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Singapore Court of Appeal Decides That Contractual Deposits Must Be Reasonable in Amount At The Time Of Contracting, But Need Not Be A Genuine Pre-Estimate Of Loss

Li Jialin and another v Wingcrown Investment Pte Ltd [2024] SGCA 48

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LEGAL UPDATE

In this Update

In *Li Jialin and another v Wingcrown Investment Pte Ltd* [2024] SGCA 48, the Court of Appeal clarified and restated the applicable framework to analyse whether a contractual deposit should be upheld and forfeited when the sale and purchase transaction falls through.

This update discusses the Court of Appeal's analysis on the law of deposits and how it is distinct from the rule against penalties, and suggests some practical considerations for commercial parties who agree for a deposit to be paid by one party ahead of completion of the transaction.

INTRODUCTION

The Court of Appeal's recent decision *of Li Jialin and another v Wingcrown Investment Pte Ltd* [2024] SGCA 48 refused to allow a vendor to forfeit, in whole or in part, a deposit which the parties agreed to be around 63% of the purchase price in their sale and purchase agreement.

This update discusses the Court of Appeal's analysis and suggests some practical considerations for commercial parties who have agreed, or who intend to agree, for a deposit to be paid by one party ahead of completion of the transaction.

RELEVANT BACKGROUND

The dispute stemmed from a cancellation in the proposed sale and purchase of an apartment unit in The Crest ("**Property**") – not once, but twice. The appellants were interested purchasers of the Property while the respondent, Wingcrown Investment Pte Ltd, was the developer of The Crest.

The first sale and purchase agreement was terminated after the purchasers started to default on their instalments from September 2016. At that point in time, the purchasers had already paid a total of $1,217,550 of the $1,785,000 purchase price to the developer.

Nevertheless, the purchasers remained interested in purchasing the Property and, following further negotiations with the developer, exercised a second option to purchase ("**Second Option to Purchase**") on 30 April 2018.

The Second Option to Purchase recorded the parties' failed first attempt to purchase the Property, and stipulated the following terms for the new purchase:

(a) The developer would grant the purchasers the Second Option to Purchase as a fresh option to purchase the Property at $1,900,000.

(b) Out of the amount which the purchasers had already paid under the first aborted purchase, $357,000 would be treated as the option fee payable under the Second Option to Purchase and another $838,354.42 would be credited towards the deposit payable by the purchasers in the event they exercised the Second Option to Purchase.

(c) Upon the purchasers' exercise of the option, there would be a distinct binding contract for the sale and purchase of the Property upon the "Terms of Sale" set out in the Second Option to Purchase.

The Terms of Sale expressly defined "Deposit" to mean the sum of $1,195,354.42 (that is, $357,000 plus $838,354.42), which would form part of the $1,900,000 purchase price. The agreement also incorporated the widely-used Law Society of Singapore's Conditions of Sale 2012 ("**Conditions of Sale 2012**"), which provide that:

(i) a party may serve a "Notice to Complete" where the other party fails to complete the sale on the scheduled completion date, and the parties must complete the sale within 21 days after the day of service; and

(ii) 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* [p]*urchaser*".

On 24 October 2018, the developer served the purchasers with a Notice to Complete. When the purchasers still failed to complete the sale, the developer gave notice on 20 November 2018 that the sale had been terminated and asserted its entitlement to forfeit the entire deposit of $1,195.354.42.

More than 4 years later, upon being served with a letter of demand claiming repayment of the entire deposit with interest, the developer changed its initial stance and purported to exercise its right to forfeit only $380,000, representing 20% of the $1,900,000 purchase price.

The purchasers sued for the return of the full deposit.

THE LOWER COURT'S DECISION

At first instance, the High Court judge accepted the developer's position that the court should focus on the $380,000 that was actually forfeited, instead of the contractually stipulated deposit of $1,195,354.42, in deciding whether a deposit amount should be upheld as a "*true deposit*" that is "*reasonable as an earnest*".

The High Court judge was persuaded that the reference to the right of the developer to "*forfeit and keep any deposit paid by the* [p]*urchaser*" under Condition 15.9(c)(i) of the Conditions of Sale 2012 was worded broadly enough to give the developer a discretion to forfeit a lesser part of any contractually stipulated deposit.

On that basis, the High Court judge found that the sum of $380,000 was reasonable as an earnest and therefore a true deposit, thereby upholding the developer's forfeiture of the $380,000 sum.

The purchasers appealed against the High Court judge's decision.

COURT OF APPEAL'S DECISION

The Court of Appeal allowed the appeal and reached a contrary conclusion on the legitimacy of the developer's forfeiture. It held that the contractually stipulated deposit of $1,195,354.42, which amounted to 63% of the purchase price, was not reasonable as an earnest and therefore could not be forfeited by the developer in whole or in part.

KEYPOINT

The Court of Appeal held that the reasonableness of the deposit must be assessed at the time of contracting, and the unreasonable sum does not become reasonable retrospectively by a party purporting to forfeit a reduced sum.

Central to the Court of Appeal's reasoning was its finding that the plain language of Condition 15.9(c)(i) was all-or-nothing and did not confer upon the developer a discretion to forfeit a lesser part of any contractually stipulated deposit. The reference to "*any amount paid as a deposit*" in Condition 15.9(c)(i) could not be interpreted as "*any **part** of the amount paid as a deposit*".

Even if Condition 15.9(c)(i) could somehow be read to give the developer such discretion, the Court of Appeal found the developer's purported exercise of its right to forfeit $380,000 on 10 April 2023 to be contrived and an afterthought. In November 2018, March 2019 and June 2019, the developer had asserted its right to forfeit the entire deposit of $1,195,354.42; and the developer continued to retain this whole sum for more than 4 years despite the purchasers' repeated calls for a refund of the deposit.

The Court of Appeal also took the opportunity to refine and restate the analytical framework in *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534, to be applied where a plaintiff sues for the return of a deposit:

(1) 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. If there is no contractual right to forfeit, there is no need to further inquire as to the reasonableness of the sum, and its recoverability will be determined under the general law notwithstanding the payer's breach.

(2) Second, where there is contractual right to forfeit, the court determines whether the sum is "*reasonable as an earnest*" and a

true deposit. If the sum is higher than customary, the payee must show special circumstances to justify the deposit.

(3) Third, if the sum is reasonable as an earnest, it is a true deposit and can be forfeited. If the sum is not reasonable as an earnest, any express or implied right to forfeit is thus unenforceable.

Applying the revised framework to the facts of the case, the Court of Appeal found that the contractually stipulated deposit of $1,195,354.42 was not reasonable as an earnest. Not only did the developer make no attempt to justify the reasonableness of that sum, the developer's subsequent attempt to forfeit a reduced sum of $380,000 was a clear acknowledgement that the deposit would not have passed the test of reasonableness.

The purchasers were therefore entitled to recover the full deposit save for the $357,000 option fee that the developer was entitled to retain in consideration for granting the purchasers the Second Option to Purchase.

COMMENTARY

Given the commercial importance of deposits which extends beyond the conveyancing context, it is timely that Singapore's highest court has clarified the law and analytical framework applicable to deposits.

After undertaking a study of the jurisprudence and the underlying principles, the Court of Appeal reiterated that the law of deposits should be kept separate and distinct from the penalty rule which typically applies to 'agreed' or liquidated damages clauses.

The penalty rule imposes limits on the parties' freedom to agree on the remedy or secondary obligation for a breach of a primary obligation under the contract. To ensure that the remedy is compensatory in nature, the rule is that any agreed remedy must be a genuine pre-estimate of the non-breaching party's loss.

Deposits, on the other hand, serve a different purpose of being an "earnest" to secure a buyer's performance of a sale and purchase contract at the time of contract formation. They are not meant to substitute for damages – a vendor who has forfeited a deposit is not barred from suing separately for damages, but he must give credit for any deposit forfeited so there is no double recovery.

Hence, even though a purchaser who loses a deposit amounting to 20% of the purchase price is in a practically similar position to one who is liable to pay liquidated damages amounting to 20% of the purchase price, the penalty rule has no application to the law of deposits.

This means the proper characterisation of a contractual clause as a deposit or a liquidated damages clause could trigger entirely different tests to determine the clause's validity. Given the Singapore courts' inclination to prefer 'substance over form', the characterisation is unlikely to turn on mere labels and parties should seek specific legal advice on how their contract should be construed if there is doubt over the enforceability of a deposit.

In determining whether a deposit amount is reasonable as an earnest, the focus is on whether the deposit is "*so large that it cannot be objectively justified by reference to the functions which such a deposit properly serves*".

Where parties seek to fix a deposit amount that is higher than the customary or conventional deposit for a particular type of contract, or if there is no such custom or convention, parties would do well to document the specific considerations that went into fixing the deposit amount. These factors may include any history of dealing between the parties, their financial means, and the commitment required on the vendor's part in keeping the subject-matter of the sale "*off the market*" for the duration of the sale. This will help counter any argument that the deposit amount was set arbitrarily and unreasonably, especially when such arguments are likely to arise only some time after the deposit amount had been agreed and paid.

Finally, given the particular wording of Condition 15.9(c)(i), the Court of Appeal's decision appears to leave open the question of how the revised analytical framework should be applied, with or without modifications, if a contract provides that the vendor shall have the discretion to forfeit "*any part of*" the deposit or "*a reasonable amount*" if the sale and purchase transaction falls through. That may have to be tested in a future case.

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