IN THE HIGH COURT OF THE REPUBLIC OF SINGAPORE

[2016] SGHC 144

Suit No 638 of 2015 (Registrar's Appeal Nos 276 and 277 of 2015)

Between

(1) Allplus Holdings Pte Ltd
(2) Hanabi Holdings Inc
(3) Leng Huat Private Limited
(4) Teoh Teck Shin Anson

… Plaintiffs

And

Phoon Wui Nyen (Pan Weiyuan)

… Defendant

GROUNDS OF DECISION

[Contract] — [Settlement agreement]
[Equity] — [Relief against penalties]

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Allplus Holdings Pte Ltd and others
v
Phoon Wui Nyen (Pan Weiyuan)

[2016] SGHC 144

High Court — Suit No 638 of 2015 (Registrar's Appeal Nos 276 and 277 of 2015)
Foo Tuat Yien JC
3, 30 November 2015; 29 March 2016

22 July 2016

Foo Tuat Yien JC:

Introduction

1 These appeals involved the construction of a clause in a settlement agreement entered into between Allplus Holdings Pte Ltd, Hanabi Holdings Inc, Leng Huat Private Limited, Teoh Teck Shin Anson (collectively, "the Plaintiffs"), the defendant ("Phoon") and Zenna Overseas Ltd ("Zenna"), a company incorporated in the British Virgin Islands.

2 The main issue before me was whether this clause was a penalty clause and therefore unenforceable. If so, the Plaintiffs' action against Phoon (*ie*, Suit No 638 of 2015 ("Suit 638")), which was premised upon the enforceability of this clause, should be dismissed. On 29 March 2016, I delivered oral judgment and held that the clause was a penalty clause and thus unenforceable.

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Accordingly, I dismissed the Plaintiffs' claim. The Plaintiffs have since appealed against my decision and I now set out my reasons.

Facts

Background to the settlement agreement

3 The facts were largely not in dispute. In August 2008, the Plaintiffs entered into a loan agreement with Zenna under which the Plaintiffs lent a total of $2.5m to Zenna ("the Loan Agreement"). The monies were to be injected as capital contribution into a joint venture involving a Chinese incorporated company. The Loan Agreement contemplated what was termed as a "reverse takeover exercise", under which Zenna's shares were to be acquired by a company listed on the Singapore Exchange.[1] The monies under the Loan Agreement were to be repaid either upon completion of the reverse takeover exercise or the repayment date (set on 18 August 2009), whichever was earlier. If the reverse takeover was completed before the repayment date, the monies were to be repaid without interest through the issuance of shares in the listed company. If not, the monies were to be repaid with interest at 12% per annum from the date of disbursement of the monies on 20 August 2008 to the repayment date, *ie*, 18 August 2009.[2] Phoon was the sole shareholder and director of Zenna.

4 The reverse takeover did not materialise. Zenna was therefore obliged to repay $2.5m with 12% interest per annum with effect from 20 August 2008 to the Plaintiffs. When no payment was made,[3] the Plaintiffs filed Suit No 868

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[1] Affidavit of Teoh Tech Shin Anson ("Anson's Affidavit") at p 26.

[2] *Ibid* at p 27.

[3] *Ibid* at p 70.

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of 2011 ("Suit 868") on 25 November 2011 against Zenna and Phoon. The Plaintiffs alleged that Zenna had breached the Loan Agreement[4] and/or was holding the monies disbursed under that Agreement as constructive trustee for the Plaintiffs.[5] With respect to Phoon, the Plaintiffs alleged that Phoon, the sole shareholder and director of Zenna, exerted effective and complete control over Zenna.[6] Phoon was accordingly the alter ego of Zenna and all transactions conducted by Zenna should be taken as transactions of Phoon, for which Phoon was responsible and liable in the same way as Zenna.[7] The Plaintiffs also alleged that Phoon held the monies on constructive trust for the Plaintiffs and/or that Phoon had wrongfully induced/procured Zenna to breach its obligations under the Loan Agreement.[8]

5 Zenna did not file a defence. On 1 June 2012, the Plaintiffs entered judgment in default of defence against Zenna for $2.5m with relevant interest.[9] In Phoon's Defence (Amendment No 1) filed on 1 November 2013, Phoon stated that the reverse takeover exercise had been unsuccessful because Zenna had not been able to raise the required capital contribution for the joint investment as the Plaintiffs and some others had not been able to fulfil their promised funding. Phoon denied any misappropriation or improper use of the loaned monies and averred that all loaned monies had been transferred to a designated bank account as required under the Loan Agreement. He also denied that he was the alter ego of Zenna and that he was personally liable for

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[4] *Ibid* at p 30.

[5] *Ibid* at p 33.

[6] *Ibid* at p 35.

[7] *Ibid* at p 35.

[8] *Ibid* at p 38.

[9] *Ibid* at pp 105-108.

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the amounts owed by Zenna. He averred that he did not even meet or negotiate with any of the Plaintiffs in respect of the Loan Agreement.[10]

The settlement agreement

6 On 6 June 2014, a few days before the affidavits of evidence-in-chief were due to be filed, the parties attended a full-day mediation at the Singapore Mediation Centre. The parties were all legally advised. At the conclusion of the mediation, the Plaintiffs, Zenna and Phoon entered into a settlement agreement ("the Settlement Agreement"). The terms were as follows:

SETTLEMENT AGREEMENT

SUIT NO. 868 OF 2011/C (the "Suit")

MEDIATION NO. 2083(2291)-101 OF 2014

Whereas the above suit has come up for mediation this day, the 6th June 2014, before Mr Lawrence Tan Shien-Loon and the parties having agreed to settle the above suit, a Settlement Agreement is made on the following terms:

1. The Defendants [Zenna and Phoon] shall pay the sum of Singapore Dollars One Million (S$1,000,000.00) (the "Settlement Sum") to the Plaintiffs as follows:

    (a) S$500,000.00 by way of a cheque dated 23 June 2014; and

    (b) S$500,000.00 by way of a cheque dated 5 June 2015.

2. Within 7 days of the Defendants paying the Plaintiffs the sum of Singapore Dollars Five Hundred Thousand (S$500,000.00) pursuant to paragraph 1(a) above, the Plaintiffs shall file:

    (a) Notice of Discontinuance of their claim in the above Suit against the 1st and 2nd Defendants with no order as to costs; and

    (b) Consent to Entry of Satisfaction of Judgment Debt against the 1st Defendant.

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[10] *Ibid* at p 79.

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> 3. Save in the event of any breach of this Settlement Agreement, the amount referred to in paragraph 1 herein is paid in full and final settlement of all or any claims whatsoever arising out of or in connection with the Loan Agreement relating to the loan of up to S$4,000,000 to ZENNA OVERSEAS LIMITED dated 19 August 2008 and/or the matters raised in the Suit (collectively, the "Subject Matter") and the Plaintiffs hereby waive any existing or future claims against the 1st and/or the 2nd Defendants arising out of or in connection with the Subject Matter.
>
> 4. In the event the Settlement Sum or any part thereof is not paid on or before the date stipulated in paragraph 1 above, the Settlement Sum shall be increased to the sum of S$2,500,000 along with interest accrued thereon at 12% per annum from 20 August 2008 to date of full payment (the "Aggregate Sum"). The Aggregate Sum less any amounts already paid under this Settlement Agreement, shall become jointly and severally immediately due and payable by the Defendants to the Plaintiffs and the Plaintiffs shall be entitled to forthwith file proceedings to recover the Aggregate Sum against the Defendants less any amounts paid under the Settlement Agreement.
>
> 5. Each party shall bear their own costs in this matter.
>
> Dated 6th June 2014.

Events after the conclusion of the Settlement Agreement

7 On 12 June 2014, Phoon issued two post-dated cheques. The first, for the sum of $500,000, was dated 23 June 2014, while the second, also for the sum of $500,000, was dated 5 June 2015 (pursuant to cl 1 of the Settlement Agreement ("Clause 1")).[11] The first cheque was successfully cleared for payment. The second cheque presented for payment on 5 June 2015 was dishonoured. On 8 June 2015, Phoon's solicitors wrote to the Plaintiffs' solicitors stating that Phoon had not transferred sufficient funds for payment of the second cheque due to an "inadvertent administrative oversight"[12] and

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[11] Phoon Wei Nyen's Affidavit ("Phoon's Affidavit") at p 3, para 7.

[12] *Ibid* at p 4, para 9.

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asked that the second cheque be presented for payment on or after 30 June 2015. The Plaintiffs' solicitors replied the following day that the second cheque had been dishonoured and formally demanded payment of $3,633,074.33 based on cl 4 of the Settlement Agreement ("Clause 4").

8 On 29 June 2015, Phoon's solicitors replied denying liability for the larger sum on the ground that Clause 4 was a penalty clause and unenforceable. They also said that Phoon would make payment of $500,000 on 30 June 2015. A fresh cheque dated 30 June 2015 for $500,000 was then delivered to the Plaintiffs' solicitors the following day. The Plaintiffs returned the cheque to Phoon's solicitors on 7 July 2015 and insisted that they would only accept the 30 June 2015 cheque if Phoon confirmed that the payment was made in part payment of his liability under Clause 4.[13]

9 Phoon did not accept the Plaintiffs' condition. On 8 July 2015, his solicitors informed the Plaintiffs that he was "ready, willing and able" to pay the $500,000 via the 30 June 2015 cheque.[14] On 16 July 2015, the Plaintiffs' solicitors replied that they were prepared to accept that cheque in payment of the undisputed portion of Phoon's liability, *ie*, the remaining $500,000 pursuant to Clause 1, without prejudice to their rights to proceed under Clause 4 for the full $2.5m plus interest at 12% per annum with effect from 20 August 2008, less the $1m that Phoon would have already paid.[15] The 30 June 2015 cheque was duly cleared.[16]

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[13] *Ibid* at p 5, para 14.

[14] *Ibid* at p 24.

[15] *Ibid* at pp 26-27.

[16] Anson's Affidavit at p 9, para 29.

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Plaintiffs' commencement of Suit 638

10 On 26 June 2015, the Plaintiffs commenced Suit 638 against Phoon for the sum of $3,644,252.41 based on Clause 4.[17] Zenna was not made a defendant. On 21 July 2015, Phoon filed an application under O 14 r 12 of the Rules of Court (Cap 322, R 5, 2014 Rev Ed) for the court to determine whether Clause 4 was void by reason of it being a penalty clause (Summons No 3493 of 2015 ("SUM 3493")). The Plaintiffs in turn filed an application under O 14 r 1 of the Rules of Court for summary judgment on 14 August 2015 (Summons No 3954 of 2015 ("SUM 3954")).

11 On 22 September 2015, the learned assistant registrar dismissed Phoon's application on the grounds that Phoon was estopped by representation from asserting that Clause 4 was a penalty clause, and that in any event, Clause 4 was not a penalty clause. The assistant registrar then granted summary judgment to the Plaintiffs for the sums due under Clause 4. Phoon then brought the present appeals (*ie*, Registrar's Appeal Nos 276 and 277 of 2015) against the decisions of the assistant registrar for SUM 3493 and SUM 3954 respectively.

My decision

12 In my view, Clause 4 was a penalty clause and thus unenforceable. Phoon was also not estopped from asserting that Clause 4 was extravagant or unconscionable. In the circumstances, I allowed both appeals and dismissed Suit 638.

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[17] Phoon's Affidavit at p 37.

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13 In order to fully appreciate the context of both parties' arguments, I begin by making a few observations on the nature and effect of a settlement agreement and how it interacts with the rule against penalty clauses.

The effect of a settlement agreement

14 It is clear that where parties have resolved their dispute by way of a valid settlement agreement, the settlement agreement *alone* governs the parties' legal relationship. The effect of the settlement agreement is to *put an end* to the issues previously raised by the parties save for any prior issues expressly reserved. Thenceforth, the only relevant disputes (if any) are those that arise from the settlement agreement (see *Real Estate Consortium Pte Ltd v East Coast Properties Pte Ltd and another* [2011] 2 SLR 758 ("*Real Estate Consortium*") at [53] and [58]; *Ling Yew Kong v Teo Vin Li* Richard [2014] 2 SLR 123 at [67]–[68]; and Gay *Choon Ing v Loh Sze Ti Peter* [2009] 2 SLR 332 at [54]). As a general rule, the parties to a settlement agreement cannot go back to the underlying claim and ask the court to relook the merits. The reasons for this principle were identified by Andrew Ang J in *Real Estate Consortium* at [59] as follows:

> The *raison d'etre* for this principle are manifold and may well extend to broader considerations concerning alternative dispute resolution and the efficacy of the administration of justice. There is much public interest in the final resolution of disputes; *interest reipublicae ut sit finis litium* … In a sense, parties with unresolved disputes ought to have better claim to the court's time and resources than those who have already settled their disputes in good faith. There is in addition the sound policy in holding parties to their compromised bargain to ensure commercial certainty. This consideration is especially compelling when it comes to commercial transactions involving corporate men acting with the benefit of legal advice. …

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Therefore, the relationship between the parties in the present dispute is to be governed *solely* by the Settlement Agreement and the obligations thereunder. The claims compromised by the Settlement Agreement are relevant insofar as they provide part of the context that the court should consider when construing the Settlement Agreement.

15 It is also well established that the rule against penalty clauses regulates only the remedies available for breach of a party's primary obligations, *ie*, only *secondary obligations*, and not the primary obligations themselves. The penalty rule does not apply to the latter because it is "not the proper function of the penalty rule to empower the courts to review the fairness of parties' primary obligations" (see the United Kingdom Supreme Court decision of *Cavendish Square Holding BV v Talal El Makdessi and another appeal* [2015] UKSC 67 ("*Cavendish*") at [73]). This means that in some cases, such as the present, the determination of whether a clause is a penalty clause may depend on whether the clause sets out a conditional primary obligation or a secondary obligation providing a contractual alternative to damages at law.

16 The main issues before me were thus:

(a) Was Clause 4 a primary obligation or a secondary obligation; and

(b) If Clause 4 was a secondary obligation, was it a legitimate liquidated damages clause providing for the breach of the primary obligation?

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Whether Clause 4 can be considered a primary obligation and therefore not a penalty clause

17 Phoon argued that Clause 4 was a secondary obligation because it operated only upon the failure to pay on time under Clause 1. On the other hand, the Plaintiffs contended that the Settlement Agreement was a "two-tier settlement agreement", or in other words, that Clause 1 was the primary obligation while Clause 4 was the "conditional primary obligation".[18] The first tier (*ie* the primary obligation) would be applicable if Phoon and/or Zenna satisfied the conditions in Clause 1 by paying the $1m negotiated settlement sum in two equal instalments of $500,000 each by the stipulated dates, the last of which was due on 5 June 2015.[19] If they failed to so pay, the dispute between the parties would be settled according to the second tier, *ie*, Clause 4, under which the settlement sum would be increased to $2.5m with interest at 12% per annum from 20 August 2008 until repayment less any sums already paid.[20] This, the Plaintiffs submitted, meant that Phoon and Zenna could either pay a smaller sum within the time specified in Clause 1 *or* have an extended period of time to pay the larger sum due under Clause 4.[21]

18 The distinction between a conditional primary obligation and a secondary obligation was explained by Lord Neuberger and Lord Sumption (with whom Lord Carnwath agreed) in *Cavendish* at [14]:

> … where a contract contains an obligation on one party to perform an act, and also provides that, if he does not perform it, he will pay the other party a specified sum of money, the obligation to pay the specified sum is *a secondary obligation*

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[18] Plaintiffs' Further Submissions ("PFS") at p 8, para 6.

[19] *Ibid* at p 8, para 7.

[20] *Ibid* at p 9, para 8.

[21] *Ibid* at p 10, para 13.

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> *which is capable of being a penalty*; but if the contract does not impose (expressly or impliedly) an obligation to perform the act, but simply provides that, if one party does not perform, he will pay the other party a specified sum, the obligation to pay the specified sum is *a conditional primary obligation and cannot be a penalty*. [emphasis added]

19 The distinction, it seems, lies with whether there was an obligation on a party to perform an act for which a failure to do so would trigger a further obligation to pay a specific sum of money. If there was such an obligation, then the latter obligation (to pay the sum of money) would be a secondary obligation subject to the penalty rule. In classifying the terms of an agreement for the purpose of the penalty rule, the court is to consider "the *substance of the term* and not on its form or on the label which the parties have chosen to attach to it" [emphasis added] (*Cavendish* at [15]).

20 The facts of *Cavendish* are helpful to illustrate this distinction. In *Cavendish*, one Mr Makdessi agreed to sell to Cavendish Square Holding BV a controlling stake in the holding company of the largest advertising and marketing communications group in the Middle East. The contract provided that if Mr Makdessi was in breach of certain restrictive covenants against competing activities, he would not be entitled to receive the final two instalments of the price to be paid by Cavendish (clause 5.1) and could be required to sell his shares to Cavendish at a price excluding the value of the goodwill of the business (clause 5.6). Mr Makdessi subsequently breached those covenants. He argued that the clauses were unenforceable as they were penalty clauses.

21 Lord Neuberger and Lord Sumption found that the impugned clauses were triggered by breach of contract but were not secondary obligations. The clauses were not concerned with regulating the measure of compensation for breach of the contract. While clause 5.1 had no relationship with the measure

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of the loss attributable to the breach of the restrictive covenants, Cavendish also had a legitimate interest in the observance of the restrictive covenants, in order to protect the goodwill of the group. The goodwill of the business was critical to Cavendish and the loyalty of Mr Makdessi was critical to the goodwill. The court could not assess the precise value of the obligation or determine how much less Cavendish would have paid for the business without the benefit of the restrictive covenants. The parties were the best judges of the degree to which each of the parties should recognise the proper commercial interests of the other. A similar analysis was applied to clause 5.6. That clause did not represent the estimated loss attributable to the breach. It reflected the reduced consideration which Cavendish would have been prepared to pay for the business on the hypothesis that they could not count on the loyalty of Mr Makdessi.

Clause 4 is a secondary obligation

22 Unlike *Cavendish*, the purpose of Clause 4 was not to give an accurate reflection of what the appropriate settlement sum should be; it was to state the consequence of non-compliance with Clause 1. In my judgment, Clause 4 was in substance a secondary obligation. Clause 1 clearly imposed an obligation on Phoon and Zenna to pay $1m in two instalments on the dates specified therein. It was only *in the event* that Clause 1 was not duly performed that Clause 4 would be triggered. Such a conclusion was supported by the wording of cl 3 of the Settlement Agreement ("Clause 3"), which provided that the payment of $1m would constitute full and final settlement of the *Plaintiffs'* claims "[s]ave in the event of any *breach* of this Settlement Agreement". The "breach" referred to in Clause 3 was clearly a reference to a breach of *Phoon's* obligations, which under the Settlement Agreement, were set out in Clause 1.

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Clause 1 was therefore a primary obligation, and Clause 4 stipulated the *consequence* of the *breach* of Clause 1.

23 The Plaintiffs' characterisation of the Settlement Agreement as being "two-tier" simply meant nothing more than that Clause 4 was triggered when Clause 1 was not complied with. This was not helpful to the question of whether Clause 4 was a primary or secondary obligation. It was an artificial way of characterising the Settlement Agreement. Under the alleged second tier (*ie*, Clause 4), Phoon and Zenna would be liable for the full sum of $2.5m with accrued interest at 12% per annum from 20 August 2008 if Phoon and/or Zenna were late in paying the second tranche of $500,000 by even a day (or by 25 days, as was the case here). It beggared belief that Phoon would take on Clause 4 as a primary obligation (albeit conditional upon breach of Clause 1, however small or large the breach was). It made no sense for Phoon to settle the claim under Suit 868 for the *full sum* claimed ($2.5m plus 12% per annum interest) as (a) he had denied liability for such a claim; and (b) he had, under Clause 1, already secured an agreement with the Plaintiffs that he and Zenna could pay a lower amount of $1m in two equal tranches in full settlement of all claims against them. While the Plaintiffs had secured a default judgment in Suit 868 against Zenna, they had not done so against Phoon.

24 The Plaintiffs argued that the two-tier structure of the Settlement Agreement gave Phoon more time to pay the amount due under Clause 4,[22] but that was clearly incorrect. Clause 4 provided that the sum of $2.5m with 12% per annum accrued interest would become *immediately due and payable* upon breach of Clause 1. In other words, upon failure to pay the second instalment of $500,000 by 5 June 2015, Phoon and Zenna became immediately liable for

[22] PFS at p 10, para 13.

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the sum stipulated in Clause 4. There was no extended time to pay that sum to speak of. In fact, Phoon was never liable to pay the sum of $2.5m with 12% per annum accrued interest to begin with; that liability arose *by virtue of Clause 4*. The effect of Clause 4 was plainly to make Phoon and Zenna liable for that sum if they failed to pay in accordance with Clause 1. In my view, that rendered Clause 4 a secondary obligation.

25 The Plaintiffs also submitted that they had been only prepared to discontinue their claims and file the consent to entry of satisfaction of judgment debt on the condition that their ability to pursue their full claims against Phoon was expressly preserved in some form. This resulted in the insertion of Clause 4 into the Settlement Agreement.[23] It is settled law that a party whose claim is compromised by a settlement agreement may expressly reserve its right to revive its original claim in the event of a breach of the settlement agreement (see *The "Dilmun Fulmar"* [2004] 1 SLR(R) 140 at [7] and *Woo Koon Chee v Scandinavian Boiler Service (Asia) Pte Ltd and others* [2010] 4 SLR 123 at [14]). Furthermore, a creditor of a present or existing debt (whether under a judgment debt or where liability was admitted by the debtor) who had agreed to settle for less may expressly reserve its right to revive that debt if the debtor fails to meet the conditions imposed by the creditor (see *Thompson v Hudson* (1869) 4 HL 1; *Novoship (UK) Limited and ors v Vladimir Mikhaylyuk and ors* [2015] EWHC 992 (Comm); and *O'Dea v Allstates Leasing System (WA) Pty Ltd* [1983] HCA 3). However, the Plaintiffs were not claiming to be entitled to pursue their claim against Phoon in its original form in Suit 868. Neither were the Plaintiffs claiming that there was an existing debt owed to them by Phoon and for which they had reserved their right to revive. Indeed, any such contention would have failed. Clause 4 did

[23] See PFS at p 7, para 5(r).

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not preserve the Plaintiffs' ability to pursue their claims against Phoon "in some form". It rendered Phoon liable for the sums demanded under those very claims (albeit upon the breach of Clause 1), sums which Phoon had never admitted liability for and had sought to contest by filing a substantive Defence in Suit 868.

26 Lastly, the Plaintiffs argued that Clause 4 was specifically bargained for in exchange for the Plaintiffs filing the notice of discontinuance and the consent to entry of satisfaction of judgment debt before the second tranche of $500,000 was paid by Phoon and/or Zenna (pursuant to cl 2 of the Settlement Agreement ("Clause 2")). This argument, however, does not assist the Plaintiffs. All clauses in an agreement are, in a sense, the result of a bargain. To say that Clause 4 was bargained for does not answer the question. Ultimately, whether a clause amounts to a primary or secondary obligation is to be determined by construing the agreement, taking into account both the text and the context of the agreement (see *Y.E.S. F&B Group Pte Ltd v Soup Restaurant Singapore Pte Ltd (formerly known as Soup Restaurant (Causeway Point) Pte Ltd)* [2015] 5 SLR 1187 at [2]). Considering all the circumstances of the case, I am of the view that Clause 4 is a secondary obligation.

27 I now turn to the issue of whether Clause 4 was a legitimate liquidated damages clause for the breach of Clause 1.

Whether Clause 4 was a legitimate liquidated damages clause

28 The Plaintiffs contended that Clause 4 was legitimate and was neither extravagant nor unconscionable in its operation. They had a legitimate interest in protecting and preserving their rights to proceed against Zenna and Phoon for the full value of their claims in Suit 868. In particular, they claimed that

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Zenna was already liable to the Plaintiffs for $2.5m with interest at 12% per annum pursuant to the judgment debt and that Phoon could have been potentially liable for same pursuant to the Plaintiffs' action against him in Suit 868.[24]

29 Phoon argued that Clause 4 was not a legitimate liquidated damages clause because it was not a genuine pre-estimate of the Plaintiffs' loss. To assess the Plaintiffs' loss, the court should refer to the specific breach of contract (breach of Clause 1 when Phoon made late payment of $500,000 by 25 days) and the loss resulting from the breach, and not the loss resulting from the underlying matter that had already been settled under the Settlement Agreement (*ie*, the Loan Agreement and Suit 868).[25] A genuine pre-estimate of the Plaintiffs' loss would be the interest on the sum of $500,000 at the prevailing rate, and not the sum claimed by the Plaintiffs against Phoon under Suit 868 and/or against Zenna under the default judgment.[26] Furthermore, all the Plaintiffs had against Phoon then were a claim that had yet to be adjudicated.

30 In my view, the Plaintiffs' argument failed. In *Xia Zhengyan v Geng Changqing* [2015] 3 SLR 732 ("*Xia Zhengyan*"), the Singapore Court of Appeal affirmed at [78] that the basic principles applicable to the question of whether a sum is void as being a penalty are laid down by Lord Dunedin in the House of Lords decision of *Dunlop Pneumatic Tyre Company Limited v New Garage and Motor Company Limited* [1915] AC 79 ("*Dunlop Pneumatic*"). The relevant passage (at 86–88) reads as follows:

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[24] *Ibid* at p 26, para 45.

[25] Defendant's Submissions ("DS") at p 9, paras 12-13.

[26] *Ibid* at p 15, para 24.

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1. Though the parties to a contract who use the words 'penalty' or 'liquidated damages' may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The Court must find out whether the payment stipulated is in truth a penalty or liquidated damages. This doctrine may be said to be found *passim* in nearly every case.

2. The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage (*Clydebank Engineering and Shipbuilding Co. v. Don Jose Ramos Yzquierdo y Castaneda* [[1905] AC 6]).

3. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach (*Public Works Commissioner v. Hills* [[1906] AC 368] and *Webster v. Bosanquet* [[1912] AC 394]).

4. To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are:

(a) It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach. (Illustration given by Lord Halsbury in *Clydebank Case*. [[1905] AC 6])

(b) It will be held to be a penalty if 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 (*Kemble v. Farren* [(1829) 6 Bing 141]). This though one of the most ancient instances is truly a corollary to the last test. Whether it had its historical origin in the doctrine of the common law that when A. promised to pay B. a sum of money on a certain day and did not do so, B. could only recover the sum with, in certain cases, interest, but could never recover further damages for non-timeous payment, or whether it was a survival of the time when equity reformed unconscionable bargains merely because they were unconscionable,—a subject which much exercised Jessel M.R. in *Wallis v. Smith* [(1879) 21 Ch D 243]—is probably more interesting than material.

(c) There is a presumption (but no more) that it is 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

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> others but trifling damage' (Lord Watson in *Lord Elphinstone v. Monkland Iron and Coal Co.* [(1886) 11 App Cas 332]).
>
> On the other hand:
>
> (d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties (*Clydebank Case*, Lord Halsbury [[1905] AC 6]; *Webster v. Bosanquet, Lord Mersey* [[1912] AC 394]).

31 Therefore, to ascertain if a liquidated damages clause amounted to a penalty, it must be assessed in the light of the loss that might flow from the *breach of the contract*. In this case, that would be the *breach of Clause 1*. The reference to what Phoon might potentially be liable for *prior to the settlement agreement* was irrelevant and misleading. The proper question to be asked was whether the sum payable under Clause 4 was a genuine pre-estimate of the loss that might flow from the breach of Clause 1. Phoon had breached Clause 1 by making payment of the second tranche of $500,000 late by 25 days. It could not be said that the sum of $2.5m plus 12% per annum interest as stipulated in Clause 4 was a genuine pre-estimate of the loss that could flow from that breach. The Plaintiffs had not shown any particular reason why it needed the payment on those particular dates, or any specific loss that might flow from late payment (other than the usual interest and/or costs of recovery). In my view, Clause 4 fell squarely within the situation identified by Lord Dunedin ([4(b)] in the passage from *Dunlop Pneumatic* set out at [30] above), *viz*, that "[i]t will be held to be a penalty if 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".

32 The "loss" which the Plaintiffs relied on, *ie*, the sums due to them under the default judgment against Zenna and any sums they could have

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potentially obtained from Phoon could not be linked to Phoon's delay in tendering the second payment of $500,000 on 30 June 2015 instead of 5 June 2015. That "loss" had occurred the moment Phoon paid the first $500,000 on 23 June 2014 and the Plaintiffs filed the notice of discontinuance relating to Phoon and the consent to entry of satisfaction of judgment debt relating to Zenna. While the Plaintiffs had obtained default judgment against Zenna (a BVI registered company without substantial assets in Singapore) for the sum of $2.5m with interest at 12% per annum, no such judgment had been obtained *against Phoon* at the time of the Settlement Agreement. Phoon may have been Zenna's sole shareholder and director, but the fact remained that Phoon and Zenna were separate legal entities (unless proven otherwise, which the Plaintiffs had not). It was also not in dispute that Phoon had not admitted (either expressly or impliedly) any liability to the Plaintiffs in relation to: (a) the Loan Agreement; or (b) Suit 868, which had been discontinued against him.

33 I note that the decision of *Cavendish* has redefined the test for penalties since *Dunlop Pneumatic*. However, *Cavendish* has yet to be considered by the Singapore Court of Appeal. At the time I gave my decision, the law in Singapore in relation to when a clause amounts to a penalty remained that in *Xia Zhengyan*, and accordingly, *Dunlop Pneumatic*. I note that George Wei J in the recent Singapore High Court decision of *iTronic Holdings Pte Ltd v Tan Swee Leon and another suit* [2016] SGHC 77 ("*iTronic Holdings*") had considered the redefined test for penalties in *Cavendish*. Wei J, however, did not come to a conclusion on whether that test applied in Singapore. Furthermore, *iTronic Holdings* was decided on 21 April 2016, *after* I gave my oral judgment on 29 March 2016. In any event, it was said in *Cavendish* (at [32]) that Lord Dunedin's four tests in *Dunlop Pneumatic* would be adequate

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and applicable in cases involving straightforward damages clauses. I was of the view that the present case was such a case and I therefore proceeded on the tests as set out in *Dunlop Pneumatic*.

34 For completeness, I also considered whether a different result would be reached on the redefined test in *Cavendish*. Lord Neuberger and Lord Sumption stated that the "true test" was "whether the impugned provision is a secondary obligation that imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation" (at [32]). Lord Hodge proposed a slightly different formulation at [255], effectively asking whether the remedy was "exorbitant or unconscionable" having regard to the interest of the innocent party in the performance of the contract.

35 With respect, even if I applied the test expounded by Lord Neuberger and Lord Sumption (or that of Lord Hodge) in *Cavendish*, the answer remained the same. Clause 4, which made Phoon and Zenna liable to pay $2.5m with interest at 12% per annum, was clearly out of all proportion to any legitimate interest that the Plaintiffs might have in upholding the timely payment of the settlement sum of $1m. Clause 4 *might have been* acceptable if it simply made Phoon and Zenna liable to pay *interest* that accrued upon the outstanding sum. An increase of the *settlement sum* from $1m to $2.5m with inclusion of backdated interest at 12% per annum was simply out of all proportion to the Plaintiffs' legitimate interest in "the enforcement of the primary obligation", *ie,* timely payment under Clause 1. The sum was therefore plainly exorbitant and unconscionable even if the Plaintiffs' interest in the performance of the Settlement Agreement was taken into account.

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The relevance of the parties having the benefit of legal advice

36 I now deal with a separate argument raised by the Plaintiffs. The Plaintiffs argued that Clause 4 did not fall foul of the rule against penalty clauses because it was the result of the parties' agreement after extensive negotiation and with legal advice. Both parties had taken into account the litigation and other risks they faced and had willingly entered into the Settlement Agreement, which included Clause 4.

37 No authority was cited for the proposition that the rule against penalties did not apply to contracts negotiated with the benefit of advice. Indeed, a secondary obligation which was not a genuine pre-estimate of the loss or, in the words of Lord Neuberger and Lord Sumption in *Cavendish* at [32], which imposes a detriment on the contract-breaker that is out of all proportion to any legitimate interest of the innocent party in the enforcement of that primary obligation, would be contrary to public policy and unenforceable, *no matter how freely or willingly entered into* at the time of contracting. The penalty rule is by its very nature an interference with freedom of contract (see *Cavendish* at [33]). If Clause 4 was void as a penalty clause, then the fact that the parties were legally advised could not, logically speaking, change that.

38 In *Cavendish*, Lord Neuberger and Lord Sumption noted at [34] that while the rule against penalties originated in the concern of the courts to prevent exploitation in an age when credit was scarce and borrowers were particularly vulnerable, the modern rule is "substantive, not procedural". Its operation does not normally depend on a finding that advantage was taken of one party. The learned law lords went on to state, however, as follows (at [35]):

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> But for all that, the circumstances in which the contract was made are not entirely irrelevant. In a negotiated contract between properly advised parties of comparable bargaining power, the *strong initial presumption* must be that the parties themselves are the *best judges of what is legitimate* in a provision dealing with the *consequences of breach*. … [emphasis added]

39 Notwithstanding the above statement in *Cavendish*, I was of the view that Clause 4 was a penalty clause. To begin with, at the time I rendered my oral judgment (*ie*, 29 March 2016), there did not appear to be a similar presumption in Singapore based on existing case law. Even if such a presumption exists, it remains no more than a "strong initial presumption". In other words, the court will give deference to the parties' agreement in respect of the quantum of liquidated damages that should be payable on the breach of a contract. However, as Blair J observed in *Azimuti-Benetti SpA v Darrel Marcus Healey* [2010] EWHC 2234 (Comm) at [21]:

> At least in connection with commercial contracts, great caution should be extended before striking down a clause as penal (*Murray v Leisureplay* at [114] Buxton LJ), *though the circumspection that the courts show before striking down a clause when the parties are of equal bargaining power does not displace the rule that the clause must be a genuine pre-estimate of damage* (*Langsat Shipping Co Ltd v Glencore Grain BV* [2009] 2 CLC 465 at [33], Lord Clarke MR). [emphasis added]

In my view, any such presumption (that Clause 4 was a legitimate liquidated damages clause) was clearly rebutted in this case. The sum payable under Clause 4, *ie*, $2.5m with backdated interest at 12% per annum, could not possibly be considered a legitimate sum to pay for Phoon's failure to pay $500,000 on time. I therefore found that Clause 4 was a penalty clause and unenforceable.

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40 I now turn to the remaining issue of whether Phoon was estopped from arguing that Clause 4 did not protect a legitimate interest or was extravagant or unconscionable.

Whether Phoon is estopped from arguing that Clause 4 was "extravagant and unconscionable"

41 The Plaintiffs argued, before the assistant registrar and initially before me, that Phoon was estopped from asserting that Clause 4 was a penalty clause and therefore unenforceable. The assistant registrar agreed, this being his primary basis for deciding in favour of the Plaintiffs. During the hearing before me, the Plaintiffs conceded that they would not, as a matter of public policy, be able to assert that Phoon was estopped by representation from raising the rule against penalty clauses if Clause 4 was indeed a penalty clause.

42 Instead, the Plaintiffs submitted that Phoon was estopped from arguing that Clause 4 did not protect a legitimate interest or was extravagant or unconscionable because the Plaintiffs had acted to their detriment by filing the notice of discontinuance and the consent to entry of satisfaction of judgment debt in reliance of Phoon's representation that he would comply with the obligations in the Settlement Agreement.[27] Phoon had obtained the benefit of those filings because he had wanted the action against himself to be discontinued and the consent to entry of satisfaction of default judgment against Zenna to be filed so that he could carry on his business deals and secure financing. It must be noted that these reasons are not exceptional reasons in the business community, where the need for financing is not uncommon. I was unable to agree with the Plaintiffs' submission. They had not identified a representation of fact by Phoon which could form the basis of

[27] *Ibid* at p 31, para 57.

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the estoppel. A representation by a party to a mediated agreement "to abide by any settlement and to effect the terms thereof reached through the mediation"[28] was not a representation of fact but was, at best, a representation of future intention – that Phoon would comply with the terms of the settlement if one was concluded at mediation. An argument that Phoon had represented that he would not contest the validity of Clause 4 because he had agreed to the terms of the Settlement Agreement could not be correct; that would mean that no contracting party would be able to dispute the validity of the terms in their agreement.

Conclusion

43 In the circumstances, I allowed Phoon's appeals. Given that the Plaintiffs' claim in Suit 638 was premised on the enforceability of Clause 4, I also dismissed Suit 868 pursuant to O 14 r 12(2) of the Rules of Court.

44 After hearing the parties' submissions on costs, I made the following costs orders:

(a) Costs of $15,000 for the hearing below plus reasonable disbursements to be paid by the Plaintiffs to Phoon.

(b) Costs of $15,000 for the appeal plus reasonable disbursements to be paid by the Plaintiffs to Phoon.

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[28] Anson's Affidavit at p 110.

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Foo Tuat Yien
Judicial Commissioner

Chacko Samuel and Yeo Teng Yung Christopher (Legis Point LLC) for the plaintiffs;
See Chern Yang and Joanna Chew (Premier Law LLC) for the defendant.

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