

Legal Update
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NEGATIVE PLEDGE CLAUSE IN SINGAPORE

I. Introduction

This article seeks to explain the effect of a negative pledge clause (“NPC”) and how parties may be affected by it. Part II considers the two types of NPCs in general and how they affect the borrower differently. Part III analyses the requirement to seek consent as a waiver to NPC. Lastly, Part IV examines the Court’s deliberation on tortious interference with NPC set out in *DBS Bank Ltd v Tam Chee Chong and another (judicial managers of Jurong Hi-Tech Industries Pte Ltd (under judicial management))* [2011] SGCA 47.^[1]

II. Negative Pledge Clause

An NPC is a common covenant found in loan agreements. It is an undertaking by the borrower to its lender to not create subsequent security interest of the encumbered asset to other lenders.^[2] The purpose is to preserve the asset by keeping it free from encumbrance by a later perfecting secured party so that the asset would be fully available to the negative pledgee in the event of a default. ^[3]

A common example would be:

“You shall not create any security interest over any of the mortgaged/said Property without our prior written consent.” (“Type 1 NPC”)

Depending on how the NPC is drafted, it may include a specific asset or all the borrower's assets. An NPC that includes all the borrower's assets may look like:

"You shall not create any security interest in respect of any of your present or future properties and assets without our prior written consent." ("Type 2 NPC")

Here, the NPC restricts the borrower from creating any subsequent security interest over all its current and future assets. In comparison, the Type 1 NPC allows the borrower to create security interest in any other assets or property belonging to the borrower so long as no subsequent interest is created in respect of the relevant asset or property pledged to the prior lender.

Importantly, NPCs can be waived if the prior lender gives written consent prior to the borrower to create subsequent interest over its assets. The rest of this article will elaborate on when consent is necessary and the possible consequence for the prior lender if consent is not obtained by the borrower.

III. Consent

Where the NPC contained in the prior lender's security document is a Type 1 NPC, consent from the prior lender would only be required when the borrower intends to pledge to the subsequent lender the same asset it has pledged to the prior lender. Where the NPC contained in the prior lender's security document is a Type 2 NPC, the borrower is required to obtain written consent from the prior lender so long as it intends to create further security over any of its assets or property. The requirement for consent accords the lender knowledge of the intended subsequent creation of security by the borrower in favour of other lenders and the discretion by the prior lender over whether to grant consent.^[4] In practice, consent is usually granted by the prior lender, subject to the possible review of the new security documents to be given by the borrower to the subsequent lenders and the internal policies and possible risk assessment of the prior lenders. Where there are multiple prior lenders, it would be necessary to obtain consent from all the prior lenders.

In some circumstances, where consent from the prior lenders is not forthcoming, especially so where the prior lender may be a foreign financial institution and do not practise providing such consents to the borrower, it would pose a commercial challenge to the borrower and the subsequent lender. Accordingly, without consent, the borrower will be in breach of the contractual promise. Additionally, the subsequent lenders may run the risk of being found liable for tortious interference even though they are not a party to the prior agreement.

IV. NPC and Tortious Interference

Despite the lack of privity of contract, the prior lender may still have a recourse against the subsequent lender for tortious interference.^[5] In *Tam Chee Chong*,^[6] Jurong Hi-Tech Industries Pte Ltd (under judicial management) and Jurong Technologies Industrial Corporation Ltd (under judicial management) (collectively, "the Respondent Companies") took up bank facilities from various banks and provided NPCs to them prior to 2006. The Appellant, DBS Bank Ltd ("DBS"), offered further banking facilities to the

Respondent Companies and wanted an all-monies charge over the sale proceeds. This is even though the Respondent Companies would not have been able to obtain the requisite consents from the other creditors as the Respondent Companies was already in default in repaying their loans to the creditors for some time. The Court noted in obiter that even if DBS was successful in its appeal to retain its charge over the proceeds of the sale, it may still be found to be liable for interfering with the contract rights of the prior lenders “vis-à-vis the [Respondent companies] under the negative pledges given by the latter”.^[7] The Court referred to the US case of *First Wyoming Bank, Casper v Mudge* 748 P 2d 713 (Wyo 1988),^[8] where the bank was found to be liable for tortious interference with an NPC for aiding and abetting the breach. Furthermore, tortious interference shares similar characteristics and elements with the economic tort of inducing breach of contract. In *M+W Singapore Pte Ltd v Leow Tet Sin* [2015] 2 SLR 271,^[9] the Court set out the following elements to determine the presence of tortious interference:

1. The defendants had knowledge of the existence of the contract (although knowledge of the precise terms is unnecessary) and intended to interfere with the plaintiff’s contractual rights;
2. The defendants induced the breach; and
3. The contract was breached and damage was suffered.

On knowledge and intention, In *OBG Ltd v Allan* [2007] UKHL 21,^[10] Lord Hoffman stated:

“To be liable for inducing breach of contract, you must know that you are inducing a breach of contract. It is not enough that you know that you are procuring an act which, as a matter of law or construction of the contract, is a breach. You must actually realize that it will have this effect.”

In *Tribune Investment Trust Inc v Soosan Trading Co Ltd* [2000] 2 SLR(R) 407,^[11] it was held that the inquiry into the procurer’s intention was an objective determination and the defendant must be found to have intended to interfere with the plaintiff’s contractual rights knowingly.

In a typical scenario, after the loan agreement is executed by the parties, the lender would proceed to register the charge and successful registration of the charge amounts to notice to the world that the charge exists. Notwithstanding the registration, in the English case of *Wilson v Kelland*,^[12] while the registration amounted to the notice of the charge, it does not amount to a constructive notice of the any special provisions contained in that charge. Similarly, in *G&T Earle Ltd v Hemsworth Rural District Council*,^[13] it was held that registration does not notify others of the terms of the charge, specifically in the context of an NPC. In Singapore, similar procedures exist under s 131 Companies Act.^[14] It is also noted that as part of the registration process, a summary of the properties securing the charge and salient restrictions found in the security instrument are reproduced in the statement containing particulars of charge, which is submitted as a supporting document for the registration. It is therefore opined by the writer that the terms of the registered charge can usually be easily retrieved from ACRA and the party who wishes to investigate whether prior charges contained NPCs can easily do so since NPCs are commonly extracted and reproduced in the statement containing particulars of charge. In addition, it is also observed by the writer that most financial institutions would include NPCs in their various loan agreements. Accordingly, subsequent lenders ought to be aware of the likely possibility of the existence of NPCs in the security instruments of the prior chargees, whether the NPC was a Type 1 NPC or Type 2 NPC and assess whether consent from the prior lender or lenders was required. It would therefore be dangerous for a subsequent lender to claim ignorance of the possible presence of NPCs in the prior charges by choosing not to extract the particulars of the prior charges.

As for the measure of damages, the position is to restore the plaintiff back to the same position as if the tort had not been committed.^[15] In *Casper v Mudge*, the creditor induced the debtor to breach the NPC.^[16] The inference resulted in a jury verdict of US\$123,997.33, which was the consequent costs incurred by the plaintiffs arising out of the defendant's interference. Where relevant, it is also possible for the Court to consider other principles affecting reduction of damages (eg. contributory negligence and mitigation), especially if the consent was unreasonably rejected or if there was no response from the prior lender.

V. Conclusion

To summarise, this article has explained what an NPC entails and elaborated on the two common types of NPCs. It has also explained the importance of subsequent lenders requiring the borrower to obtain consents from prior lenders. Where consent is not obtained, this article has also considered how subsequent lenders may be found liable for tortious interference even though they are not a party to the prior agreement. On balance, it is still uncertain how the tort of interfering with NPCs would turn out in Singapore Courts. In all likelihood, there would be NPCs which have been breached. Nevertheless, for commercial reasons or otherwise, it is noted that the NPC clause is not commonly enforced unless, perhaps, when the borrower is in the red. Notwithstanding so, it appears that the Court has stated its readiness to enforce NPCs where appropriate.^[17]

[1] *DBS Bank Ltd v Tam Chee Chong and another (judicial managers of Jurong Hi-Tech Industries Pte Ltd (under judicial management))* [2011] SGCA 47 ("*Tam Chee Chong*"), at [50].

[2] *Ibid.*

[3] Carl S. Bjerre, "Secured Transactions Inside Out: Negative Pledge Covenants Property and Perfection" (1999) 84 Cornell Law Review 1, at 306-7.

[4] Robert E. Scott, "A Relationship Theory of Secured Financing" (1986) 86 Columbia Law Review 901, at 946.

[5] Carl S. Bjerre, "Secured Transactions Inside Out: Negative Pledge Covenants Property and Perfection" (1999) 84 Cornell Law Review 1, at 338.

[6] *Tam Chee Chong*, *supra* n 1 at [50].

[7] *Ibid.*

[8] *First Wyoming Bank, Casper v Mudge* 748 P 2d 713 ("*Casper v Mudge*").

[9] *M+W Singapore Pte Ltd v Leow Tet Sin* [2015] 2 SLR 271.

[10] *OBG Ltd v Allan* [2007] UKHL 21 at [39].

[11] *Tribune Investment Trust Inc v Soosan Trading Co Ltd* [2000] 2 SLR(R) 407

[12] *Wilson v Kelland* [1910] 2 Ch 306.

[13] *G&T Earle Ltd v Hemsworth Rural District Council* [1928] All ER 602.

[14] Companies Act (Cap 50, 2006 Rev Ed) s 131.

[15] *Emerald Construction Co Ltd v Lowthian* [1966] 1 W.L.R. 691.

[16] *Casper v Mudge*, *supra* n 9.

[17] *Tam Chee Chong*, *supra* n 1 at [54].



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