

DEPOSITS IN SHARE PURCHASE AGREEMENTS

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I. Introduction to deposits

1 Share purchase agreements (“SPA”) occasionally provide that a deposit, usually expressed as a percentage of the purchase price, must be paid by the purchaser in the early stages of the transaction. These deposits are most commonly seen in transactions relating to the transfer of real estate. A deposit may be held in an escrow account until one of the following events takes place:

(a) If the transaction reaches completion, the deposit will be released either to the purchaser (who must make a separate payment for the purchase price) or the seller (in satisfaction of part of the purchase price for the transaction).

(b) If the contract is discharged on the purchaser’s breach of contract, the seller would be entitled to forfeit and keep the deposit and any interest accrued on it.

2 It has been recognised that deposits serve two main purposes. First, the deposit may constitute “security for damages for breach of contract”.² Second, the deposit may be considered earnest money, paid to “guarantee the due performance of the contract”.³ The deposit demonstrates to the seller that the buyer

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2 *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [9].

3 *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [12].

is committed to the transaction, as the prospect of forfeiture will incentivise the buyer to comply with its contractual obligations.

II. Considerations in using deposits

3 A deposit, if nothing more is said about it, is security for damages for breach of contract. If the seller has not suffered any damage, he must return the sum to the purchaser.⁴ Otherwise, the purchaser can sue for the return of the sum in unjust enrichment.⁵

4 On the other hand, parties may stipulate that even if the seller suffers no loss, the deposit is to be forfeited to the seller upon stipulated material breaches of contract by the purchaser. If the seller's damages are greater than the sum forfeited, the seller will be entitled to recover the shortfall.⁶

5 The seller's contractual right to forfeit is only enforceable if the deposit is deemed a "true deposit" – a sum that is "reasonable as earnest money", indicating the purchaser's commitment to performing the contract.⁷ Courts will consider the size of the deposit relative to the purchase price as a starting point, but may also consider other factors "relevant to the effectiveness" of the earnest payment.⁸

6 Where there is a contractual right to forfeit, but the sum paid does not constitute a true deposit, the sum will be recharacterised as an advance or part payment,⁹ consequences of which are discussed in Part III below.¹⁰

4 *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [9].

5 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [136].

6 *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [9].

7 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [130].

8 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [143].

9 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [143].

10 See paras 17–31 below.

A. When is a payment a “true deposit”?

7 The law on “true deposits” was recently clarified by the High Court in *Hon Chin Kong v Yip Fook Mun*¹¹ (“*Hon Chin Kong*”). True deposits are sums that are “reasonable as earnest money”¹² or “customary or moderate”¹³ and serve to indicate the payor’s commitment to performing the contract.

(1) Size of the deposit

8 As a starting point, courts will assess the size of the deposit as a proportion of the overall purchase price to be paid.

9 The figure of 10% of the purchase price, for example, has been regarded as a reasonable deposit in the sale and purchase of immovable property. In the case of *Workers Trust & Merchant Bank Ltd v Dojap Investments Ltd*¹⁴ (“*Workers Trust*”), the Privy Council held that the seller must establish the reasonableness of any deposit amount in excess of 10% as intended to encourage performance. As such, unless the non-defaulting party can establish the reasonableness of any deposit above 10% of the purchase price, the non-defaulting party would be unlikely to be able to retain the deposit.

10 The High Court has specified that courts will assess whether the size of the deposit relative to the purchase price is “customary or conventional” for the particular *type* of contract that the parties are entering into.¹⁵ A deposit of 10% of the purchase price may not be the custom or convention in certain other types of contracts. However, given that deposits are used mainly in SPAs where the transaction involves a transfer of real estate, parties intending to use deposits should, in most cases, adhere to the 10% guideline (in the absence of “exceptional circumstances”).¹⁶

11 [2018] 3 SLR 534.

12 *Workers Trust & Merchant Bank Ltd v Dojap Investments Ltd* [1993] AC 573 at 579.

13 *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [9].

14 [1993] AC 573 at 573.

15 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [143].

16 *Polyset Ltd v Panhandat Ltd* [2002] HKCFCA 15 at [90].

11 Courts may further consider the size of the deposit in absolute terms. The High Court in *Hon Chin Kong* held that a sum of \$300,000 – 36% of the purchase price – was reasonable, explaining that the sum was not large in absolute terms in comparison to other cases where deposits were found to be unreasonable, such as in *Workers Trust*, where the sum to be forfeited was \$2,875,000.¹⁷

(2) *Other relevant factors*

12 Parties must be mindful that the size of the deposit in relative or absolute terms is not entirely determinative of whether the deposit constitutes a “true deposit”.

13 Courts may additionally consider any factors that are “relevant to the effectiveness” of the earnest payment.¹⁸ These include the history of dealing between the parties, their financial means, and the commitment required of the seller in keeping the subject matter of the acquisition “off the market” for the duration of the sale.¹⁹

14 On the facts of *Hon Chin Kong*, for example, the purchaser was unable to keep to the payment timelines that he had proposed. The High Court found that the defendants were understandably anxious as they had financial obligations to other investments, and accordingly, the deposit of \$300,000 to assure the seller of the plaintiff’s commitment to performance of the contract was reasonable in spite of the sum being equivalent to 36% of the purchase price.

B. *Payor must be the breaching party*

15 Parties must note that generally – unless the SPA contains express terms to the contrary – the seller is unlikely to be entitled to forfeit the sum paid where the contract is discharged upon the seller’s default.²⁰

17 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [145].

18 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [143].

19 *Polyset Ltd v Panhandat Ltd* [2002] HKCFA 15 at [107].

20 W J Wong, “The Law on Deposits: Unresolved Issues” (2019) Sing JLS 274 at 277.

16 The precise conceptual basis for disallowing the payee to forfeit the sum on his own breach is unclear, but it has been suggested that:

(a) Courts may imply a term into the contract that the payee is only allowed to forfeit the sum paid if the payor is in breach.²¹ However, courts may only do so if there is a gap in the agreement in relation to the circumstances where the sum paid may be forfeited. If the contract unequivocally states that the payee may forfeit the payment under all circumstances, courts may alternatively use the equitable doctrine of contract rectification to prevent the payee from retaining the sum forfeited.²²

(b) Courts may apply the principle that parties should be disallowed from profiting from their own breach of contract. This principle has been applied where courts have held that payors cannot recover sums that they had paid if they were the party in breach of contract;²³ however, it remains to be seen whether the same principle applies to payees on their breach.

(c) Courts may invoke the Unfair Contract Terms Act²⁴ (“UCTA”), finding that the forfeiture clause constitutes the payee’s attempt to exclude restitutionary or contractual liability flowing from the payee’s own breach.²⁵ The clause might thus be captured under s 3(2)(a) of the UCTA, which applies to attempts to avoid liability for breach of contract. In this event, the forfeiture clause will be void and unenforceable unless the payee can demonstrate that the clause is reasonable under s 11 of the UCTA.

21 *Sembcorp Marine Ltd v PPL Holdings Pte Ltd* [2013] 4 SLR 193 at [31].

22 W J Wong, “The Law on Deposits: Unresolved Issues” (2019) Sing JLS 274 at 278.

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

24 Cap 396, 1994 Rev Ed.

25 W J Wong, “The Law on Deposits: Unresolved Issues” (2019) Sing JLS 274 at 278.

III. Deposits versus part payments

17 An SPA may be silent as to whether parties had intended for the purchaser's payment to be construed as a deposit or a part payment. This distinction is crucial. Unlike deposits, part payments may be returnable to the purchaser on the purchaser's breach of contract (subject to any set-off for damages that the seller may be entitled to).²⁶

18 Provisions for the forfeiture of a part payment will also be subject to the rule against penalties, and so for a forfeiture clause to be enforced, the payment must reflect a "genuine pre-estimate" of the seller's loss on the purchaser's breach of the stipulated provision.²⁷

19 The Court of Appeal in *Lee Chee Wei v Tan Hor Peow Victor*²⁸ ("*Lee Chee Wei*") considered the recoverability by the defaulting party of an early payment of money under the contract. The court distinguished a "deposit" from an "advance or part payment", as follows:

(a) The judicial approach to forfeitable deposits at common law is that the deposit will be forfeited to the seller upon discharge of the contract on the default of the buyer, irrespective of whether it would have been deemed part-payment had the contract been completed; the buyer cannot insist on abandoning the contract and yet expect to recover the deposit as this would enable him to take advantage of his own wrong.

(b) An advance payment, on the other hand, does not fall within the category of forfeitable deposits and is neither designed nor intended to secure performance. This is underscored by the premise that the seller is already amply protected by the recovery of damages he has sustained.

(c) Whether payment is construed as a deposit entitling forfeiture upon default or as an advance payment which is

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

27 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [143].

28 [2007] 3 SLR(R) 537 at [84].

returnable is to be evinced by the intention of the parties expressed in the agreement.

A. *Avoiding the recharacterisation of a deposit as a part payment*

20 If parties wish to make a sum paid in advance subject to forfeiture, they must make their intention clear in the SPA. As such, parties should be mindful of the following points.

(1) *Expressly label the payment as a “deposit” instead of an “early payment” or “instalment”*

21 It is arguable that where a particular payment is termed a “deposit” in the contract, it would usually follow that such payment is intended by the parties to be open to forfeiture upon non-performance by the depositor of its outstanding obligations. Since the payment in question is termed a “deposit”, it would seem more likely than not that the true construction of the contract in such a case, absent an express provision for its return, would be that such payment is open to forfeiture by the seller.²⁹

22 The converse is also true; if parties have described the sum as an “advance payment” or “instalment”, the sum is unlikely to constitute a deposit.³⁰ To ensure that it constitutes a deposit, parties should label the sum as such, and it should be expressly stipulated that the depositor will not be able to keep the deposit upon discharge of the contract due to the depositor’s own breach.

23 On the facts of *Lee Chee Wei*, for example, there was no specific reference in the contract to a “deposit” and there was no specific provision in the contract which dealt with forfeiture of the sum paid in advance. Accordingly, as the clauses stipulated that the purchase price was to be paid in multiple instalments in a specified manner and characterised the payment as an “instalment” in contradistinction to a deposit, the court held that the payment was

29 *Union Eagle Ltd v Golden Achievement Ltd* [1997] 1 AC 514 at 518G.

30 *Lee Chee Wei v Tan Hor Peow Victor* [2007] 3 SLR(R) 537 at [88].

likely to have been an advance payment which was, on the face of it, immediately repayable upon termination of the contract.³¹

(2) *Ensure that the sum paid is likely to constitute a “true deposit”*

24 As discussed above, where there is a contractual right to forfeit but the sum paid does not constitute a “true deposit”, the sum will be recharacterised as a “part payment”.³² Parties should thus strive to ensure that the deposit constitutes a “true deposit”, as explored in Part II above.³³

25 Parties must also note the importance of including an express provision for the forfeiture of the deposit. If the sum is eventually recharacterised as a part payment, the courts’ treatment of the sum will differ depending on whether there was an express forfeiture clause.

26 The High Court in *Hon Chin Kong* has distinguished these two scenarios:

(a) If there is an express forfeiture clause, the payor (that is, the purchaser) bears the burden of invoking the penalty rule to prove that the part payment should not be forfeited. The recharacterisation of the sum as a part payment in this scenario does not automatically give the purchaser a right to recover the payment; the seller still has a contractual right of forfeiture which must be considered. As such, the forfeiture clause must be subject to the penalty rule, just like any other clause providing for the forfeiture of part payments or instalments.³⁴

(b) If there is no express forfeiture clause, the seller is not contractually entitled to forfeit the payment, and the purchaser can sue for the repayment of the sum on the grounds of unjust enrichment.³⁵ In this event, the seller

31 *Lee Chee Wei v Tan Hor Peow Victor* [2007] 3 SLR(R) 537 at [88].

32 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [143(f)].

33 See paras 3–16 above.

34 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [140].

35 *Hon Chin Kong v Yip Fook Mun* [2018] 3 SLR 534 at [136].

would be relying on the nature of the payment *qua* deposit to persuade the court to infer a term that the payment will be forfeited upon the purchaser's default. If the sum is held not to be a true deposit, there can be no such inference. As such, the seller will not be contractually entitled to forfeit the payment.

(3) *Avoid the application of the deposit towards the purchase price*

27 As noted above, the SPA may provide that upon completion of the sale of shares, the deposit is to be released to the seller in part satisfaction of the purchase price. Parties must be mindful that the mere fact that the deposit is intended to be used as part payment of the purchase price on completion of the SPA may allow the purchaser to challenge that it is an advance payment instead of a true deposit.

28 On the whole, however, there is likely only a small risk that the purchaser would be able to make the case that the deposit is, in actuality, a part payment. This is as the Court of Appeal in *Lee Chee Wei* expressly stated that a deposit would be forfeitable, irrespective of whether it would have been deemed part-payment had the contract been completed.

29 To avoid any uncertainty as to the construction of the SPA, it would be prudent for parties seeking the forfeiture of a deposit to avoid arrangements for the deposit to eventually be used as a part payment in satisfaction of the purchase price. This would make it clearer that the deposit is purely meant as earnest money given by the purchaser to secure the due performance of the SPA, which will be forfeited by the seller (in the event of the purchaser's breach of stipulated obligations under the SPA) or wholly returned to the purchaser (in the event of completion under the SPA).

30 In practice, however, it is likely that the purchaser will favour an arrangement for the deposit to be applied towards payment of the purchase price. In this case, as a matter of semantics, there should not be any labelling of the deposit as "part or advance payment". Instead, it should continue to be called a "deposit" as

security for the purchaser's performance of its obligations under the SPA, *but* this deposit may be applied towards satisfaction of the purchase price on completion.

31 The language of the SPA can also be strengthened by expressly stating that the deposit as earnest money would be *forfeited* to the seller by the release of the deposit from the escrow agent to the seller, in the event of a breach of stipulated provisions under the SPA. However, at completion of the transaction, the deposit will be released by the escrow agent to the seller on its behalf so that the deposit can be applied towards payment of the purchase price.

IV. Deposits *versus* liquidated damages

32 The law on liquidated damages and penalty clauses does not apply to deposits.³⁶ Hence when drafting a clause on deposits, care should be taken not to confuse or conflate the deposit with liquidated damages.

33 Where a party wishes to stipulate liquidated damages (in lieu of forfeiting a deposit and then suing for damages in the event of a breach), the party should provide for this separately, and the principles relating to penalty clauses will then apply to the liquidated damages clause (“LDC”).

A. Conceptual differences

34 The forfeiture of a deposit and a claim for liquidated damages are distinct concepts as shown below:

36 *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [14].

Table 1: Differences Between Forfeiture of a Deposit and Claim for Liquidated Damages

	Forfeiture of deposit	Claim for liquidated damages
Features	Depositor has placed a sum of money in the power and possession of the payee.	Nothing has been deposited.
Nature of sum	Earnest money.	Agreed damages.
Purpose	To guarantee the due performance of the contract. ³⁷	To avoid difficulties relating to proof of actual loss by the innocent party. ³⁸
Claim for damages?	If the payee suffers greater damages than the sum of the deposit, in the event of a breach, it may recover the shortfall by bringing a claim for damages. ³⁹	The innocent party is barred from seeking damages greater than that stipulated in the LDC. ⁴⁰
Type of right	Proprietary right. Upon breach, the deposit is transformed into the property of the payee by operation of the forfeiture clause.	Debt action. The innocent party can bring an action against the defaulting party for the sum stipulated in the LDC.
Subject to the penalty rule?	No. However, courts have held that unreasonable deposits (ie, payments that are not true deposits) will be construed as part payments. A clause providing for forfeiture of the part payment will be subject to the rule against penalties.	Yes. The liquidated damages must constitute a genuine pre-estimate of the innocent party's loss on the defaulting party's breach.

37 *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [12].

38 *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [14].

39 *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [9].

40 *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [14].

B. The rule against penalties

35 The main concern with LDCs is that courts will not enforce LDCs if these are deemed as penalty clauses. A clause for a payment of a fixed sum will be held to be a penalty if:

(a) the stipulated sum is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach; and/or

(b) the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid.⁴¹

36 There is a presumption (but no more) that a clause for a payment of a fixed sum is a penalty when a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious, and others much less or trivial, damage.⁴² The question of whether a sum payable is a penalty is a question of construction to be decided upon the terms and inherent circumstances of each contract, judged at the time of making the contract, and not at the time of breach.⁴³

37 The UK Supreme Court in *Cavendish Square Holding BV v Makdessi*⁴⁴ (“*Cavendish Square*”) recently reformulated the approach to penalty clauses in English law. While Singapore courts have declined to follow *Cavendish Square* thus far, parties should consider the possibility that the position in Singapore may change.⁴⁵ As such, parties should ensure that the LDC is likely to be enforceable even if the *Cavendish Square* test is applied, as follows:

41 *Dunlop Pneumatic Tyre Company Ltd v New Garage and Motor Company Ltd* [1915] AC 79 at 87.

42 *Dunlop Pneumatic Tyre Company Ltd v New Garage and Motor Company Ltd* [1915] AC 79 at 87.

43 *Dunlop Pneumatic Tyre Company Ltd v New Garage and Motor Company Ltd* [1915] AC 79 at 87.

44 [2016] AC 1172.

45 *Seraya Energy Pte Ltd v Denka Advantech Pte Ltd* [2019] SGHC 2 at [178].

(a) The penalty rule applies only to secondary obligations, *ie*, obligations triggered by a breach of contract. The rule does not apply to primary obligations.

(b) If the penalty rule applies, courts will consider if the consequence of a breach is out of all proportion or “unconscionable” or “extravagant”, having regard to the legitimate interests of the innocent party.

C. Combined solutions

38 In order to enjoy the benefits of both a deposit and an LDC, a seller must stipulate that the purchaser’s breach of different contractual obligations will bring different consequences, as shown below:

Table 2: Consequences of Purchaser’s Breach of Different Contractual Obligations

Possible event	Contractually-stipulated outcome	Advantages
<p>Scenario 1: The purchaser has breached a stipulated contractual obligation. The breach of this provision has been envisaged to cause moderate damage to the seller.</p>	<p>The deposit will be forfeited to the seller.</p>	<p>Presuming that the deposit is likely to constitute a “true deposit”, the seller can swiftly take possession of the reasonable deposit, while still retaining the right to bring a claim for damages and/or specific performance.</p>

<p>Scenario 2: The purchaser has breached a stipulated contractual obligation. The breach of this provision has been envisaged to cause <i>serious</i> damage to the seller.</p>	<p>An LDC will be triggered and the purchaser must pay the seller a greater sum of agreed damages. In this event, the deposit may be applied towards the liquidated damages, and the purchaser must pay the outstanding amount. If the LDC is unenforceable, only the deposit shall be forfeited to the seller.</p>	<p>If the LDC is <i>enforceable</i>, the seller can claim a sum of liquidated damages much greater than the size of the deposit, which must be reasonable as earnest money. If the LDC is <i>unenforceable</i> and the seller forfeits the deposit, then the seller shall be free to make a claim for damages in respect of the shortfall. This is consistent with the law on deposits.⁴⁶ This is also consistent with the law on LDCs, whereby if an LDC is unenforceable, the claimant will still have a measure of contractual damages that exists apart from the LDC.</p>
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39 Notably, English courts have held that a contractual stipulation of the deposit as being “as and for liquidated damages” would not deprive the sum of its “character as a deposit, an earnest of performance, which was liable to forfeiture”.⁴⁷ This makes it possible for parties to contractually stipulate that the deposit may, following different events, be either forfeited to the seller, or applied towards a larger sum of liquidated damages due to the seller.

V. Concluding remarks

40 Parties seeking the forfeiture of a deposit regardless of the seller’s loss on a purchaser’s breach must ensure that the deposit is likely to constitute a “true deposit”. Parties must also ensure that the SPA is clear on their intention for the sum to be treated as a deposit, instead of an advance or part payment. Otherwise, the

⁴⁶ *Triangle Auto Pte Ltd v Zheng Zi Construction Pte Ltd* [2000] 3 SLR(R) 594 at [9].

⁴⁷ *Union Eagle Ltd v Golden Achievement Ltd* [1997] 1 AC 514 at 518G.

recharacterisation of the deposit as a part payment may allow the deposit to be returned to the purchaser following the purchaser's own breach.

41 Given the limitations of deposits, particularly that the deposit must be “reasonable as earnest money”, parties may consider using LDCs to provide a fixed amount of damages in the event of a breach. Sellers may also contemplate the use of combined solutions that allow them to reap the benefits of both deposits and LDCs, by stipulating that a purchaser's breach of different provisions in the SPA will bring different consequences.