

CASE UPDATES

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Banking

The Pacific Bank Berhad v. Kerajaan Negeri Sarawak Civil Appeal No. Q-01-8-2011(Q)

The Federal Court had on 23.4.2014 delivered its decision in *The Pacific Bank Berhad v. Kerajaan Negeri Sarawak Civil Appeal No. Q-01-8-2011(Q)* where the issue concerned whether a claim on a bank guarantee by the beneficiary may be made after the deadline or expiry date specified by the bank. The question of law which was considered by the Federal Court was:

"Whether a term in a letter of guarantee which limits or restricts the time for making a claim thereunder is void?"

The Sarawak Government (the Respondent) had granted a timber licence to a Company. As the Respondent required a bank guarantee as security for payment of royalties in respect of the licensed area, Pacific Bank at the request of the Company issued a Bank Guarantee (BG) in favour of the Respondent. In return, the Bank obtained a Letter of Indemnity from the Company's contractor. Both the BG and Indemnity were dated the same date and both expired also on the same date, ie., a year later on 24.4.1998.

The BG specifies when a claim must be made on it, as follows:

"All claims, if any in respect of this guarantee shall be made during the guarantee period failing which we shall be deemed to have been discharged and released from all and any liability under this Guarantee." ("the Said Clause").

No claim was made on the BG by the guarantee period and the Bank notified the Respondent that its BG had expired and was cancelled. However, 6 months after such expiry, the Respondent made a claim under the BG. By that time, the Letter of Indemnity given to the Bank had also already expired.

The Bank rejected the Respondent's claim which led to the Respondent filing a suit in the Kuching High Court against the Bank.

The High Court and the Court of Appeal were not with the Bank. They held that the Said Clause breached s. 29 of the Contracts Act and was therefore void. Judgment was entered against the Bank and the appeal against such Judgment was dismissed by the majority of the Court of Appeal Judges on 24.6.2010.

S.29 of the Contracts Act states:

"Every agreement by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent."

The Courts followed earlier Court of Appeal decisions which had held that clauses like the Said Clause effectively restricted a party's right to sue for the claimed sum, i.e., the party should be given the full benefit of the relevant limitation period in which to sue.

The Bank (having by now been taken over by Malayan Banking Berhad) appealed to the Federal Court. In the light of other similar Court of Appeal decisions, there was much concern amongst banks, as there was now a great uncertainty as to how long a bank's contingent liability under its guarantee would subsist and how long could a bank hold security given for the issuance of the bank guarantee. This in turn would affect the cost and practicability of giving/obtaining a bank guarantee.

On 23.4.2014, the Federal Court delivered its decision, answered the above question of law in the negative and allowed the Bank's appeal. In gist, after going through various authorities, the Federal Court held:-

- a) The liability of the guarantor under a guarantee depends on the language of the instrument. If the language of the guarantee prescribes a time limit for a demand to be made before a cause of action can arise, so be it. The plain and ordinary meaning must be given.
- b) There is a need to distinguish between an agreement prescribing the time limit in which to make a demand (and if the guarantor does not pay, a cause of action ie., a right to sue, arises), and an agreement which limits the time period for suing on the failure to pay. Section 29 of the Contracts Act only invalidates the latter as such an agreement would limit the enforcement of the right.