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The Dividing Line between Indemnities and Guarantees

The Takeaway

When drafting indemnities and guarantees, parties should take heed of the differences between the two.

In particular, parties should consider the following:

- (a) Whether parties intend:
 - i. for the promisor's obligation to hinge upon a default of the principal contract (thus rendering the contract between the parties a guarantee, rather than an indemnity); or
 - ii. for the promisor's obligation to be separately and independently enforced (this being a characteristic of an indemnity, rather than a guarantee); and,
- (b) Whether parties intend for a variation of the principal contract to have the effect of discharging the promisor's obligations (this again being a characteristic of a guarantee, as distinct from an indemnity).

This latest judgment of the Admiralty Court at Kuala Lumpur¹ ("**Judgment**") examines the scope of indemnities and guarantees, and the differences between the two.

In doing so, the Admiralty Court undertook a detailed examination of the documents in question and relied on leading Common Law authorities, which were read with provisions of the Malaysian Contracts Act.

The Background Facts

GJ Consultancy Sdn Bhd ("**GJ Consultancy**") entered into a Fixture Note ("**Principal Contract**") with Detik Timur Sdn Bhd ("**Detik Timur**"). Via the Principal Contract, Detik Timur chartered a vessel from GJ Consultancy to transport a shipment of cargo from Malaysia to China.² The Principal Contract required disputes between the parties to be arbitrated in Singapore.³ In failing to perform the Principal Contract, Detik Timur incurred dead freight and demurrage amounting to US\$280,000.⁴

¹ *GJ Consultancy Sdn Bhd v Gan Teck Lim* [2021] MLJU 933.

² Para 4.

³ Para 21.

⁴ Para 9.

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Despite having reached a settlement with GJ Consultancy to pay dead freight and demurrage, Detik Timur failed to keep to the settlement terms.⁵ As payment from Detik Timur was not forthcoming, GJ Consultancy intended to make a claim against Detik Timur via arbitration in Singapore. This was in accordance with the arbitration clause found in the Principal Contract.⁶

However, the chairman of Detik Timur ("**Promisor**"), executed a '*Letter of Indemnity and Guarantee*' ("**Letter**") in favour of GJ Consultancy which, in short, promised that he would bear personal liability for any loss or damage suffered by GJ Consultancy.⁷ The Letter required disputes arising from it to be heard by the Malaysian courts.⁸ Relying on the Letter, GJ Consultancy initiated a claim in the Admiralty Court at Kuala Lumpur against the Promisor.

The Court Applications

The Promisor applied for a stay of the Malaysian court proceedings in favour of arbitration in Singapore and to strike out GJ Consultancy's claim at the Admiralty Court.⁹

The Promisor alleged that:

- (a) The claim against him had to be heard together with the claim against Detik Timur in the arbitration in Singapore; and
- (b) The claim against him was contingent upon a successful claim proving Detik Timur's liability in the Singapore arbitration.¹⁰

The Promisor's stand was premised on the argument that the Letter was a guarantee and not an indemnity and, therefore, Detik Timur's liability against GJ Consultancy must first be established before any claim could be made against the Promisor.¹¹

GJ Consultancy contended (and as ultimately held by the Court) that the Promisor's liability under the Letter was in the nature of an indemnity. Thus, the obligations in the Letter could be enforced separately and independently from the underlying liabilities of Detik Timur under the Principal Contract. In other words, there would be no need for Detik Timur's liability against GJ Consultancy to be established before a claim could be made against the Promisor.¹²

⁵ Para 11.

⁶ Para 22(a).

⁷ Para 7.

⁸ Para 21 (c).

⁹ Para 1.

¹⁰ Para 23.

¹¹ Para 20.

¹² Para 26.

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The Admiralty Judge's Reasoning & Decision

The Judge dismissed the Promisor's application by deducing the parties' intention based on the wording of the Letter.

The three main points of the Judge's reasoning were:

- The word "*indemnify*" in Clause 1 of the Letter: "*The Charterer (Defendant) [Detik Timur] hereby agrees to indemnify the Disponent Owner in respect of any loss or damage suffered by the Disponent Owner...*" reflected the intention of the parties that the Letter was in the nature of an indemnity, and not a guarantee.¹³
- Clause 2 of the Letter, "*he [i.e the Promisor] shall be personally liable for any... demurrage imposed*" showed that the Promisor's liability to pay GJ Consultancy arose at the instance of demurrage charges being imposed because the Promisor put himself in the position of Detik Timur, as the person principally liable for the losses (as distinct from being a mere guarantor).¹⁴
- The Letter provided that any variation of the Principal Contract shall not discharge the Promisor's obligation to indemnify GJ Consultancy. The Judge held that this clause was indicative of an indemnity (as distinct from a guarantee) because under Malaysian law a variation of the principal contract without the guarantor's consent discharges the guarantor of its obligation. Therefore, the Judge reasoned, relying on speeches in the House of Lords,¹⁵ that the inclusion of this clause must mean that parties perceived the Letter to be in the nature of an indemnity.¹⁶

Conclusion

The Judgment emphasised the need for parties to pay attention to the words used in a contract due to their wide-ranging implications.

It is also a useful reminder that Malaysian courts will look to the contents of the contract to determine its impact and meaning and will not be swayed merely by the heading of contracts.

¹³ Para 37.

¹⁴ Para 38.

¹⁵ *Trade Indemnity Company, Limited Appellants; v. Workington Harbour and Dock Board Respondents* [1937] AC 1.

¹⁶ Paras 39-41.

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