

WHEN BONDS BREAK

Practical Tips for Dealing With On-Demand Performance Bonds Disputes

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Drawing upon the legal principles and illustrations from three recent Supreme Court cases, this article provides practical tips to employers and contractors embroiled in (or who wish to avoid being embroiled in) disputes involving on-demand performance bonds.

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I. Introduction

1 It is common practice for performance bonds to be required at the start of a construction project. As aptly observed by the Honourable Justice Lee Seiu Kin in *Chian Teck Realty Pte Ltd v SDK Consortium*¹ (“Chian Teck Realty”):²

The performance bond has assumed an essential role in the building and construction industry, serving as an instrument to facilitate cash flow while managing risks. In the course of the performance of a construction contract, the employer (or main contractor) makes periodic progress payments to the contractor (or subcontractor), even when the work is far from

1 [2024] 3 SLR 1031.

2 *Chian Teck Realty Pte Ltd v SDK Consortium* [2024] 3 SLR 1031 at [1].

complete. This arrangement reduces the cash flow requirement for the contractor. The employer benefits from being able to subcontract work at lower prices due to the resultant lower financing costs for the contractor, and from the availability of a larger pool of contractors to bid for the job. The risk, of course, is in the contractor going under and the employer may be saddled with additional costs to complete the works with little recourse against the insolvent contractor. ... [P]erformance bond[s] [come] into the picture, in which, for a comparatively small fee, financial institutions such as banks or insurance companies [give] the beneficiary (the employer) an undertaking to pay a certain sum of money under certain conditions.

2 Indeed, performance bonds are seen to benefit not just the employer, but also the contractor in a construction contract. While the performance bond serves as a financial safeguard *for the employer* against contractor non-performance, it also acts as a tool to ease cash flow *for the contractor*.

3 Notwithstanding their benefits to parties and to the industry, performance bonds – which usually entail high financial stakes – often become a source of disputes between parties. Drawing on three recent Supreme Court cases,³ this article provides practical tips to both employers and contractors embroiled in (or who wish to avoid being embroiled in) disputes involving on-demand performance bonds.⁴

II. A brief overview: on-demand performance bonds

4 There are generally two types of performance bonds – conditional bonds and on-demand bonds.⁵ Conditional bonds require certain conditions to be met (*eg*, proof of contractor's default) before the bond issuer (typically a bank or insurance company) is liable to pay the employer. As for on-demand bonds,

3 *Chian Teck Realty Pte Ltd v SDK Consortium* [2024] 3 SLR 1031; *Shanghai Chong Kee Furniture & Construction Pte Ltd v Church of St Teresa* [2024] SGHC 5; *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099.

4 A brief overview of on-demand performance bonds is provided in paras 4–7 below.

5 Also commonly referred to as unconditional bonds and first demand bonds.

the bond issuer is liable to pay the employer upon the employer's demand without the need for proof of any default.

5 Unsurprisingly, on-demand performance bonds are more commonly required by employers under construction contracts in Singapore. On-demand bonds have, after all, been described to be “as good as cash” because they provide the employer with certainty of payment.⁶

6 Typically, the sequence surrounding the procurement of on-demand bonds is as follows:

(a) On the instructions of the contractor (the obligor) (“Contractor-Obligor”), the bond-issuer (typically a bank or insurance company) (“Bond-Issuer”) issues such a bond to the employer (the beneficiary of the bond) (“Employer-Beneficiary”).

(b) In turn, the Contractor-Obligor furnishes security to the Bond-Issuer for the amount under the bond.

(c) After the bond is issued, the Employer-Beneficiary is entitled to make a call on the on-demand bond demanding the bond moneys to be paid to him by the Bond-Issuer in the event that the Contractor-Obligor is alleged to have committed a contractual breach.

(d) If such a call or demand is compliantly made on the terms of the bond, the Bond-Issuer is required to make prompt (if not immediate) payment of the bond moneys to the Employer-Beneficiary.

(e) In such event, the Bond-Issuer is neither entitled nor required to investigate the merits of the Employer-Beneficiary's allegation (*ie*, whether there was truly a breach of contract by the Contractor-Obligor).⁷

6 *Chian Teck Realty Pte Ltd v SDK Consortium* [2024] 3 SLR 1031 at [1]; *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [32]; both referring to *Shanghai Electric Group Co Ltd v PT Merak Energi Indonesia* [2010] 2 SLR 329 at [16].

7 *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [10(b)].

(f) Upon such occurrence, the Bond-Issuer is usually entitled to realise the security that was given to it by the Contractor-Obligor.

7 For ease of reference, the Contractor-Obligor will be referred to in this article as the “Contractor” and the Employer-Beneficiary will be referred to as the “Employer”.⁸

III. The law as to restraining calls on performance bonds

8 Once the Employer has called on the bond, the Contractor may – to avoid the realisation of its security by the Bond-Issuer – attempt to restrain the Employer from doing so or the Bond-Issuer from paying out the bond moneys. As indicated above, the Bond-Issuer is not contractually entitled to refuse a compliant demand. Therefore, the Contractor’s remaining recourse is to apply for an injunction from the court, restraining the call on the bond by the Employer or the payment of the bond moneys by the Bond-Issuer.

9 Under Singapore law, there are two grounds on which an injunction will be granted: fraud and unconscionability.⁹ The court must be satisfied that there is a strong *prima facie* case that either ground has been made out by the Contractor before an injunction can be granted.¹⁰

10 The first ground of fraud may be established by showing that the Employer had called on the bond (a) with the knowledge that its demand was invalid; (b) without belief in the validity of

8 In the context of downstream construction contracts, the equivalent of the “Contractor-Obligor” would be a subcontractor while the “Employer-Beneficiary” equivalent would be a main contractor.

9 *Bocotra Construction Pte Ltd v Attorney-General* [1995] 2 SLR(R) 262 at [46]; *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [33]. This departs from the English position wherein only the ground of fraud can sustain an injunction.

10 *Shanghai Chong Kee Furniture & Construction Pte Ltd v Church of St Teresa* [2024] SGHC 5 at [36] and [38]–[39], following *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [20] and *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [34] and [36].

its demand; and/or (c) with indifference to whether the demand was valid or not.¹¹

11 The second ground of unconscionability, on the other hand, may be made out when the conduct of the Employer is lacking in good faith,¹² or involves elements of “abuse, unfairness and dishonesty”.¹³

12 In deciding if either of the above grounds are established, the court is not tasked to make a decision on the merits of the underlying dispute between the Contractor and the Employer (eg, whether the Contractor was in default).¹⁴

IV. Practical tips for the Contractor

13 With the above principles in mind, below are tips for the Contractor preparing or seeking to injunct the Employer’s call on a bond.

A. Adducing evidence focused on the Employer’s bad faith

14 First, the Contractor should bear in mind that errors and mistaken beliefs by the Employer alone *will not* lead the court to find that there was unconscionability (much less fraud) in the Employer’s call on the bond.

15 In the High Court decision of *Shanghai Chong Kee Furniture & Construction Pte Ltd v Church of St Teresa*¹⁵ (“*Shanghai Chong Kee Furniture*”), the contractor argued that unconscionability should be inferred based on the project architect’s alleged errors in the computation of the liquidated damages (“LDs”) imposed on the

11 *Chian Teck Realty Pte Ltd v SDK Consortium* [2024] 3 SLR 1031 at [37]; *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [34]; both following *Bintai Kindenko Pte Ltd v Samsung C&T Corp* [2019] 2 SLR 295 at [74].

12 *DJY v DJZ* [2024] SGHC 301; *CEX v CEY* [2021] 3 SLR 571 at [11(c)].

13 *Shanghai Chong Kee Furniture & Construction Pte Ltd v Church of St Teresa* [2024] SGHC 5 at [36], following *BS Mount Sophia Pte Ltd v Join-Aim Pte Ltd* [2012] 3 SLR 352 at [19].

14 *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [36].

15 [2024] SGHC 5.

contractor, as well as the employer belatedly making its claim for LDs only after the bond had been called.¹⁶

16 While the court agreed “that the [architect] and the [employer] were not as cogent as they could have been with respect to an explicit claim for LDs”, the court declined to infer unconscionability as there was no evidence of any bad faith on the architect’s or the employer’s part.¹⁷ In this vein, the court stated that even if it eventually “found that the [contractor] did not commit contractual breaches, so long as the [employer] had the honest but mistaken belief that the [contractor] had done so, the call on the bond would still have been legitimate”.¹⁸

17 To this end, the Contractor’s injunction application to the court should focus on adducing evidence on the Employer’s lack of honest belief and/or bad faith, as opposed to merely finding fault with the Employer’s substantive claims against the Contractor.

18 It would do the Contractor well to show, for instance, that the Employer had *knowledge* that the Contractor *did not* commit contractual breaches but nonetheless called on the bond in bad faith. Conversely, the Contractor may not see much benefit from delving into the merits of the dispute in its application, *ie*, whether the Contractor’s breaches were actually committed.

B. Notifying the Employer of impropriety

19 Second, given the importance of proving the Employer’s lack of honest belief and bad faith, the Contractor should take care to ensure that any impropriety in the administration of the contract by a third party (*eg*, the project architect) is placed well within the Employer’s knowledge.

16 *Shanghai Chong Kee Furniture & Construction Pte Ltd v Church of St Teresa* [2024] SGHC 5 at [12].

17 *Shanghai Chong Kee Furniture & Construction Pte Ltd v Church of St Teresa* [2024] SGHC 5 at [41].

18 *Shanghai Chong Kee Furniture & Construction Pte Ltd v Church of St Teresa* [2024] SGHC 5 at [37]; applying *JK Integrated (Pte Ltd) v 50 Robinson Pte Ltd* [2015] SGHC 57 at [72].

20 In *Shanghai Chong Kee Furniture*,¹⁹ the court considered that the employer was entitled to rely on the architect’s decision on LDs, and that any errors of the architect would not be attributable to the employer in determining unconscionability. The parties had, after all, agreed that the architect was to act independently in exercising its professional judgment.²⁰

21 Nonetheless, it was observed that “if the employer had been put on notice about something improper about the architect’s certification process and had proceeded to call on the bond regardless, there may be an argument that the employer had acted unconscionably”.²¹ The court in *Shanghai Chong Kee Furniture*, however, found no such evidence suggesting that the employer had been put on such notice.²²

22 Taking a leaf out of the court’s observations, if the contract administrator has acted with impropriety, it is important for the Contractor to not only record the impropriety but also notify the Employer of the impropriety. Such records of impropriety and notification to the Employer may ultimately be crucial in establishing the Contractor’s case for unconscionability and/or fraud against the Employer.

V. Practical tips for the Employer

23 While an on-demand performance bond has been described to be “as good as cash”,²³ the Employer should be cautious – as one should be with one’s money – when it deals with an on-demand performance bond.

19 See *CEX v CEY* [2021] 3 SLR 571 at [58]–[63] as well.

20 *Shanghai Chong Kee Furniture & Construction Pte Ltd v Church of St Teresa* [2024] SGHC 5 at [43]–[44].

21 *Shanghai Chong Kee Furniture & Construction Pte Ltd v Church of St Teresa* [2024] SGHC 5 at [43].

22 *Shanghai Chong Kee Furniture & Construction Pte Ltd v Church of St Teresa* [2024] SGHC 5 at [44].

23 *Chian Teck Realty Pte Ltd v SDK Consortium* [2024] 3 SLR 1031 at [1]; *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [32]; both following *Shanghai Electric Group Co Ltd v PT Merak Energi Indonesia* [2010] 2 SLR 329 at [16].

A. Making a demand compliant with the bond's terms

24 Notwithstanding the bond's unconditional and on-demand nature, this does not mean that the Employer is given *carte blanche* to call on it. The law is clear that the Employer's call should strictly comply with the terms set out in the bond.²⁴ Examples of such terms vary and can range from the production of certain documents to simply filling out details in a stipulated form. In any case, the Employer should beware that the failure to strictly comply may well result in the Employer's call being refused by the Bond-Issuer or an injunction ordered by the court restraining the Employer's call.

25 The case of *Chian Teck Realty* is a cautionary tale in this regard. In *Chian Teck Realty*, there were two bases under which the employer could have claimed under the bond:²⁵

(a) First base (cl 1) – The employer making a claim in the form stipulated in cl 4 without any need for proof of the contractor's default.

(b) Second base (cl 3) – The bond-issuer giving 90 days' written notice prior to the expiry of the bond of its intention not to extend the bond. Upon such written notice, the employer could elect to (i) make a claim under the bond; or (ii) direct the bond-issuer to extend the bond's validity for a further period not exceeding six months.

26 The employer's demand letter to the bond-issuer did not refer to either cl 1 or cl 3. Instead, the letter only referred to cl 4 which was, in itself, not a ground for making a demand.²⁶ In the absence of an express provision under which the employer was making its demand, the High Court inferred – based on

24 *Chian Teck Realty Pte Ltd v SDK Consortium* [2024] 3 SLR 1031 at [21]; *DJY v DJZ* [2024] SGHC 301 at [33]; both following *Master Marine AS v Labroy Offshore Ltd* [2012] 3 SLR 125 at [31]–[33].

25 *Chian Teck Realty Pte Ltd v SDK Consortium* [2024] 3 SLR 1031 at [10] and [22]–[23].

26 *Chian Teck Realty Pte Ltd v SDK Consortium* [2024] 3 SLR 1031 at [24]–[25].

correspondence between the bond-issuer and the employer – that the employer’s claim was made on the second base (cl 3).²⁷

27 The second base (cl 3), however, made the employer’s entitlement to claim *conditional* upon the bond-issuer providing 90 days’ notice of non-renewal prior to the bond’s expiry. Unfortunately for the employer, the court found that this condition was not fulfilled – the purported notice provided by the bond-issuer was defective because it did not fulfil the 90 days’ written notice requirement. Accordingly, the court held that the employer’s demand was invalid and allowed the contractor’s application for an injunction.²⁸

28 The case of *Chian Teck Realty* is a stark reminder for the Employer to scrutinise the bond terms and ensure that:

- (a) its demand to the Bond-Issuer clearly refers to the provision of the bond it is making its demand under;
- (b) any conditions precedent (required by the provision it is making its demand under) are fulfilled (*eg*, provision of requisite notice); and
- (c) its demand complies with any stipulated form (*eg*, provision of necessary details in demand).

B. Taking action consistent with the bond’s character

29 Next, the Employer should be mindful that it does not act in a way contrary to its right to be paid immediately and unconditionally under an on-demand performance bond.

30 Taking any action inconsistent with an on-demand bond’s character may, to the Employer’s detriment, lead to an on-demand bond being effectively converted into a conditional bond. This was what happened in the Court of Appeal case of *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd*²⁹ (“*Star Engineering*”).

27 *Chian Teck Realty Pte Ltd v SDK Consortium* [2024] 3 SLR 1031 at [24]–[30].

28 *Chian Teck Realty Pte Ltd v SDK Consortium* [2024] 3 SLR 1031 at [31]–[35].

29 [2024] 1 SLR 1099.

31 In *Star Engineering*, the parties' underlying contract and performance bond envisaged different dispute resolution mechanisms:³⁰

(a) Under the bond, parties agreed to submit to the non-exclusive jurisdiction of the Singapore courts.

(b) Under the underlying contract, parties agreed that "[a]ny dispute which the Contractor has in relation to such call, demand, receipt, payment"³¹ was to be resolved by arbitration.

32 The employer called on the unconditional on-demand bond because of alleged breaches by the contractor.³² Subsequently, the contractor filed applications in court for (a) an injunction restraining the employer's call; and (b) temporary restraining orders on the employer's call pending the resolution of the injunction application. The High Court allowed the contractor's application for (b) and temporarily restrained the employer.³³

33 In response, the employer filed an application for a stay of the injunction proceedings in favour of arbitration. The said stay application was granted by the High Court.³⁴

34 When the dispute came before the Court of Appeal, the court opined that the employer ought to have applied to set aside the temporary restraining order obtained by the contractor.³⁵ By referring the matter of whether the employer was entitled to call on the bond to arbitration, the court considered that the employer "has in effect converted its position from that of a party holding an unconditional on-demand bond into something akin to that

30 *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [7] and [10(e)].

31 *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [7(b)].

32 *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [9].

33 *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [12]–[13].

34 *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [14]–[16].

35 *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [38].

of a party holding a conditional bond payable only upon proof of its entitlement to receive payment thereunder”.³⁶

35 Practically speaking, the employer’s act of staying the injunction proceedings and referring the matter to arbitration delayed its right to payment under the bond.³⁷ Conversely, if the employer had been successful in setting aside the contractor’s injunction application in court, the employer would have been entitled to immediate payment under the bond.

36 Accordingly, the Employer ought to be prudent as regards any actions (or omissions) it takes as regards on-demand bonds, so as not to deprive itself of the “as good as cash” benefit of on-demand bonds.

VI. Conclusion

37 The process surrounding the Employer’s call on a performance bond and the Contractor’s subsequent application to restrain the call is often a highly time-sensitive and stressful one. This is especially given the significant financial repercussions that such a call might entail, coupled with the usual accompanying breakdown of the parties’ relationship. It is therefore important for parties to be familiar with the actions to be taken and avoided, so as to act strategically and effectively amid the pressure and time constraints.

36 *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [39].

37 *Star Engineering Pte Ltd v Pollisum Engineering Pte Ltd* [2024] 1 SLR 1099 at [40] and [43].