BANKING FOCUS

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1 OF 5 INSIGHTS

Crystallisation of Floating Charge by Operation of Law: Malayan Banking Bhd v Bakri Navigation Co Ltd and another

A floating charge is a form of security that allows a lender to take security over the whole of a company's assets and undertaking while at the same time allowing the company to carry on its business with limited restrictions. It is an accepted legal principle that a floating charge will crystallise (convert) into a fixed charge if certain events occur. Such events may be grouped under two categories: (i) crystallisation events by operation of law, which are events (such as winding up) the occurrence of which are incompatible with the continuance of trading by the company as a going concern; and (ii) crystallisation events by operation of express terms, which are events expressly agreed between the parties that would trigger the crystallisation of a floating charge.

In Malayan Banking Bhd v Bakri Navigation Co Ltd and Another[1], the Court of Appeal was asked to decide on whether dealing with an asset subject to a floating charge outside the ordinary course of business crystallises the floating charge by operation of law?

Facts of the Case

Malayan Banking Berhad (**"Maybank"**) is a bank incorporated in Malaysia. Maybank granted credit facilities to NGV Tech Sdn Bhd (**"NGV Tech"**) between 2004 and 2012 for the purpose of its ordinary business, which was to build vessels for sale at its shipyard in Malaysia.

The credit facilities were supported by six debentures executed by NGV Tech in favour of Maybank. Under the terms of each debenture, NGV Tech created a floating charge in favour of Maybank over all its movable and immovable property and other assets. The debenture provided that the floating charge would crystallise: (i) upon Maybank giving written notice to that effect to NGV Tech; and (ii) *automatically* if NGV Tech "'encumbered"' in favour of a third party any property which was subject to the floating charge.

As each debenture was governed under Malaysian law, the parties agreed in the court below to proceed on the basis that the court would be able to refer to cases from Singapore, Malaysia and other commonwealth jurisdictions to determine any question of Malaysian law in respect of these debenture.

NGV Tech subsequently entered into a shipbuilding contract with Bakri Navigation Company Ltd (**"Bakri"**) to build Hull 1118 (**"Ship"**). The shipbuilding contract was novated by Bakri to Red Sea Marine Services Ltd (**"Red Sea"**) in December 2007. Bakri (the first respondent) and Red Sea (the second respondent) are part of the Bakri group. Bakri owns and operates ships, while Red Sea manages ships.

Unknown to Maybank, NGV Tech and Red Sea entered into the following series of transactions between 2009 and 2012 (collectively, **"Unauthorised Transactions"**):

- Reduction in the purchase price of the Ship under an agreement between NGV Tech and Red Sea for NGV Tech's delay in delivering other vessels to Bakri while continuing to ask Maybank for extensions of the credit facilities based on the Ship's purchase price.

[1] [2020] SGCA 41.

- Appointment of an agent by NGV Tech to, among others, take over constriction of the Ship and deliver tile and possession of the Ship to Red Sea.

- Debt set-off arising from payment made directly by Red Sea to NGV Tech's subcontractor for completing construction of the Ship against the Ship's purchase price such that Red Sea was entitled to take delivery of the Ship without payment being made to NGV Tech.

- Transfer of legal title to the Ship under construction to Red Sea under a completion agreement between NGV Tech and Red Sea and the subsequent registration of the Ship by Red Sea under its name at the ship registry at the Grendines.

When NGV Tech defaulted on its repayment obligations to Maybank, Maybank enforced the debenture and subsequently commenced an action in the High Court against the defendants. Before the court, Maybank claimed that it had an interest in the Ship as holder of a fixed and floating charge under the debenture. The floating charge crystallised over the Ship upon the occurrence of the Unauthorised Transactions that Maybank claimed were outside the ordinary course of business. The court rejected Maybank's claims. Maybank appealed the court's decision before the Court of Appeal.

Judgements of the Singapore Court of Appeal

In considering Maybanks' arguments that dealings outside of the ordinary course of business crystallise a floating charge as a matter of law, the court accepted that there is a category of events the occurrence of which are incompatible with the continuance of trading by the company as a going concern. Such a category is known as "crystallisation as a matter of law".

Under such a category, there are two types of events attributable to cessation of trading as a going concern that can bring about "crystallisation as a matter of law". These events are: (i) winding up; and (ii) cessation of trading as a going concern. Accordingly, the court rejected Maybank's arguments that dealing outside of the ordinary course of the chargor's business crystallises a floating charge as a matter of law.

Having rejected Maybank's argument, the court went to consider when dealings may be said to be outside the ordinary course of business. According to the court, the expression "dealings in the ordinary course of business" has two usage: (a) dealings with a view to trading as a going concern; and (b) dealings not amounting to a cessation of business. The court took the view that only dealings other than with a view to carrying on the company's business is a crystallising event. The court concluded that the Unauthorised Transactions did not fall outside the ordinary course of NGV Tech's business as they were effected in the course of NGV Tech's business. But the court commented that the threshold for establishing whether a dealing is outside the ordinary course of business is a high one.

Comments

The decision clarifies the position that crystallisation of a floating charge by operation of law is confined to only two limited circumstances. These circumstances do not extend to business dealings outside the ordinary course of business.

Where lenders take floating charge as a form of security, they need to be aware that mere dealing of an asset outside the ordinary course of business does not crystallise the floating charge unless such dealing amounts to a cessation of business.

However, it is open to lenders to prescribe expressly in a security document that a floating charge will crystallise automatically upon the occurrence of certain types of events. Such automatic crystallisation clauses are valid under Singapore and Malaysian law. But the High Court judge cautioned against giving "automatic crystallisation clauses a lavish interpretation".

Challenging Authenticity of Original Financing Document: CIMB Bank Bhd v World Fuel Services (Singapore) Pte Ltd

In CIMB Bank Berhad v World Fuel Services (Singapore) Pte Ltd[1], the High Court had to decide on a claim by the defendant that the debenture entered into by the parties was not authentic.

Facts of the Case

CIMB Bank Berhad (**"CIMB"**) is a bank incorporated in Malaysia. CIMB granted credit facility to Panoil Petroleum Pte Ltd (**"Panoil"**) sometime in June 2016. The credit facility was purportedly secured by an all monies limited debenture over all the goods and/or the receivables and documents representing the goods financed by CIMB, including payments under the invoices issued by Panoil to World Fuel Services (Singapore) Pte Ltd (**"World Fuel"**) (the defendant) pursuant to various sale transactions. The debenture was purportedly executed by two directors on behalf of Panoil.

CIMB served a notice of assignment of its rights under the debenture on Word Fuel sometime in August 2017, and subsequently enforced its rights as legal assignee under the debenture against World Fuel sometime in February 2018. One of the issues canvassed before the High Court was whether CIMB had proven the authenticity of the debenture. As CIMB had failed to prove that the debenture was authentic, the court dismissed CIMB's claim to enforce the debenture.

Judgements of the Singapore High Court

The court articulated that under the general principles relating to the proof of documents, a party is legally entitled to object to the authenticity of documents and to insist that the documents be admitted according to the proper rules of evidence. Even where primary evidence of a document (i.e. the original) is produced, its authenticity may be in issue. The burden rests on CIMB to prove the authenticity of the two signatures on the debenture. While CIMB had produced the original debenture, it failed to call the two directors of Panoil as witnesses. In the court's view, CIMB cannot prove the signatures' authenticity by merely producing the original debenture. It must adduce evidence to prove that the signatures on the debenture did in fact belong to the two directors of Panoil if insisted to do so by World Fuel.

The court also noted in its findings that:

- CIMB had produced the original debenture for World Fuel's inspection one day before trial.

- The debenture produced at trial appears on the face of the document to be a draft and cited examples in support of its observations: certain optional phrase has not been deleted in accordance with the terms of the debenture; the solicitor's attestation clause was incomplete with missing lawyer's name and certain key details such as the date of affixation of the common seal of Panoil.

Comments

This case serves as a useful reminder to lenders that the authenticity of original financing documents can be challenged even if they have been tendered in court, particularly in circumstances (as illustrated in this case) where there is doubt as to the authenticity of the signature or where certain key information (such as the date on which the common seal was affixed) has been left blank on the original document suggesting that it was only a draft.

With measures introduced to combat the spread of COVID-19, the way in which financing documents are executed under normal circumstances have been complicated by signatories having to work from home. Such measures have resulted in transaction parties signing documents "virtually" or using electronic platforms for signing documents (such as DocuSign).

Whatever the method adopted to execute a document, Lenders must be aware of the precise formalities for execution of a document as a simple contract or as a deed and observe strictly with the formalities for execution of a document (as a contract or deed). Failure to execute contracts properly (especially if it is in deed form) may result in the contracts being challenged in court, as illustrated in this case.

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[1] [2020] SGHC 117.

MAS Proposing to Regulate Singapore-based Digital Token Service Providers under a New Omnibus Act

On 21 July 2020, the Monetary Authority of Singapore (MAS) published a consultation paper to obtain feedback on its proposal to introduce a new omnibus act for the financial sector. The consultation paper has closed on 20 August 2020. But the timeline for implementation of the proposed has not been determined.

The proposed act will be a standalone legislative framework to regulate the financial sector by giving MAS expanded powers to address the emerging risks and challenges that impact the financial sector. Under the proposed act, a new licensing framework will be introduced to regulate Singapore-based digital taken service providers servicing customers overseas.

Under the proposed act, digital token will be defined as:

- a digital payment token (as defined in the Payment Services Act 2019 (Act 2 of 2019); or

- a digital representation of a capital markets product (as defined in the Securities and Futures Act (Cap. 289) which (i) can be transferred, stored or traded electronically; and (ii) satisfies such other characteristics as MAS may prescribe.

The types of digital token services that will be regulated under the proposed act are:

- Dealing in digital tokens.

- Facilitating the exchange of digital tokens.

- Inducing or attempting to induce any person to enter into or to offer to enter into any agreement for or with a view to buying or selling any digital tokens in exchange for any money or any other digital tokens (whether of the same or a different type).

- Accepting digital tokens for the purposes of transferring, or arranging for the transfer of, the digital tokens or arranging for the transmission of digital tokens (where the service provider does not come into possession of the digital tokens).

- Safeguarding or administration of a digital token or digital token instrument, where the service provider has control over the digital tokens or the digital token associated with the digital token instrument.

- Providing advisory services relating to the offer or sale of digital tokens.

Digital token service providers offering any of the services prescribed under the proposed act will be required to be licensed and regulated for anti-money laundering and countering of financing of terrorism risks. The licensing and ongoing requirements for digital token service providers include appointing at least one executive director resident in Singapore, incorporating a Singapore company, having a permanent place of business, and complying with financial requirements prescribed by MAS. Unless exclusions apply, existing MAS-regulated financial institutions incorporated in Singapore providing digital token services outside of Singapore will have to be licensed under the proposed act.

Sustainability Linked Lending

Sustainable finance is gaining attraction globally. According to Bloomberg data, the volume of sustainable debt issued in 2019 was US$465 billion globally. Sustainable debt covers a variety of instruments, from green bonds to the fast-emerging category of sustainability-linked loans.

There is currently no single, agreed definition of what constitutes sustainable finance in the market. The ICMA[1] has recently defined sustainable finance as incorporating climate, green and social finance while also adding wider considerations concerning the longer-term economic sustainability of the organisations that are being funded, as well as the role and stability of the overall financial system in which they operate.

In March 2019, LMA[2], APLMA[3] and LSTA[4] published the Sustainability Linked Loan Principles ("**SLLP**") in response to initiatives to facilitate and support sustainable finance. A guidance notes on the SLLP ("**SLLP Guidance Note**") was subsequently published in May 2020 to provide market participants with clarity on their application and promote a harmonised approach.

The SLLP set out voluntary guidelines aimed at enabling market participants to identify and understand the key characteristics of sustainability-linked loans in terms of:

- The communication between the borrower and the lender in relation to the overall sustainability strategy of the borrower.

- The target set by the borrower and lender to measure the sustainability of the borrower.

- The information shared by the borrower with the lender of its progress against sustainability performance targets.

- The external review of the borrower's performance against its sustainability performance targets.

A Sustainability Linked Loan as defined by the SSLP is "any types of loan instruments and/or contingent facilities (such as bonding lines, guarantee lines or letters of credit)" which incentives incentivise the borrower's achievement of "predetermined sustainability performance objectives" measured against objectives specific sustainability performance targets such as key performance indicators, external ratings, or other metrics which measure improvements.

Sustainability linked loans enable lenders to incentivise improvements in the borrower's sustainability profile. They do this by aligning the terms of the loan (for example, pricing) to the borrower's performance against sustainability performance targets (for example, improvements in the energy-efficiency rating of buildings). The advantages of entering into a sustainability-linked loan include positive impact on reputation and credibility and promotion on sustainable long-term growth and profitability. With MAS taking active steps to make sustainable financing a defining feature of Singapore's role as an international financial centre, the publication of the SLLP and the Guidance Note is a positive move for development of sustainable finance.

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[1] International Capital Market Association.
[2] Loan Market Association.
[3] Asia Pacific Loan Market Association.
[4] Loan Syndications and Trading Association.

SORA as the New Interest Rate Benchmark

SOR[1] and SIBOR[2] have served as the key interest rate benchmarks in Singapore Dollar financial market for decades. SOR is used in pricing bonds and institutional loans with hedging requirements. SIBOR is commonly used in housing, commercial and syndicated loans, trade financing, and working capital financing.

Following initiatives undertaken globally by central banks and regulatory authorities to reform interest rate benchmarks, the financial industry embarked on a similar exercise and subsequently recommended a transition from SOR to SORA[3]. It is expected that SOR will be discontinued together with the USD LIBOR benchmark after end-2021. A recent consultation report[4] is also recommending discontinuing SIBOR in three to four years and using SORA as the main interest rate benchmark for Singapore's financial markets.

In support of the use of SORA, MAS recently announced several key initiatives to support the adoption of SORA. Such initiatives include prescribing SORA as a financial benchmark under the Securities and Futures Act to safeguard the integrity of SORA and issuing a Statement of Compliance with the IOSCO Principles for Financial Benchmarks for SORA to create market confidence in the use of SORA by both domestic and international market participants.

SORA is administered by MAS since 2005. It is determined entirely from overnight transactions in the unsecured interbank market. With the adoption of a SORA-centred approach for Singapore's interest rate markets, both banks and borrowers will benefit from such adoption. For banks, the basis risk between assets and liabilities based on two different benchmarks is minimised and allows for more greater pricing efficiencies. For borrowers, the averaging effect of compounded SORA rates would result in more stable rates as compared to forward-looking term rates, which are exposed to idiosyncratic market factors.

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[1] Swap Offer Rate.
[2] Singapore Interbank Offered Rate.
[3] Singapore Overnight Rate Average.
[4] The report was issued by the Association of Banks in Singapore, Singapore Foreign Exchange Market Committee, and Steering Committee for SOR Transition to SORA.