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Guarantees — Discharged or Not Discharged

Bank Pembangunan Malaysia Berhad v Spring Hill Bioventures Sdn Bhd [2020] 1 LNS 74; [2020] MLJU 78 (CA)

The Court of Appeal in this recent judgment considered when a guarantee may be discharged under ss 86 and 88 of the Contracts Act 1950. This is an issue that is not commonly considered as ss 86 and 88 are usually contracted out under commercial guarantees.

Facts

The Bank granted two term loans to Alpha Biologics Sdn Bhd. The term loans were secured by two separate letters of undertaking executed by Spring Hill Bioventures Sdn Bhd. The terms under the term loans were subsequently varied, but without first securing Spring Hill's consent to the variations.

Alpha Biologics was later wound up. The Bank, in seeking to enforce Spring Hill's obligation under the letters of undertaking, argued that the letters of undertaking were in effect indemnities, and that even if they were guarantees, Spring Hill's obligation was only discharged in part under s 86.

Before the High Court

The High Court held the letters of undertaking to be guarantees. The court further held that Spring Hill's obligation was fully discharged under the first term loan and discharged in part under the second term loan as a result of the variations.

In the Court of Appeal

One of the issues before the Court of Appeal was whether the letter of undertaking/guarantee for the first term loan was fully discharged due to the variation. In this regard, the Bank had varied the first term loan by extending time for Alpha Biologics to commence repayment of the first term loan. Spring Hill argued that the one-year extension, given without its consent, discharged its obligation under the letter of undertaking by virtue of ss 86 and 88.

Giving time

Section 88 provides:

“A contract between the creditor and principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract.”

The Court of Appeal, in coming to its decision, noted that a guarantor will only be discharged under s 88 if “*the guarantor’s position is altered to his detriment without his assent*”.

Suraya Othman JCA held that it was therefore necessary to examine the purpose of s 88 (which is *in pari materia* to s 135 of the Indian Contracts Act). She referred to *Amrit Lal Goverdhan Lalan v State Bank of Travancore & Ors* AIR 1968 SC 1432, where the Supreme Court of India held that:

“... The reason why an agreement to give time discharges the surety is because if, after making such an agreement, the creditor were to sue the surety the latter would at once be turned on the principal debtor in breach of the agreement to give time, so that the effect of such an agreement is to prevent ‘the surety from either requiring the creditor to call upon the principal debtor to pay off the debt, or himself paying off the debt, and then suing the principal debtor, thereby causing prejudice to the surety [*Rouse v Bradford Banking Co* [1894] 2 Ch 32, 75, per A L Smith LJ].”

The Court of Appeal found that “*giving of time or indulgence alone*” did not in this case discharge Spring Hill from its obligations completely because the variation did not impact Spring Hill’s right to sue Alpha Biologics.

Varying the terms

The Court of Appeal also considered s 86.

Section 86 provides that any variance, made without the surety’s consent, in terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions *subsequent to the variance*.

Suraya Othman JCA noted that “*Section 86 discharges the guarantor partly, i.e. the guarantor is discharged subsequent to the variation and section 88 discharges the guarantor completely*”. The Court of Appeal found that, on the facts, Spring Hill’s obligation as a surety was only discharged in part.

Spring Hill was ordered to repay the principal sum with interest accrued up to the date of the variation. The High Court’s decision was therefore reversed in part.

The Bank was represented by partner Andrew Chiew Ean Vooi and associate Wong Han Wey of [Lee Hishammuddin Allen & Gledhill](#).

The judgment of the Court of Appeal may also be viewed [here](#).

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