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Understanding Breach of Contracts in Malaysia

A Comprehensive Guide to Legal Frameworks and Remedies

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AUTHOR

Chong Yeong Yoong
Partner

CTS LEGAL INSIGHT

Every business transaction relies on contracts, from simple procurement to complex infrastructure projects. A contract is an exchange of promises for which the law provides a remedy if one party fails to fulfil his promise. In Malaysia, contracts are primarily governed by the Contracts Act 1950.

A breach of contract occurs when a party fails to perform his obligations under the contract. Identifying a breach requires a clear understanding of each party's contractual duties. It is also important to note that not all non-performance grants the innocent party a right to terminate and claim for damages.

Material and Minor Breaches

Not every non-performance is treated with the same level of severity. A critical determination in any dispute is whether a breach of contract is material (fundamental) or minor.

- **Material breach** — a major failure that goes to the root of the contract and defeats its fundamental purpose. When a material breach occurs, the innocent party is generally excused from performing his obligations and may seek remedies, including terminating the contract and claiming for damages.
- **Minor breach** — a breach which does not deprive the innocent party of the main benefit of the contract. Both parties are still required to fulfil their obligations, but the innocent party is entitled to claim damages for the breach.

By way of illustration, in a sale and purchase agreement of a property, a vendor who receives the full purchase price but fails to transfer the legal title to the buyer commits a fundamental breach. The buyer can terminate the contract, demand a full refund, and claim damages. On the other hand, if the vendor is required to clear site debris on the property prior to handover but the buyer still finds debris left behind, this is only a minor breach. The buyer cannot terminate the contract, but can demand that the vendor removes the debris — or remove it himself and claim the cost of removal from the vendor.

Breach Before the Due Date for Performance

A breach can occur before performance falls due. This is known as an anticipatory breach, and it arises when a party shows that he will not deliver his promise before the due date for performance.

Section 40 of the Contracts Act 1950 sets out how an anticipatory breach can happen, namely when a party refuses to perform or disables himself from performing his promise in its entirety. This occurs when a party declares ahead of time that he will not perform his obligations, or acts in a way that makes it impossible for him to fulfil his obligations on the due date. To successfully prove an anticipatory breach, the innocent party must demonstrate that the refusal to perform was absolute and unequivocal.

When an anticipatory breach of a fundamental term occurs, the innocent party may elect to:

- terminate the contract and sue for damages before the due date for performance; or
- affirm the contract (by words or conduct), in which case the contract remains alive and binding on both parties.

Generally, an innocent party must take all reasonable steps to mitigate his losses the moment he accepts the breach and terminates the contract.[1]

However, under the rule established in *White & Carter (Councils) Ltd v McGregor* [1962] AC 413, an innocent party who affirms the contract following an anticipatory breach may perform his part and sue for the contract sum without needing to mitigate his losses, provided two strict conditions are satisfied:

- the innocent party must be able to complete his obligations on his own, without cooperation from the defaulting party; and
- the innocent party must have a legitimate interest to affirm the contract instead of merely claiming for damages. For example, a company may insist on performance where it stands to benefit from protecting its business reputation or fulfilling various contracts with third parties.

There are situations where it makes commercial sense to affirm the contract rather than terminating and suing for damages immediately. Recognising an anticipatory breach early allows management to assess whether the company should terminate the contract and mitigate its losses, or affirm the contract and sue for the contract sum, subject to the *White & Carter* rule.

Legal Remedies for Breach of Contract

Measure of damages

When a breach of contract is proven, the law primarily compensates the innocent party for his expectation loss (loss of profits) by awarding damages aimed at placing him in the financial position he would have been in had the contract been performed. Alternatively, the innocent party may elect to claim for reliance loss (wasted expenditure), which aims to restore him to the financial position he was in before the contract was made.

Deciding whether to claim expectation loss or reliance loss involves both legal and commercial considerations. In terms of evidence, proving loss of profits requires clear and non-speculative proof of future earnings, whereas wasted expenditure can be readily proven with invoices and receipts. Commercially, it must be assessed which measure of damages yields the higher payout.

Remoteness of damages

Under Section 74 of the Contracts Act 1950, which mirrors the English common law principles in *Hadley v Baxendale* (1854) 9 Ex 341, damages are categorised as follows:

- **General damages** — direct losses resulting naturally in the ordinary course of things from the breach. The law presumes the defaulting party should have foreseen these losses, such as the difference between the contract price and the market price for substitute goods.
- **Special damages** — indirect losses, recoverable only if both parties knew at the time the contract was signed that the losses were likely to result from the breach.

[1] *Teh Wan Sang & Sons Sdn Bhd v See Teow Chuan* [1984] 1 MLJ 13.

Liquidated ascertained damages

Under Section 75 of the Contracts Act 1950, the parties may agree to a specific sum as liquidated ascertained damages ("LAD") in the event of a breach, and the innocent party is entitled to claim reasonable compensation up to the agreed amount. The innocent party does not need to prove actual loss to enforce the LAD clause. Once the innocent party establishes that the breach occurred and that the LAD sum represents reasonable compensation, the burden shifts to the defaulting party to show that the LAD sum is unreasonable.[2]

Specific performance

Where appropriate, such as in cases where monetary compensation is an inadequate remedy, a court may grant specific performance under Section 11 of the Specific Relief Act 1950, compelling the defaulting party to fulfil his obligations under the contract.

Defences to a Breach of Contract Claim

A party being sued for breach of contract may raise defences to avoid or limit liability. Defences under the Contracts Act 1950 and at common law include the following.

- **Incomplete formation of a valid contract** — absence of intention to create legal relations, lack of consideration, uncertainty of terms, or lack of capacity to enter into the contract (for example, minors or persons of unsound mind).
- **Vitiating factors** — where consent was compromised at the time of contracting, such as:
  - *Coercion, undue influence or fraud* — a contract entered into under threat, improper pressure or through deception.
  - *Misrepresentation* — a false statement of fact made by one party that induces the other party to enter into the contract in reliance on that statement.
  - *Mistake* — both parties entered into the contract under a mistake as to a matter of fact essential to the agreement. A unilateral mistake by only one party does not invalidate the contract.
- **Illegality** — the consideration or object of the contract is unlawful, immoral or against public policy.
- **Frustration** — a supervening, unforeseen event outside either party's control makes performance physically or legally impossible.
- **Force majeure** — the contract expressly includes a clause that suspends or terminates a party's performance of an obligation due to unforeseen and uncontrollable events such as natural disasters, war, riots, lockdowns, public health emergencies, or changes in law rendering performance impossible.
- **Waiver and estoppel** — where a party waives the right to enforce performance, that party is estopped from later enforcing the original term.

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

Limitation period

In Malaysia, a party generally has six years from the date of the breach to sue for breach of contract. Any clause that restricts or shortens the statutory limitation period within which a party may enforce his rights is void and unenforceable.

Once the limitation period expires, the claim is time-barred and the defendant can plead limitation to strike out the suit. It is crucial to note that the defence of limitation for a breach of contract claim cannot be invoked against a void contract, as there are no enforceable rights or duties in an agreement which is void *ab initio* (invalid from the beginning).[3] However, where an innocent party seeks restitution of the benefits received by any person under a void contract, the limitation period typically runs from the date the invalidity was discovered.[4]

Duty to mitigate

Damages for breach of contract will be reduced if the innocent party fails to take reasonable steps to mitigate his losses once he becomes aware of the breach. For instance, if a supplier fails to deliver critical electrical components to a household appliance manufacturer, the manufacturer is expected to source the components from another supplier rather than halting production entirely and suing for total lost profits.

Demand Letters and Dispute Resolution

In the event of a contractual dispute, it is essential to gather all documentary evidence, including emails, letters, instant messages and notes from verbal communications. Providing a complete factual trail allows your legal counsel to properly assess the merits of your case.

Before filing an action in court, it is standard practice in Malaysia to send a formal demand letter to put the opposing party on notice and attempt a pre-action resolution. A demand letter formally records the dispute, specifies how the breach must be remedied, and sets a deadline for compliance.

Protecting Your Business Interests in Malaysia

It is important to obtain legal advice before signing any commercial contract, or immediately upon a breach occurring, to protect your legal and commercial interests. Having legal counsel review the contract and the relevant evidence when a dispute arises allows counsel to map out a clear strategy for your case.

Established in 1989, Cheah Teh Su is a Malaysian law firm with extensive experience in contractual disputes, including complex commercial disputes. The firm's dispute resolution practice has been ranked in the Chambers & Partners Asia Pacific Guide for 18 consecutive years and is consistently recognised as a Leading Firm for Dispute Resolution in the Legal 500 Asia Pacific Guide.

If you are facing a breach of contract, or are concerned about your rights and obligations under a commercial agreement, contact us to arrange a consultation with one of our partners.

[3] *Khatijah bt Abdullah & Ors v Mohd Isa bin Biran* [2017] 2 MLJ 1.

[4] Section 66 of the Contracts Act 1950.

Frequently Asked Questions

What is the difference between an actual breach and an anticipatory breach?

An actual breach occurs on or after the performance deadline, when a party fails to fulfil his obligation under the contract. An anticipatory breach occurs before the deadline, when a party signals his intention not to perform or disables himself from performing his obligation under the contract.

How long do I have to sue for a breach of contract in Malaysia?

The limitation period for a breach of contract claim is generally six years from the date the breach occurred.

What does "duty to mitigate" mean?

It is a legal requirement that an aggrieved party takes reasonable steps to minimise his losses after a breach has occurred. Failure to do so can result in a reduction of the damages awarded by the court.

Can I terminate a contract immediately after any breach?

No. Termination is typically only permitted if the breach of contract is material or fundamental, meaning it goes to the root of the agreement. For minor breaches, you can claim for damages but must still perform your obligations.

How do I decide whether to claim expectation loss or reliance loss?

You must consider both evidentiary and commercial factors. Expectation loss (loss of profits) requires clear and non-speculative proof of future earnings, whereas reliance loss (wasted expenditure) is often easier to prove with invoices and receipts. Your legal counsel will advise you on which measure of damages is legally applicable and yields the higher overall payout, based on the specific facts of your case and the available evidence.

Conclusion

Most contractual disputes are won or lost on the strength of the contemporaneous record and the speed of the response. Whether a breach is material or minor, actual or anticipatory, determines the remedies available — and the wrong election at the outset can be costly to unwind. Where the stakes are significant, taking advice before terminating, affirming or issuing a demand is invariably the more economical course.

CTS CHEAH TEH SU
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If you have any questions on this article

Please get in touch with the author.

Chong Yeong Yoong
Partner
yoong@ctslawyers.com.my

OFFICE

Cheah Teh Su
L-3-1, No. 2, Jalan Solaris
Solaris Mont' Kiara
50480 Kuala Lumpur, Malaysia

GET IN TOUCH

T +603 6203 6918
E cts@ctslawyers.com.my
W www.ctslawyers.com.my
in www.linkedin.com/company/cheah-teh-su