

LESSONS FROM INDIAN LAW: APPLYING THE NEW PRINCIPLES IN *CUBIC ELECTRONICS*

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Abstract

The Federal Court's judgment in *Cubic Electronics Sdn Bhd (in liquidation) v Mars Telecommunications Sdn Bhd* has been seen as a watershed moment for the treatment of liquidated damages clauses ('LAD clauses') in Malaysia. The long-held notion that the party who is claiming damages under a LAD clause must prove the actual damage incurred in accordance with the ordinary principles to calculate damages laid down in *Hadley v Baxendale* was shattered. In its place, the Federal Court opted to incorporate the concepts of 'legitimate interest' and 'proportionality' into Malaysian law on LAD clauses, principles which were first expounded in English cases. Unfortunately, these concepts have not been expanded on in later Malaysian cases. This article proposes that Malaysian law on LAD clauses and its newly introduced concepts can be finessed further, specifically by adopting the Indian position of requiring actual proof of loss, whenever possible, in order to prove an innocent party's 'legitimate interest'. This approach also mirrors the reality of the court's considerations in practice, as demonstrated in a recent Malaysian case cited in the article.

Keywords: Contract, liquidated damages, legitimate interest, proportionality, actual proof of loss

I INTRODUCTION

Much ink has been spilled over the repercussions of the unanimous Federal Court decision in *Cubic Electronics Sdn Bhd (in liquidation) v Mars Telecommunications Sdn Bhd* ('*Cubic Electronics*')¹ on the treatment of liquidated damages clauses ('LAD clauses') in Malaysia. While the decision has been lauded as bringing 'the application of the penalty rule as embodied in section 75 [Contracts Act 1950 ("CA 1950")] up to date with modern commercial practices',² this article views that the reasoning in the judgment can be finessed further by reconciling the judgment with Indian law on LAD clauses, specifically by adopting the Indian position of requiring actual proof of loss, whenever possible, in order to prove an innocent party's 'legitimate interest'.

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¹ [2019] 6 MLJ 15.

² Choong Shaw Mei, 'Cubic Electronics v Mars Telecommunications – Revisited or Misunderstood?', *University of Malaya Law Review* (Online Supplement, 4 April 2020) <<https://www.umlawreview.com/lex-in-breve/cubic-electronics-v-mars-telecommunications-revisited-or-misunderstood>>.

For reference, the law on LAD clauses in Malaysia as stipulated in section 75 of the CA 1950 is repeated here:

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.

Before the decision in *Cubic Electronics*, Malaysian law on LAD clauses was beholden to the decision in *Selva Kumar a/l Murugiah v Thiagarajah a/l Retnasamy* ('*Selva Kumar*'),³ where it was held that the party who is claiming damages must prove the actual damage incurred in accordance with the principles laid down in *Hadley v Baxendale*,⁴ except when it is difficult to assess the actual damage incurred. The Federal Court, agreeing with the reasoning of the Indian Supreme Court in *Maula Bux v Union of India*,⁵ held that the words 'whether or not actual loss or damage was proved to have been caused thereby' in section 75 of the CA 1950 should only be restricted to those cases where the court would find it difficult to assess damages for the actual damage or loss suffered.⁶ This position was subsequently reaffirmed by the Federal Court again in *Johor Coastal Development Sdn Bhd v Constrajaya Sdn Bhd* ('*Johor Coastal*').⁷

The effect of the *Selva Kumar* and *Johor Coastal* decisions meant that parties which had incorporated LAD clauses in their contracts ultimately could not rely on the figure of damages stipulated in the said LAD clause as they still had to prove the actual *amount* of losses to claim a corresponding amount of damages, if such losses can be assessed. This rendered LAD clauses redundant, as without the presence of LAD clauses in a contract, the innocent party can already claim damages for breach if it can prove its losses in accordance with section 74 of the CA 1950.⁸

II THE DECISION IN *CUBIC ELECTRONICS*

With two previous Federal Court decisions making the same assertion before it, the Federal Court in *Cubic Electronics* acted boldly in choosing to diverge from the past. In doing so, it breathed life into the purpose of section 75 of the CA 1950 again by

³ [1995] 1 MLJ 817.

⁴ *Hadley & Anor v Baxendale & Ors* (1854) 9 Exch 341; [1843-60] All ER Rep 461.

⁵ [1970] 1 SCR 928.

⁶ *Selva Kumar* (n3) 827 [E].

⁷ [2009] 4 CLJ 569.

⁸ Section 74(1) of the CA 1950 reads:

When a contract has been broken, the party who suffers by the breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from the breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

stating that section 75 allows reasonable compensation to be awarded by the court *irrespective of whether actual loss or damage is proven*. As explained in paragraph 74 of the judgment, the initial onus lies on the party seeking to enforce a damages clause under section 75 of the CA 1950 to adduce evidence that firstly, there was a breach of contract and that secondly, the contract contains a clause specifying a sum to be paid upon breach. Once these two elements have been established, the innocent party *is entitled to receive a sum not exceeding the amount stipulated in the contract* irrespective of whether actual damage or loss is proven, subject to the defaulting party proving the unreasonableness of the damages clause including the amount stipulated therein, if any.⁹ If there is a dispute as to what constitutes reasonable compensation, the burden of proof falls on the defaulting party to show that the amount stipulated in the damages clause is unreasonable.

The effect of the *Cubic Electronics* decision is that once a LAD clause is present in the contract, the party claiming damages only needs to prove that a breach has occurred, and not necessarily its own losses. The court will then, at its discretion, award a sum not higher than that stipulated in the LAD clause, at which point the defaulting party may adduce evidence which shows that the amount stipulated in the LAD clause is unreasonable. A curious aspect about this judgment is that while the need to prove the actual amount of losses (which rendered LAD clauses redundant) has been removed, it also appears to have removed the need to prove the existence of loss in the first place. Instead, the court stated that the ‘proof of actual loss is not the sole conclusive determinant of *reasonable compensation* although evidence of that may be a useful starting point.’¹⁰

It is unclear how this new approach will work in practice. What we can derive from this is that when an innocent party shows that a breach has occurred but does not furnish proof that he has suffered losses, the court may still award an amount of damages at its discretion (subject to the amount stipulated in the LAD clause as the maximum) without considering the presence of actual loss. Thus, two questions arise: when will the court decide that the innocent party deserves an award of damages and how will the court determine the amount of ‘reasonable compensation’ without any proof of the actual loss suffered by the innocent party?

A ‘*Legitimate Interest*’ and ‘*Proportionality*’

It appears that in the absence of proof of actual loss, the courts will deign to *award the sum stipulated in the LAD clause* as status quo unless it is plain that the innocent party does not deserve damages or deserves a lesser amount of damages, either in the court’s judgment or demonstrated with evidence from the defaulting party. This is evinced by the Federal Court’s interpretation of the English cases quoted in the judgment:

⁹ A breaching party may refute the applicability of the LAD clause in the particular context of the breach, or dispute the interpretation of the LAD clause in view of the circumstances of the case, among others. See, eg, *View Esteem Sdn Bhd v Vitalmont Development Sdn Bhd* [2014] 1 LNS 1402. See also *PJD Regency Sdn Bhd v Tribunal Tuntutan Pembeli Rumah & Anor and other appeals* [2021] 2 MLJ 60.

¹⁰ *Cubic Electronics* (n1) [74] (Emphasis added).

The restatement of the principles of law on damages clause [in English law] represents a clear shift in judicial attitude where courts are reluctant to interfere with parties' freedom of contract, especially if the contracting parties have comparable bargaining power and are properly advised.¹¹

However, caution must be exercised in celebrating this shift in judicial attitude towards upholding parties' freedom to contract as the retention of the courts' discretion in the matter means that the award of the sum stipulated in the LAD clause is still not a given. Pursuant to such judicial discretion, parties to a contract will be most concerned as to when and how the court exercises its broad discretion to award or deny an innocent party damages, the amount of which may be lesser than that stipulated in the LAD clause. Two principles were thus introduced by the Federal Court from English law: 'legitimate interest' and 'proportionality'. First, the Federal Court quoted the English case of *ParkingEye Ltd v Beavis* ('*ParkingEye*'),¹² stating that in the absence of actual loss or damage, an impugned LAD clause may be upheld 'by applying the concepts of legitimate interest and proportionality'.¹³ Second, the Federal Court quoted the English case of *Cavendish Square Holding BV v Talal El Makdessi* ('*Cavendish*'),¹⁴ which was decided together with *ParkingEye*. In quoting the *Cavendish* decision, the Federal Court opined that courts will take into account the concepts of 'legitimate interest' and 'proportionality' in deciding what amounts to 'reasonable compensation'.¹⁵

Reviewing the context of the Federal Court's quotation of *Cavendish* and *ParkingEye* in the judgment, both cases appear to enunciate two separate principles which concern 'legitimate interest and proportionality'. *Via* its quotation of *ParkingEye*, there is an indication that 'legitimate interest and proportionality' are to be considered when deciding *whether to award any amount of damages at all* (capped by the sum stipulated in the LAD clause) *when no evidence of actual loss is presented by the innocent party*. In addition, *via* its quotation of *Cavendish*, 'legitimate interest and proportionality' shall be considered again in *deciding the amount of 'reasonable compensation' once the court has decided that the innocent party should be awarded an amount of damages*, despite the lack of evidence of actual loss. It is unclear if the Federal Court actually intended for 'legitimate interest and proportionality' to be considered twice, though it may be possible that the Court only meant to consider 'legitimate interest' at the stage of considering whether to award damages, and 'proportionality' only at the stage of assessing reasonable compensation, as we shall see in further analysis of the Court's wordings below.

As is obvious, the considerations of 'legitimate interest and proportionality' are subjective and not quantifiable. This leaves a rather wide discretion to the court, as was the case in *ParkingEye*, where it was held that the car park operator was justified in charging extra for overstaying the two-hour parking period as 'It provided a valuable service in

¹¹ *Cubic Electronics* (n1) [58].

¹² [2015] UKSC 67.

¹³ *Cubic Electronics* (n1) [67].

¹⁴ [2015] UKSC 67.

¹⁵ *Cubic Electronics* (n1) [66].

maximising the use of car park spaces which benefited the landowner'.¹⁶ Based on the Federal Court's citation of the *ParkingEye* case, we know that one possible criteria for an innocent party to be considered as having a 'legitimate interest' in order to be awarded damages (where there is no proof of loss, only a LAD clause) is where it is providing 'a valuable service'. No other refinements of the criteria of 'legitimate interest' were given by the Court, concluding with an exhortation to take a 'common sense approach by taking into account the legitimate interest which an innocent party may have'.¹⁷

The Federal Court then considered 'the proportionality of a damages clause in determining reasonable compensation'.¹⁸ It is unclear if the 'proportionality of the damages clause' refers to the proportionality of the innocent party's interest in the LAD clause (which would be akin to the concept of 'legitimate interest'), or the proportionality of the figure stipulated in the LAD clause in relation to the actual damage suffered. However, we have reason to believe that the Court meant the latter, as it went on to state that:

... in a straightforward case, reasonable compensation can be deduced by comparing the *amount* that would be payable on breach with the *loss* that might be sustained if indeed the breach occurred. (Emphasis added.)¹⁹

Therefore, the Federal Court appears to have set out a proportionality test in assessing the amount of reasonable compensation to be awarded to the innocent party once it decides to award damages, with the LAD clause acting as a cap on the amount of compensation which can be awarded to the innocent party.

To summarise the above, the Federal Court in *Cubic Electronics* appears to have substituted the requirement to prove actual loss in *Selva Kumar*, with the requirement to have a 'legitimate interest' in being awarded damages. Furthermore, the requirement to prove the actual *amount* of losses as was the case in *Selva Kumar* has been replaced with the court's discretion to award any amount of damages, capped by the sum stipulated in the LAD clause.

B 'Legitimate Interest' vs Proof of Actual Loss

In terms of what can be classified as a 'legitimate interest', the only pointer offered by the Federal Court in determining an innocent party's 'legitimate interest' was to take a 'common sense approach', aside from the example of 'a valuable service' from *ParkingEye*. Given the lack of other guidance, it is probable that an innocent party will still be compelled to lead proof of actual loss when claiming for damages under a LAD clause in order to convince the presiding judge, despite the decision in *Cubic Electronics* that such proof is no longer necessary. Indeed, this reality of requiring parties to provide proof in order to advance their case, including proof of actual loss where possible, has been reflected in Indian contract law.

¹⁶ *Cubic Electronics* (n1) [67].

¹⁷ *Cubic Electronics* (n1) [68].

¹⁸ *Ibid.*

¹⁹ *Ibid.*

III THE POSITION OF LAD CLAUSES IN INDIAN CONTRACT LAW

Section 74 of the Indian Contract Act 1872 provides the following:

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.

The similarity between section 75 of the CA 1950 and section 74 of the Indian Contract Act 1872 is not coincidental; the Malaysian statute is based on its Indian counterpart. It is instructive, therefore, to review how the Indian courts have interpreted this corresponding section.

In *Fateh Chand v Balkishan Dass* ('*Fateh Chand*'),²⁰ which was also cited by the Federal Court in *Cubic Electronics*, the Supreme Court of India held, *inter alia*, that section 74:

.... merely dispenses with proof of actual loss or damage; it does not justify the award of compensation when in consequence of the breach no legal injury at all had resulted, because compensation for breach of contract can be awarded to make good loss or damage which naturally arose in the usual course of things, or which the parties knew when they made the contract, to be likely to result from the breach.²¹

As emulated by the Federal Court in *Cubic Electronics*, *Fateh Chand* acknowledged that proof of actual loss or damage may not be necessary, though the Supreme Court pointed out that no compensation should be awarded to the innocent party when no legal injury (i.e. no loss) has been suffered due to the breach. In relation to the latter, it may be pointed out that the Court did not specifically state that the duty to prove that the innocent party has not suffered losses falls to the defaulting party, which leads us to the inevitable conclusion that an innocent party claiming damages must first prove its own case with proof. Indeed, in *Fateh Chand* itself, the Supreme Court of India held that in the absence of any proof of damage suffered by the plaintiff arising from the defendant's breach of contract, the additional 13 per cent of the price which had been awarded by the High Court 'as reasonable compensation in relation to the value of the contract as a whole' must be set aside as it had been 'assessed on an arbitrary assumption'.²²

This notion that proof of damage must be furnished to the court by the innocent party in order to derive reasonable compensation has been further strengthened in subsequent

²⁰ AIR 1963 SC 1405 : LNIND 1963 SC 20.

²¹ *Fateh Chand* (n20) [10].

²² *Fateh Chand* (n20) [16].

Indian cases. In *M S Kailash Nath Associates v Delhi Development Authority and Another*,²³ the Supreme Court of India reiterated in paragraph 43.6 of the judgment that:

The expression whether or not actual damage or loss is proved to have been caused thereby means that *where it is possible to prove actual damage or loss, such proof is not dispensed with. It is only in cases where damage or loss is difficult or impossible to prove that the liquidated amount named in the contract, if a genuine pre-estimate of damage or loss, can be awarded.* (Emphasis added)

While not stated explicitly, it is intuitive that the party claiming for damages will have to lead proof of the actual damage or loss (unless the damage or loss is difficult or impossible to prove). Therefore, it suffices to conclude that Indian jurisprudence has not done away with the innocent party's need to prove actual loss where a LAD clause is present. Rather, Indian jurisprudence mandates the need to prove the existence of actual loss or damage but sheds the requirement only for cases where it is difficult or impossible to prove the damage or loss. The latter innovation is where the Indian courts have created an exception broad enough to encompass cases where it is difficult or impossible to prove the damage or loss, but justice requires that the innocent party is awarded a reasonable sum to compensate for the hardship suffered as a direct result of the breach of contract.

IV APPLICATION OF THE INDIAN POSITION TO MALAYSIAN CONTRACT LAW

It is respectfully submitted that the Indian approach to the requirement of proof in cases concerning LAD clauses is clear and flexible enough to be adopted by the Malaysian courts as well when interpreting section 75 of the CA 1950, which mirrors section 74 of the Indian Contract Act 1872. There is no doubt that the Federal Court in *Cubic Electronics* attempted to incorporate some flexibility into the Court's discretion to award reasonable compensation by introducing the concepts of 'legitimate interest' and 'proportionality'. However, as the Supreme Court of India in *Fateh Chand* has saliently warned, over-reliance on discretion may open the door to arbitrary assumptions in the absence of the requirement for any kind of proof. The Federal Court's acknowledgment in *Cubic Electronics* that 'proof of actual loss is not the sole conclusive determinant of reasonable compensation although evidence of that may be a useful starting point'²⁴ overlooks the reality that any court, in meting out justice, will insist on evidence to substantiate its decision if such evidence can be provided. The statement may mislead parties into believing that evidence of actual loss or damage is no longer required, whereas in practice the failure to furnish evidence of actual loss or damage should only be acceptable in very rare circumstances where it is difficult or impossible to do so but justice can only be served by upholding the LAD clause.

²³ AIR 2015 SC (Supp) 780 : (2015) 4 SCC 136 : LNIND 2015 SC 12.

²⁴ *Cubic Electronics* (n1) [74].

Given the current lack of clarity on the concepts of ‘legitimate interest’ and ‘proportionality’, introducing the requirement to provide proof of actual damage or loss would supplement, rather than contradict, the Federal Court’s adoption of these concepts. In order for the innocent party to prove that it has a ‘legitimate interest’ in the contract which should be protected by the court in the form of reasonable compensation, an innocent party should provide evidence of such ‘legitimate interest’ in the form of actual damage or loss, if possible. There is no need to prove the exact amount of loss as was previously required in the case of *Selva Kumar* as the court will make the assessment of damages in proportion to the sum already stipulated in the LAD clause. The innocent party only needs to prove that it would suffer some kind of loss stemming from the defaulting party’s breach, which is not a difficult threshold to cross in most cases. It should be pointed out that even in the case of *ParkingEye*, Lord Neuberger and Lord Sumption (with whom Lord Carnwath agreed) at paragraph 99 of their judgment opined that:

It is an interest of ParkingEye [to charge the £85 fee for overstaying], because it sells its services as the managers of such schemes and *meets the costs of doing so* from charges for breach of the terms... (Emphasis added)

While the true amount of loss suffered by the parking operator if any number of cars overstayed the two-hour parking limit may have been too speculative to prove, it would not have been impossible if the parking operator had wished to lead evidence that it would incur actual losses if the cars were allowed to park for an unlimited period of time without any deterrent.

Notwithstanding the above, in the unlikely situation where evidence of actual loss or damage cannot be provided but the court views that the LAD clause should be upheld in the interest of justice, the court can still establish a ‘legitimate interest’ by adopting the exception in Indian jurisprudence where evidence of actual loss or damage is not required if it is difficult or impossible to prove.

The practical need to prove actual damage or loss by the innocent party in order to claim damages where a LAD clause is present has been reiterated by Malaysian courts time and again, even after the *Cubic Electronics* decision. For example, the High Court in *MPM Project Management Sdn Bhd v Kin Keong Electric Engineering Sdn Bhd* (*‘MPM Project Management’*)²⁵ held that ‘there has to be evidence proffered by the defendant to prove actual loss or damage that has arisen from the alleged delay caused by the plaintiff in completing the electrical works’.²⁶ The High Court rebuffed the defendant’s attempt to rely on *Cubic Electronics* in claiming damages not exceeding the sum stipulated in the LAD clause as there was no evidence of any loss suffered by the defendant as a result of the alleged delay in the plaintiff’s completion of electrical works.

The High Court’s judgment in *MPM Project Management* is also worthy of note as it proceeded to cite this particular paragraph from the case of *Selva Kumar* with approval:

²⁵ [2021] MLJU 219.

²⁶ *MPM Project Management* (n25) [29].

Where there is inherently any actual loss or damage from the evidence or nature of the claim, and damage for such actual loss is not too remote and could be assessed by settled rules, any failure to bring in further evidence or to prove damages for such actual loss or damage, will result in the refusal of the Court to award such damages, despite the words “whether or not actual damage was proved to have been caused thereby” in s. 75 of the Contracts Act.²⁷

Once again, the High Court reiterated that proof of actual loss or damage must be furnished whenever possible in order to claim a sum not exceeding the sum stipulated in the LAD clause of a contract. While the Court did not apply the concepts of ‘legitimate interest’ and ‘proportionality’ in *MPM Project Management*, it is testament to the reality that these concepts must be backed by proof if an innocent party wishes to avail itself of the benefits of a LAD clause. By formalizing the need for proof of actual damage or loss as indicators of ‘legitimate interest’ and ‘proportionality’ (the court may also use the proof of actual damage or loss to determine the proportionality of the amount stipulated in the LAD clause relative to the breach in question), judicial practice can be married with legal certainty on the meaning of these concepts.

V CONCLUSION

To conclude, while the Federal Court in *Cubic Electronics* succeeded in introducing some flexibility into the enforcement of LAD clauses by doing away with the need to prove the exact *amount* of actual loss, the fact that actual proof of loss must still be furnished whenever possible may have been inadvertently glossed over. This has resulted in cases where parties have attempted to rely on *Cubic Electronics* in order to uphold a LAD clause without furnishing adequate proof of actual loss, as was the case as decided by the court in *MPM Project Management*. Future judicial decisions involving LAD clauses may wish to finesse the law further, by providing more elaboration on the criteria involved in the concepts of ‘legitimate interest’ and ‘proportionality’, as well as emphasizing the need for actual proof of loss whenever possible in order to prove an innocent party’s ‘legitimate interest’, in line with the position adopted in Indian jurisprudence.

²⁷ Ibid (Emphasis added).