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ISSUES OF INDEMNITY IN ISSUING PERFORMANCE BOND:

Aziz Abdul Hussin
INTRODUCTION

As stated by Shaik Daud J. in *Teknik Cekap Sdn Bhd v. Public Bank Bhd*, a performance bond is a written contract of guarantee by a surety (a bank, other financial institutions or an insurance company), whereby they guarantee the due performance of a contract and in the event of a breach or non-performance of the contract, they guarantee to pay, on a written demand being made, the sum stipulated in the guarantee. Issaka Ndekugri emphasized that, in its broadest sense, a bond is a promise by deed by one party to pay another a sum of money. He added that a guarantee executed as a deed in which the guarantor undertakes to answer for the debt, default, or miscarriage of another by a monetary payment is therefore a bond. In short, as stated by Donohue, D. & Thomas, G., a surety bond is a guarantee, in which the surety guarantees that the contractor, called the “principal” in the bond, will perform the “obligation” stated in the bond. It was emphasized by Peh Swee Chin, FJ. in *Esso Peroleum Malaysia Inc v. Kago Petroleum Sdn Bhd*, that performance bonds are almost invariably contract of guarantee and so named presumably to give that extra air of solemnity.
However as mentioned by Wielinski, P.J.\textsuperscript{5}, under this set of circumstances, another later of complexity arises, especially in light of surety’s right to indemnity from the owners of the bonded construction company and its corresponding right of equitable subrogation against other parties that may have had an obligation to pay, including the commercial general liability insurer of the defaulted contractor. Therefore, one of the items in Surety’s Check Lists is the existence of indemnity in every bond that they intend to issue. As we know, bond is not an insurance policy (that includes premium). The insurance company, banks or other financial institutions willing to issue bond based on a guarantee by third party known as indemnity in a special contract known as “contract of indemnity”.

I. THE PRACTICE

The abovementioned practice is actually corresponding with provisions in Malaysian statute, which are sections 77 and 78 of Contract Act 1950\textsuperscript{6}:

\textit{Section 77. “Contract of indemnity”}.
A contract by which one party promises to save the other from loss causes to him by the conduct of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity".

\textit{Illustration}
A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of RM200. This is a contract of indemnity.

\textit{Section 78. Rights of indemnity-holder when sued.}
The promise in the contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor –
\( (a) \) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
\( (b) \) all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorized him to bring or defend the suit; and
\( © \) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promise to make in the absence of any contract of indemnity, or if the promisor authorized him to compromise the suit.


\textsuperscript{6} F.M.S. Ordinance, now known as Act 136.
The High Court in *Amman Singh v. Vasudevan*\(^7\) held that section 77 of the Contracts Act 1950 defines what a contract of indemnity is, and section 78 provides the rights of the indemnity holder when he is sued, against the promisor. Further, in the context of section 77, the Supreme Court in *South East Asia Insurance Bhd v. Nasir Ibrahim*\(^8\), held that a contract of indemnity is ‘a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person’. The same court elaborate further that in a contract of indemnity, the promisor undertakes an original and independent obligation to indemnify, as distinct from a contract of guarantee which is a collateral contract by which the promisor undertakes to answer for the default of another person who is to be primarily liable to the promise.

In this context, Bhag Singh\(^9\) states that in a contract of indemnity not only is there no requirement for a default by a third party as a condition of liability but there may not even be a third party involved for either the creation or exercise of the right. By way of illustration, an insurance contract is an indemnity contract. A person who buys an insurance policy insures his property against damage. If and when the damage occurs, the insured is entitled to call upon the insurer to pay him. Of course, there may be conditions as to what can be claimed. The question of default does not arise\(^10\). Lord Holroyd Pearce in *Yeoman Credit Ltd v. Latter*\(^11\) stated that an indemnity is a contract by one party to keep the other harmless against loss but a contract of guarantee is a contract to answer for the debt default or miscarriage of another who is to be primarily liable to the promise.

II. THE SCENARIO AND ISSUES

As stated before, bond is credit guarantee issued by surety (insurance company, bank or financial institution), and a credit issued in business, the surety hopes that it will be refunded to them in the case the bond being enforced. This is the main reason why the surety needs indemnity.

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\(^11\) [1961 ] 1 WLR 828 at p. 831
Wielinski, P.J.\textsuperscript{12} wrote that, inter alia, under this set of circumstances, another later of complexity arises, especially in light of surety’s right to indemnity from the owners of the bonded construction company and its corresponding right of equitable subrogation against other parties that may have had an obligation to pay, including the commercial general liability insurer of the defaulted contractor.

The court’s approach on the abovementioned matter can be found in \textit{Malayan Assurance Alliance Bhd v. Then Fah Chin}\textsuperscript{13}. The plaintiff had at the request of the defendant and a company called Rimba Bina Sendirian Berhad issued a performance guarantee dated the 6 January 1988 to the Government of Malaysia for the due performance of a contract entered into between the government and the defendant and Rimba Bina for the latter two to upgrade, improve and carry out bitumen sealing works in respect of the Miri/Bintulu Trunk Road in Sarawak from Sungei Niah to Sungei Suai. In consideration of the plaintiff issuing the performance guarantee, the defendant, jointly and severally with some others, executed an indemnity dated the 16 March 1988 in favor of the plaintiff agreeing to indemnify the plaintiff against all losses, costs, damages, expenses, demands and payments which the plaintiff may suffer, sustain or be required to make in relation to its issuing the performance guarantee. Upon the defendant's and Rimba Bina's default in performing their obligations under the contract, the government, by letters dated the 17 July and the 17 September 1989 and the 2 February 1990 demanded payment of a sum of RM1, 720,199.30 from the plaintiff pursuant to the performance guarantee, whereupon the plaintiff paid the government the said sum on the 2 March 1990. On the 13 January 1995, the plaintiff in turn demanded from the defendant the said sum pursuant to the indemnity but the defendant failed to make any payment. It was held that the plaintiff (the insurance company) has right to be indemnified under the said indemnity, and therefore the defendant must pay the amount indemnified.

Next is the case of \textit{Suharta Development Sdn Bhd v. United Overseas Bank (M) Bhd; Tahan Insurance Malaysia Bhd (Third Party)}\textsuperscript{14}, in which the brief relevant facts is as follows: On 6 November 1997 the defendant bank issued a Bank Guarantee for a sum of RM1,312,400.50


\textsuperscript{13} [1997] 1 LNS 464 Kuala Lumpur High Court

\textsuperscript{14} [2004] 7 CLJ 458
in favour of the plaintiff as beneficiary. The bank guarantee was for the due performance of a contract between Autoways Construction Sdn Bhd and the plaintiff where Autoways contracted to build for the plaintiff 288 units of medium cost apartments in Ampang. By letter dated 23 June 1998, plaintiff made a call on the guarantee on the ground that Autoways Construction Sdn Bhd had committed a breach of its obligation under the contract which plaintiff had terminated. Autoways Construction Sdn Bhd had filed a writ and a summons in chamber for an interlocutory injunction to restrain the plaintiff from acting and demanding under the bank guarantee. It sought a declaration that the Notice of Termination dated 16 June 1998 by plaintiff’s architect was invalid. This suit was however struck out on 9 March 2002. Subsequently on 8 May 2002 Autoways Construction Sdn Bhd was wound up. Despite numerous requests, the defendant failed to settle the aforesaid sum. Plaintiff thereupon filed this writ. The defendant filed its defense and subsequently a third party notice against Tahan Insurance Malaysia Sdn Bhd. On 25 July 2003, defendant filed the statement of claim against the third party for indemnity. Defendant pleaded that by a letter of offer, defendant agreed to make available to the third party revised credit line amounting to RM9 million for performance guarantees favoring government and private bodies for 36 months. By a master indemnity for bank guarantee dated 22 January 1997 the third party agreed to indemnify defendant for guarantee issued at third party's request. On 31 October 1992 on the application by third party the defendant issued a guarantee in favor of the plaintiff for due performance by Autoways Construction Sdn Bhd in the aforesaid contract to build the medium cost apartment. The defendant prayed for the following orders against the third party, inter alia, that the third party do indemnify the defendant against the claim of the plaintiff for any judgment awarded by the court together with all costs incurred by the defendant in defending this action and the costs of these third party proceedings against the third party. Finally, the court held that the defendant is entitled to be indemnified by the third party against any judgment granted by the court in the plaintiff’s summary judgment application

The court’s further point of view and approach also can be found in Jerneh Insurance Corp. Sdn. Bhd. v. Chong Kin Yoon & others. On 14 May, 1988, the Government of Malaysia entered into a written agreement with the 1st defendant for the latter to construct and to complete bridges across Sungai Tuang and Sungai Empila in the Samarahan Division, Sarawak, for the

\[1993\] 1 LNS 122
Department of Irrigation and Drainage. At the request of all the 3 defendants, the plaintiff issued a performance guarantee dated 29 January, 1988, in favor of the Government for the due performance by the 1st defendant of his obligations under the agreement to the limit of RM179,000.00. In consideration of the issuance of the performance guarantee, the 3 defendants in turn issued a letter of indemnity dated 5 December, 1987, indemnifying the plaintiff against all losses suffered or damages incurred which may arise from the performance guarantee. At the request of all the 3 defendants, the plaintiff had also issued an insurance guarantee against advance payment dated 29 January, 1988, in favor of the Government, guaranteeing the payment of RM512,250.00 which the Government had agreed to advance to the 1st defendant under the agreement to construct the bridges. In consideration of this insurance guarantee, the 3 defendants executed a second letter of indemnity dated 5 December, 1987, indemnifying the plaintiff against all losses suffered or damages incurred which may arise from the insurance guarantee. All in all, the plaintiff gave 2 guarantees, a performance guarantee and an insurance guarantee, in favor of the Government of Malaysia and in consideration thereof, the 3 defendants executed 2 letters of indemnity in favor of the plaintiff. The 1st defendant defaulted in his obligations under the agreement with the Government and as a result, the Government demanded payment of all sums due under the performance and insurance guarantees. The plaintiff made 2 payments of RM179,000.00 and RM490,970.49 to the Government under both guarantees. It is to reimburse itself of the 2 payments that the plaintiff now seeks to enforce the 2 letters of indemnity executed by the 3 defendants. In resisting liability, the defendants maintain that their liabilities under the 2 letters of indemnity have not arisen as there is a dispute as to who had breached the contract to build the bridges and that dispute is the subject matter of a civil suit which the 1st defendant had brought against the Government. Siti Norma J. states in her judgment⁶

This is so, as under a contract of indemnity, the liability of the person giving the indemnity is primary and not dependent on the default or failure of a prior party to perform his contract. The liability is absolute and this is so even though the principal contract is unenforceable or void.

In KSM Insurance Berhad v. Chin Ting Sing Construction Co. & others⁷, the plaintiff sued the defendants on a letter of indemnity which the defendants had executed in return for the

⁶ Ibid, at p. 124.
⁷ [1993] 1 CLJ 129
plaintiff executing an insurance performance guarantee with the Government of Malaysia. The plaintiff obtained summary judgment on their claim and the first, second, third, sixth and seventh defendants appealed against the decision of the SAR. Learned Counsel for the defendants submitted that as the principal contract was between the Government of Malaysia and the first defendant, no other party not privy to the contract could sue under the performance guarantee as the contract and the benefit and power to claim under the performance guarantee was neither assignable nor transferable. Counsel further submitted that the performance guarantee was conditional and the plaintiff had first to inquire whether the first defendant was relieved from performance before making any payment under it. It was also contended on behalf of the defendants that the claim made against the plaintiff was by the State Government of Sarawak who were not a party to the contract and as such the termination of the contract and the payment made by the plaintiff were wrongful. Learned Counsel for the second and seventh defendants also submitted that his clients had only signed the letter of indemnity based on the promise by the first defendant that the subcontract was to be given to them but since this promise was not kept subsequently, they were not liable to furnish the indemnity. In dismissing the Defendants’ appeal, Abdul Malek J. held, inter alia, that the Director of Public Works Sarawak had signed the relevant contract agreement with the first defendant and the performance guarantee with the plaintiff for and on behalf of the Government of Malaysia. According to the judge, it was therefore quite in order and not improper for the same officer to terminate the first defendant's employment and to require the plaintiff to pay to the Government of Malaysia the said sum under the performance guarantee. Beside that, the plaintiff was a party to the performance guarantee and could certainly sue on it, and, the sixth defendants affidavit merely attempted to reply to the plaintiff’s earlier affidavit and by the time it was filed the Senior Assistant Registrar had decided in favor of the plaintiff. There was no necessity for the plaintiff to reply in the circumstances.

In *Capital Insurance Berhad v. Kumpulan Pantai Sdn Bhd & 2 others*[^18], the plaintiffs as general insurers had on the application and/or request of the first defendant made on the 7 June 1983, issued a security guarantee in favor of Federal Land Development Authority (FELDA) in the sum of RM 503,813.05 (“the security guarantee”) and which reads as follows:

**Indemnity**

In consideration of your having at our request providing or causing to provide security to another party (i.e. FELDA) a Guarantee/Bond for the contractor (i.e. the first named defendant) in lieu of the earnest money/security deposit as required under the contract, we (i.e. the first defendant) hereby undertake to indemnify you against all claims, losses, damages, expenses and all liabilities whatsoever arising from your providing the Guarantee/Bond or for your having caused the third party to provide the Guarantee/Bond whether with or without the security provided by you; we hereby undertake and covenant for ourselves that:

(i) You may at your absolute discretion compromise all claim, payments, demands, actions, suits, proceedings, losses, liabilities, whatsoever which may be taken or made against you;

(ii) We hereby agree to accept the vouchers or other evidence of payment made by you or obligations incurred by you... by reasons of the said Guarantee/Bond as conclusive evidence against us of our liability herein you within seven days of the receipt of a demand made by you for the same and until payment is made we will pay you interest thereon calculated from the date of such demand either before or after any Judgment or order at the prevailing Bank overdraft rate;

(iii) Any demand ... may be effectively made by prior notice to us...

(iv)...

(v) This Indemnity shall continue to remain in force and shall be valid until your liability under the said Guarantee/Bond shall cease;

(vi) In addition..., we further undertake to immediately deposit with you as security in respect of this Indemnity the sum of RM 503,818.05 at anytime you may so require of us or any of us during the currency of this Indemnity.

Dated 8 June, 1983.

Signed by first defendant.”

This counter-guarantee was supported by a guarantee/indemnity of the second and - third named defendants; being the Managing and Executive Directors respectively of the first named defendant company and which provided as follows:

Guarantee and Indemnity

This counter-guarantee was supported by a Guarantee/Indemnity of the second and - third named defendants; being the Managing and Executive Directors respectively of the first named defendant company and which provided as follows:-
"In consideration of you having at our request providing or causing to provide security to another party to provide a Guarantee/Bond for the contractor in lieu of the earnest money/security deposit required to be produced under the contract, we hereby jointly and severally undertake and agree to guarantee the performance and compliance by the contractor of his obligations to you and to indemnify you against all claims losses damages expenses and/or all liabilities whatsoever arising from your providing the Guarantee/Bond ...

We hereby jointly and severally undertake and covenant for ourselves ... in that:-
(i) You may at your absolute discretion compromise all claims, payments, demands, liabilities whatsoever which may be taken or made against you;
(ii) We hereby agree to accept the vouchers or other evidence of payment made by you... by reason of the said Guarantee/Bond as a conclusive evidence against us of our liability herein to you and we will make payment thereof to you within seven (7) days of the receipt of a demand made by you (upon us) for the same and until payment is made we will pay interest thereon ...;
(iii) Any demand hereunder may be effectually made by prior Notice to us ...;
(iv)...
(v) You may enforce this Guarantee and Indemnity against us at any time and for that purpose treats us as if we are/were liable to you as your principal debtors;
(vi) This Indemnity shall continue to remain in force and shall be valid until your liability under the Guarantee/Bond shall cease;
(viii) In addition to... we further jointly and severally undertake to immediately deposit with you as Security the sum of RM 505,818.05 at any time you may so require; of us during the currency of his Guarantee/ Indemnity.

Dated 8 June 1983.

Signed by the second and third named defendants."

The first defendant defaulted in the performing of their contract with FELDA; and as a result thereto FELDA by its letter dated 2 April 1986 terminated the contract entered into with the first defendant (the contractor) and effected a call on the said security guarantee on the 7 April 1986; and upon default or delayed payment by the plaintiffs to the said FELDA; a writ of summons was issued by FELDA against Capital Insurance Berhad (the plaintiffs herein) on 16 September 1987); wherein the said FELDA claimed against the plaintiffs herein the said sum of RM 503,818.05 being the amount due and payable by Capital Insurance Berhad under the said security guarantee. The plaintiff on the 16 November 1987 paid to FELDA, through their
solicitors being the settlement towards costs; and upon such payment; the said proceedings taken by FELDA against the plaintiffs herein were discontinued. The plaintiffs then upon the payment of the sums herein through their solicitors issued a Demand notice and followed by this writ of summons against all the defendants; demanding reimbursement and indemnity on the sum so paid. In relation to liability against surety in indemnity and party being indemnified, K.L. Rekhraj J. emphasised that it was the precise intention between the parties that the guarantee was intended to be an indemnity and the intended intentions must be given their full force and effect. The said judge states that this was a guarantee produced to the first named defendant, for their production to FELDA as an alternate to cash deposit security pursuant to the contract providing FELDA for an unqualified right to a demand at any time to pay. Therefore, the High Court held that the plaintiffs’ liability to pay FELDA crystallized as soon as a demand was made; and the plaintiffs were forced to pay upon the issuance of a writ against them. What the plaintiffs are now seeking is purely an equitable right to full indemnity/restitute reimbursement under section 70 of the Contracts Act 1950 and they cannot be denied of that right.

It is also submitted that the indemnity may be in the form of collateral with bank fixed deposit, i.e. for the performance bond issue by the bank. For example, in *Karya Lagenda Sdn Bhd v. Kejuruteraan Bintai Kindenko Sdn Bhd & anor*\(^\text{21}\), the plaintiff, at the request of the first defendant, issued a bank guarantee dated 27 June 2003 for the sum of RM2,075,700.94 ('bank guarantee') in favor of the second defendant. The bank guarantee was arranged for by the first defendant as required in the building contract between the first and second defendant. Disputes subsequently arose between the first and second defendant in the performance of the building contract, and the second defendant made a demand on the bank guarantee. As the first defendant challenged the validity of the demand, the plaintiff did not make any payment to the second defendant. The first defendant then demanded the release of its fixed deposit funds - secured for the granting of the bank guarantee - to which the plaintiff did not accede. The plaintiff commenced an interpleader proceeding in the High Court to determine whether, *inter alia*, there was liability to pay on the bank guarantee. The first defendant in turn counterclaimed against the plaintiff for the release its fixed deposit funds. The High Court decided in favor of the second defendant and dismissed the first defendant's counterclaim, resulting in the appeal to the Court of

\(^{19}\) Refers to, “Capital Insurance Bhd”.
\(^{20}\) Refers to, all those three defendants.
\(^{21}\) [2007] 6 CLJ 18
Appeal. Since the main question in this appeal concerned the validity of the second defendant's demand for payment of the bank guarantee, the issues in the appeal requiring determination were: (i) whether the bank guarantee was conditional or unconditional; (ii) whether there was mutual determination of the building contract; and (iii) whether the original bank guarantee must be presented at the time of demand before payment could be made. Raus Sharif JCA (Court of Appeal) held that the issue as to the release of the fixed deposit funds would hinge on the outcome of the main question. The said judge states that if the plaintiff did not have to pay out of the bank guarantee, the plaintiff has to release the fixed deposit funds to the first defendant.

In *Teknik Cekap Sdn Bhd v. Public Bank Bhd*[^22^], after the plaintiff demanded for the payment of the performance bond, the bank paid the amount as stated (RM422,000) forthwith, and followed by drawing of a fixed deposit for the amount of RM42,000 (which was deposited before as collateral) by the Lightweight Company. The bank also claimed the balance (that is RM422,000 minus RM42,000) from the defendants.

With regards to the method of indemnity and its scope of operation, it can be found in *Malaysia British Assurance Bhd. v. Sihazco Sdn Bhd & others*[^23^]: The first defendant accepted a tender issued by PNS Development (PNS') to construct several houses. The tender was *inter alia* subject to the first defendant's execution of a performance bond in favour of PNS in the form of a bank or insurance guarantee for the sum of RM442,977.55. At the request of the defendants and one Ching Ngew Hoe ('Ching'), the plaintiff issued an insurance guarantee dated 5 September 1994 in favor of PNS for the sum of RM442,977.55. Under the insurance guarantee the defendants were required to and did deposit cash collateral in the sum of RM44,297.76 with the plaintiff. The plaintiff agreed to pay 2% interest per annum on the collateral. In consideration of the plaintiff issuing the insurance guarantee, the defendants and Ching executed letters of indemnity dated 3 September 1994 in favor of the plaintiff whereby they undertook to indemnify the plaintiff in respect of all payments made by the plaintiff under the insurance guarantee performance bond. PNS subsequently called upon the performance bond, and the plaintiff issued a check for the sum of RM442,977.55 to PNS and demanded indemnification from the defendants and Ching pursuant to the letters of indemnity. The plaintiff after deducting the cash


[^23^]: [2004] 8 CLJ 423
collateral of RM44, 297.76 and a further RM100,000 paid by Ching to discharge his liability, claimed the balance of RM295,203.93 from the defendants. The plaintiff then applied for summary judgment and signed final judgment against the first, second, fourth and sixth defendants. The first, second, fourth and sixth defendants appealed. T Selventhiranathan J., states that,

*It is pertinent to note that under the insurance guarantee the defendants were required to and did deposit cash collateral in the sum of RM44, 297.76 with the plaintiff. The plaintiff agreed to pay interest at the rate of 2% per annum on this collateral with effect from 7 November 1994. In the circumstances, according to the plaintiff, the actual amount which was therefore due and owing by the defendants, after deducting the cash collateral deposited with the plaintiff and interest accrued thereon, stood at RM395,203.93.*

These defendants contended that the letters of indemnity executed by them were void and unenforceable for lack of consideration as the insurance guarantee was dated 5 September 1994 whereas the letters of indemnity were executed on 3 September 1994. Thus, the defendants alleged there was no consideration given by the plaintiff when the letters of indemnity were executed. T Selventhiranathan J. states that,

*However, it was abundantly clear that the defendants executed the letters of indemnity on the basis of the undertaking given by the plaintiff to issue the insurance guarantee, and which guarantee was in fact issued on 5 September 1994. Therefore it was unmistakeable that this undertaking or promise by the plaintiff must be construed as good consideration in view of the interpretation given to the expression "consideration" in s. 2(d) of the Contracts Act 1950 which reads as follows:*

(d) when, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise

T Selventhiranathan J. further states that in fact, and additionally, the exchange of mutual promises in this case, i.e. the execution of the letters of indemnity and the issuance of the insurance guarantee formed the consideration for each other as reciprocal promises within the meaning of para. (e) and (f) of s. 2 of the Contracts Act 195024, and therefore it was crystal clear

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24 Which provide as follows:
that consideration was in fact provided by the plaintiff for the letters of indemnity executed by the defendants despite their execution preceding the issuance of the insurance guarantee in point of time. The same judge added further that looking at the plaintiff's claim, there was absolutely no basis for the defendants to suggest that it was one which involved the recovery of a penalty or forfeiture or sum by way of penalty or forfeiture, as the case may be. The plaintiff's claim was based purely on the letters of indemnity executed by the defendants in respect of the sum of RM442, 977.55 paid to PNS by the plaintiff under the insurance guarantee. Then it was concluded by the Court that there was therefore no element involving any recovery of any penalty or forfeiture or sum by way of penalty or forfeiture in the circumstances. It was simply the recovery of a debt due and owing by the defendants [minus credit given for the cash collateral and interest earned thereon] as a result of the plaintiff paying out the sum of RM442, 977.55 to PNS.

As our further remarks, it is useful to cite the case of *Ulico Casualty Co. v. Atlantic Contracting & Material Co.*\(^\text{25}\) *Atlantic Contracting & Material Co., v. Ulico Casualty Co.*\(^\text{26}\). In this case, the Court examines the scope of the good faith clause in an indemnity agreement, and a principal’s obligation to indemnify a surety for payment of a claim that may not be covered by a surety bond. The Court concludes, on the facts of this case, that the surety’s payment of the obligee’s claim was a reasonable, good faith settlement based on the information made available to it at the time. Finally the court holds that the good faith standard allows the surety a discretion limited by the bounds of reasonableness, rather than by the bounds of fraud. It was further hold that the principal is bound by a reciprocal obligation of good faith and fair dealing, embedded within which is a duty to cooperate, and may not ignore, without peril, the surety’s pre-payment requests for information. Although a surety’s payment may not be included entirely in ‘labor and materials’ as covered by a payment bond where the repairs made by the obligee to the principal’s equipment add materially to the value of that particular equipment, in this case the principal failed to inform the surety of the bond coverage issue and, after a diligent investigation and a considerable amount of time had passed, the surety reasonably and in good faith paid the obligee based on information in a Proof of Claim form indicating liability.

\(e\) every promise and every set of promises, forming the consideration for each other, is an agreement;  
\(f\) promises which form the consideration or part of the consideration for each other are called reciprocal promises;

\(25\) 822 A.2d 1267 (Md. App. 2003) (Special Court of Appeal Maryland, USA).

\(26\) No. 51, Sept. Term, 2003 (US)
CONCLUSION

It is submitted that the issues relating to indemnity must be resolved before the surety issue the performance bond. It is also further submitted that these are also one of the pre-conditions that must be resolved by all parties concerned before the surety decides to issue the performance bond. That has been illustrated by Siti Norma Yaakob J. in *Malaysia Overseas Investment Corporation Sdn Bhd v. Sri Segambut Supermarket Sdn Bhd*:

> All these conditions precedent appear to have been agreed upon, for on August 9, 1984, the plaintiffs executed a Letter of Indemnity in favour of Malayan Bank Berhad and on the following day, the Bank in turn executed a performance guarantee in favour of the defendants.

The writer would like to share a report based on a White Paper dated 26 March 2002 prepared by Home Builders Association (HBA) United States of America that home builders in the western United States are curtailing construction because they cannot obtain liability insurance or can no longer afford such insurance. The same report points out that for every US$1 that California insurers collected in 1998, they paid out nearly US$1.87 for claims. In 2000, California insurers paid out about US$2.95 for every dollar in premiums. The Personal Insurance Federation of California (PIFC) has learned that by the end of 2003, some insurers were paying out close to US$5 for every one dollar collected. As a result of rising loss ratios for CGL, many insurers have abandoned the California marketplace. According to a recent California Department of Insurance Data Call, in the fall of 2002, of the 509 companies that were licensed to sell Residential Construction Defect Liability insurance, only 20 companies chose to underwrite this risk. Of those 20 companies, only 16 were actively writing new business and 4 were only renewing current business and were no longer offering new policies. The writer submits that the said scenario will directly affected the “the circle of indemnity” (the surety and indemnity) as discussed before.

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27 [1985] 1 LNS 156
Another point to ponder is that the effect of forfeiture of performance bond to those who “purchased” the said bond. In *Pernas Construction Sdn Bhd v. Syarikat Rasabina Sdn Bhd*[^30] the counsel for the defendants gave the following relevant remarks:

*As a class A contractor we can tender for government contracts for amounts of RM10 million and above. By the Defendant calling upon the Bond it resulted in our company being blacklisted in obtaining the performance bond market…. All government contracts and tender require Performance Bonds or guarantees. If we cannot obtain the Bond, we cannot enter into the tender. That's why our company is dormant till now.*

Furthermore, if the writer was the counsel for the defendants, the following will also be asserted:

*Not only our company will be affected by the abovementioned action taken by the bank, but our directors, who are the guarantor in the letter of guarantee of indemnity (before the issuance of the performance bond by the bank) will also suffer further negative implications.*

[^30]: [2004] 2 CLJ 707