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Contracting Out Of Contracts Act 1950
General Concept Of Contracts Act 1950
("CA 1950")

by

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CA 1950 was adopted from Indian Contracts Act 1872, which prior to that incorporated the principles of law of contracts in common law of England. Generally, CA 1950 governs the contractual transaction in Malaysia and providing general guidelines to contracts. Be that as it may, CA 1950 is not the only legislation in Malaysia which regulates contractual relationship as there are other legislations such as Specific Relief Act 1950 (remedies of specific performance & injunction), Civil Law Act 1956 (remedies for frustrated contracts), and Government Contracts Act 1949 (contracts by government).

As the development of contract laws in Malaysia rapidly enhance, and the necessity to have a comprehensive code to regulate contractual relationship between parties in commercial transactions, several specific legislations has been enacted along side with the governing Act on contracts. They are, for example, Partnership Act 1961, Hire-Purchase Act 1967, Sales of Goods Act 1957, Companies Act 1965, Bills of Sale Act 1950, Insurance Act 1963, Employment Act 1955 and Housing Developers (Control & Licensing) Act 1966. These Acts provide for specific rules and regulations in which the specific contract may or can be entered.

The enactment of the specific Acts regulating the specific contracts may give rise to a confusion, as to its applicability *vis-à-vis* CA 1950 as a general guideline. The question remains in an event of conflict between CA 1950 and the specific legislation, which one shall prevail over the other?. To answer the question, one may need to look into each and every legislation to find the answer. However, in general sense, reference can be made to s. 1(2) of the CA 1950 which says:

Nothing herein contained shall affect any written law or any usage or custom of trade, or any incident of any contract, not inconsistent with this Act.

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Therefore, in the event of inconsistency, the specific legislation shall prevail over CA 1950 by virtue of s. 1(2) of CA 1950. In addition, the other specific legislation normally mention its applicability in the event of inconsistency with other laws.

We said before that the CA 1950 was adopted from Indian Contracts Act which was incorporated from the English common laws. The next question to be asked is whether the CA 1950 is exhaustive and whether resort to English principles are acceptable in Malaysia in relation to CA 1950?. There is no definite answer to this question as there is no clear line of authorities. Some cases suggests that the adoption of the English common law principles are unacceptable whilst other cases states that if there is gap (lacunae) in the application of CA 1950, English common law can be adopted. The Privy Council remark in the case of *Irrawaddy Flotilla Co Ltd v. Bugwandass* [1891] 18 IA 121 may shed some light:

The (Indian Contract) Act of 1872 does not profess to be a complete code dealing with the law relating to contracts. It purports to do no more than to define and amend certain parts of that law. No doubt it treats of bailment in a separate chapter. But there is nothing to show that the Legislature intended to deal exhaustively with any particular chapter or subdivision of the law relating to contracts. (emphasis added).

Freedom Of Contract

It is trite law that parties are free to contract, as long as the contract entered into does not fall under the category of void or voidable contracts under CA 1950. It is also trite law that the Court when been referred by parties to resolve the issue arising out of contract entered into by the parties, must, uphold the agreed terms of the contract, and cannot rewrite the contract. In other words, it means that the Court cannot import its own interpretation of the contract based on other extenuating factors not relevant to the contract, as that is not the intention of the parties. As such, the contract must be interpreted by four corners of the contract, and parties are bound by it, no matter how unfair the contract may be.

This freedom of contract however is not free from abuse. Parties to the contract sometime draft their contract in a way to circumvent the clear provisions of CA 1950 so as to render its application to the contract irrelevant. In such cases, the court will have to face with a difficulty in interpreting the provision of the contracts. It may be clear if the provisions of the contract clearly

contravene the CA 1950 for example if the contract stated that the object of the contract is to traffick drugs which is clearly prohibited and void under s. 24 of CA 1950. However, the situation may become more complicated if the drafting of the contract does not touch on the clear provision of CA 1950 which render the contract void or voidable. Below are some examples of such drafting:

Example 1

Except where there is no express terms herein, the provision of CA 1950 shall not in any manner whatsoever, be applicable to the construction, interpretation, enforcement etc. of this Agreement.

Example 2

The provision of CA 1950 shall not in any manner whatsoever, be applicable to this Agreement, and the Islamic principles of contract shall be applicable.

The above examples are what the expert in contract laws called contracting out of CA 1950.

Contracting Out Of CA 1950

In general sense, contracting out means to incorporate terms and conditions in the agreement between parties, to evade application of express provisions of CA 1950. However, the question remains whether the freedom of contract is so untrammled to the extent that application of a codified statute can be evaded?

To further illustrate, let us look at some examples:

Example 3

Section 86 of CA 1950:

Any variance, made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, **discharges the surety** as to transactions subsequent to the variance.

Agreement between parties:

The Bank may at its absolute discretion vary or amend the Agreement at any time, from time to time, without prior consent or approval from the Borrower and/or the guarantor". "The guarantor shall not in any event be discharged from his liability, except with written confirmation by the Bank".

The clause in the agreement clearly eliminates the applicability of s. 86 of CA 1950. Question: Is this allowed?

Example 4

Section 29 of CA 1950:

Every agreement, by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent.

Agreement between parties:

Notwithstanding any prohibition in any statutory law, the Lender shall not proceed with any legal action against the Guarantor, except where legal action has been commenced against the Borrower for the period of one year from its commencement.

The clause in the agreement clearly drafted to evade applicability of s. 29 of CA 1950

Example 5

Section 75 of CA 1950:

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 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.

Illustration (d): Default interest of 75% is penalty, thus the court shall determine reasonable compensation.

Agreement between parties:

Default interest of 75% and, this shall not be regarded in any manner as a penalty under Section 75 of CA1950.

The big question mark is whether all the above terms is allowed and enforceable by court?

The Laws On Contracting Out

The position prior to 1984 is not clear whether parties in exercising right to freedom of contract, can contract out of CA 1950. The court tends to mould and interpret the terms of the

agreement to suit the application of the CA 1950, and avoid itself from touching the issue of inconsistency of the terms with CA 1950.

However, in 1984, Privy Council had delivered a very important decision on application of CA 1950. In the case of *Ooi Boon Leong & Ors v. Citibank NA* [1984] 1 LNS 26, the Privy Council was posted with the question: whether parties can contract out of CA 1950?

Facts Of The Case

Citibank sued Ooi & Ors (Directors of a company) as guarantor for the defaulting loan obtained by the company. In the agreement, Ooi & Ors had agreed to waive their rights in respect of any variation or alteration of the contract between Citibank and the company. Citibank then applied for summary judgment under O. 14 of Rules of the High Court 1980 to be entered against Ooi & Ors. The senior assistant registrar of the High Court allowed Citibank's application and entered judgment against Ooi & Ors. Ooi & Ors then appealed to the judge in chamber and the judge allowed the appeal and set aside the judgment entered. Citibank then appealed to the Federal Court whereby the appeal was allowed and the judgment of the senior assistant registrar upheld. Not satisfied with the decision of the Federal Court, Ooi & Ors appealed to Privy Council. The question posted to the Privy Council was:

Whether clauses 7(5), 8 and 16 of the Guarantee were void because parties cannot contract out of the section of the Contracts Act, section 86, 92 and 94.

The counsel for Ooi & Ors (appellant) put forward two arguments to the Privy Council:

Argument 1

Section 1(2) of the Act: "nothing herein contained shall affect ... any incident of any contract, not inconsistent with this Act". A term of a contract is an incident of that contract. So, nothing in the Act shall affect any terms of the contract which is **not inconsistent** with the Act. On the other hand, the Act is to affect the terms of a contract which is **inconsistent with the Act**. The term which says that the variation of contract can be made without consent or agreement by the guarantor was clearly inconsistent with s. 86 of CA 1950. Therefore the term of the agreement is void.

Argument 2

- Comparison between the form of ss. 86, 92 and 94 of the Act and the form of certain other sections which expressly envisage the parties otherwise contracting.
- Example: Section 38(2): "Promises bind the representatives of the promisors on case of the death of the promisors before performance, unless a contrary intention appears from the contract".
- There are 16 other sections like this in the Act.
- Therefore, where the Act intends contracting out to be permissible, it says so.
- Section 86, 92 and 94 do not expressly provide for contracting out, therefore contracting out is unlawful.

The Privy Council answered the argument as follows:

Answer To Argument 1

- An incident of a contract is to be distinguished from a term of the contract. Incident of a contract means legal consequences of the contract which flows from the existence of the contract.
- Section 1(2) is saying that the legal consequences of a contract which ensue at common law are to continue to apply unless some different legal consequences are spelt out by the Act.
- It does not say that the parties are unable by agreement to vary legal consequences spelt out by the Act.

Answer To Argument 2

Privy Council stated that random recognition in certain sections of the Act is quite insufficient to support the proposition.

The principle of contracting out of CA 1950 was clearly enunciated by the Privy Council. The Privy Council had this to say:

If freedom of contract was to be curtailed in relation to a particular subject matter, the prohibition should be expressed in the statute and not left by the legislature to be picked out as implication based upon sections dealing with different subject matters. When the CA intends to render an agreement void it says so in express terms as in sections 25 to 31.

Therefore, the Privy Council held that the clauses in the Guarantee were VALID. With regard to the general concept of CA 1950, Lord Brightman had this to say:

The CA 1950 is described in the long title simply as "An Act relating to contracts". It is not expressed to be a consolidating or amending statute. It is, however, clearly intended to codify the law of contract as regard those aspects of contract law which are grouped under the Act's nine definitive headings.

Thus, it is abundantly clear that parties are free to contract out of CA 1950.

Recent Attitude Of Courts

Generally, the courts in Malaysia are bound by the Privy Council's decision applying doctrine of *stare decisis*. However, some courts tend not to touch the question of contracting out but determining the rights and liabilities of the parties within the four corners of the agreement. There is no departure from the decision of Privy Council so far, thus it is still good law. In any event, the Federal Court is the only court which can overrule the said decision.

To see the recent attitude of courts in Malaysia, we shall look into some recent decisions of courts.

Case 1

In *Isito Electronic Sdn Bhd v. Teh Ah Kiam & Anor* [2004] 3 CLJ 272, Ramli Ali J held in a case concerning s. 104 of CA 1950 that:

In any event, even if s. 104 is to be considered, the court is of the view that the extent of care to be taken by a bailee under the said section can by agreement be contracted out by the parties. This was decided by the Privy Council in *Ooi Boon Leong & Ors v. Citibank* [1984] 1 LNS 26. The Contracts Act 1950 (particularly s. 1(2) does not restrict the freedom of contracting parties to decide upon what terms they desire to contract, unless they are clearly inconsistent with the Act.

Case 2

In the case of *New Zealand Insurance Co. Ltd v. Ong Choon Lin* [1992] 1 CLJ 44; [1992] 1 CLJ (Rep) 230, the question is whether the terms of the insurance policy which limit the time for filing claim is contrary to s. 29 of CA 1950. The Supreme Court held that:

A right cannot be disassociated from its remedy, and therefore condition 19 of the fire policy contravenes s. 29 of the Contracts Act 1950 as it clearly limits the time within which the respondent can enforce his statutory right to bring an action under s. 6(1)(a) of the Limitation Act 1953.

Case 3

In *Pusat Bandar Damansara Sdn Bhd & Anor v. Yap Han Soo & Sons Sdn Bhd* [2000] 1 CLJ 346, the court considered whether the default interest in the agreement would amount to penalty under s. 75 of CA 1950. The Court of Appeal held that:

Likewise, the imposition of 19% interest was allowed by the agreement. In any case, to bring the 19% interest within the ambit of s. 75 of the Contracts Act 1950, it must first be shown that it was excessive in nature. The fact that it was an agreed penalty interest as opposed to one that was fixed unilaterally by the appellants lends support to the conclusion that it could not have been that excessive. Under the circumstances, that rate of interest cannot be caught by s. 75.

Therefore, while the court in some cases adopt the principle enunciated by the Privy Council, in the other case, the court tend to look into the applicability of CA 1950 to the terms and conditions and avoid to touch on the issue of contracting out.

Conclusion

We conclude to note that in CA 1950, there are three kinds of provisions (in relation with the principle of contracting out):

- 1) Sections which clearly render the agreement void (s. 25 to 31). **Parties cannot contract out of these sections.**
- 2) Sections which expressly states the right to contract out of the section (s. 38(2) and other 16 sections). **Parties can contract out of these sections.**
- 3) Sections which generally do not expressly provide freedom to contract out. However, by virtue of s. 1(2) and decision of Privy Council, **parties can contract out of these sections.**