NOTES OF CASES

DEPOSIT OR PART PAYMENT?

Sun Properties Sdn. Bhd. & Ors. v. *Happy Shopping Plaza Sdn. Bhd.*[1]

Introduction

FORFEITURE provisions are very common in commercial transactions. Money is usually collected in advance of performance to ensure that there is a sum of money to resort to should there be a breach of contract. Quite often, the contract will confer the right to forfeit the pre-payment on breach of contract.

The law draws a distinction between a part-payment and a deposit. A deposit will quite often go in part-payment of any payment due under the contract, but is considered distinct in that it is also a guarantee of performance.[2] The Privy Council in *Linggi Plantations Ltd.* v. *Jagatheesan*[3] accepted such a distinction, and Lord Hailsham, who delivered the judgment of the Board stated that a reasonable deposit or earnest "was not normally the subject of equitable relief".[4] It might seem obvious that an agreement to a forfeiture of money on breach of contract is really no different from agreed damages which are subject to the penalty rule.[5] For some reason, which is normally stated to be the fact that a deposit is an earnest, this is not so, and *Linggi*[6] is Privy Council authority for this. It states that the penalty rule does not apply to the forfeiture of deposits, and there is no relief from forfeiture so long as the deposit is reasonable.[7] According to the Board in *Linggi,*[8] there can be equitable relief when the payment is in effect part payment:[9]

> "It is also no doubt possible that in a particular contract the parties may use language normally appropriate to deposits properly so called and even to forfeiture which turn out on investigation to be purely colourable and that in such a case the real nature of the transaction might turn out to be the imposition of a penalty, by purporting to forfeit something which is in truth part payment."

In short, equitable relief is available, but only against the forfeiture of part-payments, and "unreasonable" deposits will be

1 [1987] 1 M.L.J. 319 (High Court); [1987] 2 M.L.J. 711 (Supreme Court).
2 *Howe* v. *Smith* (1884) 27 Ch. D. 89 at p. 95; *Soper* v. *Arnold*(1 889)14 App. Cas. 429.
3 [1972] 1 M.L.J. 89.
4 *Ibid.,* at p. 91, citing Jessel M. R. in *Wallis* v. *Smith* (1882) 21 Ch. D. 243 at p. 258.
5 One obvious but seemingly immaterial difference is that one is collected beforehand. See Treitel, *The Law of Contract,* (7th ed., 1987) at pp. 768-75 for an overview of the penalty rule.
6 *Supra,* note 3.
7 Professor Treitel argues that the penalty rule applies: *The Law of Contract* (7th ed., 1987) at p. 775, with *Public Works Commissioner* v. *Hills* [1906] A. C. 368 as authority. In the Singapore and Malaysian contexts, the Privy Council decision in *Linggi Plantations,* above, would be practically binding.
8 *Supra,* note 3.
9 *Ibid.,* at p. 94.

considered to be "part-payments". The reasonableness test is based on the reasonableness of the size of the forfeited sum, and is distinct from the reasonable pre-estimate of loss test under the penalty rule. In *Stockloser* v. *Johnson*[10] Lord Denning suggested that there is a general jurisdiction in equity to relieve against the forfeiture of money if (a) there is a forfeiture clause of a penal nature and; (b) it would be unconscionable for the money to be retained.[11]

The Case

Relief against forfeiture came up for consideration recently in the Malaysian courts. The High Court granted relief against the forfeiture of a 10% deposit in *Happy Shopping Plaza Sdn. Bhd.* v. *Sun Properties Sdn. Bhd. & Ors.*[12] But on appeal, the Supreme Court endorsed the forfeiture.[13] The contract in question was for the sale and purchase of the shares of a land development company. The total contract price was $10 million. A 10% deposit was paid under clause 1 of the agreement. The full price was to be paid in two more instalments: one of $4 million and another of $5 million (clause 2). Clause 4 provided that should the purchaser fail to pay any of the sums payable under clause 2 on time, the vendor was to have the right to forfeit "all sums thencetofore paid by the purchaser to the vendors." The deposit was paid, but not the instalment of $4 million. The vendors terminated the contract and forfeited the deposit. Considering the size of the deposit, it is not surprising that the purchaser sued in an effort to recover the deposit. Section 75 of the Malaysian Contracts Act 1950 was pleaded.[14] If it applied the defendants would have been entitled to reasonable compensation only. The main issue was whether the forfeiture would amount to a penalty.[15]

High Court

At first instance, L. C. Vohrah J. held that there was a penalty.[16] But not because the deposit would have been forfeited *qua* deposit.

Though this is not considered in the judgment itself, a 10% deposit may not, on the facts, be a reasonable pre-estimate of loss but it is probably a reasonable guarantee of performance. *Linggi* would require the reasonableness test and not the penalty test to be applied. So unless the court was prepared to hold that the often used magical

[10] [1954] 1 All E. R. 630 at p. 637.

[11] *Ibid.*, at pp. 637-8. This jurisdiction was invoked and exercised in the Malaysian case of *K. Kumar Kandha Rajah* v. *El Magness* [1985] 1 M. L. J. 116. It is not clear how the English-courts will apply the jurisdiction. Lord Denning's dicta in *Stockloser* have not been declared wrong, but there have been suggestions that they are confined to the forfeiture of property rights: see *Scandinavian Trading Tanker Co. A. B.* v. *Flota Petrolera Ecuatriana* (*The Scaptrade*) [1983] 2 A.C. 694 and *Sport International Bussum B.* K v. *Inter Footwear Ltd.* [1984] 1 W. L. R. 776.

[12] [1987] 1 M.L.J. 319.

[13] [1987] 2 M.L.J. 711.

[14] Section 75 reads: "When a contract has been broken, if the sum 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 of 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."

[15] It was assumed that the forfeiture would fall within the section, presumably as "a stipulation by way of penalty" (see s. 75, above).

[16] [1987] 1 M.L.J. 319.

figure of "10" was too high, it had to look for some other basis for relief. Considering the standard practice of using "10" in contracts for the sale of land, a finding that it is too high may have a major impact on the property market.[17]

His Lordship held that the deposit did not represent a "deposit *simpliciterbut* forms in fact part and parcel of a very much larger sum of $5,000,000 in another provision which, ... , is really a general forfeiture provision in the agreement *in terrorem.*"[18] Such a provision is a penalty, and section 75 of the Contracts Act would only allow compensation.

Even though the result at this stage is not obviously unfair, the legal basis is questionable. The $ 1 million only forms part of a larger sum if the $4 million is in fact paid. There may be little doubt that it would be penal to forfeit $5 million for not paying the next $5 million. But such larger sum does not exist until the $4 million is actually paid. The forfeiture of 10% deposits is accepted practice in land sales. The court would probably have held it to be reasonable in the context of the sale of shares. Indeed, if his Lordship had held the view that the forfeiture of 10% by itself was not reasonable, he would not have had to resort to the argument that he did. Though this is not in the judgment, it is arguable that the general forfeiture clause is valid only if it passes the test in all the possible situations in which it may be used. So if a forfeiture of $5 million will not be allowed, for example when the second instalment is not paid, then the whole provision is invalid or unenforceable, and cannot be used even when an otherwise valid right to forfeit is involved: for example, when only the deposit is sought to be forfeited. The judgment would make sense if this was the position of the court, but there is no hint of this in it.

In addition, it is also arguable that the deposit can also be forfeited under clause 1 rather than clause 4. The very nature of a deposit is that it is to be forfeited for breach of contract, and the courts have accepted that there can be forfeiture even if there is no express provision for it.[19] If this is correct, then the fact that clause 4 cannot be relied upon will not be a bar to the forfeiture of the deposit. This argument was however not considered by the court.

Supreme Court

Not surprsingly, the Supreme Court allowed the appeal.[20] In the court's view, it was simply a question of whether the deposit was a "true deposit".[21] Hashim Yeop A. Sani S. C. J. delivered the judgment of the court, which found that: (a) the deposit was a "true deposit"; and (b) clause 4 provided for the forfeiture of the deposit on the failure to pay the first instalment.[22]

In the court's view, as the default was in the very first instalment, the deposit was rightly forfeited. The court did not consider the

[17] In *Linggi, supra,* note 3, a 10% deposit was upheld. There was also expert evidence in *Happy Shopping* itself to the effect that 10% is reasonable; see [1987] 1 M.L.J. 319 at p. 321. The contract in *Happy Shopping* was not for the sale of land, and it is arguable that what is unreasonable in one context might be reasonable in another.
[18] *Supra,* note 16, at pp. 321-2.
[19] *Howe* v. *Smith* (1884) 27 Ch. D. 89.
[20] [1987] 2 M.L.J. 711.
[21] *Ibid.,*at p. 713.
[22] *Ibid.,* at p. 713.

position had the default been in the payment of the second instalment (*i.e.,* forfeiture of $5 million). So it is not clear from the judgment whether the court was of the view that clause 4 can be relied upon for one purpose (the forfeiture of the deposit), even if it may not be relied upon for another (for example, when the first instalment is paid but not the second). With respect, the question was not simply whether the deposit was a true deposit, but also a quesion of whether the clause had to be valid and enforceable in all the possible situations. The final decision may be correct, but not for the right reasons unless the Supreme Court was either assuming that the deposit was not forfeited under clause 4, but under clause 1; or that clause 4 is valid even if it cannot be relied upon in all possible situations. The court did suggest that even if the first instalment had been paid, but not the second, the $1 million deposit would have been forfeitable though the $5 million may not be.[23] Though it is defensible to interpret the contract in this manner, the judgment does not examine the written words used. But this position is consistent with the view that the deposit is forfeited under clause 1 rather than clause 4.

The Implications

More interesting, and of greater significance, is the observation on the reasonableness of a 10% deposit: "The fact that the amount is $1,000,000 does not alter the position since 10% of the purchase price is normally a standard amount put as a deposit and as Lord Hailsham L. C. said in *Linggi Plantations Ltd.* v. *Jagatheesan:* 'There is nothing unusual or extortionate in a 10% deposit on a contract for the sale of land.' "[24]

The assumption seemed to have been that what is reasonable in one type of context, *i.e.,* sale of land, is reasonable in another. The contract in question involved shares, and the court did not make an assessment of whether in that context, 10% was reasonable. The decision is open to criticism on this ground. What is usual is not necessarily reasonable; and what is reasonable in one context is not necessarily so in another. The only merit of the approach of the court is that one can assume that 10% for *any* type of contract is likely to be considered reasonable. This may prove useful in terms of certainty, but it may be at the expense of justice in some cases.

The vendor walked away from the court with the shares and $ 1 million dollars, even though the loss from the breach of contract may not even have been a fraction of that sum. The case is a good warning to would be "forfeiters" not to try for too large a forfeiture. The reasonableness test actually works in favour of those who seek to forfeit. It may be that in practice, the courts look for unreasonableness rather than reasonableness. This seems to have been the case in *Linggi.*[25] What is not obviously unreasonable will probably pass the test: which is much more generous to the promisee than the penalty rule. In short, a valuable piece of advice: don't waste your time with liquidated damages as such if you can extort a pre-payment. Ask for a deposit of equal amount, if not more; but don't be too greedy - 10% of

[23] *Ibid.,* at p. 713. *Fateh Chand* v. *Balkishan Dass* A. I R. 1963 S. C. 1405 was cited by the Court, but it should be noted that it was conceded there that the deposit would be forfeitable.

[24] [1972] 1 M. L. J. 89.

[25] *Supra,* note 3.

the whole price is a safe upper limit. Call the sum a deposit or earnest in the contract. State clearly when the right to forfeit arises, and make sure that the forfeiture of the deposit is unaffected by any other larger sum that may also be forfeited. Then hope for a breach.

However attractive this advice may be to potential promisees, it leads to a more fundamental question: why the penalty rule does not apply to all deposits in the first place. However it may be defined, an earnest is by definition a sum that acts *in terrorem.* It is ultimately a matter of degree, but there can be no guarantee of performance unless the forfeiture will hurt. The real reason for the distinction may be a dislike of the penalty test. But if this is so, the right way forward is to reconsider the penalty rule.

SOH KEE BUN*

* LL.B. (N.U.S.), B.C.L. (Oxon.), Advocate and Solicitor (Singapore), Lecturer, Faculty of Law, National University of Singapore.