

Loan Capital

1) Introduction

Companies raise funds by borrowing money:

- Single loan through bank (common)
- Government grants / sources
- Issue of a marketable loan ("*Corporate Bonds*") - marketable in a similar way to shares, sometimes sold without security ("*Junk Bonds*")
- European Money raised ("*Euro Bonds*")
- Loan Capital raised by way of single / multiple loans - "*Debentures*"

2) Types of Debenture

- Usually secured
- Can be single debentures e.g. bank loan
- Or can be an issue of debenture stock - loan capital raised by means of offer to public via stock exchange
- If an issue of stock to the public - must be "*debenture trust deed*" - must be a trustee who acts as company's creditor

Loan capital - represents a set of rights against the company, as opposed to shares which represent a right in the company. These rights arise out of relationship of debtor and creditor.

If the company issues stock to the public, there must be a "*debenture trust deed*" - a document that sets out the terms of the debt / debenture which is overseen by the trustee. It is part of the trustee's duty to make sure that the terms are adhered to, and if there is a breach, the trustee may appoint an administrator / receiver.

There are certain common themes / issues that run through a debenture trust deed:

- 1) a covenant to repay the amount of the loan at the appropriate time and the interest owed (if applicable)
- 2) the creation of a floating charge over some or all of the company's assets
- 3) the creation of a fixed charge over some or all of the company's assets

- 4) the trustee will also specify, in certain circumstances (e.g. if in receivership), that the whole loan amount will become immediately repayable
- 5) a covenant to keep the company' s property properly insured and in good repair
- 6) generally explain the powers and duties of the trustee

3) Security on Debentures

- Creditors usually want security or "*charge*" on loan - Two main types:

a) Floating Charges

- Existence first recognised in 1870 (*Re Panama, New Zealand & Australia Royal Mail Co* [1870] 5 Ch App 318)
- Unique to company law
- Not effective from date of creation (as opposed to a "*fixed charge*")
- Only effective from "*crystallisation*" - the happening of certain events (e.g. winding up, liquidation, receivership, etc.) When this happens, it becomes a "*fixed charge*"
- The ability to create a floating charge is one of the advantages of incorporation. It enables a company to raise capital by mortgaging its entire assets
- Judicially defined a few years after *Re Panama et al*:

Other aspects:

- An "*equitable*" charge:
 - A charge on the assets of the company as they may change form day to day - the essence of:

"A floating charge security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charge in the varying condition in which it happens to be from time to time. It is of the essence of such a charge that it remains dormant until the undertaking charge ceases to be a going concern, or until the person in whose favour the charge is created intervenes" (Per MacNaughten at p86 in *Government Stock & Other Securities Investment Co v Manila Ply Co Ltd* [1897] AC 81)

A few years later MacNaughten said also shifting in nature - described as "hovering":

"A floating charge ... is ambulatory a shifting in its nature hovering over and so to speak floating with the property which it is to intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject within its reach or grasp ..." (Per MacNaughten at p358 in Illingworth v Houldsworth [1904] AC 355)

As far as the company is concerned, there may not be much difference, but will be important if the company goes into receivership or liquidation, since there is a list of priorities - so for creditors - which charges are payable first, etc.

b) Fixed Charges

- Similar to ordinary mortgage
- Effective from date of creation
- Can be guarantee over fixed assets of company, e.g. land, property, etc.
(land is the most common form of security (accounts for 70%), but you can also have fixed charges over other assets, over a company' s book debts, etc.)

Difference between floating and fixed charges is important - due to order of priority for creditors and members (see later notes on "*capital holders*")

4) Registration of Charges * Very Important *

- Law is in a state of flux
- DTI is considering reforms

DTI - 2 main reasons for reform:

- 1) Takes 21 days to register a charge. So, to anyone who wants to inspect the company' s debts, the charge is invisible for 21 days ⇒ true position is not clear ⇐ banks will generally avoid forwarding money for 21 days or more ⇐ other charges on land, etc.
- 2) The list of registerable charges is out of date

Currently, have to register charges on / interest in / sale of land with the Land Registry (a public body) - both public and commercial

But, there is a problem - interaction between the Land Registry and the Registrar of Companies ...

When a charge is made on land, the Registrar of Companies issues a certificate, which is meant to assure the Land Registry that there are no other legal interests in the land

The DTI are still consulting whether to reform the system. In 1994, they issued a consultation paper, and stated that there is primarily a need for publicly available information. Emphasis on information available to public. Information is necessary for those proposing to do business with the company, but is also valuable to analysts dealing with commercial information. The DTI said that there needs to be a mechanism whereby the validity of charges can be checked. They suggested three options:

- 1) The existing system should be maintained
 - 2) The core of the existing system should be maintained, but some provisions for updating and keeping up-to-date the list of registerable charges
 - 3) There should be a "*notice filing system*", which means a notice to create charges would be filed before a charge was created. But this system should not be open to public scrutiny ⇒ probably won't be implemented
- S.395 & 396 CA 1985

S.396 CA 1985 registration requirements (current):

- A charge to secure any issue of debentures
- A charge on uncalled share capital of the company
- A charge created / evidenced by an investor; which, if executed by an individual, would be require registration as a bill of sale
- A charge on land, or any interest on it, but not a charge for rent or other periodical sum of money arising from land
- A charge on the book debts of the company
- A floating charge on the company's undertakings and property
- A charge on calls made but not paid
- A charge on goodwill / patent / trademark / design / copyright / license

The above list may be amended by the Secretary of State at any time by virtue of S.396

All the above must be registered within 21 days of creation - S.395 CA 1985. If not, can render the charges liable to be held void.

The obligation to register is placed on the company itself. Failing to register is held as an offence committed by the company and by the officer of the company responsible to register that charge.

In effect, because the creditor has such an interest, it can often be the case that the creditor themselves actually register the interest.

If the property is already mortgaged, then the obligation extends to also register that second interest.

When a debt has been paid off, there is no obligation of the company to inform the Registrar of Companies, but informing him would be financially in the company's favour (⇐ potential investors, etc.)

What interests should be created? - up to the company to decide

Law regards property as sacrosanct