

THE LAW ON DEPOSITS: UNRESOLVED ISSUES

Hon Chin Kong v Yip Fook Mun

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I. INTRODUCTION

The law on deposits in Singapore was recently clarified in *Hon Chin Kong v Yip Fook Mun*.¹ The court provided a comprehensive framework for payers seeking repayment of sums paid to payees, which should provide clarity and certainty to contractual parties. Indeed, it is now clear that a “true deposit” may be forfeited by the payee. However, the current state of the law has unresolved issues, especially in relation to the interaction of the law on deposits with the penalty rule. This is particularly so in light of the significant developments with respect to the penalty rule in the UK in recent years.² It is thus appropriate to examine the decision in *Hon Chin Kong*, and the possible solutions to these unresolved issues. It is proposed that moving forward, forfeiture of part payments and deposits should be dealt with under the penalty rule, especially if *Cavendish* is adopted in Singapore.

II. FACTS AND THE HIGH COURT’S DECISION

A. Facts

The plaintiff wanted to acquire the defendants’ shares in a company, CDX Singapore Pte Ltd (“CDX”). The defendants were CDX’s sole directors and shareholders. The parties agreed that the shares in CDX would be sold to the plaintiff for \$828,000, and made arrangements pursuant to the agreement to effect the plaintiff’s takeover of CDX.

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¹ [2018] 3 SLR 534 (HC) [*Hon Chin Kong*].

² See *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 (SC) [*Cavendish*].

The plaintiff later encountered financial difficulties, and it was agreed that the purchase price would be paid in three tranches of \$300,000, \$300,000 and \$228,000, instead of a lump sum. It was also agreed that the first payment of \$300,000 would be a “down payment deposit”,³ and that the defendants would each transfer their shares only after receiving the second and third tranches of payment. The plaintiff defaulted after making the first payment and thus, no shares were transferred by the defendants.

The plaintiff demanded the return of the \$300,000 paid, but the defendants refused on the basis that it was a forfeitable deposit. The plaintiff challenged this argument on a number of grounds, including that any contractual term providing for the forfeiture of the \$300,000 was unenforceable as a penalty.⁴ It is this aspect of the decision that this note focuses on.

B. The High Court's Decision

Kannan Ramesh J dismissed the plaintiff's claim for the return of the \$300,000 paid, and found that the payment was a “true deposit” which was not subject to the penalty rule, and hence liable to forfeiture.⁵

Ramesh J reviewed local and foreign authorities and held that “true deposits” are sums paid which are reasonable as earnest money and serve to signal the commitment of the payer in performing the contract.⁶ The learned judge found that in this case, although \$300,000 was 36% of the purchase price, it was not a large sum in absolute terms compared to other cases where deposits were found to be unreasonable.⁷ Furthermore, the plaintiff was not able to keep to the timelines he had suggested, and this had caused considerable anxiety to the defendants. Ramesh J thus concluded that a deposit of \$300,000 to assure the defendants of the plaintiff's commitment to performing the contractual obligations was reasonable.

Ramesh J also took the opportunity to provide a comprehensive framework for parties seeking repayment of part payments and deposits.⁸ He stated that the starting point was whether the contract expressly or by inference (*eg*, by relying on the nature of the payment *qua* deposit) provided for forfeiture of the sum paid. If not, the payee cannot forfeit the payment, and the payer can sue for the return of the sum in unjust enrichment, subject to the payee's right of set-off for damages suffered.⁹

Where there is an express or inferred right to forfeit, then it would be forfeitable *if* it was a true deposit – *ie* it was reasonable as earnest money, or was “customary”.¹⁰ The court would consider the history of dealing between the parties, their financial means, and the detriment suffered by the payee to determine the reasonableness of the sum paid.¹¹ If the contract was of the type where a particular percentage was considered

³ *Cavendish*, *supra* note 1 at para 13.

⁴ *Ibid* at paras 20-22 and 25.

⁵ *Ibid* at para 146.

⁶ *Ibid* at paras 124, 130.

⁷ *Ibid* at paras 145-146.

⁸ *Ibid* at para 143.

⁹ *Ibid* at para 143(b).

¹⁰ *Ibid* at para 143(c).

¹¹ *Ibid* at para 143(d).

“customary”, and the sum paid was higher than customary, then the payee must show “special circumstances” to justify the amount paid.¹² True deposits are outside the scope of the penalty rule, and may be forfeited, subject to relief against forfeiture (albeit traditionally only available for forfeiture of interests in real property).¹³

Ramesh J gave two reasons for his conclusion that the penalty rule did not apply to true deposits: first, the law on deposits and the penalty rule had different gene-ses;¹⁴ second, deposits and liquidated damages clauses serve different purposes—a liquidated damages clause seeks to predetermine damages in the event of breach, while a deposit serves as earnest money.¹⁵ This is evident in the difference between situations involving forfeiture of deposits and liquidated damages clauses: the former did not preclude the innocent party from suing for damages above the value of the forfeited deposit, which would be precluded in the latter situation.¹⁶

Ramesh J also held that where there was a contractual right to forfeit, but the sum paid was not a true deposit, the sum would be recharacterised as a part payment, and any forfeiture of the part payment pursuant to an express forfeiture clause would be regulated by the penalty rule.¹⁷ This is because part payments do not serve as earnest money. Also, the fact that part payments are paid prior to breach rather than upon breach did not justify excluding the applicability of penalty rule.¹⁸ If it could be established that the forfeiture of the sum paid was penal, then the right of forfeiture would not be enforceable, and the payer could then sue for the return of the sum in unjust enrichment, subject to the payee’s right of set-off for damages suffered.

III. DISCUSSION

Hon Chin Kong is a decision that brings much-needed clarity to the law on deposits. Contractual parties now know that a true deposit may be forfeited and will not be subject to the penalty rule. It is also consistent with Singapore law to date: first, in terms of *stare decisis*, it did not apply *Cavendish*,¹⁹ which has yet to be adopted by the Singapore Court of Appeal. The test set out in *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd*²⁰ thus remains the applicable test in Singapore under the penalty rule and Ramesh J correctly recognised this point.²¹ Next, the framework provided by Ramesh J is also supported by the local and foreign authorities that were

¹² *Ibid.*

¹³ *Ibid* at para 143(e).

¹⁴ *Ibid* at para 123.

¹⁵ *Ibid* at paras 123-124, 127.

¹⁶ *Ibid* at para 128.

¹⁷ *Ibid* at para 143(f). Where the right to forfeit is inferred from the nature of the payment *qua* deposit, once the court finds that it is not a true deposit and recharacterises it as a part payment, there is no longer any inferred right to forfeit, and the sum paid is thus recoverable via a claim in unjust enrichment, see para 136.

¹⁸ *Ibid* at paras 133-134.

¹⁹ In contrast, see eg, *Leiman, Ricardo v Noble Resources Ltd* [2018] SGHC 166 [*Leiman*] at paras 196-197 and 212-215; *Nanyang Medical Investments Pte Ltd v Kuek Bak Kim Leslie* [2018] SGHC 263 at paras 119-126; and *Seraya Energy Pte Ltd v Denka Advantech Pte Ltd (YTL PowerSeraya Pte Ltd, third party)* [2019] SGHC 2 at paras 159-192.

²⁰ [1915] AC 79 (HL) [*Dunlop*].

²¹ *Hon Chin Kong*, *supra* note 1, at para 62.

considered by the court.²² Finally, Ramesh J rightly recognised that any recovery for sums paid which were not forfeitable would be via an action in unjust enrichment, subject to any right to set-off for damages.²³

However, three points of critique may be raised with respect to the decision in *Hon Chin Kong*: (a) the framework provided by Ramesh J is only applicable where the payer is in breach; it does not contemplate the situation where it is the payee that is in breach but seeks to forfeit the sum paid, (b) the existing law on deposits is problematic and cumbersome in its application, and (c) the penalty rule, especially if *Cavendish* is adopted, should be extended to deposits. These points will be examined below.

A. Breaching Payee Seeking to Forfeit Deposit

The framework provided by Ramesh J is applicable whenever a payer seeks to recover any sums paid to a payee, but it contemplates only the situation where the payer is in breach. This section considers the less common situation where it is the payee instead who is in breach, and seeks to forfeit the sums paid. Generally, unless the contractual parties expressly agree to the contrary,²⁴ the payee is not entitled to forfeit the sums paid if he is in breach. The conceptual basis for disallowing the breaching payee from forfeiting the sums paid is however, unclear, and is examined below.

1. Construction of Contract

Construction refers to the composite process which encompasses interpretation, implication and rectification.²⁵ The first mechanism to prevent the breaching payee from forfeiting the sums paid is that a court may find that there is an implied term that the payee is only allowed to forfeit the sums paid when the payer is in breach.²⁶ This may be possible only where there is a gap in the agreement with respect to the circumstances where the sums paid may be forfeited.²⁷

Where there is no gap in the agreement, the courts may instead rely on contextual interpretation to determine whether a payee may forfeit any sums paid, even where he is in breach. Even where the contract states that the sum paid is non-refundable

²² *Ibid* at paras 64-122.

²³ *Ibid* at para 136. However, the recovery of sums paid could also possibly be pursuant to the breach of an implied term, see eg, Yeo Tiong Min, “Deposits: At the Intersection of Contract, Restitution, Equity and Statute”, Sixth Yong Pung How Professorship of Law Lecture, Singapore (16 May 2013) [Yeo, “Deposits”] at para 4.

²⁴ Yeo, “Deposits”, *ibid*, at paras 39, 56; however, it cannot contravene any public policy or statutory control, see para 40.

²⁵ *Sembcorp Marine Ltd v PPL Holdings Pte Ltd* [2013] 4 SLR 193 (CA) at para 31.

²⁶ See eg, Edwin Peel, *Treitel on the Law of Contract*, 14th ed (London: Sweet & Maxwell, 2015) [*Treitel on The Law of Contract*] at 20-147.

²⁷ For eg, the contractual term may state that the sums paid may be “forfeited” or are “non-refundable”, cf Singapore Academy of Law, Law Reform Committee, *Report on Law of Part Payments and Deposits* (Singapore: Singapore Academy of Law, 2015) [*Report on Law of Part Payments and Deposits*] at paras 15, 16. See also *supra* note 25 at paras 94-95, 101, which sets out the three-step process for implication of terms.

or is forfeitable in *all* circumstances, contextual interpretation may allow a court to conclude that the term is only applicable in *all circumstances where the payer is in breach*, but not where the payee is in breach.²⁸ However, it may be argued that this is to vary, contradict or add to the term of the contract.²⁹ Indeed, a contractual term cannot be construed in a manner which is unsupported by its language.³⁰ In such circumstances, the equitable doctrine of rectification may also be available, and is perhaps, the better solution to reflect the parties' true intentions³¹ that the sums paid are forfeitable only where the payer is in breach.

2. *No Profiting from Breach*

The second mechanism to prevent a breaching payee from forfeiting the sums paid is based on the general principle that contractual parties should not be allowed to profit from their own breach of contract.³² This appears to be based on the same principle which applies to disallow breaching payers from recovering the sums they had paid, as the rationale is that they cannot profit from their own breach.³³ Thus, similarly, payees cannot profit from their own breach and forfeit the sums paid by the payers. It is however, unclear if this principle is of general application, and therefore it is uncertain if it will be applied in such a situation.

3. *Unfair Contract Terms Act*

The next mechanism will be to examine the payee's right of forfeiture under the *Unfair Contract Terms Act*.³⁴ The UCTA's long title states that "it is an act to impose further limits on the extent to which *civil* liability for breach of contract, or for negligence or other breach of duty, can be avoided by means of contract terms". This may be wide enough to include any attempts to exclude liability arising from a claim in unjust enrichment.³⁵ In the situation envisioned, the payee, who is in breach, will be relying on the forfeiture clause, which allows him to forfeit the sums paid in *all circumstances* to avoid his liability to repay the payer, where the payer is suing for unjust enrichment, or for a breach of an implied term.³⁶ The forfeiture clause is therefore an attempt to exclude restitutionary or contractual liability arising from the payee's breach, and may arguably be regulated under section 3(2)(a) of the UCTA, which governs attempts to avoid liability for breach of contract, provided that the other requirements under the provision are satisfied.³⁷ The forfeiture clause will thus

²⁸ It is possible to "read down" a broadly-worded contractual term, see *eg*, *Sandar Aung v Parkway Hospitals Singapore Pte Ltd* [2007] 2 SLR(R) 891 (CA) at paras 24 and 26.

²⁹ See *eg*, *Zurich Insurance (Singapore) Pte Ltd v B-Gold Interior Design & Construction Pte Ltd* [2008] 3 SLR(R) 1029 (CA) at para 108, *cf* para 123.

³⁰ See *eg*, *Yap Son On v Ding Pei Zhen* [2017] 1 SLR 219 (CA) at paras 31, 33.

³¹ *Supra* note 29, at para 123.

³² *Report on Law of Part Payments and Deposits*, *supra* note 27 at paras 20, 25, 43.

³³ See *Lee Chee Wei v Tan Hor Peow Victor* [2007] 3 SLR(R) 537 (CA) at para 84.

³⁴ Cap 396, 1994 Rev Ed Sing [UCTA].

³⁵ See *eg*, Yeo, "Deposits", *supra* note 23 at para 45.

³⁶ *Ibid* at paras 43-49.

³⁷ *Ibid*.

be void and unenforceable, unless the payee can establish that it is reasonable under section 11 of the UCTA. However, some have argued that the UCTA may not be applicable, as it preceded the development of the doctrine of restitution for unjust enrichment, and its language does not indicate any intention to deal with contractual terms excluding restitutionary liability.³⁸

4. Other Possible Solutions

The other possible solutions will be to deal with the breaching payee's forfeiture of the sums paid through the law on deposits, the penalty rule, or through the equitable doctrine of relief against forfeiture. There are however, problems with the law on deposits. Indeed, the current test for true deposits is problematic, as it largely focused on the reasonableness of the *amount* of the deposit or whether it is consistent with the customary percentage for deposits for certain types of contract.³⁹ The inquiry does not extend to the reasonableness of the *conduct* of the payee in forfeiting the deposit, where he is in breach. There is also uncertainty with respect to whether relief against forfeiture may be awarded beyond contracts involving a proprietary or possessory interest in land or in goods, and the type of relief a court may award, beyond extension of time to perform, which will be inapplicable here as the payee is the one in breach.⁴⁰ Therefore, it is unlikely that either of these solutions can satisfactorily deal with this problem.

The only possibility left is therefore the penalty rule. It is quite likely that it may be able to resolve this problem, especially if *Cavendish* is adopted. This is because the test set out in *Cavendish* is more capable in dealing with such unconventional situations,⁴¹ and is a *superior* test in that it can take into account not just the *amount* of deposit paid, but also the *conduct* of the payee in forfeiting the deposit.⁴² Indeed, the legitimate interest test⁴³ requires that a payee must first have a legitimate interest in requiring the payer's performance of the contract, and that the detriment, *ie* forfeiture of the sum paid be commensurate with this legitimate interest. In the situation where the payee is in breach but seeks to forfeit the deposit, he may have no *legitimate* interest in requiring the payer's performance, given that the payee is the one in breach and not the payer. Even if any legitimate interest can be established, the forfeiture of the deposit paid is also likely to be considered unconscionable in comparison to this legitimate interest. This is because the payer remains willing and able to perform the contractual obligations which the payee has a legitimate interest in, and it is therefore unnecessary and unconscionable to impose the detriment of forfeiting the sums paid. The forfeiture clause would therefore be penal and unenforceable. The penalty rule, especially if *Cavendish* is adopted, is therefore a possible solution.

³⁸ *Ibid* at paras 46, 56. See also *Report on Law of Part Payments and Deposits*, *supra* note 27 at paras 64-67.

³⁹ See *infra* note 44.

⁴⁰ See *infra* notes 52, 54-55.

⁴¹ *Leiman*, *supra* note 19 at para 197.

⁴² See Part III.C.2.

⁴³ *Cavendish*, *supra* note 2 at paras 28, 32 and 255.

B. Problems with the Existing Law

Although *Hon Chin Kong* has brought some clarity to the law on deposits, the current state of law remains problematic, as examined below.

1. The Problematic Test

To determine whether a deposit is a true deposit, the court considers whether the deposit is reasonable as earnest money, *or* if it is consistent with the customary percentage for certain types of contract.⁴⁴ The first critique is that the test of reasonableness is not sufficiently rigorous. Although Ramesh J provided some factors to be considered, such as (a) the history of dealing between the parties, (b) their financial means, and (c) the detriment suffered by the payee,⁴⁵ in *Hon Chin Kong*, it was readily resolved in favour of the defendants within one paragraph without any real balancing of these factors.⁴⁶ Moreover, as abovementioned, the test is only focused on the reasonableness of the *amount* of deposit paid, and not other aspects such as the reasonableness of payee's *conduct* in forfeiting the deposit. The test is therefore unable to deal with the situation where the payee is in breach but seeks to forfeit the sum paid.

The reliance on custom for contracts where a particular percentage for a deposit has been generally accepted is also problematic because the numerical value of the customary percentage has been described as “without logic”.⁴⁷ Furthermore, where the deposit is higher than the customary percentage, the burden shifts to the payee to show “special circumstances” to justify the amount.⁴⁸ There is therefore an over-reliance on the customary percentage,⁴⁹ with very limited scope for any progressive adjustment to take into account any changes in the nature of such contracts which may have taken place. The test for determining whether a deposit is a true deposit is thus neither sufficiently rigorous nor progressive.

2. Artificiality of Re-Characterisation

The common law re-characterisation is a useful mechanism of determining that although the contractual parties had agreed that the sum paid was meant to be a deposit, it is actually not a true deposit but a part-payment. Thus, if there is no right to forfeiture, it is generally recoverable, whether via a claim in unjust enrichment, or for breach of an implied term. However, this technique may be criticised as an “outright revision” of the parties' bargain.⁵⁰ Furthermore, an over-reliance on it may be seen as artificial: a simple part payment *with* a forfeiture clause may possibly be doubly re-characterised—first as a *deposit* which is then found to be unreasonable,

⁴⁴ *Hon Chin Kong*, *supra* note 1, at para 143(c).

⁴⁵ *Ibid* at para 143(d).

⁴⁶ *Ibid* at para 145.

⁴⁷ *Workers Trust & Merchant Bank Ltd v Dojap Investments Ltd* [1993] AC 573 at 580.

⁴⁸ *Hon Chin Kong*, *supra* note 1 at para 143(d).

⁴⁹ This reliance has been described as “questionable”, see Yeo, “Deposits”, *supra* note 23 at para 26.

⁵⁰ *Ibid* at paras 23, 53.

then as simple part payment *without* a forfeiture clause.⁵¹ This would be completely different from what the parties had agreed to.

3. *Uncertainty Surrounding Relief Against Forfeiture*

While the payer may be able to obtain relief from forfeiture, such relief is uncertain in both its scope, and the type of relief that a court may order. First, it is unclear if relief against forfeiture may be awarded beyond contracts involving proprietary or possessory interest in land or in goods.⁵² It may be argued that relief against forfeiture should also be available for contracts which do not involve proprietary and possessory interests.⁵³

Next, it is also unclear as to the type of relief a court may order, even if relief against forfeiture is found to be available. Indeed, there has been some debate as to whether a court may order the return of the sum paid, in cases which do not involve fraud, sharp practice or unconscionable conduct.⁵⁴ It has been argued that where it does not involve such procedural unfairness, the relief a court may order may be restricted to allowing extra time for performance, where the contract is yet to be repudiated by the payee.⁵⁵ *Hon Chin Kong* offered, however, no new insights into these uncertainties.

4. *Cumbersome Framework*

Finally, while the framework provided by Ramesh J brings some clarity with respect to the law on deposits, it is cumbersome in that it arguably involves too many steps. Parties must first consider if there is an express or inferred right to forfeit the sum paid. If there is, they must next examine if the sum paid is a true deposit, which is forfeitable, subject to any relief against forfeiture, where available. If it is not a true deposit, where there is still an express contractual right to forfeit, the party seeking repayment of the sum paid must then argue that the right to forfeit is a penalty. The determination of whether the sum paid is a true deposit in particular is a step which can be dealt with satisfactorily under the penalty rule, especially if *Cavendish* is adopted. Indeed, as Ramesh J pointed out, it will not yield very different results whether the current test for a true deposit, or the legitimate interest test as set out in *Cavendish*, is applied.⁵⁶ This brings us to the next part of the discussion, which is that deposits *should be* regulated by the penalty rule, especially if *Cavendish* is adopted.

C. *The Penalty Rule Should Apply*

As abovementioned, Ramesh J provided two reasons why the penalty rule did not apply to a true deposit: (1) the law on deposits and the penalty rule have different

⁵¹ *Ibid* at para 42.

⁵² See *Tan Wee Fong and others v Denieru Tatsu F&B Holdings (S) Pte Ltd* [2010] 2 SLR 298 (HC) at paras 66-67.

⁵³ *Ibid* at para 68.

⁵⁴ See *Stockloser v Johnson* [1954] 1 QB 476 (CA) at 485-488, 490-492, 501.

⁵⁵ *Ibid* at 501.

⁵⁶ *Hon Chin Kong*, *supra* note 1 at para 122.

geneses, and (2) deposits and liquidated damages clauses served different purposes.⁵⁷ However, the historical reasons alone cannot justify the differences between the law on deposits and the penalty rule, especially since the separate geneses and development of the two doctrines are mainly a result of path dependence.⁵⁸ Therefore, this discussion will focus on Ramesh J's second reason, and indeed, Ramesh J did not spend much time focusing on the historical reasons. The validity of the second reason is challenged below, and it is argued that the penalty rule, especially if *Cavendish* is adopted, should apply to deposits. This will resolve many of the existing problems associated with the law on deposits as abovementioned, and offer a better solution going forward.

1. *The Wrong Comparison*

While it is correct that a true deposit and a legitimate liquidated damages clause serve different purposes, that is arguably the wrong comparison to justify why the penalty rule should not apply to deposits. Ramesh J appears to have compared the two because of the *Dunlop* test, which is based on whether the detriment imposed is a “genuine pre-estimate of damage” and it does not apply well to deposits, as they are not meant to estimate the amount of compensation where there is a breach.⁵⁹ However, this is problematic because firstly, the *Dunlop* test also requires considering whether the term is *extravagant* and imposed *in terrorem* of the other contracting party;⁶⁰ and secondly, this approach is to confuse the *Dunlop* test with the purpose of the penalty rule, which is what we should be concerned with.

The correct question is therefore whether the requirement that deposits be reasonable and the penalty rule serve similar purposes, and if so, whether the law on deposits is redundant, and the penalty rule should also apply to deposits. It is readily apparent that both the law on deposits and the penalty rule do serve largely similar purposes; they both seek to prevent unconscionable detriments imposed by one contracting party on another to secure performance of the contract.⁶¹ The fact that a detriment is imposed prior to or after breach is insufficient⁶² to explain why the penalty rule cannot apply to deposits. Given the common purpose of the two legal rules, the law would be more coherent and streamlined if the penalty rule applies to deposits.

Academics and the English Law Commission have also argued that the penalty rule should be applicable to deposits.⁶³ This step has already been taken in *Cavendish*,⁶⁴ and even Ramesh J suggested that if *Cavendish* is adopted in Singapore, the application of the legitimate interest test should yield similar results as the current test.⁶⁵ It is

⁵⁷ *Ibid* at paras 123-124, 127.

⁵⁸ See UK, The Law Commission, *Penalty Clauses and Forfeiture of Monies Paid* (Working Paper No 61) (London: Her Majesty's Stationary Office, 1975) at paras 57, 59-60.

⁵⁹ *Hon Chin Kong*, *supra* note 1 at para 121, 124-128.

⁶⁰ *Dunlop*, *supra* note 20 at 86-87.

⁶¹ *Treitel on the Law of Contract*, *supra* note 26 at 20-148. See also *supra* note 20 at paras 53, 57, 59.

⁶² *Hon Chin Kong*, *supra* note 1 at para 134.

⁶³ See eg, Mindy Chen-Wishart, *Contract Law*, 5th ed (Oxford: Oxford University Press, 2015) at 590. See also *supra* note 61.

⁶⁴ *Cavendish*, *supra* note 2 at paras 16, 160, 161, cf 234-238, 292.

⁶⁵ *Hon Chin Kong*, *supra* note 1 at para 122.

therefore highly arguable that the penalty rule, especially if *Cavendish* is adopted, should apply to deposits. The parts below explores the benefits and practicalities of applying the penalty rule, assuming *Cavendish* is adopted.

2. Advantages of Applying the Penalty Rule

There are two advantages of applying the penalty rule to deposits. First, as above-mentioned, the current law on deposits is cumbersome in its application. It requires the redundant step of first determining whether a deposit is a true deposit, and if not, to apply the penalty rule subsequently.⁶⁶ The penalty rule, assuming *Cavendish* is adopted, can satisfactorily determine the results of both steps simultaneously through the legitimate interest test. By eliminating this redundant step, the law will therefore become more streamlined and coherent.

The second advantage is that the legitimate interest test is *superior* to the current test. The current test is problematic, as abovementioned. It is only focused on the reasonableness of the *amount* of deposit paid, or if it is consistent with a particular percentage for certain types of contract. The legitimate interest test, in contrast, first identifies the payee's legitimate interest in requiring the payer's performance of the contract, and examines whether the detriment imposed, *ie* forfeiture of the deposit, is unconscionable in comparison to this legitimate interest. This means that first, the test is not preoccupied with any customary percentage for a deposit, and instead evaluates if the amount of deposit that will be forfeited is commensurate with the legitimate interest of the payee on a case by case basis. Second, it takes into account more than just the *amount* of deposit, and can include evaluating the conduct of the payee in forfeiting the deposit. Indeed, as abovementioned, the penalty rule set out in *Cavendish*, can probably satisfactorily deal with the problem where a breaching payee seeks to forfeit the deposit paid.

One concern could be that applying the penalty rule to deposits may lead to commercial uncertainty for payees seeking to forfeit a deposit. This concern is most readily observed in cases where the payee has stipulated a deposit that is consistent with the customary percentage. Under the current test, it will be found to be a true deposit and may be forfeited, subject to any relief from forfeiture.⁶⁷ Instead, under the penalty rule set out in *Cavendish*, a court must be satisfied that the payee has a legitimate interest (which has been criticised as vague),⁶⁸ and that forfeiture of the deposit is commensurate with this legitimate interest. This means that a court may find a deposit, which is consistent with the customary percentage, to be penal.

This concern, however, is more apparent than real. This is because, first, under the legitimate interest test, the burden of proof remains on the payer throughout to establish that forfeiture of the deposit is penal. The customary percentage for a deposit therefore remains relevant. If the payer is unable to establish that forfeiture of the deposit is unconscionable in comparison to the legitimate interest of the payee, then the payee will be allowed to forfeit the deposit, subject to any relief against forfeiture. There is therefore, still a high degree of commercial certainty. More importantly, the legitimate interest test is more progressive than the current test in

⁶⁶ *Ibid* at para 143(c)-(f).

⁶⁷ *Ibid* at para 143(d)-(e).

⁶⁸ See eg, *Turf Club Auto Emporium Pte Ltd v Yeo Boon Hua* [2018] 2 SLR 655 (CA) at para 253.

that a court may choose to depart from the customary percentage for a deposit. Indeed, this may benefit a payee in that if the contract stipulated a deposit larger than the customary percentage, the burden of proof does not shift to the payee under the current test such that he must demonstrate special circumstances to justify the amount; instead, the burden remains on the payer. Therefore, a deposit larger than the customary percentage may not be penal if the court is satisfied that its forfeiture is commensurate with the legitimate interest of the payee in the particular transaction.

3. Applying *Cavendish*

It is crucial that the legitimate interest test from *Cavendish* must be applied in a principled manner,⁶⁹ even if a contracting party may have a legitimate interest beyond compensation.⁷⁰ It is therefore critical to first identify the payee's legitimate interest in the payer's performance of the contractual obligation. This can be based on the payee's legitimate interest in obtaining reasonable earnest money signifying the commitment of the payer so as to secure performance of the contract.⁷¹

Having identified the legitimate interest of the payee, it is important to consider whether the detriment imposed (*ie* forfeiture of the deposit) is unconscionable in comparison to the legitimate interest of the payee. As abovementioned, the court will evaluate both the amount of deposit that is forfeited, and the payee's conduct in forfeiting it, amongst other considerations. The customary percentage for a deposit also remains relevant to demonstrate unconscionability, but the burden of proof would remain on the payer alleging that the forfeiture of the deposit is unconscionable, and therefore, penal in nature.

Where it involves a breaching payee seeking to forfeit a deposit paid, the burden of proof will be on the payer to demonstrate that the breaching payee's forfeiture of the deposit is unconscionable, just as where it is the payer who is in breach. However, as abovementioned, this should not be a problem since the payer can likely establish that the payee has no legitimate interest in securing the payer's performance of the contract, when the payee is in breach and not the payer. Even if it is possible to establish a legitimate interest, forfeiture of the deposit will likely be unconscionable given the payer remains willing to perform any contractual obligation which the payee has a legitimate interest in, and it is therefore unnecessary to impose such a detriment. Therefore, even if the payer bears the burden of proof in such a situation, he is unlikely to face any problems. Moreover, the payer would have had to bear the burden of proof if he relied on the other solutions highlighted above in Part III.A in any case.

4. Residual Issues

There are three remaining points to be made: first, if the forfeiture of the deposit by the payee is not found to be penal, but the damages suffered by the payee are more

⁶⁹ *Cavendish*, *supra* note 2 at para 39. See also Wong Wen Jian, "Penalty Clauses: Lessons from Australia and England and Possible Legislative Reforms" [2018] Sing JLS 104 [Wong Wen Jian, "Penalty Clauses"] at 119-122.

⁷⁰ *Cavendish*, *ibid* at paras 28, 32, 152.

⁷¹ *Hon Chin Kong*, *supra* note 1 at para 121.

than the deposit forfeited, the payee is still allowed to sue for the damages suffered above the deposit forfeited.⁷² Next, where the penalty rule set out in *Cavendish* applies, if the relevant contractual term is found to be penal, it will be void and the payee must then return the deposit, subject to the compensatory damages he may set off. The outcome is thus still largely all-or-nothing, and any solution to this problem will likely require legislative intervention to allow judicial discretion in awarding a reasonable sum of money to the payee.⁷³ Finally, Lords Mance and Hodge in *Cavendish* suggested that the penalty rule and relief from forfeiture may both apply, since they operate at different points.⁷⁴ It is therefore important that the scope and type of relief that a court may order be clarified, as there are currently problems with respect to these aspects of relief from forfeiture, as abovementioned.

IV. CONCLUSION

This note discusses the various issues and problems with the law on deposits, notwithstanding the decision of *Hon Chin Kong*. It proposes that the penalty rule, especially if *Cavendish* is accepted to be part of Singapore law, should apply to deposits going forward. This would better deal with the existing issues identified here, and provide a less cumbersome framework applicable to the forfeiture of deposits.

⁷² *Ibid* at para 128. See also Mindy Chen-Wishart, *Contract Law*, 6th ed (Oxford: Oxford University Press, 2018) at 570. This position recognises that a true deposit and a legitimate liquidated damages clause serve different purposes, *ibid* at paras 123-124, 127.

⁷³ See generally, Wong Wen Jian, “Penalty Clauses”, *supra* note 69 at 124-127.

⁷⁴ *Cavendish*, *supra* note 2 at paras 160, 227, 291, 294.