

# Case Notes



## About the Author

Thulasy Suppiah is a Senior Associate at Messrs Koh Dipendra Jeremiah Law. Her portfolio of work encompasses civil and construction litigation and advisory work. She may be contacted at [thulasy@kdj-law.com](mailto:thulasy@kdj-law.com).

Since 1995, the Federal Court judgment in *Selva Kumar a/l Murugiah v Thiagarajah a/l Retnasamy* [1995] 1 MLJ 817 (“Selva Kumar”) has been instrumental in shaping the discourse on liquidated damages in Malaysia. Unfortunately, it has also formanted a trend of judicial determinations which adopt a very literal and restrictive interpretation of section 75 of the Contracts Act 1950 (“s 75 of Contracts Act”).

In essence, *Selva Kumar* propounded that notwithstanding an agreed liquidated damages clause in a contract (in this particular case, one involving the sale and purchase of a dental clinic between two dentists), the innocent party still bore the burden of proving that he had in fact suffered the damages

being claimed or, alternatively, that it is reasonable compensation in accordance with the principles set out in *Hadley v Baxendale* (1854) 9 Exch 341. An innocent party would only be exempt from this requirement in cases where it is difficult to assess actual damages and there is no known measure of damages.

## *Cubic Electronics v Mars Telecommunications:* Liquidated Damages Revisited



by Thulasy Suppiah

Now, whilst *Selva Kumar* is famously said to have blurred the distinction between penalties and liquidated damages, Malaysian Courts have consistently shown a tendency to treat liquidated damages clauses with caution and always, it would appear, in a manner protective of parties upon whom the liquidated damages clauses are being imposed, ie the contract breakers attempting to evade payment of liquidated damages to the innocent party. In early Malaysian cases such as *SS Maniam v State of Perak* [1957] MLJ 75, *Wearne Brothers (M) Ltd v Jackson* [1966] 2 MLJ 155 and *Linggi Plantations Ltd v Jagatheesan* [1972] 1 MLJ 89 (PC), the Courts did not hesitate to expressly pronounce that there was effectively no distinction between liquidated damages and penalties. Therefore, the default position with regard to liquidated damages was that the innocent party (ie the party seeking to claim liquidated damages) would not be able to recover the contract stipulated sum simpliciter – and would bear the burden of proving actual loss or that the damages sought were reasonable compensation.

### Cases Exempted from Selva Kumar

Liquidated damages clauses are most prevalent in two types of contracts: (i) construction contracts and (ii) sale and purchase agreements (“SPA”). The latter typically involves the purchaser being the innocent party who is able to claim the contract stipulated sum as damages when vacant possession has not been delivered in time by the contract breaker ie the developer/vendor. Post 1995, whilst *Selva Kumar* applied to all contracts containing a potentially unenforceable liquidated damages clause, contracts regulated by statute such as SPAs for residential dwellings<sup>1</sup>, were exempt from the *Selva Kumar* test. In accordance with the SPA, the purchaser had the unassailable and automatic right to be paid the liquidated damages sum stipulated in the SPA when a developer/vendor failed to deliver vacant possession.

Thus, notwithstanding *Selva Kumar*’s test, the Malaysian Courts continued with the policy of protecting purchasers or individuals involved in residential properties (usually for personal use and not commercial gain) and ensure their right to secure damages if there is a breach of contract (*Lebbey Sdn Bhd v Tan Keng Hong & Anor* [2000] 1 AMR 15; *Sakinas Sdn Bhd v Siew Yik Hau & Anor* [2002] 2 AMR 1953).

However, this was not the position with all other types of contracts. Subsequent decisions apply a restrictive and literal interpretation of *Selva Kumar*, specifically for construction contracts with liquidated damages clauses. The impugned clauses were treated with more suspicion, and innocent parties (non-defaulters) seeking to rely on them were typically put through the task of proving elements of reasonableness and genuine pre-estimation of a loss. Compared to the vast majority of decisions on liquidated damages clauses, there are almost no cases (this writer has only found one such case, and is happy to be corrected should there be more) that have resulted in an innocent party actually being able to enforce the right to claim for liquidated damages as a result of the defaulting party’s breaches (*Keen Builders Sdn Bhd v Utara Dua (Malaysia) Sdn Bhd (Samudra (Malaysia) Sdn Bhd, Garnishee*) [1998] 2 CLJ Supp 256).

### Selva Kumar’s Shortcomings in Commercial and Construction Cases

The trouble with the *Selva Kumar* test or how it has come to be interpreted and applied in many commercial/construction cases, was the heavy emphasis placed on the non-defaulting party to prove actual damages or loss. Excluding the notable exemptions for a small category of cases to the general test, a quick look at decisions post-*Selva Kumar* on the enforceability of liquidated damages clauses show that the default position would result in it being deemed a penalty clause unless the innocent party is able to prove actual loss or damage (*Johor Coastal Development Sdn Bhd v Constrajaya Sdn Bhd* [2009] 4 CLJ 569; (“Coastal Johore”)).

Proving actual loss or damage in many of the contracts containing a pre-agreed liquidated damages clause is frequently complex or nigh impossible, particularly in construction and engineering projects where delays or disruptions to the completion of works are neither easily measured nor measured with accuracy using any one acceptable methodology. After all, the main objective for including a liquidated damages provision is to regulate beforehand the assessment of damages as a genuine pre-estimate of damages likely to be suffered by the innocent party (usually the Employer/Main Contractor), with both parties appreciating to some extent that proving actual damage/loss will be difficult and therefore defaults to the contract in the form of late delivery of a project, for example, exposes the Employer/Main Contractor to the risk of financial or commercial loss.

Thus, the effect of the *Selva Kumar* test, which was subsequently re-affirmed by another Federal Court decision in the case of *Coastal Johor*, was that it appeared to unduly curtail the rights of non-defaulting parties by placing the burden of proving its entitlement to enforce the liquidated damages clause even if the claim was for a reasonable, pre-ascertained sum that had already been agreed to between parties as being payable by the defaulter in the event of a breach of contract.

The Court's true intention behind such a restrictive interpretation may be warranted in some cases where judicial supervision and intervention would be welcome to prevent an oppressive or unconscionable clause from operating or imposing undue hardship on the contract-defaulter.

However, there is a fundamental difference between reviewing the fairness of a contractual obligation and regulating the remedy for a breach of that contractual obligation. The "penalty rule" (ie whether a liquidated damages clause is a genuine pre-estimate of damages) regulates only the remedies available for breach of a party's contractual obligations, not the contractual obligations themselves, which is an encroachment on parties' freedom to contract (assuming that elements of fraud, duress or undue influence do not apply).

The recent United Kingdom Supreme Court case of *Cavendish Square Holding BV v Talal El Makdessi* [2015] UKSC 67 ("*Cavendish Square*") expounds on this and forms the basis of a third, more progressive view propounded by our Federal Court on the operation of liquidated damages clauses as a perfectly acceptable commercial arrangement between parties to allocate risks and financial loss in the event of contractual defaults.

## The Decision of the Federal Court

*Cubic Electronics* appears to have lifted the curse of "presumed penalty unless otherwise proven" that has plagued liquidated damages clauses undeserving of such censure.

The case itself concerned an SPA between parties which contains a liquidated damages clause. Whilst the primary focus of the case was on the treatment of deposits ie if they were forfeitable per se or subject to the principles of law applicable to damages clauses, the Federal Court invariably tread down the path of determining what principle(s) ought to apply to a damages clause. However, its judgment covered the shortcomings and weaknesses of *Selva Kumar* and *Coastal Johor* and aimed to ensure a more balanced view of liquidated damage and its enforceability under non-SPA contracts.

In this regard, *Cubic Electronics*' did not outrightly 'overturn' the principles propounded in *Selva Kumar* or *Coastal Johor*. Instead, the Federal Court stated clearly that the test in *Selva Kumar* should not be interpreted as imposing a legal straitjacket in which proof of actual loss is the sole conclusive determinant of reasonable compensation and that reasonable compensation should not be confined to actual loss<sup>ii</sup>. The fact that cases post-*Selva Kumar* had adopted a restrictive approach in requiring proof of actual loss to ascertain reasonableness was not lost on the court. The court was instead of the view that the principles in *Selva Kumar* were still good law only that there was no necessity for proof of actual loss or damage in every case where the innocent party seeks to enforce a damages clause<sup>iii</sup>.

Briefly, the key takeaways from *Cubic Electronics* on determining whether or not a liquidated damages clause is enforceable, are as follows:

Clear recognition that s 75 of the Contracts Act allows "reasonable compensation" irrespective of whether actual loss or damage is proven by the party seeking to claim liquidated damages<sup>iv</sup>:

- (a) The initial onus is on the innocent party (ie the non-defaulting party) to establish that there was a breach of contract and the contract had a damages clause with a pre-ascertained sum stipulated to be paid upon breach<sup>v</sup>;
- (b) If the contract-breaker (defaulting party insisted that the liquidated damages clause should not be enforced – then he would bear the burden of proving that the damages clause is unreasonable or ought to demonstrate from available evidence what should constitute "reasonable compensation" instead<sup>vi</sup>; and

- (c) Reasonable compensation can be derived by comparing the amount that would be payable on breach with the loss that might be sustained if indeed the breach occurred. If there is no significant difference between the level of damages spelt out in the contract and the level of loss or damage which is likely to be suffered by the innocent party, then it is a reasonable sum<sup>vii</sup>.

This Federal Court decision is credited for finally revamping Malaysia's peculiar and straitjacketed position on liquidated damages – the *Cubic Electronics* judgment cites with approval the UK Supreme Court case of *Cavendish Square* and the emphasis placed on the “notion of reasonableness”. It further echoes the sentiments of the Court in *Cavendish Square* that concepts of “legitimate interest” and “proportionality” are relevant in deciding what amounts to reasonable compensation under s 75 of the Contracts Act<sup>viii</sup>. After all, commercial or construction contracts are usually products of negotiations between parties who have comparable bargaining powers and are properly advised. They must, therefore, be taken to have freely, deliberately and mutually agreed to a contractual clause intended to pre-allocate risk and damages reasonably foreseeable for the purpose of carrying out their business.


The Federal Court recognised that if we were to insist that the innocent party bear the burden of proving that the clause was not excessive or oppressive, it would undermine the objective of including a liquidated damages clause in a contract to promote business efficacy and minimise litigation between parties, since the complaint about its unreasonableness/oppressiveness would only arise when a breach of contract has been committed by the contract-breaker.

By doing the above, it is posited that the Federal Court has achieved two goals:

- (a) Upholding the parties' right to freedom of contract – commercial parties possess a general freedom to choose whether to include a liquidated damages clause and are presumed to have done so freely and deliberately having taken into account their mutual interests.
- (b) Restoring balance in assessing when judicial intervention is warranted where liquidated damages clauses are concerned – that is, only when there is a need to relieve against a damages clause that is unconscionable, oppressive or excessive and not the contractual provision on liquidated damages itself.

## New Beginnings

*Cubic Electronics* brings with it a change of tides – liquidated damages clauses are no longer to be presumed penalty clauses unless the defaulting party is able to prove elements of unreasonableness, unconscionability or oppressiveness. It is hoped that the courts will not refrain from scrutinising the remedies prescribed in contracts containing liquidated damages clauses altogether. As the Federal Court in *Cubic Electronics* stated, it would plainly be contrary to public policy to allow a mischief sought to be remedied by a statutory provision to be defeated on the basis of freedom of contract, in much the same way as allowing the grotesque quality of Shylock's pound of flesh<sup>ix</sup>.

Instead, it is hoped that with the more nuanced approach elucidated by the Federal Court including notions of reasonableness, legitimate interest and proportionality when determining whether the compensation sought is reasonable, the courts in future can balance these considerations before coming to a decision on the enforceability of a liquidated damages clause. In other words, liquidated damages clauses are no longer cursed with the shroud of unreasonableness or oppressiveness. 



<sup>i</sup> Housing Developers (Control and Licensing) Regulations 1989

<sup>ii</sup> Para [65] of *Cubic Electronics*

<sup>iii</sup> *Supra*

<sup>iv</sup> Para [69] and Para [74](vi) of *Cubic Electronics*

<sup>v</sup> Para [70] and Para [74](vii) & (viii) of *Cubic Electronics*

<sup>vi</sup> *Supra*

<sup>vii</sup> Para [68] of *Cubic Electronics*

<sup>viii</sup> Para [66] of *Cubic Electronics*

<sup>ix</sup> Para [54] of *Cubic Electronics*

# Rajendra Rao v CIMB Aviva Assurance Berhad

by Suganthi Singam

(Court of Appeal Civil Appeal Case No. W-01 (A) 245-07/2017)

CIMB Aviva Assurance Berhad (“the Company”) was successfully defended in an action brought by its former Talent/Leadership/ Culture Lead & Business Partner (“the Claimant”).

## Decision

In its decision on 23 Nov 2018, the Court of Appeal ruled in favour of the Company and upheld the Claimant’s non-confirmation in employment by concluding that substance takes precedence over form. This decision is crucial as it recognises that in the course of assessing a probationer, the main consideration is whether the Company extended a fair assessment of the probationer notwithstanding that there was non-compliance to prescribed forms and procedures.

## Facts

The Claimant/Appellant commenced employment with the Company/Respondent as the Talent/Leadership/Culture Lead & Business Partner, Grade 20 on 5 July 2010 and was subject to a six-month probationary period in order for the Company to assess his suitability for confirmation. The Claimant’s probationary period was subject to a further extension of six months. After approximately twelve months in employment, the Claimant was informed that he was not confirmed.

The Company’s primary decision not to confirm the Claimant in employment was due to the following shortcomings:

- (a) Absenteeism/tardiness;
- (b) Lack of accountability and ownership; and
- (c) Lack of commitment.

The Claimant contended that his dismissal was unfair given the following, *inter alia*:

- (a) The Company acted in breach of its Probation and Confirmation policy when the Company extended his probationary period on two occasions [as the policy only provided for one extension];
- (b) That the Claimant’s immediate superior (CW1), failed to complete the prescribed Performance Improvement Plan (“PIP”) form for emplacement on the PIP and for purposes of extending his probationary period of employment; and
- (c) That there was purported victimisation as CW1 was only employed four months into the Claimant’s probationary period, which rendered his first four months of employment superfluous.

This was compounded as CW1 conceded that she did not have sufficient time to assess the Claimant for confirmation which resulted in the first extension of his probationary period of employment.


The Industrial Court, via Award 743 of 2016, ruled in favour of the Company. The Industrial Court held that the pertinent question was not whether there was compliance of procedure but whether the Claimant was accorded a fair assessment by the Company in its decision not to confirm the Claimant in employment. Based on the evidence before the Industrial Court which took the form of voluminous exchanges of email correspondence as well as oral testimony, the Industrial Court concluded that the Claimant was granted sufficient opportunity to prove his suitability for confirmation which he failed to do. The non-confirmation was upheld.

Aggrieved by the Industrial Court's decision, the Claimant challenged the decision by way of a Judicial Review in the High Court. The High Court concurred with the findings of the Industrial Court and concluded that the most important question was whether the Claimant was given a fair assessment and not whether there was a strict adherence to form. In this regard, the High Court upheld the decision of the Industrial Court. The Claimant challenged the High Court's decision in the Court of Appeal.

The Claimant's main grounds of appeal were:

- (a) That there were specific formats in place in assessing the Claimant's suitability for confirmation, which the Company failed to comply with;
- (b) That the Company failed to document the Claimant's performance deficiencies in the Performance Improvement Plan ("PIP") templates which was a necessary procedure;
- (c) That the Company had acted in contravention of its "Probation & Confirmation Policy" when the Company extended the Claimant's probationary period on two occasions despite the Policy stipulating that the Claimant's probationary period could only be extended once, and

- (d) That the Claimant's contract clearly provided that any assessment on his probationary period must be solely based on his first six months of employment. As CW1 admitted that she had insufficient time to assess the Claimant, the foregoing was therefore a breach of his expressed terms.

The Court of Appeal dismissed the Claimant's appeal and found that there were no merits to overturn the decisions of the High Court and Industrial Court. In the upshot, the emphasis is placed on substance over form. In assessing a probationer, the paramount question to be determined is whether an employee was given a fair and reasonable assessment as opposed to a pedantic adherence to policies. 

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