payment obligation arises if it is "manifest and clear" that "the demand has no conceivable basis" and therefore "no payment is due on the basis asserted".[1213]

Art.19 is not intended to operate as a proscriptive provision but as a descriptive, cross-jurisdictional provision to deal with exceptions to payment. It is not prohibitive in nature; it provides relief from the effects of abusive demands. The events provided for in Arts.19(1)(a-c) rest entirely on substantive law, and the examples given demonstrate by their diversity the difficulty of aggregating abusive behaviour in independent instrument matters and identifying common elements.

Horowitz describes the *UN-CIGSLC* as "far-reaching in the exceptions that it permits" and worries that this could affect the degree of abstraction in independent instruments.[1214]

For the purposes of understanding independent instrument unconscionability however, the conclusion required by Art.19(1)(b) that "no payment is due" is a substantive *decision* that may be the *result* of a finding of unconscionable conduct, ie the "basis asserted" may be unconscionable for being oppressive, for example.

The conclusion required by Art.19(1)(c) that "the demand has no conceivable basis" is one that can arise from a finding of unconscionable conduct in the underlying contract or the demand.

As both of these are outcomes or conclusions or findings, they provide no guidance on how to reach those results. To assist with that Art.19(2) provides five "types of situations" that give rise to an entitlement "to provisional court measures". These assist with clarifying the legal nature of substantive independent instrument unconscionability.

1211 *UN-CIGSLC Explanatory Note*, n221 [40].

1212 Art.20(a)&(b) only provide for restraint of the issuer's obligation to pay, breaching the independence principle.

1213 *D.Horowitz*, n369, 88-89 posits that this amalgamation also "encapsulate[s] the second formulation from *Edward Owen* – where the demand is 'made fraudulently in circumstances where there is no right to payment'."

1214 Ibid 89.

Under Art.19(2), a demand will have 'no conceivable basis' if, *inter alia*:

(a) The contingency or risk against which the undertaking was designed to secure the beneficiary has undoubtedly not materialized;

- This reflects the reasoning in *Samwoh(No.2)*[1215] where the applicant had met all their obligations. This 'situation' could arguably have the addendum '…and therefore it would be harsh or oppressive for them to insist on the demand-right.'. It constitutes substantive unconscionability.

(b) The underlying obligation…has been declared invalid by a court or arbitral tribunal…;

- This supports the argument that a demand-right arising from an invalid contract ought to be a nullity.[1216] The invalidation may be a matter of law, or equitable relief. It constitutes procedural unconscionability.[1217]

(c) The underlying obligation has undoubtedly been fulfilled to the satisfaction of the beneficiary;

- This is reflected in Singaporean case findings.[1218] Unjust enrichment would follow a successful demand – this 'situation' could arguably have the addendum '…and therefore it would be harsh or oppressive for them to insist on the demand-right.'. It constitutes substantive unconscionability.

*(d) Fulfilment of the underlying obligation has clearly been prevented by wilful misconduct of the beneficiary [*abus de droit*];*

- This approach was argued unsuccessfully in *Clough(No3)* but argued successfully in *Royal Design*. It reflects the *ex turpi causa* doctrine[1219] and the sixth category of unconscionability

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1215 *Samwoh(No.2)*, n760.

1216 Lonegrass states that "under the European civil law tradition, an accessory contract depends entirely on the existence or enforce[ability] of the principal contract. This is a well-established principle in the civil law of obligations": M Lonegrass, 13 March, 2017 correspondence with this author.

1217 See p.84.

1218 *Newtech*, n784.

1219 See p.55.

outlined above[1220] which proscribes exercising a demand-right arising from own breach. It constitutes substantive unconscionability.

(e) *In the case of a demand under a counter-guarantee, the beneficiary of the counter-guarantee has made payment in bad faith.*

- Prescient of *Boustead* which bears striking factual consistency with this.[1221] Reflects the doctrine *ex dolo malo non oritur actio*.[1222] Unjust enrichment would follow a successful demand – this 'situation' could arguably have the addendum '…and therefore it would be harsh or oppressive…' It constitutes substantive unconscionability.

2.9. Application to Demand Guarantees versus Letters of Credit

It is posited that independent instrument unconscionability should apply to both commercial letters of credit and demand guarantees, but that letters of credit should enjoy stricter independence on the basis of the different type of transaction it guarantees. This view has judicial support.

In *Chartered*, Chan J stated:

> A performance bond is as good as cash between buyer and seller only because that is the *effect* of the English decisions and not *because* it is the cause of such decisions. In *Potton Homes v Coleman Contractors*…Everleigh LJ did **not** accept that a performance bond was to be treated as cash between buyer and seller or that a performance guarantee should be treated like a letter of credit in all circumstances.[1223]

Chan CT points out in *JBE Properties* that, because of the differing obligations under the instruments, a less stringent standard (compared with letters of credit)

1220 See p.241.
1221 *Boustead(No.2)*, n159. There are also some differences in the facts, and misbehaviour under the counter-guarantee in question was implied but not alleged.
1222 *No action arises from deceit.*
1223 *Chartered*, n24, 38[E]. Emphasis added.

can justifiably be adopted when determining whether a beneficiary of a performance guarantee should be restrained:[1224]

> [A] performance bond is merely security for the secondary obligation of the obligor to pay damages if it breaches its primary contractual obligations…[and]…is not the lifeblood of commerce…Thus, **a less stringent standard** (as compared to…letters of credit) **can justifiably be adopted** for determining whether a call on a performance bond should be restrained.[1225]

His Honour recognised the different obligations inherent in the two instruments. Given the differences between them, it is reasonable to suggest that, where the Court finds the beneficiary has "no conceivable basis" for a demand against a guarantee[1226] the veil of autonomy can be lifted. The beneficiary ought to be restrained where substantive unconscionability is found in circumstances that might not excite equity's attention where a letter of credit was concerned.

The differences between performance guarantees and letters of credit are analysed by Debattista, who states that it is "misconceived" not to adopt a less stringent autonomy principle for performance guarantees than that which applies to commercial letters of credit.

Debattista examines the synchronicity between letters of credit and demand guarantees and states that the two should be detangled and demand guarantees attached "to the contract to which they properly belong, namely the underlying contract of sale."[1227]

2.10. Degrees of Materiality in Unconscionability

Finally there remains the issue of degree, for which the treatment of independent instrument fraud provides guidance. There are degrees of materiality to fraud.[1228] The Official Comment to Revised *UCC* §5-109, which "makes it clear that fraud must be 'material.'", provides an example where a two-barrel deficiency from a thousand-barrel shipment would be "an insubstantial and immaterial breach of the underlying contract." It goes on to describe material fraud as occurring:

1224 *JBE(No.2)*, n19 [10].
1225 Ibid [10]. Emphasis added. The Court found that the instrument was not independent.
1226 *UN-CIGSLC*, n10 [19(1)(c)].
1227 C Debattista, 'Performance Bonds and Letters of Credit: A Cracked Mirror Image' (1997) Jul *Journal of Business Law* 289, 289-290.
1228 Descriptions of fraud include *inter alia* 'material', 'substantial', 'egregious', and 'serious' fraud.

> only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support such a right to honor.[1229]

This thesis posits that there are *degrees* of unconscionability for the court to consider, of which only the *most* egregious or "gross" should be sufficient to restrain the beneficiary's right to make a demand:

> [O]ne cannot be assured that the term "unconscionable" carries with it identical shades of equitable wrong on each occasion in which it is bandied about. There may be different levels or thresholds of conduct all described by the word "unconscionable".[1230]

There is strong judicial support for the idea of a Continuum of Materiality with respect to evaluating allegations of independent instrument unconscionability.

In *Hortico* Young J, referring to the unconscionable use of a "statutory or contractual power for an improper purpose", stating that "it may be that in some cases...the *unconscionable conduct may be so gross* as to lead to exercise of the discretionary power."[1231]

In *Olex(No.1)* Batt J acknowledged the existence of "gross unconscionability falling short of actual fraud" but refused to accept it as grounds for an injunction. His Honour's basis for this belief was the absence of any mention of it in the cases before that time.

The Court in *Samton(No.2),* expressly referring to unconscionable conduct, stated that "[t]here are different thresholds of conduct in [the] various categories, all of which may be described as unconscionable".[1232] In the US, courts have found conduct to be "grossly unconscionable"[1233] and "grossly unfair and unconscionable",[1234] indicating recognition of a "sliding scale"[1235] of unconscionability.

The authorities broadly indicate that unconscionability is not a constant and that varying degrees of materiality can be influential in determining whether the demand-right can be restrained. It might be argued that there is difficulty enough

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1229 *Byrne*, n4, 246[1].
1230 *Dal Pont*, n418 [1].
1231 *Hortico*, n663, 554. Emphasis added. His Honour is referring to the discretionary power of injunction.
1232 *Samton(No.2)*, n383 [48].
1233 *Niemiec v Kellmark Corp* 58t N.Y.S.2d 569 (Tonawanda City Ct. 1992), 570-70.
1234 *Paragon Homes, Inc v Carter* 288 N.Y.S.2d 817 (Sup.Ct.1968), 819.
1235 *Lonegrass*, n1146.

describing and interpreting unconscionable conduct in any context; trying to impose *degrees* of severity imputes an additional level of difficulty. In response it can be taken that because only the *most* unconscientious conduct will ground injunctive relief, it will be clearly evident to a court of inquiry.

No matter to this author's knowledge in Australia or Singapore has addressed the issue of materiality with respect to unconscionability in independent instruments. The idea of variable unconscionability egregiousness is supported by the accepted recognition of degrees of independent instrument fraud.[1236]

Materiality is included here as an element for consideration when assessing independent instrument unconscionable conduct.

2.11. Limits to Independent Instrument Unconscionability

The scope of the 'genus' unconscionability doctrine[1237] can be clarified by what it has been found by reference to its exclusions, ie that conduct which the courts have expressly refused to sanction as unconscionable.[1238]

Conduct has been found to **not** be unconscionable where:

1. Unequal bargaining positions were held;[1239]
2. Harm to reputation would arise;[1240]
3. Threatening or actually making of a demand is to apply bargaining pressure;[1241]
4. Unfair contractual content is found;[1242]
5. Advantage is taken of financial need;[1243]
6. Inadequate consideration is provided;[1244]

1236 See p.66.

1237 See p.573 for the taxonomy.

1238 These are drawn from both jurisdictions and whether they would be similarly found if tested in the other is improbable.

1239 *Berbatis(No.3)*, n382 [11]: "[A] person is not in a position of relevant [*sic*] disadvantage…simply because of inequality of bargaining power." Originally proposed in the UK by Denning MR as a 'unifying concept', this was subsequently held not to constitute unconscionability in that jurisdiction.

1240 *Bocotra*, n149 [49].

1241 *Wood Hall*, n138, 391. Also see discussion at p.186.

1242 *Axelson*, n404 [13]: "…where parties have agreed on the terms the court will not refuse a decree of specific performance on the ground of unfairness."

1243 *Dal Pont*, n307, 293[fn1] states that this is unlikely to be found unconscionable but Kitto J in *Blomley*, n322, 415 expressly states that under the doctrine of unconscionable dealing, financial need taken advantage of is unconscionable.

1244 P Finn (ed), *Essays in Equity - Ch.1: I Hardingham, Unconscionable Dealing* (Sweet & Maxwell, 1985), 4: "Inadequate consideration is not *per se* a ground for equitable relief, nor is it a *sine qua non* [essential element] for relief."

7. Delaying a demand while legitimate legal proceedings progress;[1245]
8. Legal action is taken or a matter is referred to arbitration.[1246]
9. A party inadvertently or purposely breaches the underlying contract.[1247]
10. There is unfairness in trade or commerce.[1248]
11. Disobeying an order of the court not to make a demand on an independent instrument.[1249]

The above range of behaviours contributes significantly to clarifying the extent of the doctrine's scope.

1245 *Fletcher*, n943.
1246 S21(2) *ACL*.
1247 *Body Bronze International v Soleil Tanning Oxford* [2007] FCA 371 [25-33]. *Mount Sophia*, n39.
1248 *ABC v Lenah Game Meats* [2001] HCA 63[80]: "Commercial enterprises may sustain economic harm through methods of competition which are said to be unfair".
1249 *Olex(No.1)*, n38, 404. Contempt of court lies in the criminal jurisdiction.

3.0 Elements of Independent Instrument Unconscionability

From the above analyses of the independence principle, general unconscionable conduct, the unconscionability exception, and both complete lines of independent instrument authority in Australia and Singapore, the following elemental considerations for determining the presence of independent instrument unconscionability is proposed:

Table of Elements

Independent Instrument Unconscionability

1. Jurisdiction and Head of Power

a. Assumed jurisdictional oversight or legal equivalence.

b. Equity, or Statute referring to equity and 'other' matters.

2. Specific Treatment – Instruments

a. The independence of Commercial Letters of Credit are subject to a less porous independence principle.[1250]

b. The independence of all types of independent demand guarantees and standby letters of credit is subject to a less rigid enforcement and can be reviewed on the facts and on the documents.

3. Genus of Unconscionable Conduct

a. Whether the conduct is more likely to constitute Unconscionability or Undue Pressure or another category.[1251]

[1250] Unconscionability can still be found: see *Min Thai*, n591.

[1251] It is possible to conceive a factual matrix where undue pressure might also be plead in relation to an abusive demand on an independent instrument.

4. Type of Unconscionable Conduct: Procedural or Substantive

a. If procedural, is the conduct found in:

- the taking advantage of a special disadvantage; or
- the behaviour of the beneficiary during pre-contractual negotiations.

b. If substantive, is the conduct found in:

- the terms; or
- the performance of the contract; or
- making of the demand.

5. Species of Unconscionability

a. If unconscionable conduct, then the category of unconscionable conduct is either:

- exploitation of disadvantage (P);
- harsh/oppressive insistence on a right (S); and/or
- wilful misconduct giving rise to a demand-right (S).[1252]

6. Materiality

a. If substantive in the conduct/operation of the underlying matter, is the conduct *sufficiently* egregious?[1253]

b. If substantive in the demand on the instrument, is the conduct *sufficiently* egregious?[1254]

7. Standard of Proof

a. A mere allegation of unconscionable conduct is insufficient.

b. Independent instrument unconscionability has a high threshold for conduct where gross or egregious unconscionability only is sufficient.

[1252] (P)=Procedural; (S)=Substantive
[1253] This a matter of degree.
[1254] This a matter of degree.

8. Proofs

a. The applicant must satisfy the court regarding its own *bona fides*; that it seeks relief from unconscionable conduct with 'clean hands'.

b. Where the alleged conduct is procedural, the applicant must demonstrate that the contract was improperly formed for want of agreement.[1255]

c. Where unconscionability is alleged in the terms, the applicant must establish at the interlocutory stage, a strong *prima facie* case that they will be able to successfully plead this in a full hearing where the substantive issues are heard *inter partes*.

d. Where unconscionability is argued to be in conduct relating to *operationalising* the contract, the applicant must demonstrate a *prima facie* case showing that the conduct satisfies the elements of either of the two acknowledged categories of substantive unconscionable conduct.[1256]

e. Where unconscionability in the *demand* is argued, the applicant must demonstrate that the conduct satisfies the elements of either of the two acknowledged categories of substantive unconscionable conduct.[1257]

f. Where the conduct satisfies the elements of either of the two acknowledged categories of substantive unconscionable conduct, the effect must be to demonstrate that the demand is utterly lacking in *bona fides*; that there could be no conceivable basis for the demand.[1258]

1255 Where advantage was taken of a person's special disadvantage.
1256 This is expected to be 'wilful misconduct' most frequently.
1257 This is expected to be 'harsh insistence on a right' most frequently.
1258 This would include such cases as *Newtech*, n784, in which the demand was found unconscionable where the underlying obligation had been substantially fulfilled.

9. Evidentiary Matters

a. Independent instrument unconscionability is found on the facts, and on the documents;

b. There is an implied term to act in good faith with respect to exercising a demand-right on an independent instrument.[1259]

c. A special disadvantage is not necessary but can be probative;

d. No moral obloquy need be present;

e. *Mala fides* is not a necessary element;

f. The terms of the contract may be probative to procedural unconscionability.

10. Unconscionability Exclusions

a. Unfairness by itself. All unconscionability is unfair; not everything unfair is unconscionable.

b. Those behaviours already found or stated as not being unconscionable.[1260]

11. Remedies Possible

a. If the unconscionable conduct is *procedural*:

- whether the contract is void ab initio per the doctrine of restitutio in integrum, or
- the term relating to the independent instrument (or any other relevant term) ought to be severed, or
- whether the contract is voidable by the plaintiff.[1261]

1259 This does not extend to the underlying contract. It is purely for the purposes of determining whether the demand has been made in good faith.

1260 See list p.251.

1261 Termination will not act retrospectively.

b. If the unconscionable conduct is *substantive*:

- an injunction to restrain the demand-right on an independent instrument;
- an order to restrain the beneficiary dealing with funds already received;
- the severance or severability of any relevant terms, and/or
- Damages.

c. The Issuer is typically not to be restrained from honouring.

3.1. Finalé

It should be noted that the obligations of the banks remains the same *on the strict proviso that the injunction issued only restrains the demand-right of the beneficiary*. Given that this proviso is met, nothing in the above interferes with the independence principle nor any of the international rule sets. It is unlikely to be incumbent upon the issuer to determine the presence of unconscionable conduct in the formation or operation of the contract, or in the demand itself. They will continue to operate behind the veil of autonomy and to base their decisions on the documents alone.

This framework for independent instrument unconscionability reflects the main points in relation to this type of conduct. The stakes are high – large amounts are involved.

The market prefers certainty and can accommodate higher transactional risk it has identified. If substantive unconscionability, without more, grounds relief against abusive demands on independent instruments the range of elements to be found must be fully scoped. The above framework represents a strong formulation with which to commence that process.

4.0 Summary of the Characteristics of Independent Instrument Unconscionability

This analysis provides legal and academic foundations for establishing independent instrument unconscionability as a separate and structured doctrine for treating abusive demands that fall short of fraud but are sufficiently egregious to attract injunctive relief.

Some from the independent instrument user community might argue that the integrity of the independence principle would be undermined by unconscionability.[1262] This would be a distraction and a contradiction[1263] that can be resolved within the law. The integrity of the independence principle is one of many relatively important factors that the court must consider. The fact that abusive demands can cause considerable economic disruption brings into play socio-economic factors that are arguably equal in weight to the integrity of a doctrine of *lex mercatoria*.

The court, as the final arbiter of these matters, must balance the interests of all stakeholders including, but not exclusively, those of the commercial parties concerned. This is not to downplay the significance of the independence of the instruments. The independence principle provides much benefit to the lawful beneficiary, as it was designed to do; it also provides solace to the unscrupulous.

This would be addressed and remedied by a well-framed doctrine of independent instrument unconscionability.

Reservations about the doctrine generally have been expressed. Cornell states:

> The difficult question with unconscionability is not whether it works towards a legitimate end, but whether its application comes at too great a price.[1264]

The doctrinal conflict with respect to unconscionability has been described as “the intensifying tussle between classical contract principles and developments such as good faith, unconscionability and estoppel”.[1265] Mason J has said, “there are [some]

1262 *Debattista*, n1227, 291.

1263 The Official Comment to *UCC-Revd.5*, n11, §5-109 specifically instructs the court to lift the veil of autonomy in relation to fraud: “The courts *must examine the underlying transaction* when there is an allegation of fraud”. Emphasis added.

1264 *Epstein*, n1161, 303.

1265 *Kuehne*, n45, 64[fn7].

who think that unconscionability has gone, if not too far, just about as far as it can go."[1266]

However, if the Court will not look further at the *substantive* elements of a dispute to found the doctrine, properly applied unconscionability as a ground to injunction is foreclosed to any independent instrument matter and abusive calls will go unchecked. Therefore, substantive unconscionability needs to be adopted as an element of 'independent instrument unconscionability'.

By restraining unconscionable conduct to procedural unconscionability, which is unlikely to be raised in an independent instrument dispute, the underlying contract essentially becomes impervious to unconscionability as a defence to abusive demands.

This is, in itself, an unconscionable outcome that perhaps ought to be remedied.

[1266] *Mason*, n196, [Forward].

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