

CHAPTER 1

INTRODUCTION

1.1 Background of Study

A contract is an agreement enforceable by law.¹ When two or more persons enter into a contract, their intention is normally to carry out the terms of contract as promised.² As a general principle, once a party enters into a contract, he must perform his obligations strictly according to the terms of contract.³ He is liable to answer for any of the obligations, which he has failed to discharge and it is no defence to an action for incomplete performance that the party has done everything that can be reasonably undertaken if the end result falls short of that required of the contract.⁴

There are only two parties to a building contract: the employer and the contractor but due to the customary divisions of duties within the building process, several other persons are named.⁵ Some of these are professional advisers to the em-

¹ Section 2(h) of Contracts Act 1950.

² Alsagoff, Syed Ahamad. (2003). *Principles of the Law of Contract in Malaysia*. Malaysia: Malaysia Law Journal Sdn. Bhd., pp.1

³ Chow, Kok Fong. (1988). *An Outline of the Law and Practice of Construction Contract Claims*. Singapore: Longman Singapore Publishers Pte. Ltd., pp.27

⁴ *Paradine v Jane* [1647] Aley 26

⁵ Turner, D.F. (1971). *Building Contracts: A Practical Guide*. London: George Godwin Ltd., pp.9

ployer, who are also given defined responsibilities and powers under the contract, some of which may be quasi-judicial.⁶ A breach of contract is essentially a non performance of a contractual obligation under conditions for which no legal excuse for the non performance exists.⁷ The ordinary remedy for breach of contract is an action for damages; the innocent party is entitled to claim for a financial amount, which would compensate him for the loss incurred as a result of the breach committed by the other party. In the example of late completion, the usual redress afforded the employer would be to award him liquidated damages calculated according to a rate stipulated in the contract.⁸ In exceptional cases, where a breach takes on a very serious nature so that it adversely affects some fundamental aspect of the contract, the innocent party may under common law, bring the contract to the end.⁹

Liquidated damages may as a provision in a contract, and therefore agreed between the parties to the contract at the time of entering into it, which aims to determine in advance the extent of the liability for some future, specified breach.¹⁰ Construction contracts frequently contain a “liquidated damages” clause in favour of the owner. This typical liquidated damages clause provides that if the contractor fails to complete the work by the agreed completion date, he will be required to pay the owner a stipulated amount for each day thereafter until completion.¹¹

For example, clause 40¹² of PWD Forms 203A (Rev 10/83), and clause 22 of PAM 98¹³ provides a provision of Damages for Non-completion. Briefly, the provi-

⁶ Ibid.

⁷ Chow, Kok Fong. (1988). *An Outline of the Law and Practice of Construction Contract Claims*. Singapore: Longman Singapore Publishers Pte. Ltd., pp.28

⁸ Ibid, pp.29

⁹ Ibid.

¹⁰ Turner, D.F. (1971). *Building Contracts: A Practical Guide*. London: George Godwin Ltd., pp.17

¹¹ Kenny, P. (2001, March). *Liquidated Damages: how much of a threat can they be?* Heavy construction News. Toronto: Mar 2001 vol.45. Iss.3. Pg.32. URL:<http://proquest.umi.com/pqdweb?did-37477610&sid-8&Fmt-3&clientld.21690&RQT-309&VName-PQD>

¹² If the Contractor fails to complete the Works by the “Date for Completion” stated in the Appendix or within any extended time under Clause 43 hereof and the S.O. certificates in writing that in his opinion the same ought reasonably so to have been completed the Contractor shall pay or allow the Government a sum calculated at the rates stated in the Appendix as Liquidated and Ascertained Damages for the period during which the said Works shall so remain and have remained incomplete and the S.O. may deduct such damages from any monies due to the Contractor.

sion indicates that in the event of late completion, the contractor shall pay to the employer the LAD a specified amount per day of delay until the completion date. The employer may deduct such sum from any monies payable to the Contractor under this Contract. In addition, the LAD is considered as the actual loss that will be suffered in breach of contract and the contractor agrees to pay the said sum without the need of proving damages by the employer.

Statutory provision for liquidated damages in Malaysia is found in Section 75 of the Contracts Act 1950.¹⁴

“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 Federal Court in *Selvakumar a/l Murugiah v Thiagarajah a/l Retnasamy*¹⁵ held that the employer is required to prove his actual loss suffered in accordance with the general principles of proof of damages. The Federal Court, in interpreting Section 75 held that the plaintiff who is claiming for actual damages in an action for breach of contract must still prove the actual damages or reasonable com-

¹³ 22.1 If the Contractor fails to complete the Works by the Date for Completion of within any extended time fixed under Clause 23.0 or sub-clause 32.1 (iii) and the Architect certifies in writing that in his opinion the same ought reasonably so to have been completed, then the Contractor shall pay to the Employer a sum calculated at the rate stated in the Appendix as Liquidated and Ascertained Damages (LAD) for the Date for Completion or any extended date where applicable to the date of Practical Completion. The Employer may deduct such sum as a debt from any monies due or to become due to the Contractor under this Contract.

22.2 The Liquidated and Ascertained Damages stated in the Appendix is to be deemed to be as the actual loss which the Employer will suffer in the event that the contractor as in breach of the Clause thereof. The Contractor by entering into this Contract agrees to pay to the Employer the said amount(s) if the same become due without the need of the Employer to prove his actual damage or loss.

¹⁴ Sundra Rajoo. (1999). *The Malaysian Standard Form of Building Contract (The PAM 1998 FORM)*. 2nd ed. Kuala Lumpur; Malayan Law Journal Sdn. Bhd., pp.195

¹⁵ [1995] 2 MLJ 817

pensation in accordance with the settled principles in the English landmark case of *Hadley v Baxendale*.¹⁶ Any failure to prove such damages will result in the refusal of the court to award such damages. The Contracts Act s75 provides an instance in which Malaysian law departs significantly from the line of English common law.¹⁷

Under common law, a liquidated damages clause must comply with the ‘penalty’ principle established by Lord Dunedin in the landmark case of *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*.¹⁸ that:

“The essence of liquidated damages is a genuine covenanted pre-estimate of loss.”

What is meant by the term ‘genuine pre-estimate’ was further explained in *WT Malouf Pty Ltd v Brinds Ltd*¹⁹ as:

“A genuine pre-estimate means a pre-estimate which is objectively of that character: that is to say, a figure which may properly be called so in the light of the contract and the inherent circumstances. It will not be enough merely that the parties honestly believed it to be so.”

The court in Malaysia have concluded that the distinction between liquidated damages and penalties does not apply, the situation being governed by section 75 of the Contracts Act which has been held to have erased this distinction.²⁰

¹⁶ [1854] 9 Ex 341

¹⁷ Robinson, N.M., *et.al.* (1996). *Construction Law in Singapore and Malaysia* 2nd ed. Singapore: the Butterworth Group of Companies., pp.244

¹⁸ [1915] AC 79

¹⁹ [1981] 52 FLR 442

²⁰ See e.g. *Choo Yin Loo v SK Visuvalingam Pillay* [1930] 7 FMSLR 135, *The Hua Khiow Steamship Co. Ltd. v Chop Guan Hin* [1930] 1 MC 175, 1 JLR 33; *SS Maniam v The State of Perak* [1957] MLJ 75; *Wearne Bros (M) Ltd. v Jackson* [1966] 2 MLJ 155; *Linggi Plantation Ltd v Jagatheesan* [1972] 1 MLJ 89, [1971] 2 PCC 749, reversing [1969] 2 MLJ 253, which in turn reversed [1967] 1 MLJ 177; and *Wee Wood Industries Sdn. Bhd. v Guannex Leasing Sdn. Bhd.* [1990] 2 CLR 1060. See also the Bruneian Case of *Chung Syn Kheng Electrical Co Bhd. v Regional Construction Sdn Bhd.* [1987] 2 MLJ 763 which, however, is not, with respect, wholly unambiguous. Cf *Chiam Keng v Wan Min*

In addition, there is a general duty requiring that reasonable steps to be taken to mitigate losses flowing a breach particularly in the case of anticipatory breach.²¹ The party who has failed to mitigate the losses cannot later recover any such loss flowing from his neglect.²² This is a long established principle applied in *Kabatanan Timber Extraction Co. v Chong Fah Shing*.²³ The Federal Court held that, it was the duty of the respondent to take reasonable steps to mitigate the damages caused by the appellant when he failed to deliver logs to the mill but left them some 500 feet away. This principle also applied in *Joo Leong Timber Merchant v Dr. Jaswant Singh a/l Jagat Singh*.²⁴ The respondent counterclaimed for loss of rental income against appellant's claim for the balance sum due for the completed building works was dismissed by the High Court due to respondent's failure to show that he had taken all reasonable steps to mitigate his damage.

Construction contracting is extremely time sensitive and timely completion of a project is frequently seen as major criteria of a project success.²⁵ Owners lose opportunity and profits waiting for completion of late projects.²⁶ Hence, a liquidated damages provision provides a straight forward method of calculating damages recoverable by an owner in the event of late completion. However, the recent position seems to put more burdens to employer in his effort to impose LAD. The recent case, *Joo Leong Timber Merchant v Dr. Jaswant Singh A/L Jagat Singh*²⁷, employer is now liable to take mitigation in enforcing LAD although it is silent in the provision of LAD in the forms of contract. Failure in taking mitigation will cause the employer fail in recovering the LAD.

[1924] 5 FMSLR 4 at 14. But cf *Malayan Credit Ltd. v Mohammed Kassim* [1965] 2 MLJ 134 and *Government of Malaysia v Thelma Fernandez* [1967] 1 MLJ 194. Reference may be also be made to the Indian Supreme Court decision of *Fateh Chand v Balkrishan Dass* AIR 1963 supreme court 1405.

²¹ Vohrah, B. and Wu, Min Aun. (2003). *The Commercial Law of Malaysia*. Malaysia: Pearson Malaysia Sdn. Bhd., pp.179

²² *Ibid.*

²³ [1969] 2 MLJ 6

²⁴ [2003] 5 MLJ 116

²⁵ Allen, P.E.(Jan, 1995). *The Estimation of Construction Contract Liquidated Damages*.

URL:<http://www.library.findlaw.com.civil.remедies/damages/liquidated.damages./html>

²⁶ *Ibid.*

²⁷ *Supra.*

As a result, the court is now applying the principle of mitigation in awarding LAD and the employer should be prudent while imposing LAD, whereby they will have to make sure that they fulfil the requirements of mitigation by taking reasonable steps to mitigate his losses and damages upon the breach of contract by the contractor.

1.2 Problem Statement

Each of the standard form of contract provides for payment of an agreed sum by the contractor when completion of work is not within the stipulated time. The payment is known as liquidated and ascertained damages. The amount is usually recorded in the appendix to the form of a contract.²⁸ Liquidated damages are a sum, which represents a genuine pre-estimate of the loss caused by the breach, that is, of what is needed to put the plaintiff into as good a position as if the contract had been performed.²⁹

The liquidated damages provisions in the usual standard forms of contract for construction work is to stipulate a rate for each day of delay in completing the works, clearly links the severity of delay to the quantum of damages payable.³⁰ Most standard forms of construction contract are drafted to permit the parties to fix the damages payable for late completion in advance. When these damages are a genuine pre-estimate of the loss likely to be suffered or a lesser sum, they can rightly be termed as liquidated damages.³¹

²⁸ Ashworth, A. (2001). *Contractual Procedures in the Construction Industry*. 4th ed. England: Pearson Education Limited., pp.32

²⁹ Burrows, A. S. (1987). *Remedies for Torts and Breach of Contract*. London: Butterworth & Co. (Publishers) Ltd., pp.283

³⁰ Chow, Kok Fong. (1988). *An Outline of the Law and Practice of Construction Contract Claims*. Singapore: Longman Singapore Publishers Pte. Ltd., pp.159

³¹ Eggleston, B. (1997). *Liquidated Damages and Extension of Time in Construction Contracts*. 2nd ed. London: Blackwell Science Ltd., pp.4

Most construction contracts provide a contractual mechanism, which allows the employer to deduct liquidated damages from amounts due to the contractor.³² For examples, in PAM 98³³ (clause 22), PWD 203A³⁴ (Clause 40), and CIDB³⁵ (Clause 26) provide a provision of Damages and Non-completion to enable the employer to recover their damages in the event of late completion by contractor. However, contractors often seek to challenge the enforceability of Liquidated Damages clause³⁶, which they consider that it has been wrongly deducted and alleged that employer actually suffered no loss in the event of delay and fails to mitigate his losses in the event of breach.³⁷

Such challenges may cause an uncertainty to the employer, as it is not expressed in the provisions. Further, the employers may not be aware that they are obligated to take mitigation in enforcing LAD. Thus, this matter may give raise to some queries, such as, whether the employer is bound to mitigate his loss in the event of enforcing the LAD. Since all standard forms of contract are silent about the duty to mitigate loss, then what are the rules that may override the provisions of LAD in the contract? In addition, if the employer is really bound to comply with the mitigation rules, then what are the circumstances does the employer could take mitigation and to what extent they should act to mitigate his losses?

Regarding the quantum of damages, whether the employer is entitled only for the loss that he managed to mitigate, or he is totally not entitled to recover his loss if he failed in taking the duty of mitigation. Furthermore, it may be doubted that what are the circumstances that the employer is considered has conducted the said duty and how does the tribunal make the decision on this matter.

³² Steve, Chan. (2004). Lecture 4: Duty to Mitigate, Constructive Acceleration, Challenges to Liquidated Damages. Bullet-Proof EOTs-with Particular reference to PWD/JKR standard Forms of Contract. 27 July, 2004. Kuala Lumpur: James R Knowles (M) Snd. Bhd., pp.17

³³ Agreement and Conditions of Building Contract

³⁴ Standard Form of Contract to be used where Bills of Quantities Form Part of The Contract

³⁵ Standard Form of Contract for Building works (2000 Edition)

³⁶ Steve, Chan. (2004). Lecture 4: Duty to Mitigate, Constructive Acceleration, Challenges to Liquidated Damages. Bullet-Proof EOTs-with Particular reference to PWD/JKR standard Forms of Contract. 27 July, 2004. Kuala Lumpur: James R Knowles (M) Snd. Bhd., pp.18

³⁷ Ibid.

In short, whether the duty to mitigate should have a controlling influence on the conduct of the innocent / injured party, or whether it is merely a method of assessing the recoverable loss and how does the mitigation may effect the enforcement of LAD by the employer? As a result, it is important to investigate the actual position of employer in enforcing the LAD.

1.3 Objectives of the Study

The objectives of the study are:

1. To determine the requirements of mitigation in enforcing the LAD provisions in Construction Contracts.
2. To determine the extent that employer has to mitigate his losses in enforcing LAD provisions.

1.4 Scope and Limitations of the Study

This research will be focused on following matter:-

1. The provision of Liquidated and Ascertained Damages in the standard forms of contract used in Malaysia, namely, JKR 203A, PAM98, and CIDB 2000.
2. Court cases related to the issue particularly Malaysian cases. Reference is also made to cases in other countries such as United Kingdom, Brunei, Singapore, Australia, and Hong Kong.

1.5 Significance of the Study

The provision of LAD is provided in most standard form of building contracts in favour of the employer to recover their damages or losses due to delay in completion. However, the contractor often seek to challenge the enforcement of LAD is challenged by the contractor on certain grounds as before discussed. Such challenge put the employer in an uncertain position while enforcing LAD although the compensation for non-completion has pre-agreed by the contracting parties and stipulated in the contract.

Therefore, this study is expected to unfold the queries that arise in the event of enforcing LAD in relation to mitigation. Thus, an employer will be aware of their obligations, rights, and duties in the event of recovering his damages or losses. In short, the finding of the study could be used as guidance to the employer and putting them in a better position in enforcing LAD. Finally, it is believed that the result will also be capable to resolve disputes in relation to LAD in the construction industry.

1.6 Research Methodology

Briefly, the research process will be divided into five (5) stages:

- a. Identifying the research issue,
- b. Literature review,
- c. Data and information collection,
- d. Research analysis,
- e. Conclusion and recommendations

1.6.1 Stage 1: Identifying Research Issue

Identifying the research issue is the initial stage of the whole research. To identify the issue, firstly, it involves reading on variety sources of published materials, such as journals, articles, seminar papers, previous research papers or other related research papers, newspapers, magazines, and electronic resources as well through the World Wide Web and online e-databases from University of Technology Malaysia, UTM library's website.³⁸

1.6.2 Stage 2: Literature Review

Literature review is the second stage of the research. Literature review will be involved the collection of documents which from secondary data for the research, such as books, journals, newspapers.³⁹ Indeed, published resources like books, journals, varies standard form of contract, and related statutory are the most helpful in this literature review stage. Besides this, reported court cases from different sources like Malayan Law Journal, Australia Law Report, and Building Law Reports will be referred.

1.6.3 Stage 3: Data and Information Collection

Third stage of this research is data and information collection stage. This is an important stage towards achieving the objectives. This stage will be begun just

³⁸ <http://www.psz.utm.my>

³⁹ Blaxter, L., *et al.* (1996). *How to research*. Buckingham; Open University Press., pp.109

after the previous two stages are completed. The further action is to collect the relevant information based on the secondary data from the published resources and carry out case studies. Lexis-Nexis database is the main source in getting the related cases. The system provides cases based on different sources of law reports available, such as Appeal Cases Report, All England Report, Building Law Report, King's Bench Report, Singapore Law Report and other common jurisdictions.

1.6.4 Stage 4: Research Analysis

In this stage, it is able to determine whether the stated objectives has been achieved or vice versa. Different types of analysis will be carried out according to the requirements of the objectives. It is important in conducting case study in the way to identify the trends and developments in the issue that is to be studied.

1.6.5 Stage 5: Conclusion and Recommendations

Conclusion and recommendations is the final stage of the research. In this stage, the findings would able to show the result of the research. A conclusion need to be drawn in-line with the objectives of the research. At the same time, some appropriate recommendations related to the problems may be made for a better solution in relation to the said problem, or for further research purposes.

1.7 Research Flow Chart

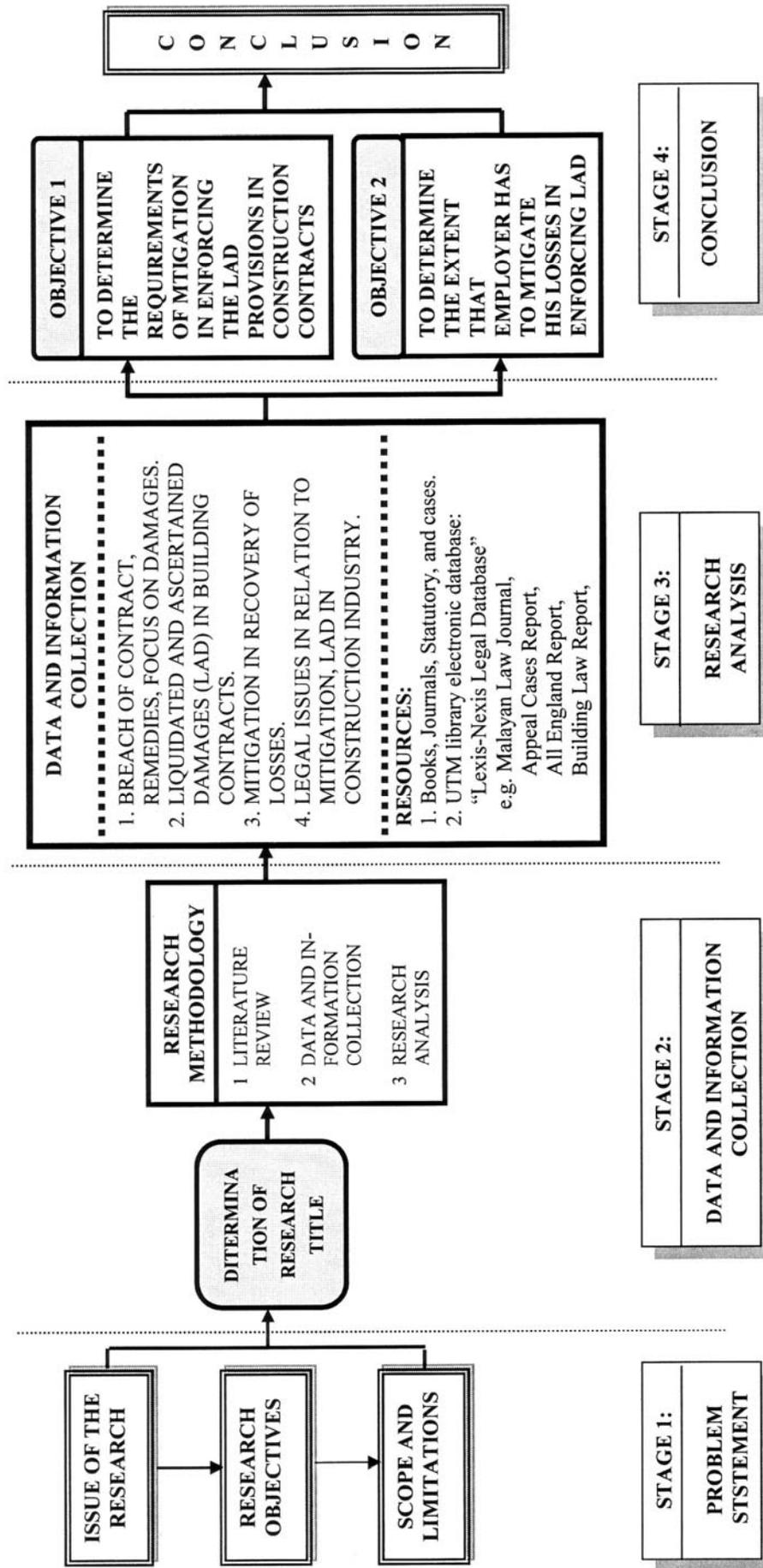


Figure 1.1 Research Flow Chart

1.8 Conclusion

Briefly, this research is related to the issues on principles of mitigation, and Liquidated and Ascertained Damages (LAD) in building contracts. The report will be divided into five (5) chapters.

1.8.1 Chapter 1: Introduction

The first chapter is an introduction to the whole research and consisting of a few sub topics. The first sub topic is background of the study; followed by problem statement, that influence such research to be carried out. Subsequence is the objectives of the research that stated the aims of the study; the significance of the research as to overcome certain problems in the industry; scope and limitations to the research and finally is the research methodology that to be used during the process of research.

1.8.2 Chapter 2: Liquidated and Ascertained Damages (LAD)

Briefly, this chapter will be covered by a few important subtopics, such as introduction, definition of the term, LAD and LD, principle of LAD, LAD in the Malaysian position and finally the issues or cases in relation to the enforceability of LAD in the event of breach of contract.

1.8.3 Chapter 3: Mitigation

This chapter will discuss the definition, theories, rules, and principles of mitigation. Besides that, the function of the principle applied in damages as remedy in the event of breach of contract will also be discussed. Related cases will be incorporated in the explanation for getting a better understanding of the terms and its application.

1.8.4 Chapter 4: Requirements of Mitigation and The Extent of Mitigation in Enforcing LAD Provisions

This chapter is the essential part of the whole report. The significant task is to obtain the research's findings, namely the requirements of mitigation, and to what extent the employer has to mitigate his losses in enforcing LAD provisions.

1.8.5 Chapter 5: Conclusion and Recommendations

This chapter is the final part of the whole report and is considered the conclusion chapter. Briefly, this chapter includes the summary on the research findings, conclusion and recommendations and suggestions for further research.

CHAPTER 2

LIQUIDATED AND ASCERTAINED DAMAGES (LAD)