NAME : Aafreen Manzoor.

SEMESTER : B.A.L.L.B. – 5th Sem.

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Introduction to the concept 'Debentures'.

The word "debenture" although not a new word, has at the present day a signification of modern growth. In the statutes relating to companies, the first mention of the word "debentures" was in the Directors Liability Act, 1890, and the next in the Preferential Payments in Bankruptcy Amendment Act, 1897. The word also occurs, in its present day sense, in the Stamp Act, 1870, the Stamp Act, 1891, and in the Bills of Sale Amendment Act, 1882. In the Companies Act, 1990 and in the later company statutes it is of comparatively frequent occurrence. Etymologically debenture is simply debentur: they are due; or, there are due; and centuries ago the word was used as indicating a written acknowledgement of indebtedness.[1] A Debenture is basically some of the loan amount the company was interested to raise from the public, that is why it issues debentures. A person who has bought a debenture and holding it is the creditor of the company. It is a document issued under the seal of the company.[2]

Historical Perspective of 'Debentures'.

Debentures, as direct charges upon the earnings of a corporation, are products of the industrial development of the nineteenth century. With the growth of great commercial undertakings it was soon perceived that the true value of their assets consisted in their earning capacity as a whole rather than in the value of their parts.[3] Issue of debentures and debenture stock began to figure in the raising of capital for both new enterprises and conversions in all industries. The growth of utilization of debentures and debenture stock during the 1870s and early 1880s was encouraged as a consequence of the clarification at this time by the courts of various legal aspects of debenture issues. Perhaps the most important of these decisions was that of the Court of Appeal which confirmed the validity of floating charges. Whilst there was a decline in the use of uncalled capital as security for debenture issues towards the end of the nineteenth century this mechanism was still very much in vogue in the 1880s. Indeed in those companies which lacked a broad array of tangible assets, such as was the case

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[1] F. Shewell Cooper, *Debentures,* (first published 1920, Sir Isaac Pitman & Sons) 2

[2] Nain Rachna, 'Concept of Debentures in India' (LegalServicesIndia), https://www.legalserviceindia.com/legal/article-262-concept-of-debentures-in-india.html accessed 01 June 2020

[3] Harvard Law Review, Vol. 24, No. 5 (Mar., 1911), pp. 389-391

for financial corporations, the use of uncalled capital as the principal security for the issue of debentures retain its hold into the 20^{th} century.[4] In India, the capital market was highly regulated and was liberalised only since the beginning of the eighties. It was further opened up in 1992, with the introduction of various self-regulatory legislation, and the creation of SEBI as an overall regulatory body for the capital market. It is seen from the results if the analysis of the NIM from 1951-1988 that NIM as a channel for private corporate investments in India has grown over the years. This growth can be periodised into the pre-intermediation phase, intermediation phase and pre-liberalisation phase. Finally, the NIM experienced a boom in the pre-liberalisation phase, i.e.; in the 1980s, with debentures as the principal source of financing.[5]

Debentures – Meaning.

Companies play a significant role in a country's economy and make a special contribution to national development. The primary object of this paper is to give a general survey of the debentures relating to companies as contained in the Companies Act, 1956 with its various Amendments.[6] A debenture is one of the capital market instrument which helps business houses to raise funds from the market for the development of the business. The word debenture has been derived from the Latin word "debere" which means borrowing or taking a loan.[7] "Debenture" includes debenture stock, bonds or any other instrument constituting a charge on the assets of the company or not.[8] Debenture means a document evidencing the debt which the company has taken from the public. A debenture need not be under seal although usually it is. Debenture is the description of an instrument while debenture stock is the description of a debt or sum secured by an instrument. Debentures may be registered, bearer, secured, unsecured, redeemable or irredeemable.[9] The definition of debentures has been

[4] Rob McQueen, '*A Social History of Company Law: Great Britain and the Australian Colonies 1854-1920*' , (first published 2013, Ashgate Publishing) 212

[5] 'Introduction to debentures', https://shoshganga.inflibnet.ac.in/bitstream/10603/15188/17/17_conclusion.pdf&ved , accessed 01 June 2020

[6] J Minattur, 'Company Law', (2015), https://www.google.com/url?sa=t&source=web&rct=j&url=http://14.139.60.114:8080/jspui/bitstream/123456789/738/20/Company%2520Law.pdf&ved accessed 01 June 2020

[7] Khushnum Motafram, "Different Types of Debentures and their use", (IPleaders, October 2019), https://blog.ipleaders.in/different-types-of-debentures-use/amp/ accessed 01 June 2020

[8] Section 2(30) of Companies Act, 2013

[9] Supra note 6, p. 578

defined by Chitty J. in *Levy v. Abercorris Slate and Slab Company*,[10] in the following words: 'If a document is capable of either creation of a debt or acknowledgement of it, and any other document that is able to fulfil either of these conditions can be termed as debentures'.[11]

Provisions Governing Debentures – Following provisions of the Companies Act, 2013 governs the floatation, issue and allotment with regard to debentures: Section 2(30) – Definition; Section 44 – Nature of debentures; Section 71 – Provisions relating to issue and allotment of debentures; Rule 18 of the Companies (Share Capital and debenture) Rules, 2014 – Rules pertaining to issue and allotment of debentures.[12]

Fixed and Floating Charge – Charge is defined in Section 2(16) of the Companies Act, 2013 which basically says that charge can be –

I. An interest or lien;
II. Created on the property or assets of a company; and
III. Any of its undertakings or both as security and includes a mortgage.[13]

Charges are of two types:

I. Fixed Charge- Such a charge is against a specific clearly identifiable and defined property. The property under charge is identified at the time of creation of charge. The nature and identity of the property does not change during the existence of the charge. The company can transfer the property charged only subject to that charge so that the charge holder or mortgage must be paid first whatever is due to him before disposing off that property.
II. Floating Charge: Such a charge is available only to companies as borrower. A floating charge does attach to any definite property of a circulating and fluctuating nature such as stock-in-trade, debtors, etc. It attaches to the property charged in the varying conditions in which happens to be from time to time. Such a charge remains dormant until the undertaking charge ceases to be a going concern or until the person in whose favour charge created takes steps to

[10] (1887) LR 37 CHD 260, 264: 58 LT218
[11] Akriti Gupta, 'Debenture: Meaning, Features and Kinds', (LegalBites, 14 November 2019), https://www.legalbites.in/debentures-meaning-features-kinds/ accessed 01 June 2020
[12] Supra note 7
[13] Kashish Khattar, 'Creation of Charges under the Companies Act, 2013 – A compliance checklist' (IPleaders), https://blog.ipleaders.in/charges-under-the-companies-act/amp/ accessed 02 June 2020

crystallise the floating charge. A floating charge on crystallisation becomes a fixed charge.[14]

It was in 1870, by the decision in *Panama, New Zealand and Australian Royal Mail Company* (5Ch. App.318) that the validity and efficacy of a floating charge were first established.[15] The Privy Council decision in *Agnew v. Inland Revenue Commissioner*[16] (on appeal from the Investments Ltd.) decides that where a charge over the uncollected book debts of a company leaves the company free to collect and then use the proceeds for its own benefit in the ordinary course of business, the charge is inevitably a floating charge and not a fixed charge, whatever the debenture might say.[17] On the other hand, a fixed charge has been defined as: "the appropriation of real or personal property for the discharge of a debt or other obligation."[18]

Kinds of Debentures – Debentures are generally classified into different categories on the basis of:

1) Convertibility of the instrument.
2) Security of the instrument.
3) Redemption ability.
4) Registration of instrument.[19]

On the basis of convertibility, Debentures may be classified into following categories:

A. Non-convertible Debentures (NCD) - This type of debentures cannot be converted either into preference shares or equity shares. NCD can either be unsecured or secured.
B. Partly Convertible Debentures (PCD) – Apart of these instruments are converted into equity shares in future at the notice of issuer. The issuer decides the ratio for conversion. The ratio is usually decided at the time of subscribing the debentures.[20]

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[14] 'Charge' (LegalServicesIndia), www.legalserviceindia.com/company%20law/com_3.htm accessed 02 June 2020
[15] Supra note 1, p. 5
[16] [2001] B.C.C. 252
[17] Philip R. Wood, 'Fixed and Floating Charges', (November 2001), The Cambridge Law Journal Vol. 60, No.3, pp. 472-474, https://www.jstor.org/stable/4508810?seq=1, accessed 02 June 2020
[18] Eilis Ferran, 'Floating Charges. The Nature of the Security', (Jul., 1988), The Cambridge Law Journal Vol. 47, No. 2, pp. 213-237, https://www.jstor.org/stable/4507164?seq=1 accessed 02 June 2020
[19] '*Executive Programme Study Material COMPANY LAW*' (The Institute of Company Secretaries of India), p.256
[20] Supra note 2

C. Fully Convertible Debentures (FCD) – These are fully convertible into Equity Shares at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as ordinary shareholders of the company.[21]

D. Optionally Convertible Debentures (OCD) – It is at the option of the debenture holder to convert these debentures into share. The price for such conversion is decided by the issuer and was consented upon by both parties at the time of issue of debenture.[22]

On the basis of Security, debentures are classified into:

A. Secured debentures – The debentures that are secured using the assets which are kept as collateral of the company. If the company defaults in paying loan, the loan is reclaimed after selling the debenture. The charge created over the debentures may be fixed or maybe floating.

B. Unsecured debentures – These are not issued against the assets of the company. There is no collateral attached with the loan. In case of default, the debenture holder can only approach tribunal to reclaim back the loan amount.[23]

On the basis of Redeemability, debentures are classified into:

A. Redeemable debentures – are the debentures where the date of redemption of the debentures are specifically mentioned in the debenture certificate issued, where on such date, the company is legally bound to return the principal amount to the debenture holder.

B. Irredeemable Debentures – continue for perpetuity and unlike redeemable debentures, there is no fixed date on which the company needs to pay the debenture holders. It becomes redeemable only when the company goes into liquidation.[24]

On the basis of Registration, debentures may be classified as:

A. Registered Debentures – The Commonest type of debenture is a simple registered debenture, containing in the instrument itself a floating charge on the undertaking of the company, and providing for the repayment of

[21] Supra note 19, p. 256
[22] Supra note 2
[23] Sakshi Sethi, 'Debenture and debenture holders', (LawTimesJournal, 21 February 2020), http://lawtimesjournal.in/debenture-and-debenture-holders/ , accessed 03 June 2020
[24] Supra note 7

the principal money on a fixed date. A registered debenture is a debenture providing that the principal money due thereunder is to be paid to the registered holder of the debenture.

B. Bearer Debentures – A debenture, which is not a registered debenture, provides for the payment of both principal and interest to the bearer, that is to say, the actual holder of the debenture. To such a debenture interest coupons are attached, also payable to bearer. These debentures are commonly called bearer debentures.[25]

Remedies of Debenture Holders –

Following are the remedies of debenture holders:

1. According to the rule 18[11], it is the duty of the debenture trustee to communicate debenture holder defaults, if occurs, with respect to redemption of debentures or payment of interest and any either action taken by the trustee himself. Besides, the debenture trustee appoints a nominee director on the board of the company if there are 2 consecutive defaults by the company in payment of interest to the debenture holder or failure in redemption of debentures.
2. As per the section 71(8) of the Companies Act, 2013 the debenture holder is entitled to interest and redemption of debentures in accordance with the conditions of their issue.
3. In section 71(10) of the Companies Act, 2013 there is a provision if the company makes a default either in payment of interest due or in redemption of debentures on date of maturity of debentures, the Tribunal may, on application wither of debenture trustee or of any or all of the debentures and, after hearing the parties involved, direct, through order, the company to redeem the debenture with payment of principal amount as well as the interest overdue.
4. Further if the companies make a default in complying with the order of the tribunal, the section 71(11) of the companies Act, 2013 provides that the tribunal shall punish the officers in default with an imprisonment which may extend to 3 years or with fine shall minimum be of 2,00,000 rupees and can extend to 5,00,000 rupees or both.

[25] Supra note 1, p. 12

5. Section 164(2) (b) imposes for disqualification of the directors of the company who has defaulted in redemption of debentures on the date of maturity and if such default has continued for 1 year or more.
6. Section 186(8) of the Companies Act, 2013 provides that any company who has failed to repay any deposits or payment of interest shall not give any loan or guarantee or make any acquisition or provide any security till such default subsists.[26]

International Perspective of Debentures.

The English Court of *Appeal in Fons Hf. V. Corporal Ltd.*[27] has recently confirmed that the phrase "debenture" when used in a charge agreement should be given its ordinary wide meaning. But if the decision in Fons can be taken as laying down a general definition of "debenture", then it seems that any contract or legislative drafter seeking to give it a narrower meaning would have to provide specifically for that. In some cases such as *Re MC Bacon Ltd.,*[28] the security is referred to as a "mortgage debenture" or even just a "debenture", but this may lead to some confusion. Patten L.J. followed the two well-known decisions of Chitty J. in *Edmonds v. Blaina Furnaces Company*[29] and *Levy v. Abercorris Slate and Slab Company,*[30] which had held that debentures are simply instruments that create or acknowledge a debt. However, in a dispute between contracting parties with minimal externalities, perhaps even concerning legislation where words do not clearly dictate otherwise, it is likely that a court will, as a starting point, see debentures as "specific identifiable agreements embodied in written documents" that create or acknowledge a debt.[31]

Judicial Perspective of Debentures – Judicial Pronouncement about Debentures. The following kinds of documents have been held to be treated as debentures—

A. A legal mortgage of freehold and leasehold land, [*Knightsbridge Estates Trust Ltd. v. Byme]*[32]

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[26] Supra note 2
[27] [2014] EWCA Civ. 304.
[28] [1990] B.C.L.C. 324.
[29] (1887) 36 Ch.D. 215.
[30] (1887) 37 Ch.D. 260.
[31] Hans Tjio, 'The Unchanging "Debenture", [November 2014], The Cambridge Law Journal.
[32] 1940 AC 613: (1940) 2 All 401.

B. A series of income-bonds by which a loan to the company was repayable only out of its profits, [*Lemon v. Austin Friars Investment Trust Ltd.*][33]

C. A note by which a company undertook to pay a loan but gave no security, [*British India Steam Navigation Co. v. IRC*][34]

D. A receipt or a certificate for a deposit made with a company when the deposit was repayable after a fixed period after it was made, [*United Dominions Trust Ltd. v. Kirkwood*][35]

E. The definition of debenture is so wide as to include any security of a company whether constituting a charge on the company's assets or not, [*Cf. Pearl Assurance Co. Ltd. v. West Midlands Gas Board*[36]].[37]

Conclusion.

From the paper we can conclude that, a debenture is basically an obligation instrument that recognises a credit to the organisation and is executed under the normal seal of the organisation. We can also sum up that debentures are sources of long term finance having both a short term and long term portion.

[33] 1926 Ch 1 (CA).
[34] (1881) 7 QBD 165.
[35] (1966) 2 QB 43.
[36] (1950) 2 All ER 844 (ChD).
[37] Supra note 19, p. 255

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