

THE ENFORCEABILITY OF CULPA IN CONTRAHENDO IN MALAYSIA

Mohd Azizie Abdul Aziz

Faculty of Law,

University Kebangsaan Malaysia

43600 Selangor, Malaysia

Email: azizieaziz11@gmail.com

Sakina Shaik Ahmad Yusoff

Faculty of Law

University Kebangsaan Malaysia

43600 Selangor, Malaysia

Email: kinasay@ukm.edu.my

ABSTRACT

Culpa in contrahendo is a significant doctrine which recognizes a pre-contractual duty to negotiate in good faith and not to lead a negotiating party to act to his disadvantage before the conclusion of a firm contract. Lack of this doctrine in the Malaysian Contracts Act 1950 ('the 1950 Act') - the primary statute that regulates contracts law in Malaysia is a major concern due to its significance in regulating contemporary commercial relations, especially in an international context. This paper identified two main reasons for such absence, namely (i) continuous reliance on the English common law legacy; and (ii) the conventional theoretical foundation of the 1950 Act. The English common law legacy remains in the Malaysian legal system, although 59 years have passed since independence. Accordingly, following the English common law position, Malaysian courts also does not recognize the general duty of good faith in contract. This position is further restricted by the classical doctrine of freedom of contract underlying the 1950 Act, which afforded the parties the freedom to decide whether to continue with the negotiations or simply withdraw from them. This paper however argues that these barriers may still be overcome and now is the right time to reform the Malaysian contract law by recognizing the doctrine of culpa in contrahendo in contract formation. For this purpose, this paper addresses the extent in which pre-contractual liabilities are enforceable in Malaysia and its current position in England, Singapore and Australia including under the United Nations Convention on Contracts for the International Sale of Goods (CISG) and UNIDROIT Principles for International Commercial Contracts. Ultimately, this paper proposes a harmonious solution by recognizing the doctrine of culpa in contrahendo as part of the lex mercatoria and by ratifying the CISG.

Key words: Contracts Act 1950, *Culpa in contrahendo*, good faith, pre-contractual liability.

Introduction

Contract law forms one of the most fundamental elements of any legal framework. It is the essential part of many day-to-day interactions, as all kinds of sales on a domestic and international level are based on contract. Businesses and consumers would be thwarted without a law of contract to support these contracts. In Malaysia, the primary and most significant piece of legislation governing contracts is the Contracts Act 1950 ('the Act of 1950'). It was first legislated in 1899¹ based on the Contracts Act 1872 ('the Act of 1872') from India. By doing this, the legislature has taken a step backward, as it has adopted an incomplete code on the law of contract. Lord Macnaghten in *Irrawaddy Flotilla Co. Ltd v Bugwandas*² describes the Act of 1872 as follows:

"The Act of 1872 does not profess to be a complete code dealing with the law relating to contract. It purports to do no more than to define and amend certain parts of that law... there is nothing to show that the Legislature intended to deal exhaustively with any particular chapter or subdivision of the law relating to contracts."

Moreover, the fact that the Act of 1950 is more than 100 years old and short of any major reforms being undertaken (Cheong, 2011) is a major concern.

Problem Statement

Thus far, the 1950 Act remains out of step with the realities of 21st century commercial practice. In the last 100 years, business and commercial environment have changed significantly. The vitality of modern economic, trade liberalization and technological advancement requires the law of contract to adapt itself to modern demands. It should be able to respond to changing values and concerns within society, resolve issues as they develop, respond to scientific or technological developments, and not remain idle. Attempts to insert archaic law onto ever-changing situations would result in a struggle to conform novel issues into an out-dated legal framework (Kidd & Daughtrey, 2000) and may promote injustice.

¹ Contracts Enactment 1899.

² (1891) 18 IA 121.

A cursory look into the 1950 Act reveals that it is lacking in the provision relating to the doctrine of *culpa in contrahendo*. This doctrine recognizes a pre-contractual duty to negotiate in good faith and not to lead a negotiating party to act to his disadvantage before the conclusion of a firm contract (Kessler and Fine, 1964). The non-availability of this form of liability may cause injustice to those involved in pre-contractual negotiation under the expectation that a firm contract would be established. The law should not permit one to unfairly withdraw from pre-contractual negotiations without legal consequences, especially in situations in which a party has invested a large amount of money and work for the business. The injuries that may result from the unjustified withdrawal can be equal or even bigger than the injuries caused by the breach of contracts. A party might also abuse this right to terminate negotiations in order to gain some unfair advantage other than the advantage expected from the potential contract and insists on contractual terms so clearly unreasonable. In addition, the literatures on the application of doctrine of *culpa in contrahendo* in Malaysia are also very limited. Nurhidayah (2009) only discussed the duty of good faith under the Hire-Purchase Act 1967, while Thanasegaran (2016) wrote on the doctrine of utmost good faith or *uberrimae fidei* under the insurance law in Malaysia.

Objectives

Apprehending the significance of having comprehensive and conversant law, this research paper attempts to provide the appropriate response to this legal issue and fill in the gaps in the law of contract as well as in the literature by first uncovering the causes or barriers for the non-recognition of doctrine *culpa in contrahendo* in Malaysia. Thereupon, this paper analyzes the possible ways to overcome the legal barriers, followed by a proposal for the extension of this doctrine into the 1950 Act in harmonious and nonconflicting manner.

The Legal Barriers

The absence of pre-contractual duty of good faith in the 1950 Act and the court reluctant in enforcing such duty are due to two main factors namely (i) continuous reliance on English common law legacy; and (ii) the immortality of conventional doctrine underlying the Act.

(i) English Common law Legacy

English common law does not recognize a duty of good faith in negotiation. Lord Ackner writing for the House of Lords in *Walford and Others v. Miles and Another*³ laid down the law in these terms:

...the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations...A duty to negotiate in good faith is unworkable in practice as it is inherently inconsistent with the position of a negotiating party. It is here that the uncertainty lies.

Lord Craighead in *Chartbrook Limited v Persimmon Homes Limited*⁴ explains the reason for the non-recognition fearing that it will contravene the principle of freedom of contract.

Since the Contracts Act 1950 is silent on this good faith duty, the usual practice by Malaysian court is to apply the English common law. This is due to the fact that the Act was developed based on the common law principles and by the application of section 3 and 5 of the Civil Law Act 1956. As a result of continuous reliance, the position in Malaysia is similar to the common law in not recognizing the pre-contractual duty of good faith. This can be seen in the recent case of *Aseambankers Malaysia Bhd & Ors v. Shencourt Sdn Bhd & Anor.*⁵

(ii) Conventional Theoretical Foundation of the Contracts Act 1950

According to classical contract theory of the nineteenth century, the exercise of freedom of contract is the key to individual welfare and the common good (Edward , 2009). Courts were reluctant to inquire into the fairness of contracts but to enforce bargains as made. Since the 1950 Act made based on English common law in the nineteenth century, the structure upon which it was built is therefore based on the doctrine of freedom of contract (Nuretina, 2005). This was recognized by the Privy Council in *Ooi Boon Leong v Citibank NA*⁶ as follows:

“Section 1(2) has no effect on the freedom of contracting parties to decide upon what terms they desire to contract. It would be indeed surprising if so devastating an inroad into the common law right of freedom of contract were introduced by the legislatures in a section which is primarily devoted to expressing the short title to the Act and which moreover appears in a part of the Act which is merely headed ‘Preliminary’.”

³ [1992] 2 AC 128, at p. 138.

⁴ [2009] UKHL 38, at p.3.

⁵ [2014] 2 CLJ 773.

⁶ [1984] 1 MLJ 222.

Due to this classical contract theory, the negotiating parties are therefore free to withdraw from negotiations at any stage and contractual obligations only began with the consummation of a contract. The party himself has to deliberate whether his bargains are wise or otherwise, and not for courts to consider.

Surpassing the Barriers

This paper is of the view that the time has come to reform the 1950 Act and break away from the abovesaid barriers. It is further argued that it is passable to do so, but it will require a paradigm shift of the judiciary and the legislature.

(i) From English Common law to Malaysian Common law

Fifty-nine years have passed since independence and English common law still dominate the mind of Malaysian judges and legal practitioners. Even decisions from other common law jurisdictions beyond England have come to be cited with increasing frequency in Malaysian courts. Malaysian judges should be brave enough to look at English common law with critical eyes and develop the law to serve Malaysian (Farid Sufian, 2009). Diversity and pluralism in Malaysia are a fact and this would justify a departure from English law. Malaysian law should be interpreted according to Malaysia terms. This is connected with the ideas of national pride and identity. Analysis of the reported cases discloses that application of English common law depending on judges' discretion. For instance, in *JM Wotherspoon & Co. v. Henry Agency House*,⁷ Suffian J brought in the principle of English law on *del credere* agency on the ground that the 1950 Act is in comprehensive. However, twelve years later, the same judge rejected the application of English Partnership Act 1890 in *Tan Mooi Liang v. Lim Soon Seng*,⁸ due to the existence of many provisions relating to partnership in the Contracts Act 1950. Moreover, most judges simply apply the common law decisions without due regards to the Civil Law Act 1956,⁹ on the grounds that the common law is a non-binding source and being used to fill in gaps in the local legislation.

It is submitted that, a duty of good faith is totally rejected in English contract law. Such duty may still be implied as decided by the English High Court in *Yam Seng Pte Limited v International Trade Corp Limited*.¹⁰ This duty may be implied not as a matter of law, but as a matter of fact. The English Court of Appeal in *Mid Essex Hospital Services NHS Trust v. Compass Group UK and Ireland Ltd (Trading as Medirest)*,¹¹ while restated the position that there is no general doctrine of good faith in English contract law added that "a duty of good faith is implied as an incident of certain categories of contract." In addition, the duty of good faith has entered into English law via European Union (EU) legislation. Other common law countries such as Singapore and Australia have also moved towards recognizing this duty of good faith. Singapore courts have upheld an express duty to negotiate in good faith in *HSBC Institutional Trust Services (Singapore) Ltd (Trustee of Starhill Global Real Estate Investment Trust) v Toshin Development Singapore Pte Ltd*.¹² V.K. Rajah JA, giving the judgment of the Court, held:

"In our view, notwithstanding Lord Ackner's statement in Walford (at 138) that "[a] duty to negotiate in good faith is ... unworkable in practice", that case does not have the effect of invalidating an express term in a contract which employs the language of good faith (see [40]–[41] below). As a preliminary observation, we are of the view that a valid distinction can be drawn between the pre-contractual negotiations in Walford and the "negotiations" between the Parties under the Rent Review Exercise in the present case."

The duty of good faith also has become part of Singapore law under the Sales of Goods (United Nation Convention) Act 2013 as a result of the ratification and enactment of the CISG. Meanwhile in Australia, the New South Wales Court of Appeal in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*¹³ held that the principal had a duty to act reasonably and honestly when exercising powers under a standard form government contract. Priestley JA stated there were strong arguments for the recognition of a duty of good faith and fair dealing in contractual performance. Further, an obligation of good faith and reasonableness was implied into the performance of a franchise agreement in *Burger King Corp v Hungry Jacks Pty Ltd*.¹⁴ It was stated that a duty of good faith and reasonableness ensure powers under a contract are only exercised to the extent necessary to achieve the parties' legitimate contractual interest. Currently, Standards Australia is proposing a new suite of Standards, AS 11000: General conditions of contract AS11000 introduces a new obligation on each party to act in good faith towards the other.

(ii) From Freedom of Contract to Fundamental Fairness

There is a major impediment with the conventional doctrine of freedom of contract as the market economy could no longer accord with the reality of the modern world. It is less relevance today as equal parties did not exist and strong parties were able to impose unfair and repressive bargains upon those who were weak and vulnerable (Edwards, 2009). Freedom of contract in the current social context is only a theoretical freedom. Thus, a paradigm shift in legal theory and practice can displace the

⁷ (1962) 28 MLJ 86.

⁸ [1974] 2 MLJ 60.

⁹ *Ayer Hitam Tin Dredging Malaysia Bhd v. YC Chin Enterprise Sdn Bhd* [1994] 2 MLJ 754; *Sia Siew Hong & Ors. v. Lim Gim Chian & Anor* [1996] 3 CLJ 26; *Mohd Fariq Subramaniam v. Naza Motor Trading Sdn. Bhd.* [1998] 6 MLJ 193; *Kheamhuat Holdings Sdn Bhd v. The Indian Association, Penang* [2006] 2 CLJ 1040;

¹⁰ [2013] EWHC 111 (QB).

¹¹ [2013] EWCA Civ 200.

¹² [2012] 4 SLR 738.

¹³ (1992) 26 NSWLR 234.

¹⁴ (2001) 69 NSWLR 558.

traditional emphasis on negative freedom and anti-regulation. Legislatures had to depart from the classical theory which protected freedom of contract and replaces it with relational theory in order to foster fundamental fairness between parties who engage in transactions (Dorfman, 2012). Instead of viewing society as composed of individuals, society should be viewed as composing economic classes in which inequality of bargaining power became the main concern. State action and judicial interference were therefore, necessary to ensure fairness for those who could not protect themselves in contractual relations.

Proposal

A sound and coherence step towards recognising the doctrine of *culpa in contrahendo* without encroaching upon an inherited system of common law principles and the conventional theory of contract is by recognising this doctrine as part of international commercial law or '*lex mercatoria*' and adopting international treaties and conventions containing the said doctrine. The ratification of the United Nations (U.N.) Convention on Contracts for the International Sale of Goods (CISG) or the UNIDROIT Principles for International Commercial Contracts is a potential evolution in this respect. Both the CISG (art. 7) and the UNIDROIT Principles (art 1.7) acknowledge that good faith plays an important rule for international contracts. The Principles establish a further duty not to continue or break off precontractual negotiations in bad faith (art. 2.15 (2)) and it is bad faith when a party starts or continues negotiations while "intending not to reach an agreement with the other party" (art. 2.5 (3)). The good faith principle thus demands fair negotiations with a clear view to reach an agreement. Misuse of the negotiation process to the detriment of the other party offends the standard of good faith recited in the Principles. Currently, Singapore is the only country in the Association of South East Asian Nations (ASEAN) to be a Contracting State to the CISG. Indirectly, ratification will also promote unification of law within ASEAN. Singapore, Malaysia, Myanmar and Brunei are part of the common law tradition, whilst Indonesia and Thailand are part of the civil law tradition. Cambodia, Vietnam and Laos have been influenced by socialist law and civil law. The Philippines are a mixed jurisdiction of civil and common law due to Spanish and American influence.

Conclusion

The scope of this research is limited to the duty of good faith at pre-contractual stage under the 1950 Act to the exclusion of the duty of good faith in the performance of contract and also utmost good faith in the insurance law. It is paramount that once parties enter into contractual negotiations, they owe to each other a relationship of trust and confidence which require them to act in good faith and with due diligence (Gil-Wallin, 2007). Hence, this paper submitted that the enforceability of the doctrine of *culpa in contrahendo* from the beginning of the negotiations of a probable contract is a step in the right direction. The introduction of this doctrine into the Malaysian contract law would be consistent with the modern commercial practices and improve the regime under which negotiations take place. Accordingly, this will require a paradigm shift of the judges and the legislature to develop Malaysia own common law and moving forward based on the modern theories of contract, which is more in line with the 21st century commercial practices.

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