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## Application Of Section 75 Of The Contracts Act 1950: Analysis Of The *Tekun Nasional* Case

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Recently, in *Tekun Nasional v Plenitude Drive (M) Sdn Bhd and Another Appeal* [2021] 10 CLJ 206, the Federal Court dealt with the application of Section 75 of the Contracts Act 1950 (CA) in assessing damages arising from the termination of an agreement. The Federal Court held that:

- For a decision to be binding retrospectively, the case must still be at the trial stage to enable the parties to prepare and argue their case, based on the burden of proof applicable at that material time.
- It is settled law that if a sum named in a contract was exorbitant and unreasonable for it to be paid in case of a breach, it ought to be treated as a penalty and therefore, void under Section 75 of the CA.

This alert examines the reasoning behind this decision and its significance.

### Background Facts

The Appellant, Tekun Nasional (Tekun), is an agency under the Ministry of Entrepreneur Development, which provides financing facilities to entrepreneurs and businesses. The Respondent, Plenitude Drive (M) Sdn Bhd (Plenitude), had proposed to Tekun to develop an efficient information infrastructure system which upgrades the loan repayment facility by introducing the MG system. The MG system was to be used for the collection of repayment from the borrowers by using an ATM card via e-debit transactions.

On 29.8.2014, Tekun awarded the Implementation and Outcome Management System for the Tekun Nasional project to Plenitude. Subsequently, on 18.9.2014, an agreement was executed between the parties where Plenitude undertook to design, develop and supply all hardware, software and technology which would enable a more efficient collection of loan repayments under the MG System. In relation to this, Plenitude was to supply a

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minimum of 500 mobile gadgets for Tekun's use as well as providing the relevant technical services.

Plenitude completed the development of the MG system and on 26.11.2014, a total of 28 mobile gadgets were delivered to Tekun branches in the Federal Territory. Another 653 mobile gadgets were also ready to be delivered to all Tekun branches nationally but Tekun refused to collect them. On 20.3.2015, Tekun ordered all its officers to stop using the mobile gadgets, failed to pay the invoices issued by Plenitude, refused to continue with the MG system and blocked Plenitude's access to its database and system.

Plenitude then issued notices to Tekun to rectify the breach of the agreement within 30 days. However, Tekun failed to do so. Upon Tekun's failure to rectify its breach, Plenitude issued a notice to Tekun to terminate the agreement and demanded the sum of RM29,829,132.40 as damages, which was computed based on a formula in the agreement. This clause provides that if the agreement is unilaterally terminated by either party during its subsistence, the defaulting party shall pay compensation to the other party reflecting that party's opportunity loss of income for the unexpired term of the agreement.

### The High Court's Decision

After full trial, the High Court allowed Plenitude's claim on liability but held that the RM29,829,132.40 claim was for special damages which was against Section 75 of the CA. The High Court ordered for the damages to be assessed.

### The Court Of Appeal's Decision

On the issue of liability, the Court of Appeal found no appealable error. However, it disagreed with the finding of the High Court that the claim of RM29,829,132.40 was a claim for special damages. The Court of Appeal held that the amount claimed by Plenitude was general damages quantified in accordance with the agreed formula as provided under the agreement but opined that the said amount was a penalty, which was not claimable under Section 75 of the CA. Nevertheless, the Court of Appeal took the view that Plenitude was entitled to be compensated for the loss or

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damage resulting from the breach including any loss of earnings and profits.

## The Federal Court's Decision

The Federal Court allowed Tekun's appeal in part, where it affirmed the decision of the Court of Appeal on the issue of liability. However, the Federal Court held that Plenitude had failed to prove damages and accordingly, ordered that only RM5,000 be awarded as nominal damages.

## Analysis

In arriving at its decision, the Federal Court examined the applicability of its earlier decision in *Cubic Electronics Sdn Bhd (in liquidation) v Mars Telecommunications Sdn Bhd* [2019] 6 MLJ 15. In the *Cubic* case, the Federal Court had ruled that the onus lies on the party seeking to enforce a damages clause under the Section 75 of the CA to adduce evidence in support. In the event that there was any dispute in relation to the reasonable amount of damages to be paid, the burden of proof is on the party resisting the claim to establish that the clauses allowing for the damages including the sum provided under the contract to be unreasonable.

Prior to the *Cubic* case, the burden was on the innocent party to show that the damages stipulated in the liquidated damages clause were a reasonable compensation following *Selva Kumar a/l Murugiah v Thiagarajah a/l Retnasamy* [1995] 1 MLJ 817 and *Johor Coastal Development Sdn Bhd v Constrajaya Sdn Bhd* [2009] 4 MLJ 445.

Plenitude argued that pursuant to the *Cubic* case, the onus was on the party (in this case, Tekun) seeking to enforce a clause under Section 75 of the CA to adduce evidence of the breach of contract. Further, it was argued that Tekun bore the burden of proof to establish the unreasonableness of the agreement or to demonstrate what would be reasonable compensation. It is Plenitude's contention that Tekun had failed to discharge this burden and thereby, Plenitude was entitled to RM29,829,132.40 in damages as provided under the agreement. It was argued by Plenitude that there was no necessity for it to prove of actual loss or damage as the innocent party to the breach.

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On the other hand, Tekun submitted that the *Cubic* case does not and cannot apply retrospectively as it would create manifest injustice. As the *Cubic* case was not even decided when the matter was before the High Court, the burden of proof remains on Plenitude to adduce evidence to prove that the amount claimed was reasonable. Tekun argued that it had presented its case at the High Court based on the burden of proof applicable at the material time.

The Federal Court agreed with Tekun's submission and opined that following *Letchumanan Chettiar Alagappan @ L Alagappan v Secure Plantation Sdn Bhd* [2017] 4 MLJ 697, for a decision to be binding retrospectively, a case must still be at the trial stage so that the parties can prepare and argue their case based on the burden of proof applicable at that time. Hence, the ratio in the *Cubic* case should not be applied retrospectively to cases where full trial has been completed and decided by the court of first instance. The ratio in the *Cubic* case was applicable prospectively i.e. to cases where trials have not been completed.

The Federal Court also held that when there is a clause on damages, it must evaluate the reasonableness of the clause in question. Following its earlier decisions in construing Section 75 of the CA, the relevant clause in the agreement must be evaluated against the available evidence to ascertain whether the amount calculated based on the clause is proportionate to the legitimate interest of the innocent party in the performance of the primary obligation. If the amount stipulated is exorbitant, then the clause must be regarded as an unreasonable penalty clause and was therefore void. Where a plaintiff relies on a reasonable penalty clause, it must be supported by cogent evidence of actual loss.

In the *Tekun Nasional* case, the Federal Court held that no evidence of damages, whether oral or documentary, was proven by Plenitude to justify the claim for damages based on the agreed formula the agreement to allow the court to determine whether or not their profit projection was highly speculative or grossly excessive. As an award of damages must be proportionate to the loss suffered, it was held that Plenitude failed to prove its losses in support of its claim for general damages.

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As a result, the Federal Court agreed with the Court of Appeal that Tekun was liable for breach of the agreement. However, in relation to damages, the Federal Court substituted the order for an assessment of damages with an order that a sum of RM5,000 be awarded as nominal damages as Plenitude had failed to prove general damages.

## Commentary

This decision by the Federal Court is significant as it reflects the cautionary approach taken by our apex court to prevent injustice through the retrospective operation of its rulings to parties in litigation in matters where a full trial was completed based on the law applicable at the material time. This decision reiterates the trite law that if a sum named in a contract was exorbitant and unreasonable for it to be paid in case of a breach of the contract, it ought to be treated as a penalty and therefore, void by virtue of Section 75 of the CA.

Authored by Elani Mazlan, an Associate with the firm's Dispute Resolution practice.

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