

Treating On-Demand Bonds as Cash-In-Hand: Analyzing the Use of “Unconscionability” as a Ground for Challenging Claims for Payment under On-Demand Bonds

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Abstract : On-demand bonds, also known as unconditional bonds, are commonplace in the construction industry as a means of safeguarding the employer from any potential non-performance by a contractor. On-demand bonds may be obtained from commercial banks, and they serve as an undertaking by the issuing bank to honour payment on demand without questioning and/or considering any dispute between the employer and the contractor in relation to the underlying contract. Thus, whether or not a breach had occurred under the underlying contract, which triggers the demand for encashment by the employer, is not a question the bank needs to be concerned with. As a result, an unconditional bond allows the beneficiary to claim the money almost without any condition. Thus, an unconditional bond is as good as cash-in-hand. In the past, establishing fraud on the part of the employer, of which the bank had knowledge, was the only ground on which a bank could dishonour a claim made under an on-demand bond. However, recent jurisprudence in common law countries shows that courts are beginning to consider unconscionable conduct on the part of the employer in claiming under an on-demand bond as a ground that contractors could rely on to prevent the banks from honouring such claims. This has created uncertainty in connection with on-demand bonds and their liquidity. This paper analyzes recent judicial decisions in four common law jurisdictions, namely, England, Singapore, Hong Kong, and Sri Lanka, to identify the scope of using the concept of “unconscionability” as a ground for preventing unreasonable claims for encashment of on-demand bonds. The objective of this paper is to argue that on-demand bonds have lost their effectiveness as “cash-in-hand” and that this is, in fact, an advantage and not an impediment to international commerce, as the purpose of such bonds should not be to provide for illegal and unconscionable conduct by the beneficiaries.

Keywords : fraud, performance guarantees, on-demand bonds, unconscionability

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