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A CASE OF SIGNED BUT NOT NECESSARILY SEALED - HONG LEONG FINANCE

By Low Kee Yang.

Business Times Singapore, 2 June 1994

ASSUME you are a bank officer who has recently approved a loan to a company and, as security, you have taken a guarantee from three directors. Through an unfortunate turn of events, the company defaults and is wound up.

A nightmare, isn't it? Not quite, you comfort yourself. After all, there are the three guarantors. But assume further that of the three, one has absconded, another has died and the last is desperately seeking some way out of liability. An unlikely set of facts? Perhaps, but it actually happened recently. Worse, the remaining guarantor managed to find a way out!

The case is Hong Leong Finance Ltd v Goh Khim Teik, reported in the Singapore Law Reports (1994) Volume 1.

In 1982, Hong Leong Finance (HLF) granted a S$4 million loan to Chinese Pottery Arts and Handicraft Pte Ltd. Among the securities taken was a guarantee signed by directors A, B and C.

When the company subsequently defaulted, HLF enforced the securities and the company was wound up. HLF then sued the guarantors.

As director A had absconded, the action was commenced against directors B and C only. But as director B had died, the writ was served on director C.

There is cynical definition of a guarantee being a situation where "a person who cannot pay gets another who will not pay to say that he will". As might be expected director C had no intention of bearing the company's burden.

His defence was basically that it was intended that all five directors should sign as guarantors and since two of them did not sign, he was not liable under the guarantee.

The principle on which director C was relying is undisputed: If it was a condition of the guarantee that all the directors must sign, then the failure of a single director to sign would render the guarantee ineffective. In practice, the document of guarantee would seldom have such an express condition. The principle is further refined and has been stated as follows:

"Where a surety had executed a document in the belief derived from the form of the document that it would be executed by all the sureties named as such in the document as persons who were to sign, he would be relieved from his obligation if all the others did not sign." (Hansard v Lethbridge, 1892).

In other words, if the form of guarantee gives a guarantor the impression that other persons will also be guarantors (because their names also appear as such), then the guarantor will not be bound unless all the others sign the guarantee as well.

The rationale for such a rule is easy to understand. When making the difficult decision of whether to undertake a guarantee obligation, the fact that some other person (or persons) is willing to share the liability is an important consideration.

In law, co-guarantors have what is known as the right to contribution. For example, if directors A and B jointly and severally guarantee the payment of S$1,000 and director A has paid S$1,000, he is entitled to ask director B to "contribute" S$500 to him.

The rule therefore appears to be a sensible one.

Did the facts substantiate director C's defence? The judge's finding of facts was as follows. The guarantee named five persons as guarantors directors A, B and C as well as directors D and E.

On a particular day, directors A, B and C went to the lawyer's office to sign the guarantee. Director C signed after director A had done so. He expected directors D and E to subsequently sign the guarantee. But unknown to him, the names of directors D and E were later crossed out and they did not sign.

The judge, L P Thean, thus ruled that since director C signed the guarantee on the understanding that directors D and E would also sign, their failure to do so meant that director C was not bound by the guara

But one may ask, isn't it common to have a clause in the guarantee such as "this guarantee shall bind every person signing it, notwithstanding its non-execution by any other proposed guarantor"?

Doesn't such a clause take care of the problem?

The answer to the first question is "yes" and to the second, surprisingly, is "no".

It is common to find such a clause in standard form guarantees. In the case report, there is no mention of such a clause in the guarantee. Presumably, there was none.

But would such a clause have saved HLF? It may surprise lawyers that it would not. No doubt such a clause, being a term of the guarantee should bind the guarantor.

But for the term to be binding, the agreement (ie, the guarantee) must be binding in the first place.

Where a guarantor alleges and succeeds in proving that it was the intention that all guarantors should sign, the legal argument is that there is a condition precedent to the operation of the guarantee. If not all of the proposed guarantors sign, the guarantee does not come operation at all (eg Molsons Bank v Cranston, 1918).

For this reason, the guarantor who has signed escapes liability even though there is a clause which says that he is liable notwithstanding the failure of others to sign.

So what do you do when one (or more) of the proposed guarantors is away, as so often happens in Singapore nowadays? There are some options.

For one, you may decide to reduce the number of proposed guarantors and make sure that all the parties understand it to be so and that this is properly reflected in the guarantee.

But this may not be a good alternative as it may be in the interest of the bank (and the guarantors) that there should be more persons undertaking liability.

Another option is to get the guarantor who is overseas to sign another guarantee. Even then, one should be very cautious, as another case, Indian Bank v Raja Suria (1993) shows. Six of seven directors had signed a guarantee which all seven were intended to be signatory to. Later, the seventh director signed a separate but identical guarantee.

The Court of Appeal held that:

It was a condition precedent of the first guarantee that all the named guarantors should sign;

The second guarantee was not incorporated into the first guarantee and therefore, both guarantees were unenforceable.

A somewhat startling result, it would appear, but the reasoning is technically correct.

To avoid unenforceability, the proper course would have been to make specific reference to the first guarantee in the second one such that the latter may be regarded as having been incorporated in the first.

It will be clear by now that the simple matter of getting a guarantee signed can end up being a complicated thing ... And, the above considerations are not the only relevant ones.