

A Clash of the Courts on Liquidated Damages: Court of Appeal of Singapore v UK Supreme Court

Liquidated and ascertained damages (**LAD**) clauses: to enforce or not to enforce? In December 2020, in *Denka Advantech v Seraya Energy*,¹ Singapore's Court of Appeal (**SGCA**) was the latest to tackle this perennial conundrum of contract law. Given the prevalence of LAD and LAD-type clauses, *Denka* may have important implications for contracts of all kinds in Malaysia, especially in the construction, energy and property sectors.

Denka Advantech v Seraya Energy

In 2015, the UK Supreme Court in *Cavendish Square v Makdessi*² held that an LAD clause will be upheld if the sum payable upon breach is proportionate to a "legitimate interest" that the innocent party had in performance of the primary obligation. A legitimate interest is not limited to recovery of loss, and can include other commercial, non-pecuniary interests.

In *Denka*, the SGCA rejected this expansive conception of "legitimate interests". For the SGCA, the only legitimate interest is compensation for loss due to the breach, estimated at the time of contracting. If an LAD clause stipulates a sum that is more than a genuine pre-estimate, the clause will be unenforceable. It is irrelevant that, factually, the LAD clause may be commercially justifiable for some other reason.

Effect on LAD Clauses under Malaysian Law

The divide between *Denka* and *Cavendish Square* was whether the "legitimate interest" can be non-compensatory, beyond pure recovery of loss. In Malaysia's own landmark case in 2018, *Cubic Electronics v Mars Telecommunications*,³ the Federal Court did not specifically answer the question, perhaps because it did not need to. In Malaysia (unlike in the UK and Singapore), contract law is governed principally by statute, the Contracts Act 1950, which binds the courts. As section 75 specifically makes "reasonable compensation" the decisive factor, the Malaysian courts are likely to lean towards *Denka* on this question, rather than *Cavendish Square*.

Importantly, a common element to all three jurisdictions is that, for the penalty rule to be engaged, there must be a breach – a requirement that the Australian courts have eschewed.⁴ It is this requirement that makes the primary-secondary obligation distinction important.

For parties seeking to enforce (or resist enforcement of) existing LAD clauses, *Denka* is likely simply to reinforce the Malaysian courts' commitment to striking down LAD clauses that stipulate sums that far exceed a genuine pre-estimate of the loss that might be caused by a breach.

For parties negotiating LAD clauses at the pre-contractual stage, it is important to ensure that the clause meets at least two requirements:

¹ *Denka Advantech Pte Ltd and another v Seraya Energy Pte Ltd and another and other appeals* [2020] SGCA 119

² *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis (Consumers' Association intervening)* [2015] UKSC 67; [2016] AC 1172

³ *Cubic Electronics Sdn Bhd (in liquidation) v Mars Telecommunications Sdn Bhd* [2019] 6 MLJ 15 (FC)

⁴ *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30; *Paciocco v Australia and New Zealand Banking Group Ltd* [2015] FCAFC 50

- (a) Firstly, it should be clear in substance whether the event triggering an LAD clause is or is not a breach. If it is not a breach, the courts will be unable to even begin to review the enforceability of the clause.
- (b) Secondly, the sum stipulated must be a genuine pre-estimate of the loss that the breach might cause. This can be achieved by estimating the losses that would be recoverable at common law for that breach (unless the contract specifically excludes the common law right to terminate).

An earlier version of this article was first published by the authors in January 2021.

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