



On Demand Performance Bond : Unconscionable to Demand when Works Completed?

PENGERANG REFINING COMPANY SDN BHD V SINOPEC ENGINEERING (GROUP) CO LTD & ANOR [W-02(IM)(C)(A)-565-04/2025 & W-02(IM)(C)-558-04/2025]

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ISSUES

Often times, the construction contract would require the contractor to provide a performance bond to the employer to guarantee the contractor's performance of the contract, i.e. to deliver the completed project as per the contract.

Dispute often arises on the legitimacy of the employer's demand on the performance bond, especially where parties are in dispute on the performance or non-performance of the contractor and one of the grounds to restrain the employer's demand on the performance bond or receipt of monies thereunder is on the grounds of the demand being unconscionable.

Where a project is completed, would a demand on the performance bond be unconscionable? Can an employer withhold certification of completion on the basis of unpaid LAD by the contractor and thereafter make a demand on the performance bond?

These questions were examined by the Court of Appeal in the recent case of **Pengerang Refining Company Sdn Bhd v Sinopec Engineering (Group) Co Ltd & Anor** [W-02(C)(A)-565-04/2025 & W-02(IM)(C)-558-04/2025].

BRIEF FACTS

The brief facts of the case are as follows:-

- (a) The Appellant, Pengerang Refining Company Sdn Bhd ("PRC"), appointed the Respondents, entities within the Sinopec group, to carry out the engineering, procurement, construction and commissioning of Refinery Package 2 (CDU, ARDS and HCDC Units) for the Refinery and Petrochemical Integrated Development (RAPID) Project ("EPCC Contract") in Pengerang, Johor.



- (b) Pursuant to the EPCC Contract, the Respondents provided 2 performance securities, namely a performance bond in the sum of USD132,902,900.00, being 10% of the contract price ("Performance Bond"), together with parent company guarantee from the 1st Respondent's parent company to guarantee all the 1st Respondent's obligations and liabilities under the EPCC Contract.
- (c) A dispute arose between the parties and the Respondents issued a Notice of Dispute dated 10.06.2024 to the Claimant.
- (d) By way of Notice of Arbitration dated 10.07.2024, the Respondents commenced arbitration against the Appellant. Thereafter, the Appellant had served a Response to the Notice of Arbitration to the Respondents on 09.08.2024.
- (e) Meanwhile, the Appellant made a demand under the Performance Bond. Pursuant to the demand, the Respondent applied to the High Court for interim measure to restrain the Appellant's call on the Performance Bond ("Interim Measure Application").
- (f) The Respondents obtained an Ex-Parte Order to restrain the Appellant from calling and/or receiving monies pursuant to the demand under the Performance Bond pending a final award in arbitration. After hearing both parties, an ad interim order was given to continue restraining the demand / receipt of monies until disposal of the Respondents' application.
- (g) Simultaneously, the Appellant also applied to set aside the Ex Parte Order ("Application to Set Aside Ex-Parte Order").
- (h) On 24.03.2025, the High Court allowed the Interim Measure Application and dismissed the Application to Set Aside Ex-Parte Order.
- (i) The Appellant appealed to the Court of Appeal against the decision on both applications.

ISSUES BEFORE THE COURT OF APPEAL

The main issue for determination before the Court of Appeal is:-

"36. Whether the Appellant's demand on the Performance Bond is unconscionable?"



UNCONSCIONABLE TO DEMAND ON PERFORMANCE BOND WHEN WORKS COMPLETED

At the outset, the Court of Appeal made clear that, where the works are completed, a demand on the performance bond would be unconscionable. The Court of Appeal, by reference to its earlier case of Global Upline, notes that the fundamental purpose of providing the performance bond is a form of guarantee in the event the contractor fails to deliver the completed project. Implicitly, upon delivery of the completed project, the performance bond ceases to serve its intended purpose.

- “41. *The law is settled that, where the works are completed, any demand on the Performance Bond will be unconscionable...*
- 43. *In Global Upline Sdn Bhd v Kerajaan Malaysia and anor appeal [2018] MLJU 175, the Court of Appeal inter alia, held:*

“...Of course how a performance bond clause is worded may differ but its essence does not depart from the fundamental purpose of providing a form of guarantee given by the contractor which is liable to be called upon by the employer on the occurrence of a breach that results in the failure by the contractor to deliver on its promise to deliver up the completed project within the agreed time frame as per the contract.””

UNPAID LAD = GROUNDS FOR DENYING COMPLETION STATUS?

The Court of Appeal categorically stated that unpaid delay damages is not a ground to withhold completion certification, in this case the Certificate of Provisional Acceptance. This is especially considering that the employer had started generating revenue from the operation of the facility. Under such circumstances, a demand on the performance bond would be unconscionable, considering the non-issuance of completion certificate was not due to non-completion of the project.

- “44. *Here, we find that the Appellant deliberately withheld the issuing of the approved Performance Test Report for ARDS Unit 1210 to the Respondents (despite the project being completed after inspection and testing) in order to avoid having to issue the Certificate of Provisional Acceptance.*
- 45. *Via a letter dated 8.12.2023, the Appellant informed the Respondent that they are not entitled to the certificate of Provisional Acceptance because the Respondent has not paid the Appellant the delay damages in the amount of USD132,902,900.00 which to us the Appellant is not entitled to after the said facility has been completed and handed over to the Appellant. More so the Appellant has also earned revenue from*



operating the facility. Accordingly, we find that the Appellant demands on the Performance Bond is unconscionable.”

ALTERNATIVE REMEDY – PARENT COMPANY’S GUARANTEE

Finally, the availability of alternative remedy open to the Appellant / Employer also appeared to be pivotal in the Court of Appeal’s decision as the Court of Appeal finds that the Appellant is not without remedy upon completion and after returning the Performance Bond, for it can still demand on the Parent Company’s Guarantee.

“46. *In addition, the Appellant’s here is not without remedy after completion when the Performance Bond should have been handed back, as the Appellant can still make a demand on the Parent Company’s Guarantee.”*

DECISION OF THE COURT OF APPEAL

In the upshot, the Court of Appeal dismissed the appeals and concluded that the calling of the Performance Bond is against the purpose of the said Bond.

“47. *In summary, we can safely conclude that the calling on the Performance Bond by the Appellant is against the purpose of the said Bond.”*

For completion, the Court of Appeal also agreed with the High Court that there are no grounds to set aside the Ex Parte Order.

KEY TAKEAWAYS

Following this decision, the following points should be noted:-

- (a) **Post-completion bond calls risk being unconscionable.** Where works have been completed and handed over, a performance bond ceases to serve its intended function of securing performance during execution, and any demand thereon is *prima facie* unconscionable.
- (b) **Unpaid LAD does not justify withholding completion certification.** In circumstances where the facility was completed, tested, and already generating revenue, unpaid delay damages did not justify withholding completion documentation or calling on the performance bond.
- (c) **Conduct and availability of alternative remedies matter.** The Court took into consideration the employer’s withholding of the Performance Test Report as well as the fact that alternative remedies remained available under the parent company guarantee, reinforcing that the bond was being deployed for a purpose beyond its intended function.



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