

Singapore Court of
Appeal Adopts UK
Decision of *Dunlop*
in Deciding That
Payments Under
Agreements
Between Parties Are
Unenforceable
Penalties

*Ethoz Capital Ltd v Im8ex Pte
Ltd and others* [2023] SGCA 3

31 January 2023

LEGAL
UPDATE

In this Update

In *Ethoz Capital Ltd v Im8ex Pte Ltd and others* [2023] SGCA 3, the Court of Appeal upheld the findings by the Judge of the General Division of the High Court, that the certain payments under agreements between the parties were unenforceable penalties.

The Court of Appeal followed the seminal decision of *Dunlop Pneumatic Tyre Co, Ltd v New Garage and Motor Co, Ltd* [1915] AC 79 in coming to this decision.

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INTRODUCTION

In *Ethoz Capital Ltd v Im8ex Pte Ltd and others* [2023] SGCA 3, the Court of Appeal upheld the findings by the judge of the General Division of the High Court (“**Judge**”), that certain payments under agreements between the parties were unenforceable penalties.

The Court of Appeal followed the seminal decision of *Dunlop Pneumatic Tyre Co, Ltd v New Garage and Motor Co, Ltd* [1915] AC 79 which held that the application of the penalty doctrine is “a question of construction to be decided upon the terms and inherent circumstances of each particular contract”. The Court of Appeal also held that the prevailing test in Singapore for whether a provision is an unenforceable penalty is set out in the *Dunlop*.

The Court of Appeal further held that when determining whether a clause creates a primary obligation or secondary obligation triggered upon breach, it is important that the court analyses the whole contract and not just the impugned clauses in isolation.

Our update discusses this decision.

BACKGROUND

Ethoz Capital Ltd (“**Ethoz**”) lent \$6.3m to the 1st respondent, Im8ex Pte Ltd (“**Im8ex**”) under three loan facilities (“**Prior Facilities**”) which were secured by mortgages over four different properties (“**Properties**”) and were also guaranteed by the 2nd and 3rd respondents.

In July 2019, the parties began to discuss renewing the Prior Facilities, and eventually signed a new set of four loan facilities (“**Facilities**”). The total amount advanced under the Facilities was \$6.3m (“**Advance**”). The Advance was secured by mortgages over the Properties and guaranteed by the 2nd and 3rd respondents.

Clauses 5(A) and 7(A) provided that the Facilities were at an interest rate of 3.75% per annum, with 180 equal monthly instalment payments to be made over 15 years.

Schedule 3 of the Facilities included an amount termed “Total Interest” which was the aggregate of *all* the interest payments and was the amount arrived at when the flat rate of 3.75% *per* annum is applied to the Advance.

Significantly, Clause 7(B) provided that the Total Interest “shall be deemed earned and accrued in full upon the drawdown of the Advance”. This clause was not present in the Prior Facilities.

Clause 14(B)(2) further provided that the Total Interest would be “immediately due and payable” upon an event of default (which included the failure to pay a sum under the Facilities when it is due). Upon default, Im8ex would have to pay default interest (“**Default Interest**”) at a rate of 0.065% per day (“**Default interest Rate**”).

Im8ex defaulted on payment within the first year of all the Facilities. Ethoz applied to court for the delivery of vacant possession of the Properties, and the payment of the Advance, the Total Interest and the Default Interest.

Ethoz's application was granted, and Im8ex filed an appeal which was heard by the Judge. Im8ex argued that the payment of Total Interest upon default and Default Interest were unenforceable penalties.

The Judge allowed Im8ex's appeal. He found that the payment of Total Interest upon default was a secondary obligation and ultimately, an unenforceable penalty. He also held that the payment of Default Interest was an unenforceable penalty as the Default Interest rate was an "extravagant increase" from the regular contractual interest rate.

Ethoz appealed to the Court of Appeal.

COURT OF APPEAL'S DECISION

The Court of Appeal upheld the Judge's findings that the payment of the Total Interest upon default and the Default Interest, were unenforceable penalties.

The prevailing test in Singapore for whether a provision is an unenforceable penalty is set out in the seminal case of *Dunlop*. The classic statement of principle is that "[t]he essence of a penalty is a payment of money stipulated as in terrorem of the offending party" while "the essence of liquidated damages is a genuine covenanted pre-estimate of damage".

The Court of Appeal observed that there is a difference between paying a debt immediately and paying a debt in instalments over a period of time. The obligation to pay the Total Interest in instalments was determined by the Court of Appeal to be the primary obligation under the Facilities. The obligation to make immediate and full payment of Total Interest upon default was determined by the Court of Appeal to be a secondary obligation triggered only upon breach and was therefore unenforceable.

KEYPOINT

It is important that the court analyses the whole contract (and not just the impugned clauses) when determining whether a clause creates a primary obligation or secondary obligation triggered upon breach.

The Court of Appeal also held that the payment of Default Interest was an unenforceable penalty as on the face of the Facilities, the increase between the regular interest rate and the Default Interest rate was an "extravagant increase" which Ethoz could not justify.

COMMENTARY

Lenders should note that demanding the full payment of interest immediately after a default carries a real risk of having the clause classified as a secondary obligation, and consequently, an unenforceable penalty clause.

Parties should also avoid resorting to “clever drafting” to try and circumvent the *Dunlop* principle. The Court of Appeal has made it clear that it will adopt a “substance over form” approach to interpret contractual clauses. Instead, it would be more prudent for parties to focus on showing that the liquidated damages constitute a “genuine pre-estimate” of loss.

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