

Federal Court rules that termination clauses should be construed strictly

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The recent Federal Court decision in *Catajaya Sdn Bhd v Shoppoint Sdn Bhd*⁽¹⁾ has breathed new life into the interpretation of termination clauses in contracts. Indeed, it sounded a cautionary note to the business community at large when the Federal Court held that termination clauses must be interpreted strictly.

Facts

The dispute arose from the termination of a share sale agreement (SSA) between Catajaya Sdn Bhd (appellant) and Shoppoint Sdn Bhd and its shareholders (respondents). Under the SSA, the appellant was to purchase a piece of land held by Shoppoint Sdn Bhd by acquiring its shares.

The SSA stipulated specific timelines for the payment of the purchase price, whereby the appellant would pay the balance purchase price by the agreed completion date.

The appellant, knowing that it could not pay the balance purchase price by the due date, applied to the respondents for a time extension before the completion date. However, the respondents rejected the request for an extension on the basis that time was of the essence, as expressly provided in the SSA. After the rejection, the appellant lodged a private caveat on said land.

The second and third respondents then gave notice to the appellant to exercise its right of termination pursuant to Section 11 of the SSA. The respondents proceeded to file an action in the high court for, among other things, a declaration that the SSA had been lawfully terminated and the removal of the private caveat.

Termination clauses in SSA

There were two relevant termination clauses in the SSA:

Section 11 – Purchaser's Breach

*11.1 In the event that the Purchaser shall breach any of its obligations herein, the Vendors may by notice in writing terminate this Agreement... **provided always that Completion has not taken place** whereupon this Agreement shall forthwith cease to have any further effect or force and neither party shall have any further claim against the other save for antecedent breach...*

Section 12 – Termination

12.1 This Agreement shall continue to be valid and binding until completion via receipt of the full Purchase Price... unless terminated earlier pursuant to Section 12.2 hereunder.

*12.2 This Agreement may be terminated by either party by notice in writing to the other and **wherein the consequences under Section 10 and Section 11 shall be applicable to the Purchaser and the Vendor** respectively:*

*i) if either of the parties hereto shall commit any material breach of its obligations under this Agreement and **shall fail to make good such breach within thirty (30) days from the date of receipt of notice** from the other party requiring it to do so. (Emphasis added.)*

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High court decision

Quite distinct from Section 11, any party that wished to terminate the SSA under Section 12 had to give prior written notice of rectification to the defaulting party.

The issue was whether a termination under Section 11 was subject to compliance with the requirement to give notice to rectify, which was found only in Section 12. If the answer was yes, the respondents' termination of the SSA would be invalid because they had not allowed the appellants any time to pay the balance purchase price.

In determining the issue, the high court held that there was no prerequisite compliance with Section 12 of the SSA. To do so would consequently grant more time to the appellant to complete the purchase beyond the completion date, which would be inconsistent with the express provision that time was of the essence. It was held that Section 11 was an independent and standalone provision to allow for termination in the event of a fundamental breach, which, in the present case, would be the appellant's failure to settle the balance purchase price by the completion date.

Court of Appeal decision

The Court of Appeal held that Sections 11 and 12 were two independent provisions which catered for the termination of the SSA under different circumstances and, accordingly, dismissed the appellant's appeal.⁽²⁾

The Court of Appeal agreed with the high court that the notice of rectification under Section 12.2 would grant the appellant a time extension, which was not the intention of the parties, which had sought to ensure strict adherence with the payment deadline.

Federal Court decision

At the Federal Court, the key question was whether termination clauses should be construed strictly in Malaysia.

The court had no difficulty ruling in the affirmative. In effect, there must be strict adherence with the termination clauses in an agreement.

This gave rise to more questions as to how the parties should interpret Sections 11 and 12 of the SSA.

The Federal Court took an entirely different view from both the high court and the Court of Appeal. It held that Section 11 could not be read in isolation of Section 12 as they were meant to complement each other. This was because Section 12 referred to Section 11 and made it mandatory for the defaulting party to be given 30 days to rectify a breach.

It was further held that it would defy any commercial sense if the appellant, which had paid a substantial sum as a deposit for the purchase of the shares and the land, was not given any opportunity to rectify the breach.

Premised on the above, the Federal Court allowed the appeal and set aside the orders of the Court of Appeal and the high court.

Comment

In a commercial contract, it is not uncommon to find more than one clause allowing termination under different scenarios. In light of the approach taken by the Federal Court, subject to the wording and construction of the termination clauses, they may well be interpreted and read as a whole to unveil specific requirements which must be met prior to termination.

The Federal Court decision is a warning to all contracting parties not to rush the termination of a contract. Instead, care and a meticulous reading of the entire contract are required to ensure strict compliance with the termination clauses. Failure to do so will likely result in an unlawful termination.

For further information on this topic please contact Gan Khong Aik or [Lee Sze Ching \(Ashley\)](mailto:Lee Sze Ching (Ashley) at Gan Partnership) at Gan Partnership by telephone (+603 7931 7060) or email (khongaik@ganlaw.my or szeching@ganlaw.my). The Gan Partnership website can be accessed at www.ganlaw.my.

Endnotes

(1) *Catajaya Sdn Bhd v Shoppoint Sdn Bhd* (Civil Appeal 02(f)-49-05/2019 (B)).

(2) *Catajaya Sdn Bhd v Shoppoint Sdn Bhd* (2019] MLJU 1829).

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