ONLINE RESOURCES CHAPTER C

MARKETABLE LOANS

SUMMARY OF POINTS COVERED

- What is in this chapter
- Stock
- Trustees
- Stock certificates
- Contracts for the allotment of debt securities
- Information for debenture holders
- Convertibles
- Meetings
- Prospectuses and listing particulars
- What can be learnt from this chapter
- Further reading

C.1 WHAT IS IN THIS CHAPTER

C.1.1 CHAPTER OVERVIEW

This chapter deals with arrangements by which a company borrows a large sum of money long term. The money is put up by a number of investors who are entitled to receive interest payments (usually twice a year) and, at the end of the term of the loan, repayment of principal. Sale of all or part of an investor's entitlements is possible and arrangements are usually made for trading on a stock exchange. Marketable loans were once issued to the general public in the same way as shares, but nowadays they are usually held in large quantities by financial institutions and specialist investors. They are described as 'wholesale' rather than 'retail' investments. Interests in marketable loans are called 'debt securities', or 'bonds', or, in CA 2006, 'debentures'. Transfers of debt securities (unless they are convertibles—see **C.7**) are generally exempt from stamp duty (Finance Act 1986, s 79).

C.1.2 KEY LEGISLATION

Key legislation which you should be able to consult when reading this chapter:

- FSMA 2000, ss 79–82, 86;
- CA 2006, ss 423, 431, 432, 580, 738, 740, 749, 859B, 859P, 859Q.

All that legislation is in *Blackstone's Statutes on Company Law*.

- The Listing Rules (LR) and the Prospectus Rules (PR) in the FCA Handbook, which is at **handbook.fca.org.uk**.

C.1.3 MOST SIGNIFICANT CASES

The following cases, which are considered in this chapter, are particularly significant and are recommended further reading:

- *Assénagon Asset Management SA v Irish Bank Resolution Corp Ltd* [2012] EWHC 2090 (Ch), [2013] Bus LR 266
- *Azevedo v Imcopa Importação, Exportação e Indústria de Óleos Ltda* [2013] EWCA Civ 364, [2015] QB 1

Your particular course of study may require you to read other source materials.

C.2 STOCK

For the purpose of measuring each investor's interest, when a company arranges a marketable loan it is nowadays usual to regard the whole amount borrowed as a 'stock' having a certain nominal value. This nominal value may be equal to, less than, or even greater than the amount actually loaned.

Each investor is regarded as being interested in a proportion of the stock, having a certain nominal value.

The nominal value of a particular investor's stockholding is normally the same as the amount of principal to be paid to that investor by the company at the end of the term of the loan. In some marketable loans, the company promises that when it repays principal it will additionally pay a certain percentage of the principal as a bonus, known as a redemption premium.

It is permissible to issue marketable loan securities at a discount, that is, for less than their nominal value (*Re Anglo-Danubian Steam Navigation and Colliery Co* (1875) LR 20 Eq 339). Usually, the amount of the discount is written off over the term of the loan.

C.3 TRUSTEES

If debt securities are to be listed, it is usual for a trust to be constituted for the duration of the loan, with a trustee, or trustees, whose duty is to look after the interests of the stockholders. A trust for stockholders is invariably constituted in a deed.

A major advantage of a trust for a marketable loan is that security can be given for the loan by means of a contract between the company and the trustees. (Not all marketable loans are secured: those that are not are usually described as 'unsecured loan stock'.) The contract of security is normally incorporated in the deed constituting the trust, and it normally gives a floating charge on the company's business and property, and a fixed charge on the company's land.

When a trust has been constituted, the contract to pay interest and repay principal must be between company and trustee, not company and stockholder (*Re Uruguay Central and Hygueritas Railway Co of*

Monte Video (1879) 11 ChD 372; *Re Dunderland Iron Ore Co Ltd* [1909] 1 Ch 446). The practical result of this is that only the trustee may take proceedings against the company, and this preserves the equality of the stockholders. Where security has been given in a contract with a trustee, only the trustee may enforce that security, for example by appointing an administrator. If a trustee is dilatory, any stockholder (as beneficiary of the trust) may ask the court to order performance of the trustee's duties.

If the trust deed gives security, any stockholder must, on request, be sent a copy, for which the company may charge a fee, of the trust deed covering the stock (CA 2006, s 749).

If the trust deed creates a charge on the company's property or undertaking, it must be registered at Companies House and a certified copy of the deed must be delivered (s 859B; see **11.7.2**) and the company must keep a copy of the deed available for inspection (ss 859P and 859Q).

C.4 STOCK CERTIFICATES

A stock certificate is a certificate given by a company that a person is the holder of stock to a specified nominal value.

A stock certificate issued in connection with a marketable loan is a written acknowledgement of a company's indebtedness and is therefore a 'debenture' for the purposes of CA 2006 (see **11.2.2.5**). CA 2006, s 738, says that the meaning of 'debenture' is to include debenture stock.

A stock certificate for a marketable loan may be made out to bearer and be transferable by delivery alone. Such a document is judicially recognised as being a negotiable instrument (*Bechuanaland Exploration Co v London Trading Bank Ltd* [1898] 2 QB 658). Bearer debentures are exempt from stamp duty on issue and transfer (Finance Act 1986, s 79(2)). Normally, issue and transfer of debenture stock and unsecured loan stock are through a register operated in the same way as a company's register of members. Normally a trust deed covering a marketable loan requires the company to maintain a register of stockholders.

If a company maintains a register of debenture holders, it must observe the same rules on where it must be kept, on provision of copies, and on permitting inspection of the register as apply to the register of members (see **Online resources, Chapter A.4.2.6**). A stockholder, whether or not also a member, may not be charged a fee for inspecting the register.

C.5 CONTRACTS FOR THE ALLOTMENT OF DEBT SECURITIES

Company marketable loans are company securities and the law stated in **Chapter 7** applies to them, except that:

(a) There is no limitation on the payment of underwriting commission on marketable loans—CA 2006, s 552 (see **7.8**), does not apply to debt securities.

(b) An allotment may be made however small a response there is to the offer—CA 2006, s 578 (see **7.9**), does not apply to issues of debt securities.

It was held in *South African Territories Ltd v Wallington* [1898] AC 309 that a contract for the allotment of debentures would not be enforced by an order for specific performance, and so CA 2006, s 740, gives a statutory power to the courts to order specific performance.

C.6 INFORMATION FOR DEBENTURE HOLDERS

The holder of any debenture of a company (that is, any document it has issued evidencing indebtedness) is entitled to ask for a copy of the company's most recent annual accounts as submitted to its members (CA 2006, ss 431(1) and 432(1)). Under s 423(1), a company must send a copy of its annual accounts and reports to every holder of its debentures (unless it is unaware of a holder's address: s 423(2)). See **Online resources, Chapter B.6.1**. Holders of debt securities are rarely, if ever, entitled to attend members' meetings.

C.7 CONVERTIBLES

Unsecured loan stock, or occasionally secured debenture stock, may carry a right to exchange the stock at a future date for shares of the company that issued the stock.

The trust deed covering the loan would specify how the number of shares to be allotted is to be related to the nominal value of stock given in exchange. Often there are several different dates on which conversion may be made, with a different exchange rate for each conversion period.

The issue of convertible securities is subject to the rules on authority to allot, discussed in **6.3.4** (CA 2006, s 594(2)(b)). The issue of securities convertible into equity shares is subject to the rules on members' pre-emption rights, discussed in **6.3.5** (s 560(2)(a)).

The terms of issue of a convertible security must not result in the company receiving less than the nominal value of the shares issued (*Mosely v Koffyfontein Mines Ltd* [1904] 2 Ch 108; CA 2006, s 580).

C.8 MEETINGS

The terms of issue of debt securities often make provision for meetings of the holders of the securities which can, for example, agree to a change in the terms on which the securities were issued. As with meetings of shareholders, it is usually provided that a majority vote at such a meeting binds all holders of the securities, whether they attended the meeting or not. As with meetings of shareholders (see **14.14.3**), a majority decision which oppresses the minority is invalid. Two recent cases have tested what may be a quite widespread practice of a borrowing company offering an incentive to vote in the way favoured by the company.

In ***Azevedo v Imcopa Importação, Exportação e Indústria de Óleos Ltda*** [2013] EWCA Civ 364, [2015] QB 1, the Court of Appeal held that a company may make cash payments to holders of debt securities who vote in favour of a resolution restructuring the loan so that its terms are more favourable to the company. This is known as consent solicitation and the payments are called consent payments. Lloyd LJ, at [63], said that he could see:

> nothing wrong or unlawful, in general terms, in a process of putting to all members of a class a proposal which offers benefits open to all who vote in favour of the resolution, but not to the others. No member of the class is thereby excluded from participation in the offered benefits except by his own choice as to whether, and if so how, to vote.

The availability of the advantage to all voters was sufficient to distinguish the case from *Menier v Hooper's Telegraph Works* (1874) LR 9 Ch App 350 (discussed at **14.14.3**), where the dissenting minority could not have gained any benefit from voting for the resolution ([2013] EWCA Civ 364 at [66]).

This decision may be contrasted with ***Assénagon Asset Management SA v Irish Bank Resolution Corp Ltd*** [2012] EWHC 2090 (Ch), [2013] Bus LR 266. There it was held that what is known as 'exit consent' cannot be used. Exit consent is a technique for forcing bondholders to exchange their current securities for new ones with terms that are more favourable to the borrowing company. It is used when the existing securities have a poor market value, reflecting the issuer's inability to pay interest and repay the amount borrowed on the original securities. The technique works as follows. Bondholders are invited to exchange their bonds for the new ones before a deadline. They can only make the exchange if they commit, irrevocably, to voting in favour of a resolution at a meeting of bondholders to be held after the deadline. The resolution will change the terms of the existing bonds so that they are worthless. The resolution does not affect those who have exchanged their bonds for new ones, but will destroy any remaining value of bonds which have not been exchanged. Holders who consider that if they refuse to exchange, the issuer can and will offer a better deal, cannot do so unless they are certain that the resolution will not be passed. If the bonds are in bearer form, they will not even be able to contact other holders to find out how they are going to act. Declaring that this is an invalid oppression of the minority, Briggs J said, at [85]–[86]:

> 85. This form of coercion is in my judgment entirely at variance with the purposes for which majorities in a class are given power to bind minorities, and it is no answer for them to say that it is

> the issuer which has required or invited them to do so. True it is that, at the moment when any individual member of the class is required (by the imposition of the pre-meeting deadline) to make up his mind, there is at that point in time no defined minority against which the exit consent is aimed. But it is inevitable that there will be a defined (if any) minority by the time when the exit consent is implemented by being voted upon, and its only purpose is to prey upon the apprehension of each member of the class (aggravated by his relative inability to find out the views of his fellow class members in advance) that he will, if he decides to vote against, be part of that expropriated minority if the scheme goes ahead.
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> 86. Putting it as succinctly as I can, oppression of a minority is of the essence of exit consents of this kind, and it is precisely that at which the principles restraining the abusive exercise of powers to bind minorities are aimed.

In ***Azevedo v Imcopa Importação, Exportação e Indústria de Óleos Ltda***, Lloyd LJ said, at [37], that its facts were too far away from ***Assénagon Asset Management SA v Irish Bank Resolution Corp Ltd*** for the decision in that case to be of assistance. Although the test of benefit being available to all voters applies to both consent payment and exit consent, it may be that the deprivation of the property of the dissenting voters is what distinguishes exit consent and makes it unlawful.

C.9 PROSPECTUSES AND LISTING PARTICULARS

C.9.1 PROSPECTUSES

The requirements for form and content of prospectuses for debt securities in Commission Regulation (EC) No 809/2004 make a distinction between the retail market (the general public) and the wholesale market (professional investors) which applies to debt securities (recital 14). The criterion used in the Regulation to distinguish between retail and wholesale debt securities is nominal value (or minimum investment if there is no nominal value). Securities with a nominal value or minimum investment of less than €100,000 (or equivalent in another currency) are regarded as intended for the retail market (art 7); securities with a nominal value or minimum investment greater than or equal to €100,000 (or equivalent) are regarded as intended for the wholesale market (art 12). On the London Stock Exchange, the wholesale market for debt securities and convertibles is the Professional Securities Market (PSM).

A prospectus is not required for a public offer of wholesale debt securities (Directive 2003/71/ EC, art 3(2)(c) and (d); FSMA 2000, s 86(1)(c) and (d)). A prospectus is required for admission to trading on a regulated market, but the summary in non-technical language can be omitted (Directive 2003/71/EC, art 5(2); PR 2.1.3R) and the content requirements are simpler than for shares. The content requirements for wholesale debt securities are set out in Regulation (EC) No 809/2004, art 12 and annex IX (registration document) and art 16 and annex XIII (securities note). These requirements are reproduced in the FCA Handbook, PR 2.3.1EU and PR App 3EU.

A prospectus is not required for admission to trading on the Professional Securities Market of the London Stock Exchange, because the PSM is not a regulated market. Instead, the LSE requires securities traded on the PSM to be listed and the FCA classifies PSM securities as 'specialist securities' for which it requires listing particulars, which give the same information as a prospectus (see **C.9.2**).

C.9.2 LISTING PARTICULARS FOR THE PROFESSIONAL SECURITIES MARKET

'Specialist securities' are defined in the FCA Handbook Glossary as:

> securities which, because of their nature, are normally bought and traded by a limited number of investors who are particularly knowledgeable in investment matters.

LR 4 contains special rules for any application for listing of specialist securities for which a prospectus is not required. In practice it seems that the only securities issued by UK companies to which LR 4 will apply are wholesale debt securities to be admitted to the London Stock Exchange's Professional Securities Market. A prospectus is not required for a public offer of wholesale debt securities (Directive 2003/71/EC, art

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3(2)(c) and (d); FSMA 2000, s 86(1)(c) and (d)) and is not required for admission to the PSM, because it is not a regulated market, but admission to trading on the PSM is restricted to listed securities.

A specialist security which is exempt from the prospectus requirement cannot be listed unless FCA-approved listing particulars have been published (FSMA 2000, s 79; LR 2.2.11R, 4.1.1R, 4.1.2G and 4.1.3R). Listing particulars fulfil the same function as a prospectus, but are regulated domestically rather than by EU legislation. However, LR 4.2 draws the requirements for the form and content of listing particulars from the requirements for prospectuses. Listing particulars, like a prospectus (see **7.4.3**), are subject to a general duty to disclose all information required by investors to make an informed assessment of the securities (FSMA 2000, s 80). Exemptions from disclosure, corresponding to those available under s 87B for a prospectus (see **7.4.3**), are available under s 82 for listing particulars. Supplementary listing particulars are required by s 81 in circumstances corresponding to those for which a supplementary prospectus is required (see **7.4.4**), but there is no provision for withdrawal of agreement to buy or subscribe for the securities on publication of supplementary listing particulars.

The option to publish listing particulars is not available for issues for less than €2.5 million (FSMA 2000, s 87(3); LR 4.1.1R), because there already is an option to publish a prospectus for such an issue (see **7.4.5.3**). However, it is unclear whether this option applies when the issue is for less than €100,000.

C.10 WHAT CAN BE LEARNT FROM THIS CHAPTER

C.10.1 SUMMARY

Chapter C has briefly stated the law governing marketable loan securities issued by companies. The financial press usually calls these ‘bonds’ but in CA 2006 they are ‘debentures’. Marketable loan securities are usually issued as stock and it is usual to appoint trustees to look after the interests of the stockholders. Ownership of stock is evidenced by a stock certificate. Some loan securities are convertible into shares. Meetings of stockholders may be held to approve changes to the terms on which their securities were issued.

Marketable loans are traded on the Professional Securities Market of the London Stock Exchange and there are special prospectus rules for that market.

C.10.2 LEGAL CONCEPTS

- Debenture (bond, marketable loan)
- Stock
- Trustee for stockholders
- Consent solicitation
- Exit consent
- Specialist securities
- Listing particulars

C.10.3 POINTS OF LAW

- Marketable loan securities may be issued at a discount (*Re Anglo-Danubian Steam Navigation and Colliery Co* (1875) LR 20 Eq 339).
- But the terms of issue of a convertible security must not result in the company receiving less than the nominal value of the shares issued (*Mosely v Koffyfontein Mines Ltd* [1904] 2 Ch 108; CA 2006, s 580).
- Issuing convertible securities is subject to the rules on authority to allot (CA 2006, s 594(2)(b)) and, if they are convertible into equity shares, to the rules on members' pre-emption rights (s 560(2)(a)).
- Exit consent cannot be used (*Asségnagon Asset Management SA v Irish Bank Resolution Corp Ltd* [2012] EWHC 2090 (Ch), [2013] Bus LR 266).

C.11 FURTHER READING

C.3 B Liu, 'Why are bond trustees sued more often in New Zealand?' (discussion of the role of trustees for stockholders).

C.8 R Peel, 'Assessing the legality of coercive restructuring tactics in UK exchange offers' (2015) 4 UCL J Law and Jurisprudence 162 (full discussion of *Azevedo v Imcopa Importação, Exportação e Indústria de Óleos Ltda* [2013] EWCA Civ 364, [2015] QB 1 and *Assénagon Asset Management SA v Irish Bank Resolution Corp Ltd* [2012] EWHC 2090 (Ch), [2013] Bus LR 266).