

# Crystallising the floating charge to preserve your clear interest – Looking beyond the crystal ball

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## Introduction

In *Jurong Aromatics Corp Pte Ltd (receivers and managers appointed) and others v BP Singapore Pte Ltd and another matter* [2018] SGHC 215, the Singapore High Court considered the effect of a no-assignment clause and a no-charging clause (in a contract between a chargor and a third party) on a pre-existing fixed charge and/or crystallised floating charge over the chargor's assets, and how this affected the chargee's (usually, a lender's) rights in an insolvency setoff situation.

We will first summarise the key points arising from the High Court's decision and then discuss why it is important for debenture holders, usually lenders, to regularly assess whether their right to crystallise their floating charges has arisen (or indeed has crystallised).

## Relevant Facts

Jurong Aromatics Corp Pte Ltd (JAC) entered into various feedstock supply agreements and product offtake agreements with Glencore Singapore Pte Ltd and BP Singapore Pte Ltd (collectively, the Defendants), whereby JAC would purchase condensate from the Defendants, process them and then sell the processed output to the Defendants. Under this contractual arrangement, debts became due and owing both ways; from JAC to the Defendants, and from the Defendants to JAC.

JAC subsequently obtained a loan from a loan syndicate (the Senior Lenders), secured by a first fixed charge and first floating charge over all of JAC's assets, including its present and future receivables. The debts owed by the Defendants to JAC clearly fell within the scope of the Senior Lenders' floating charge. JAC also assigned to the Senior Lenders all its receivables that it was entitled to receive from the Defendants under the feedstock supply agreements and product offtake agreements.

After JAC ran into financial difficulties, the Senior Lenders appointed receivers and managers (R&Ms) over all of JAC's assets and the Senior Lenders' floating charge over all of JAC's assets was crystallised. Thereafter, JAC entered into further agreements with the Defendants which contained the relevant no-assignment clause prohibiting JAC from, amongst other things, assigning its rights under these agreements without the prior written consent of the Defendants. Under these agreements, the Defendants' debts owed to JAC also fell within the scope of the Senior Lenders' (crystallised) floating charge as JAC's receivables.

JAC and the R&Ms (the Plaintiffs) sought payment of the Defendants' debts. The Defendants resisted on the basis that they were entitled to set off their debts to JAC against the debts owed by JAC to them by way of insolvency setoff and/or equitable setoff. Given the impasse, the Plaintiffs sought a declaration from the High Court that the

Defendants were not entitled to set off JAC's debts from the Defendants' debts.

## Decision

The High Court agreed that the Defendants were not entitled to set off their debts against the debts owed by JAC to them by way of insolvency setoff or equitable setoff.

On insolvency setoff, the High Court held that one of the key elements to establish insolvency setoff was not satisfied, i.e. there was no mutuality between the debts sought to be set off. To satisfy the requirement of mutuality, there must be identity between the holder of the beneficial interest in the claim and the person against whom the cross-claim is asserted. The reasoning of the High Court in coming to its decision is important:

- a. a charge on an asset is not an assignment of the asset; it is instead an encumbrance on the full equitable ownership of the asset which does not require a transfer of the ownership, whereas an assignment involves a transfer of ownership or an interest, or some part of it. As the Defendants' no-assignment clause did not expressly include a prohibition against charging, the clause did not extend to prohibit JAC from creating over a charge over its assets;
- b. if a debenture holder's fixed charge or floating charge is expressed to cover future receivables, these receivables become subject to the debenture holder's fixed charge and/or crystallised floating charge as soon as they arise. A third party dealing with the debtor cannot simply invoke a contractual clause to prohibit the debenture holder's pre-existing charge from operating on the receivables. Therefore, even if the Defendants' no-assignment clause did extend to prohibit charging, it could not affect the Senior Lenders' fixed charge and crystallised floating charge which had already attached on JAC's receivables prior to the clause coming into effect. The Senior Lenders already acquired an equitable interest in JAC's receivables by reason of the crystallisation of the floating charge before the no-assignment clause came into existence;
- c. nevertheless, a charged asset may cease to be subject to the charge, e.g. the debenture holder may agree to release the charged assets, waive its rights to the charged assets, be estopped from asserting its rights to the charge assets, or where there is a decrystallisation of the crystallised floating charge. On the facts, none of these exceptions applied;
- d. furthermore, in addition to their interests under the charge, the Senior Lenders also already acquired an interest in the receivables pursuant to JAC's assignment of receivables to them before the no-assignment clause came into effect;
- e. given that the Defendants' claims were against JAC qua the company, but the holder of the equitable interest in the Plaintiff's claims were the Senior Lenders and not JAC, there was therefore no mutuality between the parties' claims and the Defendants were not entitled to assert insolvency setoff against the Plaintiff's claims.

On the point of equitable setoff, the High Court held that insolvency setoff did not bar the application of equitable setoff as a matter of principle. Equitable setoff applies where there is a close relationship or connection between the dealings and the transactions which give rise to the respective claims, such that it would offend one's sense of fairness or justice to allow one claim to be enforced without regard to the other. However, on the facts, equitable setoff did not apply because the parties' cross-claims against each other did not bear a close connection.

## Practical implications, generally

Contracting parties must now bear in mind that if they wish to prohibit their counterparties from charging their own assets, they must use clear and express words to that effect in their contracts. A no-assignment clause prohibiting assignment per se is not sufficient. In the discussions that follow below, the term "no-charging clause" below will refer to a clause which specifically prohibits charging of assets, or in any way creating a charge, security interest and/or

any encumbrances over such assets.

## Practical implications for debenture holders with fixed and floating charges

Debenture holders may now be more assured that once they obtain a fixed charge over the chargor's assets and/or their existing floating charge crystallises and attaches on the chargor's assets, their equitable interests in the charge(s) are generally not affected in the event that the chargor subsequently agrees with a third party not to assign or create a charge over its assets.

As demonstrated in this case, the timing of the crystallisation of an existing floating charge can be critical in determining whether the debenture holder's claims are affected by a no-charging clause.

In the banking context:

- a. It is common for lenders to include in their debentures (or security deeds) a power to crystallise their floating charges upon the occurrence of specified events. Such events usually relate to situations whereby the bank is aware or has reason to believe that a chargor is in financial distress, and/or which puts the chargor's assets subject to a floating charge at risk of being used by the chargor to satisfy its debts to other creditors, or to be used as collateral to obtain a loan from another bank to try to revitalise its business.
- b. It is also common for lending facilities to prescribe an obligation on borrowers to provide at regular intervals timely financial information about themselves, including financial ratios. The facility terms also usually empower the lenders to obtain relevant documents on request.
- c. It is therefore important that lenders request and/or review this information timeously so that they can decide whether they can, and if so, should, crystallise their floating charge to best preserve their security interest in the security provided because the borrower is usually free to sell, assign or otherwise dispose of the assets in the ordinary course of business as long as the floating charge has not crystallised.

This case is a timely reminder. While the oil and marine sector may be seeing the light after years of difficulty and oil prices are relatively high, the construction sector is experiencing a turn for the worst after many quarters of low margins and an increasingly competitive environment. According to The Business Times on 11 October 2018, at least 20 construction and engineering firms were involved in winding up applications in the third quarter of 2018 alone.

Lenders must also be careful after the crystallisation of the floating charge. As the High Court had recognised in this case, a charge may cease to operate if the chargor is able to show one or more of the classic situations of waiver, estoppel, or decrystallisation (if the charge is a crystallised floating charge). These may be shown if the chargee has agreed or represented that it will not assert its equitable interest in the charged assets. Outside of these three classic situations, the chargee's equitable interest may also be defeated if the charged assets are sold to a bona fide purchaser for value without notice of the charge.

Lastly, the High Court appears to leave open the possibility that a chargor may use very clear exclusionary words in a no-assignment or no-charging clause (in a contract with a third party) to prevent a chargee's crystallised floating charge (and/or its pre-existing fixed charge) from affixing onto the chargor's future receivables. It is unclear whether the Court will give full effect to such a clause when one considers that as soon as the receivables arise, they are immediately subject to the chargee's crystallised floating charge or fixed charge, as the High Court held in this case. Therefore, regardless of how unambiguous a no-assignment or no-charging clause may be drafted to prevent the operation of a crystallised floating charge and/or pre-existing fixed charge, and leaving aside for the moment any issues of tracing and following (from receivables to proceeds), it remains to be seen how the Singapore court will

decide this specific issue in the future.

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## Your Key Contacts



**Kia Jeng Koh**

Senior Partner, Singapore

D +65 6885 3698

[kiajeng.koh@dentons.com](mailto:kiajeng.koh@dentons.com)