

Clarifying the law of deposits versus the law of penalties in Singapore:
***Li Jialin and another v Wingcrown Investment Pte Ltd* [2024] SGCA 48; [2024] 2 SLR 372**

I. Executive Summary

When parties enter into a contract, there is always the possibility of one or more of the parties breaching the contract. Rather than relying on the court to (after a breach) assess appropriate damages for the breach, parties will instead include in the contract stipulated damages (or monetary penalties) for breach of such contract. Under the law though, these stipulated damages are subject to what is known as the penalty rule. In brief: where a damages clause stipulates a payment that represents a genuine pre-estimate of loss upon breach of contract, it is considered enforceable due to its compensatory nature for the breach in question – these are known as “liquidated damages” clauses. However, where a damages clause stipulates an excessively large payment, to the extent that it is meant to cause “terror” in the breaching party to compel it to act in a certain way, it is considered unenforceable, as the intent of such a clause is to deter breach rather than to compensate for loss – these are known as “penalty” clauses.

Given incorporation of the requirement of a deposit in many contracts, one may wonder if deposits are also subject to the penalty rule. In *Li Jialin and another v Wingcrown Investment Pte Ltd* [2024] SGCA 48, the Court of Appeal (“CA”) answered this in the negative. Notwithstanding movements in other jurisdictions in favour of convergence of the two laws, the law of deposits and the penalty rule remain distinct. Deposits require the buyer to hand over an “earnest” (typically a sum of money) to the seller, which the seller might forfeit if the buyer fails to fulfil his contractual obligations. Unlike damages clauses, deposits do not impose secondary obligations onto the buyers or intend to compensate for loss. Instead, they serve to filter out unserious buyers, signal the buyer’s good faith, and motivate the buyer’s contractual performance.

Given this context, the CA refined the framework for the recovery of an alleged deposit. First: it must be determined whether there is a contractual right to forfeit the sum alleged to be a deposit upon the payer’s breach. Second: where there is a contractual right to forfeit, the court determines whether the sum is a true deposit – in brief, the test is whether the sum is reasonable as an earnest. Third: if the sum is reasonable as an earnest, it is a true deposit and can be forfeited. However, if the sum is not reasonable as an earnest, it is not a true deposit and cannot be forfeited.

The CA also stressed that the reasonableness of the sum as an earnest is assessed at the time of contracting and not the time of forfeiture. If it is not reasonable at the time of contracting, it is not a true deposit and therefore not subject to forfeiture.

II. Material Facts

Li Jialin and her father (“**the buyers**”) were interested purchasers in an apartment unit in The Crest (the “**Property**”), a housing project under development by Wingcrown Investment Pte Ltd (“**Wingcrown**”). In 2015, they exercised an option to purchase the Property (the “**First Option**”) and entered into a sale and purchase agreement (the “**First Sale and Purchase Agreement**”) with Wingcrown.

After having paid \$1,217,550 towards the purchase price, however, the buyers defaulted on the remaining instalments. The First Sale and Purchase Agreement was thus terminated by Wingcrown. Pursuant to the terms of the First Sale and Purchase Agreement, Wingcrown issued a notice purporting to deduct \$379,195.58 from the instalments paid. This sum consisted of

\$22,195.58 in interest, taxes and other expenses, and \$357,000 representing 20% of the purchase price to be forfeited. The balance of \$838,354.42 would be refunded to the buyers. Despite this, the buyers remained interested in purchasing the Property. They signed a second option to purchase (the “**Second Option**”), with the following terms:

- (a) Wingcrown would issue the buyers a fresh option to purchase the Property at the price of \$1,900,000.
- (b) Out of the sum of \$379,195.58 forfeited or deducted for the failed first attempt to purchase the Property, \$357,000 would not be forfeited but instead credited as the “**Option Fee**” payable under the Second Option.
- (c) Notwithstanding the terms of the First Sale and Purchase Agreement, \$838,354.42 (the “**Refund Amount**”) would be instead credited as the deposit payable should the Second Option be exercised by the buyers.

The Second Option also expressly defined “**Deposit**” to mean “the sum of \$1,195,354.42” (Refund Amount of \$838,354.42 plus the Option Fee of \$357,000). Additionally, the Law Society of Singapore’s Conditions of Sale 2012 were incorporated into the agreement. The material conditions in this case were as follows:

- (a) Condition 15.3: A party may serve a “Notice to Complete” where the other party fails to complete the sale on the scheduled completion date; and
- (b) Condition 15.9(c)(i): If the Purchaser does not comply with the terms of any effective Notice to Complete, the Vendor may “forfeit and keep any deposit paid by the Purchaser”.

The buyers then exercised the Second Option, but again failed to complete the sale. Wingcrown subsequently served them with a Notice to Complete (for the Second Option). Two months later, Wingcrown gave notice that the sale had been terminated and asserted its entitlement to forfeit the stipulated deposit of \$1,195,354.42.

In 2023, the buyers asserted their intention to take legal action if Wingcrown did not return \$1,195,354.42 with interest. In response, Wingcrown purported to exercise its right under Condition 15.9(c)(i) to forfeit a reduced sum of \$380,000. Taking the position that it was entitled to a further sum of \$326,397.38 as expenses incurred for the abortive attempts to purchase the Property, Wingcrown then returned the balance of \$488,957.04 to the buyers. However, the buyers believed that they were entitled to the full deposit. As such, they commenced suit against Wingcrown in the High Court (the “**HC**”), seeking: (a) declarations that the entire sum of \$1,195,354.42 was not a true deposit and amounted to an unenforceable penalty; and (b) an order that the entire sum of \$1,195,354.42 (less the \$488,957.04 already paid) be refunded with interest.

The HC disagreed with the buyers, and upheld Wingcrown’s forfeiture of the sum of \$380,000. Firstly, the HC accepted the framework in *Hon Chin Kong v Yip Fook Mun and another* [2018] 3 SLR 534 (the “**Hon Chin Kong framework**”) as the applicable framework to determine whether a deposit should be forfeited. Central to the *Hon Chin Kong* framework was the “True Deposit Test”, which states that for a sum to be a true deposit that may be forfeited, it must be reasonable as an earnest. The HC accepted Wingcrown’s argument that the True Deposit Test should be applied only to the sum which was actually forfeited (ie, \$380,000). This was because Condition 15.9(c)(i) was worded broadly enough to confer upon Wingcrown a discretion to forfeit a lesser part of any contractually stipulated deposit. On this basis, the HC found that the sum of \$380,000 was reasonable as an earnest and therefore a true deposit, the forfeiture of which was not subject to the penalty rule under the *Hon Chin Kong* framework. The buyers

appealed.

III. Issues

The CA discussed the following issues on appeal:

- (a) the distinction between the law of penalties and the law of deposits;
- (b) the proper interpretation of Condition 15.9(c)(i); and
- (c) the correct framework for the recovery of a sum alleged to be a deposit and whether it applied in this instance.

A. *Distinction between law of penalties and law of deposits*

The CA first discussed the historical differences between the law of penalties and the law of deposits, concluding that deposits serve a different purpose from damages (liquidated or otherwise), and the two areas of law should continue to be kept distinct.

The penalty rule was an invention of equity, originally created to grant relief from the strict enforcement of penal bonds. It was later adopted by the common law around the 18th century. Under the common law, the rule developed into one which operates in the realm of remedies, and which prevents the imposition of a payment disproportionate to the amount of loss suffered upon a breach of contract.

The law of deposits is ancient by comparison. It can be traced back to the laws of ancient Greece, where a buyer in a contract of sale was required to hand over an *arrha* (or earnest) to the seller. The *arrha* typically took the form of a ring or a sum of money. Both buyer and seller were bound by this: if the buyer failed to pay the purchase price, the *arrha* would be forfeited to the seller; conversely, if the seller defaulted on his obligation, he would have to return the *arrha* and pay as much in addition. In this form, the *arrha* was incorporated into the laws of Rome, and later found its way into English common law. What remains now is the earnest function of the deposit, being “an earnest to bind the bargain so entered into, and creates by the fear of its forfeiture a motive in the payer to perform the rest of the contract”. It was also in the common law courts that a requirement of reasonableness was introduced. This is the “True Deposit Test”, a mechanism to control against an abuse of the deposit.

Given the different lineages of these two areas of laws, the courts have always strived to keep them separate and distinct. Ironically, it was this very effort which led to suggestions of a melding of the two areas of law, as the former came to be defined in contradistinction to the latter, and later as an exception to the latter. Indeed, there have been recent movements in other jurisdictions in favour of a convergence of the law of deposits and the law of penalties.

Addressing the broader question of whether the law of deposits had a place in our law today, the CA reiterated that the law of deposits should be retained. The function of the law is to serve society, and history has shown that society has use for deposits. As discussed above, deposits have been a part of commerce since ancient times and continue to be widely used today. Furthermore, the function of a deposit as an *earnest* remains relevant today: it continues to be an assurance of at least the purchaser’s performance at a practical level. A deposit “shows the vendor that the purchaser is serious about the purchase and will not leave him high and dry ... It is a sign of good faith and sieves out frivolous or fickle purchasers. At the same time, it motivates the purchaser to follow through with the contract”. This last aspect of motivation is a very real one. For instance, while a purchaser who loses a 20% deposit may be in the same economic position as one who is liable to pay 20% in liquidated damages, the practical reality is that the former will likely have greater impetus to perform because he has already parted

with his money.

Further, the legal tests are quite different. The movement in other jurisdictions in favour of a convergence of these two laws was possibly motivated by the shift in the law of penalties in these jurisdictions away from the realm of compensation and towards the concept of “legitimate interests”. However, this test has not been accepted in Singapore. In *Denka Advantech Pte Ltd v Seraya Energy Pte Ltd* [2021] 1 SLR 631, the CA rejected the legitimate interests test, affirming the classic formulation of the penalty rule (under *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79), which states that a penalty is a payment stipulated as *in terrorem* of the breaching party, beyond a genuine pre-estimate of the likely loss. The fundamental basis for the CA’s decision to uphold the classic formulation was that the penalty rule operates only in the sphere of secondary obligations, specifically the obligation on the part of the defendant to pay damages to the plaintiff.

However, deposits do not operate in the sphere of secondary obligations. They are not meant to compensate, and their forfeiture is not (as a matter of principle) a substitute for damages. The true sting of a deposit lies not in any liability imposed on the purchaser, but in how the payment as an earnest prevents any claim for restitution of that sum in unjust enrichment. A vendor who has forfeited a deposit is not barred from suing separately for damages, subject to the requirement to give credit for the value of any deposit forfeited.

B. Interpretation of Condition 15.9(c)(i)

The CA then considered whether Condition 15.9(c)(i) conferred a discretion on Wingcrown to decide whether and when to forfeit the deposit, as well as the amount to be forfeited.

The CA found that the HC erred in treating Condition 15.9(c)(i) as a discretionary forfeiture clause: the plain language of the clause simply did not support such an interpretation. The provision in the clause stated that the vendor may forfeit and keep “any deposit paid by the Purchaser”. Wingcrown argued that this provision conferred upon itself a discretion to forfeit a lesser part (ie, 20%) of the amount paid. However, this interpretation was rejected as the language was clearly a reference to “any amount paid as a deposit” and not “any *part* of the amount paid as a deposit”.

Additionally, the CA found it difficult to see how a discretionary forfeiture clause would serve the purpose of a deposit. The purpose of a deposit is to serve as an earnest at the formation of the contract, and in this context, to secure the buyer’s performance of the sale and purchase contract. This purpose would be better served if the consequences of non-performance were clear to a buyer at the point of entering into the contract. By contrast, a buyer’s performance would hardly be better secured by the prospect that the deposit may not be fully lost even in the event of non-performance, given the seller’s discretion to forfeit any lesser amount.

The CA also doubted the interpretation of such a discretionary forfeiture clause to the extent that it purportedly gave Wingcrown such a discretion to decide whether and when to forfeit, to the extent that it could exercise this “discretion” nearly five years after terminating the sale and purchase contract (and indeed only after the buyers had threatened legal action against it).

The CA clarified that this did not mean that Wingcrown was contractually prohibited from forfeiting a lesser sum of the deposit. Such an act would simply be a matter of goodwill as opposed to contractual right. What Wingcrown could not do was to forfeit a lesser sum in order to retrospectively justify the deposit as reasonable. This would put the cart before the horse.

C. Revised framework for the recovery of a sum alleged to be a deposit

The CA then considered the *Hon Chin Kong* framework and its continued applicability in Singapore. This framework applies where a party sues for the return of a deposit. In summary, the *Hon Chin Kong* framework contemplates first an inquiry into the existence of a contractual entitlement to forfeit the sum paid upon the payer's breach – that is the most fundamental characteristic of a deposit. If such an entitlement exists, the True Deposit Test is applied to determine if the sum is reasonable as an earnest. If the sum is not reasonable, then it is not a true deposit, and court is to apply the penalty rule to determine if the sum is forfeitable. After considering the previous iteration, the CA affirmed its general applicability but also noted the need for modifications. Accordingly, the CA set out a revised version of the *Hon Chin Kong* framework. It features two sections – an explanatory preamble and a simplified three-step test.

(i) Preamble. The penalty rule applies to secondary obligations, particularly the obligation to pay damages. It is focused on compensation, which constitutes the broad policy underlying the award of contractual remedies. Thus, where an agreed remedies clause (most commonly, a liquidated damages clause) purports to operate as a substitute for the court's determination of the appropriate extent of compensation, it is subject to judicial scrutiny. The question is whether the clause is a genuine pre-estimate of loss. If it is not, it is not compensatory and is unenforceable as a penalty.

Deposits, however, are not intended to be compensatory; instead, they serve an important signalling function. It shows the vendor that the purchaser is serious about the purchase and will not leave him high and dry. It is a sign of good faith and sieves out frivolous or fickle purchasers. At the same time, it motivates the purchaser to follow through with the contract, to avoid forfeiture for non-performance. In this light, policy considerations of compensation do not apply to deposits. Deposits do not operate in the sphere of secondary obligations and are not intended to be a substitute for damages. They operate outside the scope of the penalty rule.

This does not mean that parties are free to agree to excessive and extravagant deposits. The law requires that the deposit must be reasonable as an earnest; otherwise, the right to forfeiture is unenforceable, regardless of whether it is express or implied. It is not open to the court to recharacterise the right of forfeiture into a right to liquidated damages which remains enforceable subject to the penalty rule – to do so would be to impute an element of compensation which did not otherwise exist. If a deposit is not compensatory when reasonable, it is also not compensatory when unreasonable. The purchaser may therefore seek a recovery of the sum paid, under the general law.

(ii) Three-step test. Thus, where the claimant sues for the return of a sum alleged to be a deposit, the appropriate framework is as follows:

(a) First, the court determines whether there is a contractual right to forfeit the sum alleged to be a deposit upon the payer's breach. This will involve consideration of the parties' intentions and the terms of the contract, and may be express or implied. Where there is an express forfeiture clause to this effect, this will be sufficiently clear. Where there is no such clause, the right of forfeiture may nonetheless be implied from the use of words such as "deposit".

A reference to a sum described as a deposit being compensatory as liquidated damages could displace the inference that it is intended to be a deposit which is forfeitable upon breach. If there is no contractual right to forfeit, the inquiry stops here, and the recoverability of the sum will be determined under the general law.

(b) Second, where there is a contractual right to forfeit, the court determines whether the

sum is a true deposit. The test is whether the sum is reasonable as an earnest. The sum will be reasonable if it is customary or conventional. If it is higher than customary, it may nevertheless be reasonable if the vendor can show special circumstances to justify the deposit.

(c) Third, if the sum is reasonable as an earnest, it is a true deposit and can be forfeited. However, if the sum is not reasonable as an earnest, it is not a true deposit and cannot be forfeited. When the right to forfeit is unenforceable, the claimant's right to recover the deposit will be decided under the general law.

Applying the revised framework to the facts, the CA held that the contractually stipulated deposit (ie, \$1,195,354.42), which amounted to 63% of the purchase price, was not reasonable as an earnest. Wingcrown made no attempt to justify the reasonableness of the sum. The very fact that Wingcrown, in response to the buyers' letter of demand, purported to forfeit a reduced sum of \$380,000 despite having already elected to forfeit the entire deposit previously was a clear acknowledgment by Wingcrown that the deposit would not have passed the test of reasonableness. Wingcrown offered no other reason for this about-turn. Thus, the sum of \$1,195,354.42 was not a true deposit and could not be forfeited, and the buyers were entitled to pursue a claim for a recovery of the sum of \$1,195,354.42 (less \$488,957.04) in unjust enrichment.

IV. Lessons Learnt

Given that the Law Society of Singapore's Conditions of Sale 2012 are commonly incorporated into conveyancing agreements, it is vital for the parties to understand that Condition 15.9(c)(i) is not a discretionary forfeiture clause. As such, the reasonableness of a deposit must be assessed at the time of contracting. Therefore, developers should stipulate a sum that is reasonable as an earnest.

Moreover, legal practitioners should avoid using the language of penalties to describe an unreasonable deposit. As the CA clarified, a deposit and a damages clause will trigger vastly different tests to determine their enforceability. Given the widespread use of "deposits", accurately characterising a contractual clause is crucial in areas beyond property transactions.

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