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# Divergence and Convergence in the Law of Contractual Penalties and Liquidated Damages Clauses in England, Singapore, and Malaysia

**Joshua Teng[1] · Kailash Kalaiarasu[1]**

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**Abstract**

Contracts often make provision for the remedies available upon breach, i.e., by providing for a sum or stipulation available to either party upon breach by the other (an 'agreed damages clause'). A persistent question is whether, and to what extent, such clauses are enforceable. In this paper, we analyse the convergences and divergences between Malaysia, Singapore, and England, in particular following decisions in the apex courts. These clauses are always enforceable under s 75 of the Malaysian Contracts Act 1950, albeit up to the point of 'reasonable compensation' only. Whereas, in Singapore and England, if the clause is found to be a 'penalty' it is liable to be unenforceable *in toto*. Malaysian law also differs in that a truncated assessment for 'reasonable compensation' is provided for in statute. We argue that the 'proportionality' and 'legitimate interest' elements in the *Cavendish* analysis, over the compensatory-centric analysis in *Denka Advantech*, may be a better fit with the concept of 'reasonable compensation' under Malaysian law, and may give content to the statutory interpretation of the phrase in future cases.

**Keywords** Penalty rule · Liquidated damages · *Dunlop Pneumatic* · *Cavendish Square* · *Denka Advantech* · Section 75 of the Malaysian Contracts Act 1950 · *Cubic Engineering*

✉ Joshua Teng
joshua.teng@skrine.com

Kailash Kalaiarasu
kailash.kalaiarasu@skrine.com

1 Advocates and Solicitors (Malaya); Skrine, Kuala Lumpur, Malaysia, Kuala Lumpur, Malaysia

## Introduction

When parties contract with one another they often make provision for the remedies available to either party upon breach by the other, that is, by providing for a sum or stipulation available to either party upon breach by the other (an 'agreed damages clause'). A persistent question of law is whether, and to what extent, such clauses are enforceable. In England and Singapore, Lord Dunedin's tests in *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd*[1] were the mainstay whereas in Malaysia, agreed damages clauses usually required proof of actual loss to be enforceable. The last 6 years has seen a series of apex court decisions from Malaysia, England, and Singapore that has resulted in a significant reframing of the law in this area. In this paper, we analyse the convergences and divergences between the respective jurisdictions.

With regards to the position in England, we analyse the shift from the traditional position in *Dunlop* to the modern restatement of the law in *Cavendish Square Holding BV v Makdessi and ParkingEye Ltd v Beavis*.[2] In Singapore, we examine the decision in *Denka Advantech Pte Ltd v Seraya Energy Pte Ltd*[3]—a resolute defence of *Dunlop* that rejects the 'legitimate interest' test in *Cavendish*. We proceed with an analysis of the Malaysian position, starting with an historical account of s 75 of the Malaysian Contracts Act 1950 ('MCA') and culminating with the Malaysian Federal Court's decision in *Cubic Electronics Sdn Bhd v Mars Telecommunications Sdn Bhd*.[4]

We argue that insofar as the question of enforceability of the agreed damages clause is concerned, the Malaysian position differs from that of Singapore and England in that the question of whether an agreed damages clause is a 'penalty' (and therefore unenforceable *in toto*) does not arise in Malaysian law. Agreed damages clauses are always enforceable in Malaysian law, although only up to the extent of 'reasonable compensation' whereas they are valid or unenforceable *in toto* in Singapore and England if they fall foul of the penalty rule. A further difference may be found in the truncated process for assessing 'reasonable compensation' as a result of s 75 of the MCA consistent with the statutory provision dispensing with the need for proof. As for where Malaysian law may be headed, we argue that the concept of 'reasonable compensation' in s 75 of the MCA is a better fit with the principles set out in *Cavendish* than those espoused by the Singaporean Court of Appeal in *Denka Advantech*. Therefore, the *Cavendish* analysis, which received favourable treatment in *Cubic*, represents a step in the right direction for Malaysia.

[1] [1915] AC 79 (HL).
[2] [2016] AC 1172.
[3] [2020] SGCA 119.
[4] [2019] 6 MLJ 15.

### The Penalty Doctrine at Common Law: General Principles

The penalty rule at common law finds its origin in the equitable jurisdiction to relieve a party from defeasible bonds.[5] With a decline in the use of defeasible bonds, the penalty rule continued to develop at common law in the context of damages clauses.

The boundaries of the doctrine at common law were limited to clauses which sought to award a compensatory remedy to an innocent party upon a breach of contract by the defaulting party (Burrows, 2016: 23(1)–(3)). In this regard, it should be noted that whilst the High Court of Australia in *Andrews and others v Australia and New Zealand Banking Group Limited*[6] has extended the scope of the penalty rule to allow for the review of primary obligations between contracting parties, this approach has been rejected in England and Singapore where the courts have maintained that the penalty rule is only engaged when the sum or stipulation in question is imposed as a secondary obligation.[7] S 75 of the MCA in Malaysia similarly dictates that the court's ability to review an agreed damages clause is premised on the sum or stipulation being a payment upon breach.

The traditional position, as discussed further below, also presented a dichotomy between clauses that were a genuine pre-estimate of loss (enforceable as a liquidated damages clause), and those which did not represent a genuine pre-estimate of loss and were held *in terrorem* (unenforceable as a penalty) (Beale, 2017: 26–183). The practical effects of the application of the penalty rule at common law were such that there is no jurisdiction for the court to modify the terms or the quantum of the sum specified in the agreed damages clause. If an agreed damages clause was found to be a valid liquidated damages clause, it would generally be enforced on the terms stipulated in the contract; conversely if the agreed damages clause is found to be a penalty, it would be void and therefore unenforceable *in toto*.[8]

The burden of proving that an agreed damages clause is a penalty lies with the party who seeks to escape liability under it, not on the party who seeks to enforce it,[9] and the relevant circumstances in assessing whether an agreed damages clause is a penalty or liquidated damages are those that exist at the time the contract was made (Halson 2018: 52, 2.44). The implications of these aspects are particularly relevant for the Malaysian position with regards to the truncated assessment of damages and the sliding scale of 'reasonable compensation' under s 75 of the MCA.

[5] For a more detailed history of the equitable origins of the penalty rule and its subsequent development at common law, see: Halson (2018), [1.01]–[1.25] and *Cavendish*, [2016] AC 1172 at [3]–[11].

[6] (2012) 247 CLR 205.

[7] See *Cavendish* [2016] AC 1172, [40]–[43] and *Denka Advantech* [2020] SGCA 119, [74]–[90].

[8] The innocent party would still have a remedy in claiming common law damages as per the principles in *Hadley v Baxendale* (1854) 9 Exch 341.

[9] *Murray v Leisureplay plc* [2005] IRLR 946, at [69].

## The Position in English Law

### Dunlop: The Traditional Statement of the Penalty Rule

The classic statement of the penalty rule at common law is found in Lord Dunedin's speech in *Dunlop*, the facts of which are well-known. Briefly, the appellants entered into a contract with the respondents for the supply of motor tyres, covers, and tubes. The terms of the agreement prohibited the respondents from doing several things, including not to sell any of the appellants' goods to any private customers or to any co-operative society at prices less than the price list issued by the appellants. The agreed damages clause in that case stipulated that New Garage would 'agree to pay to the Dunlop Pneumatic Tyre Company, Ltd. the sum of £5 for each and every tyre, cover or tube sold or offered in breach of this agreement, as and by way of liquidated damages and not as a penalty'.[10] Dunlop later discovered that New Garage had sold covers and tubes below the price list and brought an action against New Garage, claiming damages as their remedy. Breach of contract was proven; the court directed an inquiry as to damages, where it was held that the stipulated sum of £5 represented liquidated damages and not a penalty. The Court of Appeal reversed that finding[11] and awarded nominal damages.[12] On appeal, the law on liquidated damages and the penalty rule fell to be considered by the House of Lords.

Lord Dunedin, who delivered the leading speech in *Dunlop*, summarised that the 'essence of a penalty is a payment of money stipulated as *in terrorem* of the offending party' whereas 'the essence of liquidated damages is a *genuine covenanted pre-estimate of damage*'.[13] This is the so-called 'liquidated damages/penalty dichotomy'. He formulated four tests to determine whether an agreed damages clause was a penalty or an enforceable liquidated damages clause:

(i) 'It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach';
(ii) 'It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid';
(iii) 'There is a presumption (but no more) that it is penalty when a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage'; and
(iv) 'It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is

[10] *Dunlop* [1915] AC 79 (HL) at 81, 85.
[11] By a 2–1 majority.
[12] *Dunlop* [1915] AC 79 (HL) at 80–82.
[13] Ibid. at 86 (emphasis supplied).

> probable that pre-estimated damage was the true bargain between the parties.'[14]

For the vast majority of the twentieth century, Lord Dunedin's statement of the law on penalties and the 'Dunedin tests' formed the *locus classicus* on the law of agreed damages clauses in England.[15] However, as none of the tests concludes that a clause which is *not* a genuine pre-estimate of loss is necessarily one which carries a deterrent effect,[16] the application of Lord Dunedin's tests in *Dunlop* developed such that the *in terrorem* requirement became redundant for the penalty rule (Halson 2018: 24). The courts' exercise for assessing the enforceability of an agreed damages clause was thus primarily determined by whether it represented a genuine pre-estimate of loss at the time of entering into the contract—and not strictly because the clause was intended to coerce or intimidate the other party. This is an unsurprising result given that the idea of a clause representing a genuine pre-estimate of loss between parties does not easily share a rational connection to the idea of a clause having a deterrent effect on a party (and the subjectivity that this may entail).[17]

Towards the turn of the twenty-first century, the English courts started introducing a broader 'commercial justification' approach that etched away at the tangled dichotomy between a genuine pre-estimate of loss and a penalty clause held *in terrorem*. In this renewed approach, it was considered that even if an agreed damages clause was not a genuine pre-estimate of loss, it would still be possible to enforce the clause if there was some other (commercial) reason to justify it. The foremost of this is Colman J's decision in *Lordsvale Finance plc v Bank of Zambia*.[18] *Lordsvale* was concerned with a provision in a loan agreement for interest to be payable at a higher rate if the borrower fell into default.[19] In arriving at his decision, Colman J sought to recast the penalty rule in modern terms, focusing on whether the agreed damages clause in the contract was commercially justifiable although not necessarily a pre-estimate of loss suffered upon default by the customer. Although previous authorities suggested that such provisions were penal, Colman J found that the clause was

[14] Ibid. at 87–88.

[15] *Cavendish* [2016] AC 1172, at [25]; Scottish Law Commission's *Discussion Paper on Penalty Clauses* No. 162 (2016), at [2.6].

[16] Lord Dunedin does, however, appear to equate the two concepts in his analysis of the facts in *Dunlop*. He found that there was no reason to find that the sum specified in the agreement was 'extravagant' and that there was no reason to find that the clause intended to deter the respondents from breach (i.e. 'a penalty to be held *in terrorrem*'). *Dunlop* [1915] AC 79, at 88.

[17] '[The] two concepts are not natural opposites or mutually exclusive categories […]. The fact that the clause is not a pre-estimate of loss does not therefore, at any rate without more, mean that it is penal. To describe it as a deterrent (or, to use the Latin equivalent, in terrorem) does not add anything.' [2016] AC 1172, at 1204 (*per* Lords Neuberger and Sumption).

[18] [1996] Q.B. 752.

[19] Ibid. at 763–764: 'There would therefore seem to be no reason in principle why a contractual provision the effect of which was to increase the consideration payable under an executory contract upon the happening of a default should be struck down as a penalty if the increase could in the circumstances be explained as commercially justifiable, provided always that its dominant purpose was not to deter the other party from breach.'.

enforceable as its predominant purpose was not to deter a breach but represented the commercial risk in the transaction.[20]

In *Murray v Leisureplay plc*,[21] an employee sought to enforce an agreed damages clause stipulating that he was to receive a year's salary in the event of wrongful termination. His employer argued in response that the clause was unenforceable as a penalty. All three members of the Court of Appeal approved of Colman J's commercial justification approach in *Lordsvale*, with Arden LJ fashioning a similar test that would allow for an agreed damages clause to be enforced if there was 'some other reason which justified' it even if it did not constitute a genuine pre-estimate of loss under the *Dunlop* tests.[22] On the facts of *Murray*, Arden LJ found that the clause in question posed commercial advantages for both the employee and the employer and noted that it was not shown that the parties could not reasonably have come to the view that the clause was a genuine pre-estimate of loss or that it was not otherwise justifiable.[23]

This approach of justifying the enforceability of an agreed damages clause by reference to broader surrounding commercial reasons was expounded by Lord Atkinson in *Dunlop* too. Lord Atkinson examined the nature of the appellants' trade and business and concluded that, in substance, the agreed damages clause was designed to avoid a systemic undercutting of prices by other sellers and to prevent an overall breakdown of Dunlop's trade and business.[24] He reasoned that the sum stipulated in the agreed damages clause was enforceable as it represented a genuine pre-estimate

[20] *Lordsvale* [1996] Q.B. 752, at 763–764. But note that, on the facts of the case, the clause in question provided for a modest increase in the interest rate. Colman J left open the possibility that an exceptionally large increase in the rate of interest could be struck down as a penalty, ibid. at 767: 'If the increased rate of interest applies only from the date of default or thereafter there is no justification for striking down as a penalty a term providing for a modest increase in the rate. I say nothing about exceptionally large increases. In such cases it may be possible to deduce that the dominant function is in terrorem the borrower. But nobody could seriously suggest that a 1 per cent rate increase could be such. It is in my judgment consistent only with an increase in the consideration for the loan by reason of the increased credit risk represented by a borrower in default.'.

[21] [2005] IRLR 946.

[22] Ibid. at 954, [54(v)]: 'Has the party who seeks to establish that the clause is a penalty shown that the amount payable under the clause was imposed in terrorem, or that it does not constitute a genuine pre-estimate of loss for the purposes of the *Dunlop* case, and, if he has shown the latter, is there some other reason which justifies the discrepancy between [the breaches of contract that the contractual damages provision apply to] and [the amount payable on breach under that clause in the parties' agreement]?

[23] Ibid. at 956, [76].

[24] '[The] object of the appellants in making this agreement, if the substance and reality of the thing and the real nature of the transaction be looked at, would appear to be a single one, namely, to prevent the disorganization of their trading system and the consequent injury to their trade in many directions. […] The very fact that this sum is to be paid if a tyre cover or tube be merely offered for sale, though not sold, shows that it was the consequential injury to their trade due to undercutting that they had in view. They had an obvious interest to prevent this undercutting, and on the evidence it would appear […] impossible to say that that interest was incommensurate with the sum agreed to be paid.' *Dunlop* [1915] AC 79, at 92 (*per* Lord Atkinson).

of Dunlop's *interest* in securing the due performance of the contract[25] and not necessarily because it represented a genuine pre-estimate of their *loss*. On this analysis, it would follow that an agreed damages clause which was not commensurate with securing the performance interest between parties would be treated as a penalty.

Whilst this commercial justification approach represented an altogether broader and more nuanced position than the predominant focus on the compensatory principles found in Lord Dunedin's tests, the modern cases did not discard entirely the *in terrorem* requirement under the traditional statement of the law—an aspect that was clarified in *Cavendish*.

### Cavendish: The Modern Statement of the Penalty Rule—the 'Legitimate Interest' Test

In 2015, the UK Supreme Court had occasion to review the penalty rule in English law. The resulting decision, although framed as a reinterpretation of the *Dunlop* test, has fundamentally departed from the traditional statement of the penalty rule.

There were two separate appeals heard in *Cavendish*. *Cavendish Square Holding BV v Makdessi*[26] (the 'Makdessi Appeal'), and *ParkingEye Ltd v Beavis*[27] (the 'ParkingEye Appeal'). The leading judgment in *Cavendish* was jointly delivered by Lords Neuberger and Sumption.[28] They observed that whilst Lord Dunedin's four tests had 'achieved the status of a quasi-statutory code',[29] the tests were being applied too literally and that resulted in artificial categories and distinctions between a genuine pre-estimate of loss and a penalty, and between a genuine pre-estimate of loss and a deterrent.[30] Lords Neuberger and Sumption correctly point out that the scope of the penalty rule is to govern agreed damages clauses which are *penal*

[25] 'The damage has been proved to be of that nature in the present case, and the very fact that it is so renders it all the more probable that the sum of £5 was not stipulated *in terrorem*, but was really and genuinely a pre-estimate of the appellants' probable or possible interest in the due performance of the contract.' Ibid., at 96. (*per* Lord Atkinson).

[26] Briefly, this case related to a share sale agreement which stipulated the consequences that would follow if Mr Makdessi were to breach his non-compete obligations for a period after the sale: firstly, that he would lose the right to receive future payments forming part of the purchase price; and secondly, that Cavendish would have the option to buy Mr Makdessi's remaining shares at a lower price. Mr Makdessi breached his non-compete obligations. One of the questions before the Supreme Court was whether the clauses were unenforceable as penalties. On the facts, the clauses in question were held to be enforceable, but mainly on the point that they were primary obligations and therefore did not engage with the penalty rule.

[27] The facts of this case concerned one Mr Beavis who overstayed in a car park that was managed (but not owned) by ParkingEye. The car park had notices which displayed that the parking would be free for the first two hours but anyone who overstayed would be charged £85. Mr Beavis overstayed for an hour. He was later served with a demand to pay the £85 charge but refused to comply. Mr Beavis contended before the Supreme Court that he should not have to pay the charge because, *inter alia*, it was a penalty at common law and therefore unenforceable. However, on the facts of the ParkingEye Appeal, the £85 was held to be a recoverable sum that did not breach the penalty rule.

[28] The Supreme Court sat as a bench of five judges and each delivered their own judgment.

[29] *Cavendish* [2016] AC 1172, at [22].

[30] Ibid. at [31].

in nature and that this is a question that cannot be solely determined by whether the clause is a genuine pre-estimate of loss.[31] In this regard, Lords Neuberger and Sumption preferred instead Lord Atkinson's analysis in *Dunlop* and the modern 'commercial justification' cases,[32] which they considered to have provided a better insight into the unenforceability of agreed damages clauses in instances where the clause exceeds the party's performance interests in the contract.[33]

Thus, in determining whether an agreed damages clause is unenforceable as a penalty, Lords Neuberger and Sumption reformulated the rule as follows: 'The true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation.'[34] Lord Mance[35] and Lord Hodge[36] (Lord Toulson concurring)[37] had each formulated the penalty rule on similar terms.

Some comments can be made in respect of the penalty rule as reformulated in *Cavendish*. Firstly, the *Cavendish* test places no emphasis on the long-standing requirement to show that the agreed damages clause represents an attempt to accurately forecast the loss that an innocent party would suffer on breach. This realignment of the penalty rule in *Cavendish* by reference to the legitimate interests of the innocent party also elegantly does away with the opaque dichotomy in *Dunlop* between a genuine pre-estimate of loss and the metaphysical quality of a clause being held *in terrorem* of the defaulting party.[38] But as a compensatory interest is an example of a legitimate interest, there may yet be an understandable retreat to the genuine pre-estimate of loss analysis in cases where the agreed damages clauses are straightforward and where the only legitimate interest involved is that of compensation for breach. This represents a continuing—albeit narrower—role for Lord Dunedin's four tests to determine the enforceability of an agreed damages clause in England.[39]

[31] Ibid. at [31].

[32] Although they were not entirely without criticism either: 'Colman J in the *Lordsvale* case and Arden LJ in the *Murray* case [2005] IRLR 946 were inclined to rationalise the introduction of commercial justification as part of the test, by treating it as evidence that the impugned clause was not intended to deter. […] It had the advantage of enabling them to reconcile the concept of commercial justification with Lord Dunedin's four tests. *But we have some misgivings about it. The assumption that a provision cannot have a deterrent purpose if there is a commercial justification, seems to us to be questionable*.' Ibid. at [28] (*per* Lords Neuberger and Sumption) (emphasis supplied).

[33] Ibid. at [24]–[28].

[34] Ibid. at [31]–[32].

[35] 'What is necessary in each case is to consider, first, *whether any (and if so what) legitimate business interest is served and protected* by the clause, and, second, whether, assuming such an interest to exist, the provision made for the interest is nevertheless in the circumstances *extravagant, exorbitant or unconscionable*.' Ibid. at [152] (*per* Lord Mance) (emphasis supplied).

[36] '[T]he correct test for a penalty is *whether the sum or remedy stipulated* as a consequence of a breach of contract *is exorbitant or unconscionable* when regard is had *to the innocent party's interest in the performance of the contract*.' Ibid. at [255] (*per* Lord Hodge) (emphasis supplied).

[37] Ibid. at [293].

[38] *Cavendish* [2016] AC 1172, [31].

[39] Ibid. at [32].

Secondly, whilst *Cavendish* advanced a normative shift for the underpinnings of the penalty rule, the concept of a 'legitimate interest' was left undefined by the Supreme Court. This may not be a concept so easily circumscribed in the context of contractual remedies (Rowan 2019: 149–163). It thus remains to be seen how the courts will treat the reformulated proportionality element and the factors that a court may regard as relevant to the legitimate interest test under the *Cavendish* penalty rule. These include factors such as: the relevant criteria to identify any purported performance interest in a contract as a 'legitimate' one; and how such legitimate interests are valued for purposes of a proportionality analysis against the sum or stipulation in the agreed damages clause.[40] Without further clarity on such aspects, the *Cavendish* test may present a concept that is too wide or flexible and is therefore left to be measured at the discretion of judges.

This can be seen on the facts of the ParkingEye Appeal in *Cavendish*. Lords Neuberger and Sumption held that the £85 charge by ParkingEye had two main objects which they thought to be perfectly reasonable.[41] One was to manage the efficient use of parking space and to deter inconsiderate parking practices.[42] More controversially, however, was the second purpose which recognised the £85 charge as part of ParkingEye's revenue and profit-generating scheme from its services provided.[43] They held that these were 'legitimate interests' and that the sum charged by ParkingEye was not out of proportion to its legitimate interests or that of the landowner.[44] The £85 charge was thus held to be recoverable from Mr Beavis. As we discuss later in this paper, it is to be doubted whether that second purpose of 'making a profit' ought to have been recognised as a legitimate interest on the facts of the case. It remains to be seen whether the interest of making a profit, that presumably applies to the vast majority of commercial transactions, would still be applied in favour of a party enforcing an agreed damages clause in situations where the court has misgivings about the party or the transaction in question.

This wider scope employed by the 'legitimate interest' test would also appear to contradict a party's purpose of inserting an agreed damages clause in the first place, that is, to preserve the availability of a remedy against the defaulting party without entering into potentially protracted and expensive litigation to determine the enforceability of the clause. In contrast, the fact of the *in terrorem* requirement becoming redundant means that the *Dunlop* tests have arguably settled into a

[40] See Rowan (2019) for a discussion on the factors that are or might be relevant in determining whether a party has a legitimate interest in performance for agreed damages clauses. This is done primarily through a review of other contexts where a "legitimate interest in performance" is relevant, such as cases awarding gains-based damages in the context of restitutionary money awards. Rowan's list of the relevant factors for the legitimate interest test include the importance of the obligation to which the damages clause attaches, the seriousness of the consequences of its breach, the impact on the interests of third parties, the protection of the public interest, the protection of non-financial expectations, and the presence or absence of certain characteristics in the contracting parties such as whether the parties are of equal or comparable bargaining power.

[41] *Cavendish* [2016] AC 1172, at [98].

[42] Ibid. at [98].

[43] Ibid. at [98].

[44] Ibid. at [99].

relatively straightforward and certain set of criteria for parties. An agreed damages clause arrived at based on a comparison against the greatest loss likely to be suffered upon breach is expected to be an easier process for parties to undertake than it would be to, firstly, identify all legitimate interests in the performance of the contract, and secondly, to place an appropriate value that is not disproportionate to the identified interests.

On the other hand, it has also been suggested that the reformulated proportionality element in *Cavendish* would permit a broad margin of error before a clause will become unenforceable, and it could be a way for courts to more readily uphold bargains and promote a greater certainty amongst commercial parties dealing at arm's length such as to enforce agreed damages clauses on the terms stipulated (Halson 2018: [2.48]). If at all, that may be the case once the courts have further refined the ambit of the 'legitimate interest' test but given the present uncertainty, it is expected that defaulting parties are more likely to contest the summary enforcement of agreed damages clauses.[45]

## The Position in Singaporean Law

Unlike India and Malaysia, Singapore has not codified its law of contract through statute. Contract law in Singapore is thus primarily governed by the common law. The Singaporean position on the penalty rule is heavily informed by the traditional statement of the law in *Dunlop*. In 2015, in the case of *Xia Zhengyan v Geng Changqing*,[46] the Singaporean Court of Appeal reaffirmed that the law on penalties in Singapore is embodied within the principles laid down by Lord Dunedin which in turn 'constitute the backbone of all analysis on this topic' in Singapore.[47] Five years later, in the case of *Leiman, Ricardo v Noble Resources Ltd*,[48] the Singaporean Court of Appeal reaffirmed that *Dunlop* remains the leading statement on the penalty rule in Singapore.

In late-2020, in *Denka Advantech Pte Ltd v Seraya Energy Pte Ltd*,[49] Andrew Phang Boon Leong JA, delivering the unanimous judgment of the Singaporean Court of Appeal, fundamentally disagreed with the *Cavendish* test and re-endorsed Lord Dunedin's statement of the principles in *Dunlop*.[50]

The purpose underlying the penalty rule as conceived in *Denka Advantech* was that it seeks to prevent the imposition of a remedy that is disproportionate to the loss suffered as a result of a breach.[51] This conception of the penalty rule is a result of the Court of Appeal recognising that an agreed damages clause is a type of

[45] For a practitioner-centric summary of the likely development of the operation of the law of penalties following the decision in *Cavendish*, see Edelman (2018): [16.014].

[46] [2015] SGCA 22.

[47] Ibid. at [78].

[48] [2020] SGCA 52.

[49] [2020] SGCA 119.

[50] Ibid. at [151].

[51] Ibid. at [90].

contractual remedy, and is therefore subject to the norm that a contractual remedy must aim to compensate the innocent party and not to punish the defaulting party.[52] The Court of Appeal reasoned that determining the enforceability of an agreed damages clause by reference to whether it is a genuine pre-estimate of loss is consistent with the defaulting party's secondary obligation to provide compensatory relief upon breach.[53] On this analysis, the Court of Appeal was of the view that an agreed damages clause which stipulates for a sum that is more than a genuine pre-estimate of loss is supra-compensatory and is therefore necessarily penal for purposes of the penalty rule.[54]

The characterisation of a supra-compensatory clause as 'penal' highlights the normative divergence that now exists between England and Singapore. In *Cavendish*, the enforceability of an agreed damages clause is judged in relation to the performance interests in the contract (which may include compensatory interests); whereas in *Denka Advantech*, the enforceability of an agreed damages clause is assessed in relation to a party's compensatory interests alone. The Court of Appeal was thus committed to the compensatory principles enunciated by Lord Dunedin in *Dunlop* and on that basis, was compelled to reject the *Cavendish* approach. They saw the *Cavendish* test as overstepping the boundaries of contractual remedies and secondary obligations, that went beyond compensating the innocent party.[55] The Court of Appeal therefore concluded that: 'the "legitimate interest" (or commercial interest) of the plaintiff, whilst grounded in practical factual circumstances, has no role to play at the level of legal principle—except to the extent that the "legitimate interest" concerned is coterminous with that of compensation'.[56]

In this regard, there is some merit to be had in preserving the certainty that Lord Dunedin's tests are said to bring for commercial parties, but the overemphasis in *Denka Advantech* on the compensatory principles within the context of contractual remedies may be problematic in other respects. For instance, not all contractual remedies are payments of money designed to protect compensatory interests. The contractual remedies that a court may award upon breach of contract include specific or injunctive relief, which do not speak to the innocent party's compensatory interests alone. Therefore, *Denka Advantech* may have overextended its position insofar as it attacks the 'legitimate interest' test as one that goes beyond the orthodoxy of contract law in situations where an agreed damages clause seeks to protect non-compensatory interests. The narrower conception of the penalty rule in *Denka Advantech* also offers a restricted view of the full scope of remedies that parties may contractually agree to for a breach of contract. It should be noted that agreed damages clauses are particularly relevant for commercial parties in situations where there is undoubtedly some loss suffered upon breach but there is an inherent difficulty in ascertaining

[52] Ibid. at [93].
[53] Ibid. at [152].
[54] Ibid.
[55] Ibid. at [101], [109], [116].
[56] Ibid.

or proving the actual loss upon breach—as was the situation in *Dunlop*.[57] In such situations, but for the contractually-agreed remedy, the likelihood of receiving only nominal damages upon breach creates a significant disincentive preventing parties from entering into the contract in the first place. It therefore seems counterintuitive to determine the enforceability of a *party*-assessed remedy based on the rigid rules applicable to a *court*-assessed remedy, especially when considering that commercial parties dealing at arm's length are arguably in the best position to identify their potential interests and exposures in a given transaction.[58]

Whilst the Court of Appeal was able to draw a consistent line of argument for its compensatory-centric approach to justify the penalty rule, it elides the so-called dichotomy between a genuine pre-estimate of loss and a clause held *in terrorem* as found in Lord Dunedin's statement of the law. From the Court of Appeal's characterisation of supra-compensatory clauses, it may be reasonably inferred that the Court of Appeal would consider that the 'penal' or 'punitive' quality of such clauses creates a deterrent against a party from breaching a contract. However, without the Court of Appeal offering further analysis on this juxtaposition of a genuine pre-estimate of loss and the *in terrorem* requirement under the traditional statement of the penalty rule, the decision in *Denka Advantech* is better seen as a defence of the genuine pre-estimate of loss tests in particular and not of Lord Dunedin's statement of the law as a whole.

Further, it should be noted that the Court of Appeal in *Denka Advantech* also considered that the relevant elements discussed in *Cavendish* (such as the commercial justification for an agreed damages clause as well as the relative bargaining power between parties) and Lord Atkinson's approach in *Dunlop* should be subsumed under the traditional rubric of assessing whether or not the agreed damages clause concerned is a genuine pre-estimate of the likely loss in general based on Lord Dunedin's tests.[59] It is, however, unclear how the broader concepts identified in *Cavendish* would fit within Lord Dunedin's four tests.

In the final analysis, although the position in both jurisdictions were once closely aligned, there is now a significant divergence between the position in English law as

[57] 'and lastly, if my view of the facts in the present case is correct, then Rigby L.J. would have agreed with me, for the last words of his judgment are as follows: "On the other hand it is stated that, when the damages caused by a breach of contract are incapable of being ascertained, the sum made by the contract payable on such a breach is to be regarded as liquidated damages. The question arises, what is meant in this statement by the expression 'incapable of being ascertained'? In their proper sense the words appear to refer to a case where no rule or measure of damages is available for the guidance of a jury as to the amount of the damages, and a judge would have to tell them they must fix the amount as best they can." To arrive at the indirect damage in this case, supposing no sum had been stipulated, that is just what a judge would, in my opinion, have had to do.' *Dunlop* [1915] AC 79, at 88 (*per* Lord Dunedin, citing Lord Rigby's remarks in *Willson v Love* [1896] 1 QB 626, 633—634).

[58] On the suitability of parties assessing damages that would be difficult to ascertain or prove in court: 'Turning now to the facts of the case, it is evident that the damage apprehended by the appellants owing to the breaking of the agreement was an indirect and not a direct damage. […] But though damage as a whole from such a practice would be certain, yet damage from any one sale would be impossible to forecast. It is just, therefore, one of those cases where it seems quite reasonable for parties to contract that they should estimate that damage at a certain figure […].' Ibid. at 88 (*per* Lord Dunedin).

[59] [2020] SGCA 119, at [153].

stated in *Cavendish* and the position in Singaporean law as stated in *Denka Advantech*. The chief reason for this divergence stems from the respective courts' starting conception of the 'penalty rule' and the underlying norms which are said to define the 'penal' quality of an agreed damages clause. The resulting difference in England and Singapore is further emphasised by the Singaporean Court of Appeal's view that it would have reached a different conclusion to the Supreme Court in the ParkingEye Appeal if it were to decide the matter based on Lord Dunedin's *Dunlop* principles.[60]

## The Position in Malaysian Law

The law of contract in Malaysia was codified through statute, namely, the Malaysian Contracts Act 1950 (MCA). The law on agreed damages clauses in Malaysia is found in the discussion on s 75 of the MCA.

S 75 of the MCA reads:

75. Compensation for breach of contract where penalty stipulated for.
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 supplied)[61]

From the above, it may be appreciated that the elements underlining the application of s 75, MCA are as follows: (i) it is contingent upon a breach of contract (i.e. relates to secondary and not primary obligations); (ii) it applies either where there is a sum or other stipulation payable or performable upon breach of contract in favour of the innocent party; (iii) the sum or stipulation is enforceable in the absence of proof of actual damage or loss; and (iv) however, the sum or stipulation may not

[60] Ibid. at [182]: [it was] 'evident that whatever legitimate interests ParkingEye had, they had *little to do with compensation for loss*. Rather, it seems to us that broad *appeal was made to non-compensatory interests*, including how the respondent sold its management services to landowners and how the charge formed part of the respondent's income stream. […] we consider the reasoning therein to be, with respect, a step too far from the fundamental tenets of contract law as they presently stand.'.

[61] We are grateful to Alexander Loke for the suggestion to set out the statutory provision in this manner.

always be enforced in full and is subject to reduction commensurate with the level of 'reasonable compensation'.

The history of the section begins in *Maniam v State of Perak*.[62] In *Maniam*, the Malaysian courts began on the correct footing, acknowledging, as the Privy Council did in *Bhai Panna Singh v Bhai Arjun Singh*[63] that '[s 75 of the MCA] cuts through the most troublesome knot in the common law doctrine of damages.'[64] The comments made by the Privy Council in *Bhai Panna Singh* relate to s 74 of the Indian Contract Act, 1872 (ICA) which is *ipsissima verba* s 75 of the MCA.[65] Curiously, however, the court in *Maniam*, while finding that s 75 of the MCA was of no application, went on to opine that 'in our law in every case if a sum is named in a contract as the amount to be paid in case of breach it is *to be treated as a penalty*.'[66] In doing so, the court seemingly resorted to the need to treat an agreed damages clause as a *penalty* to justify any intervention to grant relief amounting to 'reasonable compensation'.

Nearly a decade later, the Malaysian appellate court in *Wearne Brothers (M) Ltd v Jackson*[67] alluded to the concept of a genuine pre-estimate of loss as justifying the full recovery of the sum stipulated in the contract to be payable on breach. Relying also on *Bhai Panna Singh*, the court held that 'the effect of [s 75 of the MCA] is to disentitle the plaintiff to recover *simpliciter* the sum fixed in the contract whether as penalty or liquidated damages'[68] and that damages suffered must be proved 'unless the sum named is a genuine pre-estimate.'[69] With respect to the judge in *Wearne Brothers*, the requirement that the plaintiff must 'prove the damages', appears to be in tension with the express proviso 'whether or not actual damage or loss is proved to have been caused thereby' in s 75 of the MCA, and is uncomfortably close to the resurrection of the penalty-liquidated damages divide which 'ceased to be of great legal importance'.[70]

When it came to deciding the case on the facts of the case in *Wearne Brothers*, however, the judge expressed the *ratio* of the case in terms which suggest that the court upheld the agreed damages clause on the basis that it was not 'unreasonable', noting that it appeared to represent a 'genuine pre-estimate of damages for depreciation contemplated by the parties at the time when they entered into an agreement' and '[does] not appear to be unreasonable, disproportionate to the nature and extent of depreciation.'[71] Expressed in different terms, *Wearne Brothers* may be understood to stand for the proposition that where an agreed damages clause is shown to be a

[62] [1957] 1 MLJ 75.

[63] (1929) 2 Mad LJ 323.

[64] *Maniam* [1957] 1 MLJ 75, 76.

[65] As such, Malaysian courts, when interpreting the MCA, regularly engage with the decisions of the Indian courts on the Indian Contract Act, 1872.

[66] *Maniam* [1957] 1 MLJ 75, 76.

[67] [1966] 2 MLJ 155.

[68] Ibid. at 156.

[69] Ibid.

[70] Ibid.

[71] Ibid.

genuine pre-estimate of damages, that would be sufficient to establish that the award of the stipulated sum would be 'reasonable compensation' in the circumstances of the case.

The burden placed upon the plaintiff to 'prove damages' in order to obtain reasonable compensation, however, appeared to take a life of its own in the following decades. Chief of these was in the case of *Selva Kumar a/l Murugiah v Thiagarajah a/l Retnasamy*[72] where the Malaysian Federal Court, which is the highest court of Malaysia, relying on *Bhai Panna Singh*,[73] and the Indian Supreme Court cases of *Fateh Chand v Balkishen Das*[74] and *Maula Bux v Union of India*,[75] extended and entrenched the position in law holding that proof or evidence of *actual damage or loss* is required in order to justify the award of such reasonable compensation.[76]

A distinction was drawn in *Selva Kumar* between contracts where reasonable compensation would be difficult to assess on the one hand and contracts where reasonable compensation could be readily assessed in accordance with 'settled rules'[77]—such settled rules being a reference to the principles laid down in the case of *Hadley v Baxendale*[78] and which are as enumerated in s 74 of the MCA.[79] *Selva Kumar* also restricted the applicability of the phrase 'whether or not actual damage was proved to have been caused thereby' to those cases where the court would find it difficult to assess actual damage or loss.[80] A plaintiff would have to prove actual damage or loss in the usual way in all other cases. A failure to adduce evidence of actual loss or damage would result in the award of nothing more than nominal damages, in spite of the statutory provision which indicated the contrary.[81] This position was further entrenched by the Malaysian Federal Court in *Johor Coastal Development Sdn Bhd v Constrajaya Sdn Bhd*.[82]

This requirement of proof of actual damage or loss before such a clause could be enforced, whether in full or in part, was seen to be difficult to reconcile with the express wording of s 75 of the MCA. In that regard, it is noteworthy that a number of first instance decisions doubted the correctness of the proposition on the need to prove 'actual loss or damage' arising out of *Selva Kumar*. Among these were the High Court cases of *Lebbey Sdn Bhd v Tan Keng Hong*[83] and *Yap Yew Cheong v Dirga Niaga (Selangor) Sdn Bhd*.[84] In *Lebbey*, the High Court disregarded the *ratio*

[72] [1995] 1 MLJ 817.
[73] (1929) 2 Mad LJ 323.
[74] [1963] AIR 1405.
[75] [1970] 1 SCR 928.
[76] *Selva Kumar* [1995] 1 MLJ 817, 826.
[77] Ibid. at 827. See also *Johor Coastal Development Sdn Bhd v Constrajaya Sdn Bhd* [2009] 4 MLJ 445, [33].
[78] (1854) 9 Exch 341.
[79] *In pari materia* with Sect. 73 of the Indian Contract Act, 1872.
[80] See also [2009] 4 MLJ 445, [35]–[37].
[81] *Selva Kumar* [1995] 1 MLJ 817, 829.
[82] [2009] 4 MLJ 445.
[83] [2000] 7 MLJ 521.
[84] [2005] 7 MLJ 660.

in *Selva Kumar* viz. that there was an overall requirement for proof of actual loss or damage before a claim for compensation could be made, and that the requirement of proof of the same was dispensed with *only* in circumstances where the court would find it difficult to assess actual damage or loss. Instead, the High Court employed a literal interpretation to s 75 of the MCA, namely that:

> …[where] the parties have agreed to liquidated damage[s] if one party breaches the [contract], whether or not actual damage or loss is proved to have been caused [t]hereby, the complaining party will be entitled to reasonable damages not exceeding the amount agreed to by the parties as liquidated damages.[85]

Distinguishing *Selva Kumar*, the High Court in *Lebbey* interpreted the *Selva Kumar* decision as dealing with a liquidated damages clause which was 'unreasonable'.[86]

The literal interpretation of s 75 of the MCA was also applied in the case of *Yap Yew Cheong*.[87] There, the High Court observed that the purpose of such a stipulation is to 'smoothen the evidential path of the injured party' in the light of the exacting exercise for the injured party to prove his monetary damages against a contract-breaker incentivised to resist and challenge every iota of evidence advanced.[88] The High Court had also noted that the effect of the *Selva Kumar* decision is such that an injured party 'will be deprived of benefitting under [a] liquidated damages clause, namely recovery of actual loss without proof' and that in 'construing an Act of Parliament, by reference to some authorities from other jurisdictions, there was a need to give effect to the will of Parliament no matter what the consequences would be.'[89]

Also in issue is the continued reference to the measure of damages obtainable under *Hadley v Baxendale* principles as the basis for adjudging the reasonableness or otherwise of any compensation claimed pursuant to a stipulation within the contract. For present purposes it is observed that there is a dissonance between the approach under *Hadley v Baxendale* principles, as contained in s 74 of the MCA, where loss is to be assessed at the time of breach, and the usual operation of an agreed damages clause, the enforceability of which (and, the extent to which enforceable) ought to be ascertainable from the moment the contract containing such a clause is entered into.[90]

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[85] *Lebbey* [2000] 7 MLJ 521, 525.

[86] Ibid. at 527—529. The High Court in *Lebbey* found the imposition of liquidated damages at the level of 12 per cent of the purchase price was reasonable in the light of the fact that the defendant who sought to contend that the rate of 12 per cent was unreasonable had also, in a separate clause in the agreement not in issue in the proceedings, stipulated a rate of 12 per cent for any late delivery (i.e. breach of the agreement) on the part of the plaintiff.

[87] [2005] 7 MLJ 660, 678.

[88] Ibid. at 679.

[89] Ibid. at 679–680. Unfortunately in the case of *Yap Yew Cheong*, the High Court continued to make reference to a supposed distinction between a penalty clause and a liquidated damages clause.

[90] See a further discussion on the subject below.

In 2018, the Malaysian Federal Court sought to correct the course from the state of the law enshrined in *Selva Kumar* and *Johor Coastal*, in the case of *Cubic Electronics Sdn Bhd v Mars Telecommunications Sdn Bhd.*[91] In essence, *Cubic* was critical of and significantly departed from the position in *Selva Kumar* and *Johor Coastal* and clarified 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.'[92]

In addition, the crucial features of the decision in *Cubic* were: (i) the acceptance by the Federal Court that concepts such as that of 'legitimate interest' and 'proportionality' which featured in the *Cavendish* decision were relevant considerations in the determination of the measure of reasonable compensation for the purposes of s 75 of the MCA[93]; (ii) that proportionality and legitimate interest be adjudged by a common sense approach, and that a comparison of the amount payable on breach with the loss that might be sustained by reason of the breach ought not to be significantly different[94]; and (iii) that upon the innocent party's proof of a breach of contract by the counterparty and that the agreed damages clause applied to such a breach, the burden of proving the unreasonableness of the stipulated sum would shift to the party in breach.[95] The Federal Court in *Cubic* also emphasised that these features, in particular the placement of the burden of proof on the party in breach was in line with the commercial or policy purpose of the agreed damages clause and the free consent of parties in entering a contract containing such a stipulation.[96]

However, *Cubic* did not go so far as to rule that proof of actual loss was irrelevant to the determination of a s 75 claim. It also did not clearly demarcate between the analytical approach to be taken under a *Hadley v Baxendale*[97] assessment for loss or damage at the time of breach as opposed to the reasonableness of the compensation sought as adjudged at the time of entry into the contract (that is, to be consistent with the settled position at common law).

That said, even in recent times, when the Malaysian Federal Court in *Tekun Nasional v Plenitude Drive (M) Sdn Bhd*[98] was asked to deal with the pre-*Cubic*[99] position in Malaysian law, it had described it as 'settled law that if a sum is (sic) named in a contract is exorbitant and unreasonable for it to be paid in the case of breach, it must be treated as a penalty and therefore void under s 75 [of the MCA].'[100] The Federal Court went on to hold that the method of calculation employed was an 'inaccurate representation of the actual loss of profit'[101] and 'since

91 *Cubic* [2019] 6 MLJ 15.

92 Ibid. at [65].

93 Ibid. at [66]–[68].

94 Ibid. at [68].

95 Ibid. at [70]–[73].

96 Ibid. at [71]–[73].

97 As enshrined in s 74 of the MCA.

98 [2021] 6 MLJ 619.

99 *Cubic* [2019] 6 MLJ 15. Notwithstanding that the decision of the Federal Court in *Tekun Nasional* post-dated the Federal Court's decision in *Cubic*, the Federal Court applied the law pre-*Cubic* as it was the applicable law at the time of the trial of the matter.

100 *Tekun Nasional* [2021] 6 MLJ 619 at [71].

101 Ibid. at [72].

[the innocent party] had failed to prove damages, [the Federal Court allowed] nominal damages'.[102] Thus, the persistence of the problem of interpretation of s 75 of the MCA, both in relation to the classification of an agreed damages clause as a 'penalty' or otherwise and in the need to prove damages or actual loss, remained.

Some comments may be made in respect of the Malaysian legal position, viz. s 75 of the MCA. The first point is that while the abolition of the penalty-liquidated damages dichotomy has been repeatedly emphasised by the Malaysian courts, the consequence of finding that a clause is a penalty or not a genuine pre-estimate of loss, i.e. that the clause is unenforceable *in toto*, continues to be applied, as though the Malaysian position is similar to the position in English law. This is perhaps attributable in some part to the use of the terminology of 'stipulation by way of penalty' in s 75 of the MCA, the language of which is traceable to the 1899 amendments to the ICA.[103] Illustration (f) of s 75 of the MCA, in particular, significantly muddies the waters by stating: '*A* undertakes to repay *B* a loan of RM1,000 by five equal monthly instalments, with a stipulation that, in default of any instalment, the whole shall become due. This stipulation is *not by way of penalty*, and the contract may be enforced according to its terms.'[104]

It is likely that the insertion of illustration (f) in such terms was, if anything, mere approval of the outcome, and arguably the *ratio*, in *Wallingford v Mutual Society*[105] and in *Protector Endowment Loan & Annuity Co v Grice*[106] both of which held that a clause in a contract which stipulated that the balance of a loan payable by way of instalments was payable upon default in the payment of a single instalment (viz. an acceleration clause). At the very least, these would have been within the contemplation of the drafters of the 1899 amendments to the ICA.[107] Instead, the reference to a 'stipulation by way of penalty' in illustration (f) is anomalous when compared with the entirety of the provision as it emphasises the need to determine whether a clause is a penalty or otherwise, and makes no reference to 'reasonable compensation' at the heart of the provision. As such, the expansion, or clarification, of the ambit of

[102] Ibid. at [73].

[103] S 74 of the ICA. See also, illustrations (d) onwards to the Indian statute, introduced by the 1899 amendments.

[104] Emphasis supplied.

[105] (1880) 5 App Cas 685, HL.

[106] (1880) 5 QBD 592.

[107] This is apparent in the words of illustration (f) viz. 'this stipulation is not by way of penalty, and the *contract may be enforced according to its terms*' (emphasis supplied) which echo those of Lord Hatherley in *Wallingford*: 'If there had been indulgence at any time upon given terms, as long as those terms are observed, the indulgence lasts. When those terms are departed from the indulgence at once fails, and the original contract is revived in full force… *There is nothing to prevent that contract being carried out to the full extent… The sum is plainly secured by a contract and that contract must be observed*.' *Wallingford* (1880) 5 App Cas 685, 702 (emphasis supplied). See also, Bramwell LJ in *Protector Endowment Loan*: 'A definition of the principle may possibly be that where a sum is payable as a punishment for a default, or by way of security, and the realization of that sum is *not within the original intention of the parties*, the sum is a penalty; *but when it forms part of the original intention*, that upon default a sum otherwise payable at a future period, shall become forthwith payable, it is no longer a penalty.' (1880) 5 QBD 592, 595 (emphasis supplied). For a further discussion on acceleration clauses, see Andrews (2011): [19.18].

s 74 of the ICA involved the unintended transplantation of the need, found in English law, to immunise a provision from being a 'penalty' clause so as to justify its enforceability.

It would not have been necessary to frame the acceleration clause in illustration (f) as a 'stipulation…not by way of a penalty' in order to achieve the intended result, namely the ability to enforce payment of the full balance sum in favour of the plaintiff. This is so because in the vast majority of cases it would be unsurprising for any court to find that reasonable compensation for the plaintiff would, at the very minimum, be 'the amount so named' or the 'penalty stipulated for' where money or money's worth were advanced by the plaintiff, the value of which was now sought to be recovered by the plaintiff, provided that the stipulated amount corresponds with the value of the initial loan or debt.[108]

Alternatively, all that is achieved by the phraseology of 'stipulation by way of penalty' is to clarify that s 75 of the MCA only bites in the case of secondary, and not primary, obligations. This interpretation is justified on the basis that the phrase 'stipulation by way of penalty' is parallel to the phrase 'amount to be paid in the case of such breach', consonant with the legislative intention in seeking to extend the applicability of s 75 to cases not involving *in solido* sums only (Swaminathan 2018: 16–19), rather than the importation of the concept of enforceability of the provision for being *penal* in nature as understood under the English common law.

A second point to be noted is the court's reliance upon the principles of determining 'reasonable compensation' with reference to the criteria in *Hadley v Baxendale*, contained in s 74, MCA. As noted above, *Cubic* has not necessarily resolved this outstanding issue by leaving proof of actual loss as an option, though no longer requiring it. By retaining, albeit in a residual fashion, the relevancy of proof of actual loss suffered by the innocent party on breach, a key object of such stipulations would fail to be achieved—namely the relative determinacy of the parties' liabilities in the light of the clause containing the stipulation or stipulated sum and the truncation of the process of determining quantum envisaged by its inclusion and enforceability. Further, it is questionable whether a comparison between the value of the stipulation or the stipulated sum and the damages that would, in a counterfactual scenario where no clause containing the stipulation existed, be obtainable by way of s 74, MCA is appropriate.

It is suggested that unlike the position in Singapore as expressed in *Denka Advantech*[109] the wording of s 75, MCA does not require that the questions of principle are confined to that of compensation only, or in other words that the award of the

[108] If illustration (f) is understood as referring to a form of conditional primary obligation, of the kind envisaged in *Cavendish*, then perhaps its inclusion in the terms as currently legislated would be more readily appreciable. However, that avenue would be in apparent tension with the prefatory words of s 75 of the MCA i.e. 'when a contract *has been broken*', besides also being a surprising interpretation of the words 'in default' found in illustration (f). In addition, ss 74 and 75 would appear to have comprehensively provided for non-specific remedies in the event of a breach of contract rendering an attempt to place remedial stipulation outside of the framework in ss 74 and 75 curious at best.

[109] [2020] SGCA 119, [152].

sum by a court ought to be made on strictly compensatory principles only. While contrary to the decision in *Selva Kumar*,[110] it is submitted that there is little in s 75 which mandates a strict application of the compensatory principle. The compensatory principle, applicable in s 74 of the MCA, is encapsulated not in the use of the word 'compensation' but in the remainder of s 74 which provides that it be 'for any loss or damage cause 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' and in the exclusion of 'any remote and indirect loss or damage sustained by reason of the breach.'[111]

Accordingly, when 'compensation' is referred to in s 75 of the MCA, it is not meant to be shorthand for s 74 of the same but refers instead to a *broader* term denoting the payment of a sum of money or, arguably, the performance of some other stipulation for money's worth, flowing from the defaulting party to the innocent party as a legal consequence of the former's breach of contract. Fidelity to the legislative intent, as understood by the express wording of the statute, would be best served by denying the contention that the analysis in s 75, and the ambit of its enforceability, must be bounded within the realm of the compensatory principle alone, without reference to other relevant legitimate interests (including the performance interest in the contract) that may have informed the parties' decision to enter into a contract containing an agreed damages clause.[112]

## Towards Convergence: the Way Forward?

It remains to be discussed what insights or observations may be drawn from the discussion of the jurisprudence in Malaysia, Singapore, and England above, and how this may be useful in charting the way forward, particularly in the context of Malaysian law.

The first observation is that the factors which are relevant to the 'legitimate interests' and proportionality tests for the enforceability of such a stipulation in England would be relevant to the assessment of whether the compensation sought pursuant to s 75 of the MCA and through the enforcement of an agreed damages clause is reasonable, or what the level of reasonable compensation should be. That there is 'nothing objectionable in holding that the concepts of "legitimate interest" and "proportionality" are relevant' to the assessment of reasonable compensation under s 75 of the MCA has been accepted in *Cubic*.[113] Given that the broader meaning to the phrase "compensation" in s 75 of the MCA seemed to find favour with the Federal Court in *Cubic*,[114] our view is that the principles underlying the broader legitimate

[110] *Selva Kumar* [1995] 1 MLJ 817, 826.

[111] As also noted in Swaminathan in relation to s 73 of the ICA (2018: 19–22).

[112] The importance of giving effect to legislative intention was also highlighted in *Yap Yew Cheong* [2005] 7 MLJ 660, 679–680.

[113] [2019] 6 MLJ 15 at [66]; see also Lim (2019): [36].

[114] Albeit arguably not the *ratio* of the Federal Court in *Cubic*.

interest test in *Cavendish* is a better fit for the Malaysian position on agreed damages clauses, rather than the compensatory-centric principles advanced in *Denka Advantech*.

In determining whether the stipulation or sum in an agreed damages clause represents reasonable compensation, or the level of reasonable compensation to be awarded by a court, it is also suggested that the factors to be taken into account in adjudging reasonableness ought to be confined to those facts that were known (or reasonably known) or knowable by the parties at the time of entering into the agreement. In this regard, insofar as the ParkingEye Appeal was concerned, the majority decision of the United Kingdom Supreme Court in *Cavendish* must be treated with some circumspection.

As mentioned earlier, in the ParkingEye Appeal heard in *Cavendish*, the Supreme Court found that there were two reasonable objectives to the scheme operated by ParkingEye, namely: (i) to manage the efficient use of parking space in the interests of the retail outlets, and of the users of those outlets who wish to find spaces in which to park their cars; and (ii) to provide an income stream to enable ParkingEye to meet the costs of operating the scheme and make a profit from its services.[115] These objectives underpinned the legitimate interests that were later described by the Supreme Court.

In that regard, whilst it would be readily appreciable on the part of a motorist that the operation of a scheme which permitted two hours of parking without charge that there existed a legitimate interest in ensuring that the scarce resource of available parking spaces needed to be properly managed so as to ensure their availability from time to time for the patrons of the retail outlets which it serviced, it is unlikely that the same could be said for the finding of a legitimate interest in levying a charge for overstaying to enable the operator to obtain a profit which was founded upon the particular operation of the scheme that was in all likelihood neither known nor knowable to the motorist.[116] It would be equally plausible for the motorist to assume that ParkingEye's business model was one where the landowner paid a fee to ParkingEye for its operation of the carpark, where the fee was passed on to the tenants in some proportion. This would particularly be so where the parties to the contract are not two business entities who have come together to enter into an agreement, but instead where an agreement was entered into by the conduct of the consumer motorist. The possibility that different schemes might have been employed by ParkingEye would at the very least make it difficult for a consumer, who enters into the contract by conduct, to determine precisely which legitimate interests would or could be relied upon by ParkingEye.[117]

[115] *Cavendish* [2016] AC 1172, [98].

[116] See DiMatteo (2017): 1887–1891. DiMatteo notes the inconsistency in the Supreme Court's approach in *Cavendish*: 'The Court refers to the traditional approach: the determination of a penalty is to be judged within the four corners of the contract, by evaluating party intent and taking into account an ex post determination of damages. But, in fact, the Court is doing just the opposite by looking *outside of the contract to the scheme of which the user is unaware*.' (emphasis supplied).

[117] Ibid. 2017: 1891. DiMatteo also suggests that there are alternative schemes that could have been adopted by ParkingEye in furtherance of its interests, which should have been considered by the Supreme Court in *Cavendish* in assessing whether the clause (imposing a fixed fee) was penal.

This is in contrast to the objectives and legitimate interests of the scheme in *Dunlop* which were known to, or at the very least readily knowable by, the party in breach of the agreement, being a reseller or distributor of Dunlop's goods. After all, on the facts of *Dunlop*, the party in breach of the agreement was the one who had applied to Dunlop to supply Dunlop's goods and could also have been taken to have had sufficient information to appreciate that the maintenance of a uniform price to the public, without which the distribution structure, of which the party in breach was a part, could not be sustained. This principle was stated in *Cavendish* albeit inappositely applied with respect to the latter of the 'legitimate interests' found by the Supreme Court therein.[118]

The question then turns to what considerations are relevant for the determination of 'reasonable compensation'. As it stands, the statute provides little guidance on what constitutes 'reasonable compensation' and it is observed that the illustrations emphasise that a plaintiff is entitled to reasonable compensation but does not go on to illustrate how or at what point of time that reasonableness is to be determined.

It is envisaged that, in the light of the fact that the determination of the level of reasonable compensation may be a summary or truncated process,[119] the assessment of reasonableness will tend towards a qualitative assessment of the propriety and justifiability of the assumptions underpinning any formula or derivation coupled with some evidence of the veracity of the baseline figures, rather than a quantitatively-driven assessment of what the reasonable quantum ought to be. Consideration of the legitimate interests (including performance interests, compensatory interests, and broader commercial justifications) of the innocent party, as known or reasonably knowable by the party in breach, would undergird any assessment of the suitability of the formula for deriving the appropriate level of reasonable compensation. If the stipulated sum is found to not be reasonable, then the court is legislatively empowered to make an adjustment to the unreasonable part(s) of the formula or derivation to arrive at an overall sum for reasonable compensation.

Further, while the wording of s 75 of the MCA does not necessarily preclude the assessment of reasonableness at the time of the breach of contract, it would be peculiar if it were treated otherwise in the light of the purpose of including such a stipulation since the parties 'should be able to know with a reasonable degree of certainty the extent of their liability and the risks which they run as a result of entering into the contract'.[120] The approach taken by *Wearne Brothers* in focusing the analysis to the question of what was 'contemplated by the parties at the time when they entered into [the] agreement' and whether the sum fixed did not appear to be 'unreasonable or disproportionate to the nature and extent' of the interest in question (in *Wearne Brothers*, the depreciation of a vehicle), is preferable and aligned with the policy considerations underpinning such stipulations.

[118] *Cavendish* [2016] AC 1172, [99]: '… the question whether a contractual provision is a penalty turns on the construction of the contract, *which cannot normally turn on facts not recorded in the contract unless they are known, or could reasonably be known, to both parties*.' (emphasis supplied).

[119] See further below.

[120] *Philips Hong Kong Ltd v Attorney General of Hong Kong* (1993) 61 BLR 41.

While *Cubic* substantially alleviated the difficulties inherent in *Selva Kumar* and *Johor Coastal*, the Malaysian Federal Court fell short in not eliminating the need for proof of actual loss or damage under s 75 of the MCA. Instead, noting that the cases of *Selva Kumar* and *Johor Coastal* had imposed a requirement for proof of actual loss or damage as a prerequisite for a claim for reasonable compensation under s 75, *Cubic* posited that:

> 'there is no necessity for proof of actual loss or damage in every case where the innocent party seeks to enforce a damages clause. Selva Kumar and Johor Coastal should not be interpreted (as what the subsequent decisions since then have done) as imposing a legal straitjacket in which proof of actual loss is the sole conclusive determinant of reasonable compensation. Reasonable compensation is *not confined to actual loss*, although evidence of that may be a *useful starting point*.'[121]

However, it may be that leaving the door open for the evidence of actual loss or damage to be adduced might undermine the purpose of including such an agreed damages clause in the first place, at least practically if also not in principle. If it remains a relevant consideration for the purposes of determining reasonableness, the tendency of a party to litigation, or their legal counsel, would be to put ever increasing amounts of material for the court that would be 'relevant' to the question of reasonableness. It also sits uneasily with the principle inherent in the utility of the determinacy of liability prior to any dispute occurring to base the assessment on matters that could only be conceived of post-breach, inviting an unhelpful degree of *ex post facto* rationalisation.

S 75 of the MCA, unlike the binary, all-or-nothing approach to penalty clauses and liquidated damages in England and Singapore, allows for an adjustment of the level of compensation to be awarded by the court. In that regard, it is submitted that what is envisaged is a relatively simple and truncated process, by reference to the dispensation with the need to prove actual loss or damage. Leaving proof of actual loss as a relevant option disincentivises the use of a summary process for determining the award of reasonable compensation and would, in effect, add a further layer of issues to be determined.

It has been extra-judicially observed that, following *Cubic*, there is still 'uncertainty on the resultant consequences if the court finds the stipulated provision unreasonable', and the question arises whether proof of actual loss is then required in those circumstances, or whether the court may determine 'reasonable compensation by adjustment of the stipulated provision' (Lim 2019: [44]). It is observed here that unlike in England and Singapore, where the invocation of the penalty rule is a basis of the court's jurisdiction to intervene in the otherwise commercial affairs of parties in order to grant relief by refusing to enforce the penalty clause, the juridical basis for intervention in the MCA arguably arises from the power granted to the court to make an adjustment, and that any adjustment is at least *prima facie* justified provided that it falls within the scope of reasonableness legislated within s 75.

[121] *Cubic* [2019] 6 MLJ 15, [64]–[65] (emphasis supplied).

Further, the dispensation of the need to invoke the penalty rule to make an adjustment, by way of a relatively truncated process, is justifiable as a matter of principle. It must be borne in mind that unlike the position in Singapore and England, the naming of a sum or a stipulation in a contract governed by s 75 of the MCA sets a strict cap on the amount of compensation obtainable by a plaintiff. There is no fall-back scenario where the clause is found to be invalid or unenforceable *in toto* and the usual measure of actual loss or damage under *Hadley v Baxendale* principles is then assessed[122] since in every case of an agreed damages clause in Malaysia the clause will be enforceable albeit only up to a certain point (i.e. up to the point of 'reasonable compensation').

In the light of that, where *A* and *B* enter into a contract where the stipulation upon breach favours *A*; (i) *A* and *B* must be deemed to have contracted on the basis of the underlying statutory rule which consists in s 75 of the MCA. That would be the law's understanding of the parties' intentions in the light of s 75, MCA[123]; (ii) in this bargain, *A* obtains the opportunity to have a valid and enforceable stipulation (up to a point of reasonable compensation) on a summary basis, but *A* irrevocably gives up any claim above that amount; and (iii) *B*, on the other hand, *accedes* to the validity and enforceability of the stipulation (up to the point of reasonable compensation) and an assessment on a summary or truncated basis of determining reasonable compensation but obtains a fixed cap on the maximum liability that it may incur.

In this conception of the operation of s 75 in respect of the parties' objective intentions in the light of the default statutory rule, the determination of the level of reasonable compensation by the court through a summary process would cohere with apparent Parliamentary intention as well as the widely-held purpose of the adoption of such stipulations in the first place. The ability for the court to determine reasonableness *and* make any adjustment that is necessary would have been part of the design of the statutory scheme under s 75 which is, in effect, *opted into* when the parties to a contract name a sum or other stipulation to be the consequence of a breach of contract. The fact that compensatory interests are not the chief end of s 75, but an award (or an adjustment of the award) to align with notions of reasonableness, would be consistent with the conception of the approach above.

## Conclusion

The ripples that began with *Cavendish* have landed up on South-East Asian shores, albeit with differing effects. Leaving that aside, it cannot be denied that the ensuing debate has brought to the fore the differences in the policies and norms that underpin the treatment of agreed damages clauses. In that regard, Lord Neuberger's

[122] With the possibility, however unlikely, of obtaining an award of damages based on *Hadley v Baxendale* principles in excess of the agreed damages clause.

[123] Alternatively, it may also be suggested that unless clear contrary intention is shown, this would be the objective view of the reasonable bystander to the contract.

exhortation that the common law jurisdictions 'learn from each other'[124] remains a timely one. Whether *Cavendish* and *Cubic* will ultimately prove (practically and doctrinally) sustainable across a wider range of cases, or whether the relative certainty of *Dunlop* and *Denka Advantech* will prove commercially preferable in the long run, remains to be seen. The success or otherwise of either position will depend for the most part on what refinements to those legitimate interests (including performance interests) which can be taken into account in determining whether a clause is *penal* or whether the stipulated sum is *reasonable*, respectively, are made in the near future, in the knowledge that any maladjustment in respect of the former may serve to buttress the orthodoxy espoused in *Denka Advantech.*

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## Declarations

**Conflict of interest** There is no conflict of interest.

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[124] *FHR European Ventures LLP v Cedar Capital Partners LLC* [2015] AC 250, [45].