

Bank Guarantees in Singapore: Balancing Autonomy and Justice in Commercial Transactions



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A bank guarantee is a crucial document in commercial transactions, providing a financial safety net for parties entering into transactions. Its role in mitigating risk and fostering trust makes it an integral feature of contracts in industries like construction, trade, and real estate.

This article examines the concept of bank guarantees, their legal treatment under Singapore law and their implications in practice.

1. Understanding Bank Guarantees

A bank guarantee is a contractual obligation undertaken by a bank to pay a specified amount to a beneficiary if the applicant (on whose behalf the guarantee is issued) fails to meet their contractual obligations. This instrument serves as an assurance mechanism for the beneficiary, ensuring compensation in case of non-performance or default.

Bank guarantees can be broadly categorized into (i) performance guarantees, (ii) financial guarantees and (iii) bid bonds.

Firstly, performance guarantees are issued to ensure that an applicant performs their contractual obligations, such as completing a project or delivering goods. In the construction industry, contracts working on projects for developers or the government are often required to provide a performance bond. For large scale projects, this amount can reach millions. Instead of depositing cash with the developer or government, the contractor can obtain a performance guarantee. This performance guarantee serves as commitment from the bank that, should the contractor fail to complete the required work under the contract the developer or government can claim the guaranteed amount from the bank.

Meanwhile, financial guarantees are a second type of bank guarantee which secure the payment of monetary obligations, such as rent or loan repayments. To

elaborate, retailers may need to provide a financial guarantee to a landlord as security for a tenancy agreement. In obtaining a financial guarantee, the company assures its suppliers that payment is guaranteed not only by the company but also by the bank issuing the financial guarantee. This assurance facilitates a smoother transaction between the parties.

Lastly, Advance Payment Guarantees are a type of bank guarantee to secure an advance payment made by one party (i.e. the buyer) to another (i.e. the seller). It ensures that if the recipient fails to deliver goods or services, the advance payment can be recovered by the guarantor.

2. Legal Framework Governing Bank Guarantees in Singapore

One of the principles of bank guarantees is their autonomy. This means the guarantee operates as an independent contract. The bank's obligation to pay is not contingent upon disputes arising from the primary contract.

For example, if the contractor disputes the validity of a claim for non-performance, the bank is still required to honour the Advance Payment Guarantee in the absence of fraud or unconscionability.

Bank guarantees in Singapore are governed by contract law and judicial precedents.

In *Bocotra Construction Pte Ltd and others v Attorney-General* [1995] 2 SLR(R) 262,

The court of appeal emphasised the autonomy of bank guarantees. The bank's obligation to honour a demand is independent of the underlying contractual disputes¹.

In *GHL Pte Ltd v Unitrack Building Construction Pte Ltd and another* [1999] 3 SLR(R) 44, the Court of Appeal introduced unconscionability as a valid exception, distinguishing it from fraud. It was a ground for granting an injunction to restrain the enforcement of a

¹ *Bocotra Construction Pte Ltd and others v Attorney-General* [1995] 2 SLR(R) 262 at [34]

performance bond. Briefly, the facts are that GHL engaged Unitrack as a subcontractor for construction work. Unitrack provided a performance bond. Subsequently, disputes arose over delays and defects in Unitrack's work. GHL sought to invoke the performance bond, claiming that Unitrack had failed to meet its obligations. However, Unitrack argued that GHL's call was unconscionable because GHL's demand was made prematurely and there had been no formal determination of a breach.

The court held that for there to be unconscionability, the conduct must be oppressive and that the applicant must provide clear evidence of oppression or bad faith. In this instance, the court held that GHL's call on the bond was not sufficiently unconscionable to warrant an injunction. This stance was subsequently reaffirmed in *JBE Properties Pte Ltd v Gammon Pte Ltd* [2011] 2 SLR 47, where the case refined the unconscionability doctrine, stating that minor breaches are insufficient grounds for restraining payment².

More recently in *Chian Teck Realty Pte Ltd v SDK Consortium and another* [2024] 3 SLR 1031, the High Court reiterated the principles of unconscionability³.

3. Key Features of Bank Guarantees

Bank guarantees are documentary in nature, meaning the bank assesses claims solely based on the documents presented. For example, a written demand by the beneficiary citing the applicant's failure to perform is typically sufficient to trigger payment under the guarantee.

As for unconditional guarantees, the bank is obligated to pay upon the beneficiary's demand without requiring proof of default.

Meanwhile, in a conditional guarantee, payment is subject to the beneficiary providing evidence of the applicant's default.

4. Drafting and Managing Bank Guarantees

This article recommends some key clauses to be drafted in bank guarantees.

These include the (i) purpose and scope of the obligations, (ii) the conditions for payment - parties should specify whether the guarantee is conditional or unconditional, (iii) duration and expiry of bank guarantee - parties should include precise terms for validity and termination and the (iv) governing law and jurisdiction of the bank guarantee.

Furthermore, parties should assess the financial implications of providing collateral and ensure that the terms of the guarantee align with their contractual obligations. Lastly, beneficiaries should verify the bank's creditworthiness to avoid issues during enforcement.

5. Conclusion

To conclude, bank guarantees remain a cornerstone of financial security in Singapore, allowing parties to transact across industries. The legal framework governing these instruments, underpinned by the principles of autonomy and exceptions like fraud and unconscionability, strikes a delicate balance between protecting beneficiaries and preventing abuse.

This article was authored by our Partner [Oon Thian Seng](#) and Senior Associate [Angeline Woo](#).

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² *JBE Properties Pte Ltd v Gammon Pte Ltd* [2011] 2 SLR 47 at [10]

³ *Chian Teck Realty Pte Ltd v SDK Consortium and another* [2024] 3 SLR 1031 at [3]