Introduction

There are two certainties in life. Death. And the fact that contracts will be broken. If a contract is broken, the injured party’s remedy lies in an action for damages. The purpose of damages is to compensate the injured party, not to punish the contract-breaker. How much damages should the injured party receive? This depends on his loss - which he must generally prove in each case. Once he has proven his loss, the courts will usually award him sufficient damages to put him in a position as though the contract had been performed.

Proof of loss in construction projects is, however, an exacting task. As a result of the problems related to proof, construction contracts typically provide for a sum of money to be paid as ‘liquidated damages’ for late completion.

In most common law jurisdictions - such as Australia, New Zealand, England and Singapore - an employer will be entitled to liquidated damages as compensation. However, in Malaysia - which is also a common law jurisdiction - the position is somewhat different by virtue of section 75 of the Contracts Act. This provision has been interpreted by the courts as deeming liquidated damages to be penalties and accordingly invalid.

Effect Of Section 75 Of The Contracts Act

Section 75 of the Contracts Act provides as follows:

‘When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.’ (Emphasis added).

The Malaysian cases are very clear on the effect of section 75 of the Contracts Act, ie, in every case where a sum is named in a contract as the amount to be paid in case of breach, such sum is to be treated as a penalty. The leading case on section 75 is the Federal Court’s decision in Selva Kumar a/l Murugiah v Thiagarajah a/l Retnasamy (1995) (‘Murugiah’). In Murugiah, the Federal Court made it clear that:

- section 75 deems a liquidated damages clause to be penal and therefore invalid (except as a ceiling for recovery). Accordingly, any sum expressed as liquidated damages cannot, in and of itself, be automatically recovered by the injured party;
- even if a contract contained a liquidated damages clause, an injured party must still prove his actual loss;
- if owing to ‘a lack of an established measure of damages’, an injured party found it difficult to prove his actual loss, his claim would not fail. Instead, section 75 would permit him to recover ‘reasonable compensation’ (ie, a sum which is ‘reasonable and fair according to the court’s good sense and fair play’) capped at the value of the sum expressed as liquidated damages; and
• the relevant words in section 75 which permit an injured party to obtain recovery - despite being unable to prove his actual loss - are the words, ‘whether or not actual damage or loss is proved to have been caused thereby’.

If everything went as scripted by the Federal Court in Murugiah, contractors would have rejoiced and employers would have endured sleepless nights. For employers, the Murugiah case could not have come at a worse time. With projects becoming increasingly complex - and hence, more susceptible to delay - the inability to rely on a liquidated damages clause and the corresponding requirement of having to prove actual loss was a daunting prospect. They thus began amending their liquidated damages clauses to try to circumvent the Murugiah ruling concerning actual proof. Sensing this discomfort, the lower courts in Malaysia also struggled to find a way around the Murugiah ruling which was binding on them.

Getting Round Restriction On Liquidated Damages Clause In Late Completion Cases

The most recent and detailed example of the courts finding a way round the Murugiah ruling is the decision of the Malaysian High Court in Sakinas Sdn Bhd v Siew Yik Hau & Anor (2002) (‘Sakinas’). It involved a buyer of a condominium apartment. His contract with the developer, in a standard form prescribed by the Malaysian Housing Developers (Control and Licensing) Regulations (1989), contained a liquidated damages clause. It stated that liquidated damages would accrue for each day of late completion. The developer completed 13 months late. Therefore, liquidated damages accumulated in the buyer’s favour to the tune of over RM18,000. The buyer sued for this sum but did not provide evidence of the actual loss suffered. Could he still recover?

Applying Murugiah, the court acknowledged that the buyer was indeed required to prove his actual loss. However - and importantly for those in the construction industry - it held that while the buyer had not adduced any evidence of his actual loss for late completion, it did not matter because he did not have to. This was because late completion was a species of breach for which ‘no known measure of damages was employable’, and it simply came down to what the court considered was a fair amount to be paid as ‘reasonable compensation’. On the facts, the full sum of RM18,000 claimed as liquidated damages was found to be ‘reasonable compensation’.

Why are delays in completion considered a species of breach for which ‘no known measure of damages was employable’?

This is because a variety of losses is involved such as financing charges, rental expenses, loss of profit, loss of use and loss of enjoyment. Particularly instructive for employers in building projects is the High Court’s reasoning as to why ‘no known measure of damages was employable’ for late completion. The court explained that if there was a delay in the completion of the building, the purchaser may suffer in various ways such as having to commence paying the loan instalments without getting the enjoyment of the house. If he is renting a house, he will have to keep on paying the rental for it. If he had bought the house as an investment, he would have been deprived of the rental that he would have received. Moreover, there was the element of hardship in the case, for example, of a person who had to pay both the rental of his present accommodation and the loan instalments.

The court also stated that irrespective of the circumstances and intention of the house buyer, it could be said that in every case of delay in completion, the purchaser would be deprived, at very least, of the rental that he would have received had he chosen to rent out the house. It would be a substantial loss in theory. The court, however, recognised the difficulty of proving loss of rental, especially where the whole project is delayed so that there is no case on which to base a fair comparison. The court noted that ‘a trial of the question of rentability may result in different awards of compensation in respect of different properties in the same housing development, whereas the delay suffered is the same.’

While there is a clear public policy element in the Sakinas case (since it concerned a residential development), it is worth stressing that the condominium developer would arguably have been able to recover his liquidated damages in full from the contractor, albeit also in the form of ‘reasonable compensation’ under section 75 of the Contracts Act. This is because in computing his own liquidated damages under the building contract, the developer would conceivably have passed on to the contractor the very same liquidated damages the condominium buyers could claim against him.
Conclusion

While liquidated damages are recognised as valid in most common law jurisdictions, they are invalid in Malaysia by reason of section 75 of the Contracts Act, as construed by the Federal Court in *Murugiah* which requires the injured party to prove his actual loss.

The *Murugiah* ruling had created hardship for those in the construction industry, where proof of actual loss is often difficult, costly and time-consuming. The recent decision of the Malaysian High Court in *Sakinas*, however, has given employers hope by showing the readiness of the courts to consider delays in construction projects as a species of breach for which ‘no known measure of damages was employable’. This paves the way for the courts to award reasonable compensation, possibly taking the form of an award equal to the full value of the liquidated damages specified by the parties. In this manner, liquidated damages may continue to have relevance in the Malaysian construction industry, notwithstanding the effect of section 75 of the Contracts Act.

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