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Abstract

When corporations issue debentures to raise debt finance they may subsequently become holders of their own debentures either by repurchasing them or by taking them as security for loans advanced to third parties. In addition, if corporations are allowed to hold their own debentures there may be an opportunity to offer them as security. This paper examines the effectiveness of such transactions. The focus is on the effect of common law principles and the application of s 1051 of the Corporations Law. This section allows corporations to redeem their debentures and to re-issue them without it being regarded as an issue of new debentures.

Keywords

debentures, redemption, re-issue, section 1051, Corporations Law

REDEMPTION AND RE-ISSUE OF DEBENTURES: ITS EFFECT ON SECURITY TRANSACTIONS

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Introduction

When corporations issue debentures to raise debt finance they may subsequently become holders of their own debentures either by repurchasing them or by taking them as security for loans advanced to third parties. In addition, if corporations are allowed to hold their own debentures there may be an opportunity to offer them as security. This paper examines the effectiveness of such transactions. The focus is on the effect of common law principles and the application of s 1051 of the *Corporations Law*. This section allows corporations to redeem their debentures and to re-issue them¹ without it being regarded as an issue of new debentures.²

To this date there has been little, if any, commentary on s 1051. It is necessary to determine the effect of the section and then to identify the conceptual difficulties that seem to arise from its operation. We will focus on the issuer holding and the various types of instruments that fit within the definition of debenture as defined in s 9 of the *Corporations Law*. In addition, we will consider conflicts where debentures are used as security. This paper seeks to identify the intention of the legislature in drafting the provisions and to develop possible solutions to conceptual difficulties.

Definition and Nature of Debentures

A 'debenture' is a document which either evidences or acknowledges the creation of a debt³ or makes provision for the repayment of a loan to be made in the future.⁴ A definition such as this has a very wide application and

1 *Corporations Law* s 1051(1).

2 *Ibid* ss(2). They also retain equal priority as if they were never redeemed, assuming that they are debentures that rank *pari-passu*. If not, they would rank in order of the dates they were first issued: ss(3). They are nearly always ranked *pari-passu* in order to enhance marketability: see Schmitthoff and Stevens, *Palmer's Company Law*, 24th ed para 44-16.

3 *Levy v Abercorris Slate & Slab Co* (1887) 37 Ch D 260 per Chitty J at 264 'In my opinion a debenture means a document which either creates a debt or acknowledges it, and any document which fulfils either of these conditions is a 'debenture'. I cannot find any precise legal definition of the term, it is not either in law or commerce a strictly technical term, or what is called a term of art.' Compare this common law definition with the dictionary definition which says a 'debenture' is essentially an acknowledgment of indebtedness and a covenant to pay or repay: Stroud, *Judicial Dictionary* (4th ed) (1972) Vol 2.

4 In *Handevel Pty Ltd v Comptroller of Stamps* (1985) 10 ACLR 207 the High Court majority (Gibbs CJ dissenting) held that the relevant instruments were not dutiable as debentures as they did not acknowledge, create or secure an existing debt and did not provide for the future repayment of a loan. See also the case of *Edmonds v Blaina Furnaces* (1887) 36 Ch D 215.

definitions in the company codes in England and Australia became inclusive in an attempt to refine the definition. For example, in the previous English companies legislation a 'debenture' included 'debenture stock, bonds, notes and any other securities of a corporation.' It has been argued⁵ that past definition hindered rather than eased the process of determining the scope of 'debenture' as it was used in those statutes.⁶

Section 5(1) of the Australian *Companies Code* discarded the term 'and any other securities' to reinforce the point that the essential nature of a debenture is the creation or acknowledgment of debt. Section 9 of the *Corporations Law* goes further and dispenses with any inclusive definition at all. It adopts a definition of debenture that is closer to the original dictionary meaning. Essentially, a debenture is defined as a document that either acknowledges or creates the indebtedness of the issuer, for money lent or deposited with it. This acknowledgment may entail some form of security over property⁷ and may also take the form of debenture stock.⁸

Because of the wide, non-inclusive definition, the *Corporations Law* goes on to exclude certain documents. One important exception are documents issued by banks⁹ acknowledging debts incurred in the ordinary course of business. Bank certificates of deposit will not be debentures and therefore s 1051 will not apply to them. Certificates of deposit are receipts which evidence the contract of a depositor with a bank and as such they are evidence of a chose in action which potentially could be assigned or offered as security.¹⁰ In addition, the receipt may be a negotiable instrument if it is regarded as such by the market.¹¹ The only way documents acknowledging or creating a debt issued by banks could be debentures is if they arise out of extraordinary business activities in which case, s 1051 would apply. Section 1083 excludes the operation of certain provisions, including s 1051, *only* when it is an activity within the ordinary course of banking. In any case it is unlikely that a bank would issue debentures outside the ordinary course of its business as there would be problems with their marketability. The debenture holders would rank

5 See JK Armitage, *The Debenture Trust Deed*, Ch 10 of Austin & Vann, *The Law of Public Company Finance* (1986) Law Book Company, at 259.

6 The cases of *Knightsbridge Estates Trust Ltd v Byrne* [1940] AC 631 and *Comptroller of Stamps (Vic) v Handevel Pty Ltd* (1984) 84 ATC 4338, at Full Court level, both held the words, 'and any other securities of a corporation', used in the statutory definitions prior to the *Companies Code*, to extend the definition to catch a simple mortgage or charge on freehold land even where they did not create or acknowledge a debt. Previously they would not have been considered debentures. The High Court in *Handevel* (1985) 85 ATC 4706, overturned the decision of the Full Court, ruling that the reference to 'securities' in the relevant *Stamp Duties Act* was meant to supplement the categories of debentures – 'stocks, bonds, and notes', and should not be read as enlarging the scope of debentures to include documents that are different in character to these categories.

7 The word 'charge' is used and is defined widely as a charge created 'in any way including a mortgage': s 9.

8 See below under: (ii) 'equitable chose in action'.

9 Section 9 'debenture' definition: para (c). Also excluded are cheques, payment orders, bills of exchange and promissory notes of face value of more than \$50 000: para (d) and (e).

10 See discussion below on how to assign 'legal choses in action'. See also *Anning v Anning* (1907) 4 CLR 1049; *Elliott v Elliott* (1898) 15 WN (NSW) 186.

11 Eg: *National Australia Bank of Australasia Ltd v Scottish Union and National Insurance Co* (1951) 84 CLR 177. See discussion below on how to assign negotiable instruments.

after depositors in the event of liquidation. The *Banking Act*¹² imposes a duty on the Reserve Bank to protect depositors¹³ and allows the Reserve Bank to call for information from a bank in order to aid them.¹⁴ A bank is required to notify the Reserve Bank where it considers it is unlikely to be able to meet its obligations. As a result the Reserve Bank may investigate the affairs of the bank, take control of it and carry on its business until depositors have been repaid.¹⁵ Section 16 gives deposit holders a prior claim over the assets of the bank.¹⁶ This paper is therefore directed at corporations other than banks.

The wide definition of debentures in s 9 directs attention to three possible types of interests which may underlie a debenture:

- i) legal choses in action,
- ii) equitable choses in action, and
- iii) negotiable instruments.

The structure of Euromarket debenture issues also requires separate examination as the resultant right of 'debenture' holders is unique.

Understanding the nature, method and consequences of assigning these interests is necessary if we are to analyse transactions involving a corporation reissuing and redeeming its debentures. This will be particularly relevant where debentures are offered or taken as security by the corporation which issues them.

(i) *Legal Chose in Action*

A legal chose in action is an 'incorporeal bundle of rights enforceable by action for debt in the courts of common law'.¹⁷ By this we mean that the property is intangible and incapable of being held physically. The owner has an intangible right of action to recover the debt owed.¹⁸ A legal chose in action can be assigned even though it is not tangible. It may be assigned either at law or in equity however, to assign at law, it must be a present existing proprietary right which is either vested or contingent.¹⁹ This is because the common law does not recognise the assignment of future property. If it was not a present existing right it can only be assigned in equity if there is consideration and the property is clearly defined. Equity will then enforce it as an agreement to assign in the future.²⁰ To assign at law, the assignment must be expressed to be of the

12 1959 (Ch) Div 2.

13 Ibid s 12.

14 Ibid s 13.

15 Reserve Bank may act on advice of Attorney General as well.

16 *Reserve Bank Act* 1959 (Ch), s 86. Debts due to the Reserve Bank are also subject to s 16 of the *Banking Act* 1959 (Ch).

17 Everett D, 'Security over Banking Deposits' (1988) Aust Bus L Rev at 352.

18 For a concise discussion of the nature of choses in action see: Everett & McCracken, *Financial Institutions Law*, (1990), p125-131. For a broader discussion of dealings with them see: Sykes, *The Law of Securities*, (1986), Chapter 16.

19 Per Windeyer J in *Norman v FCT* (1963) 109 CLR 9 at 26.

20 Ibid Per Windeyer and McTiernan JJ.

present existing right to something in the future,²¹ which in our case would be the right to the principal and interest.

In order to assign a chose in action at law certain formalities need to be met under statute.²² There must be: an absolute assignment,²³ not by way of charge, in writing, signed by the assignor, and notice in writing given to the debtor either by the assignor or the assignee.²⁴ In addition, the *Corporations Law* also requires similar formalities to be met for a valid transfer of a 'marketable security.' Section 1091 requires a proper instrument of transfer to be delivered to the corporation except in cases of transmission by operation of law. It will only be a proper instrument of transfer if in relation to 'marketable securities', it complies with ss 1100-1105. 'Marketable securities' is defined in s 9 and s 1097(1) to include 'debentures'. The effect of the sections is to require notice to be given to the corporation so that it may record the transfer on its register of debenture holders.²⁵ It also imposes *ad valorem* stamp duty. The transfer of a debenture that is not a negotiable instrument will be completed by means of a form under ss 1097-1112.

If these requirements are not met, equity may help.²⁶ If there is consideration, then all that is required is a clear evincing of intention to assign and there would be a valid and enforceable contract which equity could enforce. This is based on the maxim: equity looks as done that which ought to be done.²⁷ Another requirement is that the property assigned must be properly, specifically and precisely identified.²⁸ Where there is no consideration for the assignment there may be a voluntary equitable assignment if the donor of the gift has done all that he or she must do,²⁹ which is essentially, to execute the

21 See examples: *Shepherd v FCT* (1965) 113 CLR 385 – assignment of present existing right to contingent future royalties; *Everett v FCT* (1979) 143 CLR 440 – assignment of present existing interest in the partnership; *FCT v Booth* (1986) 68 ALR 547 – assignment of an existing right to receive rentals in the future where the lease was for a prescribed period. All of these were said to be valid legal assignments even if they were voluntarily.

22 Traditionally, debts could not be assigned as they were regarded as a personal relationship between creditor and debtor. Now under statute whole debts can be assigned at law example: *Judicature Act* 1870 (UK), *Law of Property Act* 1925 (UK), s 136(1); *Property Law Act* 1974 (Qld), s 199; *Conveyancing Act* 1919 (NSW), s 12; *Law of Property Act* 1936 (SA), s15; *Conveyancing and Law of Property Act* 1884 (Tas), s 86; *Property Law Act* 1958 (Vic), s 134; *Property Law Act* 1952 (NZ), s 130.

23 *Norman v FCT* (1963) 109 CLR 9 per Windeyer J.

24 Express notice to the assignee is not needed under the statute: *Grey v Australian Motorists and General Insurance Co Ltd* [1976] 1 NSWLR 609 per Samuels JA.

25 Section 1047 onwards requires a corporation to keep a register of debenture holders in most cases. This may cause problems when the debenture is a negotiable instrument: see discussion below.

26 An assignment of a legal interest which has not fulfilled all the formalities required at law may be valid in equity: *Norman v FCT* (1963) 109 CLR 9.

27 *William Brandts Sons & Co v Dunlop Rubber Co* [1905] AC 454.

28 *Tailby v Official Receiver* (1988) 13 App Cas 523; [1886-90] All ER Rep 486.

29 In *Milroy v Lord* (1862) 4 De GF & J 264; [1861-73] All ER Rep 783, Lord Justice Turner laid down the test saying that 'a donor of a gift must have done everything, which according to the nature of the property, was necessary to be done in order to transfer the property in equity.' In the UK 'everything necessary' means *everything necessary to be done by the assignor*: *Re Rose*; *Rose v IRC* [1952] Ch 499; [1952] All ER 1217. In Australia the position is now the same: *Property Law Act* 1979 (Qld) s 200; *Corin v Patton* (1990) 169 CLR 540 which adopted Griffith CJ's approach in *Anning v Anning* (1907) 4 CLR 1049. They said it gives effect to the clear intention of the donor rather than insisting on strict compliance with legal form. Note that there must at least be writing because of s 199, but anyone can give notice: *Olsson v Dyson* (1969) 120 CLR 365; [1969] ALR 443.

instrument of transfer in writing. The notice to the debtor can be left to the assignee.

(ii) *Equitable Chose in Action*

The obligation created by the debenture may be an equitable chose in action. Debenture stock arose from the need to simplify the relationship between the debtor corporation and the debenture holders.³⁰ Instead of issuing separate debentures each for a definite amount, a corporation would treat a total amount borrowed from a number of lenders as a single stock. Certificates are then issued declaring each holder to be entitled to a definite amount, part of the stock.

Debenture stock are not instruments evidencing debt but equitable interests under an instrument (usually a trust deed) which evidences a collective debt divided into units. They are treated as debentures for the purposes of the *Corporations Law*.³¹ Regardless of whether there is consideration or not for a valid equitable assignment³² there need only be evidence of a clear intention to assign³³ coupled with writing.³⁴

(iii) *Negotiable Instrument*

The debenture may be a chose in action as discussed above but in the form of a negotiable instrument. The essential difference between the two is that a negotiable instrument has a different method and consequence of assignment. A chose in action may be classified as a negotiable instrument either by statute³⁵ or by commercial custom and usage. The test of negotiability stems from 'the law merchant'.³⁶ The courts will look to the custom and usage of a

30 Debentures were subscribed by such a large number of investors that it became inconvenient to issue single debentures. Where the debentures were secured over property of the corporation (eg a mortgage on fixed assets or a charge) each debenture holder would have had to provide consent for the issuing corporation to deal with its assets. With debenture stock, a trustee holds the single debt and can give consent on behalf of the debenture stock holders. See Pennington RR, *Company Law*, 5th Ed 1985 at p 475.

31 Section 9 Definition 'includes a unit of a debenture'.

32 of an existing equitable interest.

33 Per Windeyer J *Norman v FCT* (1963) 109 CLR 9; also *Kekewich v Manning* (1851) 1 De GM & G 176.

34 Examples: *Property Law Act* 1974 (Qld) s 11(1)(c) and *Conveyancing Act* 1919 (NSW) s 23C(1)(c). Note also that an equitable assignment can take place by complying with the legislative requirements for transfer of a chose in action. See *Property Law Act* 1974 (Qld), s 199; *Conveyancing Act* 1919 (NSW), s 12; *Law of Property Act* 1936 (SA), s15; *Conveyancing and Law of Property Act* 1884 (Tas), s 86; *Property Law Act* 1958 (Vic), s 134; *Property Law Act* 1952 (NZ), s 130.

35 *Bills of Exchange Act* 1909 (Cth) Part IV. Section 95 of the *Bills of Exchange Act* applies most of the attributes of negotiability to promissory notes. In most cases, however, a debenture will fail to meet the criteria for a promissory note (s 89) for several reasons. The promise to pay on a debenture is often not unconditional and any debenture with a floating interest rate, or where default interest is payable, will not be a promise to pay a 'sum certain'. In addition any acceleration clause on the face of the debenture will mean that it is not payable at a fixed or determinable time. Promissory notes of face value less than \$50 000 are the only form that may be debentures and only where there is an underlying debt: *Corporations Law* s 9 definition of 'debenture' para (d) excludes cheques, payment orders and bills of exchange.

36 It has been described as, 'a customary law approved by the authority of all Kingdoms and Commonwealths, not established by authority of any prince': Gerard de Malynes in *Ancient Law Merchant* 1622.

particular instrument to determine whether it exhibits attributes of negotiability and then will regard it as negotiable.³⁷ In summary, a negotiable instrument can be transferred by delivery, if made 'to bearer',³⁸ or by delivery and indorsement if made 'to order'.³⁹ The transferee, if *bona fide* and for value without notice of a defect, takes title free of any previous defects. A negotiable instrument thus transcends the 'nemo dat' rule which says that a purchaser does not gain title where a seller tries to pass title that he never had. The idea is that the original owner never intended title to pass.⁴⁰

The *Corporations Law* also appears to contemplate that negotiable instruments can be debentures as it allows the use of 'other forms of transfer permitted by law'⁴¹ other than by execution and delivery of a proper instrument of transfer under s 1091. It would appear that this would include transfers in the nature of a negotiable instruments. There is, however, sub-section (1) of s 1110 which maintains the need to execute the proper instrument of transfer in any event. How do we reconcile this? The intended effect of sub-section (1) is to aid in the keeping of a register of debenture holders,⁴² however, in the case of a negotiable instrument the requirement of a register is quite simply a commercial impossibility considering the whole point of a negotiable instrument is that it is able to be transferred easily and without notice. It appears to be yet another anomaly of the *Corporations Law* and it is unlikely the provisions will be enforced to prevent the transfer of negotiable instruments. This is especially so given that the courts have not restricted the definition of debentures to non-negotiable instruments. In the case of *Bechuanaland Exploration Co v London Trading Bank*,⁴³ it was held that a debenture made 'to bearer' may well be regarded as a negotiable instrument while bearer debenture stocks have generally been treated, by commercial custom, as negotiable.⁴⁴ The courts

37 See Examples mentioned in Everett & McCracken, *Financial Institutions Law* (1990) para 314 where they explain the circular nature of defining a negotiable instrument: *Miller v Race* (1758) 1 Burr 452; 97 ER 398; *London Joint Stock Bank v Simmons* [1892] AC 201; The authors go on to discuss the various factors that the court will take into account in determining whether the court will regard the instrument as negotiable: See para [310-315]. *Bechuanaland Exploration Company v London Trading Bank* [1898] 2 QB 658. This case was affirmed in *Edelstein v Schuler & Co* [1902] 2 KB 144 per Bigham J at 154: 'In determining whether a usage has become so well established as to be binding on the courts of law, the length of time during which the usage has existed is an important circumstance to take into consideration.' *Goodwin v Roberts* (1875) 1 App Cas 476 defined the law merchant as 'neither more nor less than the usage of merchants and traders in the different departments of trade, ratified by the decision of courts of law, which, upon such usages being proved before them, have adopted them as settled law'.

38 (Cth) *Bills of Exchange Act* 1909 s 36(2).

39 (Cth) *Bills of Exchange Act* 1909 s 36(3).

40 The case of *Gibson v Minet* (1891) 1 H Bl 569 at 606; 126 ER 326 at 347 Per Eyre CJ, noted that the characterisation of an instrument as negotiable was an extraordinary privileged exception to the ordinary laws of property.

41 Section 1110(5).

42 Section 1047 requires a corporation to keep a register.

43 [1891] 2 QB 568. Note: that the fact that the debenture was payable 'to bearer' was only a helpful indication that the instrument might be negotiable: *Glynn v Baker* (1811) 164 All ER 468. Compare this with the case of *Re Rhodesia Goldfields Ltd* [1910] 1 Ch 149 where it was held that a debenture, that was not payable 'to bearer', was subject to the equities unless otherwise provided for. This contemplates that a debenture may still be a negotiable instrument even if not payable 'to bearer' eg if payable 'to order'. In either case it depends on more than the wording. Debentures payable 'to bearer' have however, often been held to be negotiable: *Edelstein v Schuler & Co* [1902] 2 KB 144; *Goodwin v Roberts* (1875) LR 10 Ex 337; (1876) 1 App Cas 476 (overruling *Crouch v Credit Foncier* (1873) LR 8 QB 658).

44 See RR Pennington, *Company Law*, 5th ed (1985) p407. There has not been a case on this yet.

will always look at the particular instrument for elements of negotiability in their use.

Debenture issues in the Euromarket

Eurobonds, Euro-notes or Euro commercial paper are often issued in the international financial markets.⁴⁵ Each of these three instruments will fall within the definition of a debenture⁴⁶ in the *Corporations Law*. Commercial practice has necessitated the development of a satisfactory method of transferring these instruments. If they are negotiable instruments⁴⁷ then they will be transferable by delivery or delivery and endorsement. However, for 'safety'⁴⁸ reasons the markets have demanded that these instruments be issued in a form that is non-negotiable. Two solutions have developed.

The first solution is similar to the current practice in Australia. Debentures are issued by a borrowing company to a clearing house. The two main clearing houses are Euro-clear and CEDEL.⁴⁹ Subscribers are required to open two accounts with the clearing house,⁵⁰ a cash account and a securities account. All the debentures are held physically by the clearing house and each subscriber has a right to a certain number of securities as determined by his securities account. This contractual right⁵¹ to a number of securities, rather than particular securities deposited, gives the instruments the character of fungibles.⁵²

This practice is being abandoned in Euromarkets in favour of a second solution, issuing global notes. The reasons for this move are 'practical and financial, rather than particularly legal concerns'.⁵³ Costs and inconvenience of printing thousands of debentures and storing them physically are two factors influencing the move to global notes.

In a global note issue the borrowing company deposits with a bank or institution (as depository for the clearing house), a note, in bearer form, for the total amount of the debenture issue, on the same terms and conditions of the debenture issue. Most global notes contain the unusual provision that if at any time there is a default by the borrowing company the global note shall become void and the clearing house shall not be entitled to any remedies under the note.

45 See in general A Boxall, 'Global Bonds and Notes', Ch 4 of G Burton ed, *Directions in Finance Law*, (1990) at p117-118.

46 Ibid: *Levy v Abercorris Slate and Slab Co* (1887) 37 Ch D 260, at 264 per Chitty J.

47 A Boxall, 'Formal Legal Requirements and Restrictions' in *Structuring Securitisation Deals*, BLEC, 1986, p45.

48 The principle of title enhancement means a negotiable debenture could be obtained by fraud and then transferred so as to give good title to the transferee who has no notice of the fraud.

49 This is an acronym of the French name 'Centrale de Livraison de Valeurs Mobilieres'.

50 Euro-clear, Terms and Conditions, s 3; CEDEL, Management Regulations, Preamble.

51 That is, a chose in action.

52 Fungibles are 'things which, being identified only by reference to their number, weight or dimensions, can be used without distinguishing one for the other' translation by Burton G, *Directions in Finance Law*, Butterworths, 1990, p 125 of G Cornu, *Vocabulaire juridique*, 1987, Presses Universitaires de France, Paris, p 134.

53 Boxall A, *Global Bonds and Notes*, in Burton G, *Directions in Finance Law*, Butterworths, 1990, p 121.

The debenture holders are protected, however, by a deed poll given by the borrowing company to all debenture holders, that they will pay on the terms contained in original global note. The reason for this provision is that clearing houses are reluctant to have to enforce global notes on behalf of debenture holders, they are primarily institutions developed for the transfer of securities not their enforceability.

Under the concept of fungibility a debenture holder does not have any claim '... to any specific securities certificates' that may be held by the clearing house. The debenture holder will have only a contractual right against the clearing house to '... repossess ... an amount of securities ... equivalent to the amount credited to any Securities Clearance Account in its name...'.⁵⁴

This relationship between debenture 'holders' and the borrowing company is vastly different from that of a normal issue of debentures. Rather than a debtor/creditor relationship between the borrowing company and the debenture holder, when global notes are used or securities are deposited with the clearing house the debenture holder will have nothing more than a contractual right to a number of securities held by the clearing house.

If there is default this relationship will change immediately. The global note will be cancelled and because of the deed poll each debenture holder will have a right to sue the borrowing company.

The conclusion is that before default, the debenture holder has no chose in action against the borrowing corporation.

When a debenture is part of a Euro-issue the transfer of debentures must take place through the clearing house. If a participant wishes to transfer his interest in debentures held by the clearing house the transferor need only have its security account debited and the transferee's account credited with the relevant amount.

Complications only arise when the transferee is not a member of the clearing house. The transfer must then be made by way of an assignment of the debenture holder's contractual rights against the clearing house. In Queensland this transfer of a chose in action is governed by s 199 of the *Property Law Act*, notice and writing is required otherwise the assignment will only be valid in equity.⁵⁵ However, in the case of Euro-issues through the Euro-clear system the governing law will be Belgian.⁵⁶ That particular law will govern the necessity for notice and priorities when an assignment of a chose in action is made.⁵⁷

54 Euro-clear, Terms and Conditions, s 4(a).

55 See above under earlier discussions on legal and equitable chose in actions.

56 Or Luxembourg law if the clearing house is CEDEL. See Boxall *Global Bonds and Notes* article in Burton G, *Directions in Finance Law*, Butterworths, 1990, at 125 and Collins, *Dicey & Morris on the Conflict of Laws*, (1987) Rule 121.

57 See Collins, *Dicey and Morris on the Conflict of Laws*, 1987, Stevens & Sons Ltd, London, Rule 121.

Re-issue and Redemption of Debentures

Section 1051(1)-(3) of the *Corporations Law* allows a corporation to re-issue debentures after they have been redeemed. The section does not specifically provide for redemption of debentures⁵⁸ but rather it is necessarily implied by the operation of the section.⁵⁹

Section 1051 (1) states that when debentures are redeemed they are not cancelled unless a contrary intention is evident. It further gives power to the corporation to re-issue the debentures. It appears that the section contemplates the corporation will be able to hold its own debentures during the period in between redemption and re-issue. The next logical step is to ask what is the nature of the interest when the corporation holds them during this time? The provision makes no reference to this situation.

It can be argued by analogy that the intention was to allow the debentures to be treated similarly to negotiable instruments. The *Bills of Exchange Act* 1909 (Cth) is said to be a codification of the law merchant on negotiable instruments and was an adoption of the UK legislation of 1882. In the case of *Stock Motor Ploughs Ltd v Forsyth*,⁶⁰ Dixon J said that:

It is in the main a transcript of the English Act of 1882. It is not a statutory expression of any design or plan conceived or policy devised by the legislature. It is an attempt to convert a part of the *lex nonscripta* into *lex scripta*.

Given that the *Bills of Exchange Act* is a codification of the law merchant it is arguable that the principles within the Act are potentially applicable to all forms of negotiable instrument and not limited to those referred to in the Act,⁶¹ specifically cheques, bills of exchange and promissory notes.⁶² In any case promissory notes may also be debentures for the purposes of the *Corporations Law*⁶³ where there is an underlying debt and not just a bare promise to pay. The apparent overlap provides tenuous support for the argument that s 1051 was intended to reflect certain elements of negotiability. The *Bills of Exchange Act* would appear to contemplate that a maker of a promissory note can also be the holder of it at any time *before* its maturity date. Section 66 states that:

When the acceptor of a bill is or becomes the holder of it at or after its maturity, in his own right, the bill is discharged.

That this section specifically states that a bill is discharged *only* when an acceptor becomes the holder of the bill 'at or after maturity' implies that

58 Compare with s 193 of the *Corporations Law* which allows corporations to issue redeemable preference shares.

59 Section 1050 provides a similar implication.

60 (1932) 48 CLR 128 at 137.

61 This is important as instruments under the *Bills of Exchange Act* 1909 are largely excluded under the *Corporations Law* from being debentures.

62 Section 95 applies the sections of the Act pertaining to bills of exchange to promissory notes.

63 As long as not with a face value of over \$50,000; s 9 definition of 'debenture' para (c).

before maturity it is not discharged. The argument is that this is the logical corollary given that the holding of a promissory note at maturity discharges it.⁶⁴

The historical development of negotiable instruments was as a form of credit and as such the instruments were expressed to be payable at a future date. This expression is used in the definition of promissory notes in the *Bills of Exchange Act*.⁶⁵ This feature of a fixed date for payment suggests that up until the maturity date, the underlying debt will not be enforced and as such there is no problem in having the person obliged to pay on the negotiable instrument, also being the holder. In the case of an instrument that is payable on demand they would simply not make a demand on themselves to pay and could pass the instrument on to future holders to enforce the debt or obligation. Perhaps more significant is that a negotiable instrument's ease of transfer and title enhancement has the commercial result of an increased potential for circulation and trade. Because of this it seems logical to allow the maker to hold its own debentures, as long as it is before maturity, in order to prevent any potential hindrance to their circulation.

This interpretation works well if the debentures are in fact negotiable instruments. If, on the other hand, it is no more than a legal or equitable chose in action, the interpretation gives rise to conceptual difficulties. It appears to abrogate the common law rule that when a debenture was repurchased or transferred to the company that issued it, the debt was discharged. The assignment of a debt to the debtor discharges the debt.⁶⁶ In essence the corporation 'would become owner of a right of enforcement which is dependant upon the debtor suing himself'.⁶⁷ It could be argued that the legislature was intending to abrogate this rule to ensure easier trade of debentures. More likely the intent was to allow companies to use debentures more than once in order to save costs in producing debenture instruments. In any case the result is the same and it is questionable whether it is a desirable one.

Another indication of how the operation of s 1051(1)-(3) goes against established principle is seen in the Australian Accounting Standards⁶⁸ definitions on 'assets' and 'liabilities'. Pursuant to these standards there is a

64 Note: that he must be a holder for value: *Nash v DeFreville* [1900] 2 QB 72 at 89 per Collins LJ.
65 Section 89.

66 *Neale v Turton* (1827) 130 ER 725 at 726 per Best CJ: 'There is no principle by which a man can be at the same time plaintiff and defendant.' Also *In re Charge Card Services Ltd* [1986] 3 WLR 697 at 719H per Millet J in relation to debts in general.

67 See Everett D, 'Security over Banking Deposits' (1988) *Australian Business Law Review* p 352 at p 363. Where Professor Everett looks at the principle in relation to bank deposits which are also legal choses in action and quotes the case of *Broad v Commissioner of Stamp Duties* [1980] 2 NSWLR 40 at 46D. Also the cases of *Trevor v Whitworth* (1887) 12 App Cas 409 at 424; *Re Dronfield Silkstone Coal Company* (1881) 17 Ch D 76 where it was held that a share repurchase is similarly impossible due to the share's nature as a legal chose in action. There has been argument that such repurchases are possible: For a discussion on share repurchases see Magner E S, 'Repurchase, Redemption, and the Maintenance of Capital', Ch 7 of Austin & Vann, *The Law of Public Company Finance*, Law Book Company, 1986. Since those articles, share repurchases are possible by virtue of Part 2.4 Division 4B of the *Corporations Law* and in any event s 206PC of the *Corporations Law* deems repurchased shares to be cancelled.

68 SAC 4.

strong possibility that a company that has repurchased its own debentures will not even account for them on its balance sheet. A debenture is normally contained on the liability side of an issuing corporation's balance sheet. 'Liability' is defined as:

future disposition of economic benefits that a reporting entity is presently obliged to make to other entities as a result of past transactions or other past events.

When a company repurchases its own debentures there is no disposition that is required to be made 'to other entities'. A company will only owe a debt to itself.

Similarly the accounting standards say that 'assets' are:

service potential or future economic benefits controlled by the reporting entity as a result of past transactions.

It is unlikely that there is any 'future service potential or future economic benefit' to a corporation that owes itself a debt.

The ability of the issuer of negotiable instruments to hold its own instruments, is supported by the fact that there is a greater potential for circulation of them. More importantly, along with this increase in circulation, negotiable instruments have the benefit of title enhancement which normal legal and equitable choses do not. By allowing the issuer of non-negotiable debentures to also be a holder of them the legislation is artificially promoting the attribute of ease of circulation without the safeguard of title enhancement. This seems an odd conclusion considering the *Corporations Law* seems to recognise the difference between negotiable instruments and other legal or equitable choses in action.⁶⁹

Debenture issues in the Euromarket

The legal structure of Euro issues of debentures is quite different to a normal debenture issue. It was suggested above that a debenture holder under a global note issue is not a creditor of the borrowing company. Rather, each debenture holder has a right to a specific number of debentures or a specific value of the global note held by the clearing house. Under this scenario when a borrowing company purchases 'debentures' in its own company it is only really purchasing a contractual right, or chose in action, against the clearing house. Before default of the borrowing corporation there is no conceptual difficulty.

After default the legal relationships change. The global note is cancelled and the deed poll comes into operation giving each debenture holder a right to sue on the covenant in the deed poll, thus converting the interest in to an ordinary debenture. After default the *Bills of Exchange Act* and the *Corporations*

69 See *Corporations Law* s 1110(5) re: transfer of debentures.

Law will apply with the same result. This may allow an issuing corporation to hold its own Eurodebentures.

If the interpretation of s 1051 of the *Corporations Law* and s 66 of the *Bills of Exchange Act* is that a debenture is able to be held by its issuer before maturity, two results follow:

- i) The corporation may be able to take security over its own debentures for advances made by it to another entity.
- ii) The issuer holds a right of action against itself which is not cancelled (as would be the case at common law) and as such there is the possibility that it can be offered as security for loans or advances made to itself.

Debentures as security

There are two types of transaction to be dealt with:

- i) Where a corporation takes its own debentures as security for a loan or advance it has made.
- ii) Where a corporation offers its redeemed debentures as security for a loan or advance made to it.

Before examining each of these transactions it is useful to consider briefly the nature of purported security transactions with respect to the various instruments that fit within the definition of debenture.

(i) Nature of transactions with debentures

Mortgage (Assignment)

A mortgage is simply an assignment of property to the creditor, as security, with an equitable right to redeem the property upon satisfaction of the debt. The assignment of the property will be in the same form as discussed for each definition of debenture.⁷⁰ It seems that a mortgage of a debenture is possible no matter whether it is a bare legal or equitable chose in action, or a negotiable instrument.

The mortgage of a debenture may require registration. Section 262(1)(f) of the *Corporations Law* requires charges⁷¹ on 'book debts' to be registered, however, 'book debts' do not include 'marketable securities' or negotiable instruments.⁷² Debentures are included within the definition of 'marketable security'⁷³ and therefore, charges on debentures are not able to be registered as charges on book debts. Section 262(1)(g), however, requires registration of

70 *Durham Brothers v Robertson*, [1898] 1 QB 765 at 772(CA); *Tancred and Ors v Delgoa Bay and East Africa Railway Co* (1889) 23 QBD 239 at 242.

71 Charge is given a wide definition in s 9 to include 'mortgages'.

72 Section 262(4) *Corporations Law*.

73 *Ibid* s 9.

charges on 'marketable securities' and is supported by s 262(1)(d).⁷⁴ Section 262(1)(g) excludes from registration:

- i) a charges created in whole or in part by the deposit of a document of title to the marketable security; or
- ii) a mortgage under which the marketable security is registered in the name of the chargee.

It appears that registration, with respect to mortgages of negotiable instruments, is limited to cases where it is effected in equity where the debenture is not deposited with the mortgagee. A legal mortgage of a debenture in the form of a legal chose in action would require registration of the transfer⁷⁵ to the mortgagee as discussed above. This is clearly excluded in paragraph two.

Charge

A charge is different in character to a mortgage. The essential point to note is that no title in the property is passed to the chargee. As Lord Atkin stated in *National Provincial and Union Bank of England v Charnley*:⁷⁶

...the creditor gets no legal right of property, either absolute or special, or any legal right to possession, but only gets a right to have the security made available by an order of the Court.

The view is supported by Day J in *Burlinson v Hall*:⁷⁷

By a charge the title is not transferred, but the person creating the charge merely says that out of a particular fund he will discharge a particular debt.

No formal requirements⁷⁸ are needed except in relation to land and that the chargee's right arises out of either a contract or a trust.⁷⁹

The result is that a charge over a debenture is possible no matter whether it is a legal or equitable chose in action or, a negotiable instrument. As for registration, it appears that the exclusions in s 262(1)(g), above, will not necessarily apply if the charge is effected simply by contract and therefore it should be registered. Section 262(1)(a) requires registration of all floating charges over any type of property. If the charge is not registered it will not be protected by the rules regarding priority in the *Corporations Law*.⁸⁰

74 Which requires registration of charges on 'personal chattels' which includes a document evidencing a thing in action and a marketable security: s 262(3).

75 A legal transfer of a marketable security must be in accordance with the *Corporations Law* ss 1091, 1100, 1101. See also Schedule 2 Forms 1-4.

76 [1924] 1 KB 431 at 449-450.

77 (1884) 12 QBD 347 at 350.

78 Everett D, 'Security over Banking Deposits' (1988) Aust Bus L Rev at 358 citing Starke J in *Palmer v Carey* (1924) 34 CLR at 392 quoting *Tailby v Official Receiver* (1888) 13 App Cas at 543.

79 Ibid citing Starke J in *Palmer Case* at 392 (for contracts) and Issacs J at 390 (for trusts).

80 Section 279-282. An unregistered charge may lose priority to a registered charge subject to s 280(1)(b).

Pledge

It is a well established principle of law that a pledge can only be taken over something which is capable of delivery and physical possession.⁸¹ The judicial definition of a pledge makes the same assumption. In *Donald v Suckling*,⁸² Shee J states:

A [pledge] is defined by Sir William Jones (*On Bailments*, pp118-136) to be 'a bailment of goods by a debtor to his creditor to be kept by him till his debt is discharged'...; and by Lord Stair (*Institutions of the Law of Scotland*, bi, tit. 13, s.11), '...or in the case of not-payment of the debt, to sell the pledge and pay himself out of the price'; and by Bell (*Principles of the Law of Scotland*, ss 1326, 1363; 4th ed., p.512), 'a real right or jus in re, inferior to property, which vests in the holder a power over the subject, to retain it in security of the debt for which it is pledged, and qualifies so far and retains the right of property in the pledger or owner'.⁸³

From this we can see that where a debenture is a bare legal or equitable chose in action it will not be able to be given as a pledge as the nature of the interest is intangible and thus incapable of physical delivery and possession.

In the case of debentures this intangible property may often be coupled with a right to tangible property in the form of a chose in possession. It would be possible to take a pledge over a particular physical document, however, the question is whether taking a pledge over the debenture document will be effective as security? The whole strength of the security lies on the ability of the pledgee to hold the legal chose in action. A pledge of the debenture document will only be effective if it results in the legal chose in action also being held by the pledgee. This will be the case where the document itself evidences the title to the debt as in the case of a negotiable instrument.⁸⁴ The idea was stated succinctly by Cottrill:⁸⁵

In short, only if a debenture so embodies a holder's rights that endorsement and transfer of possession effect transfer of all the rights created by the debenture may it be the subject of a pledge.

It appears then that only debentures that are negotiable will be able to be pledged. It has already been noted⁸⁶ that where a debenture is made payable 'to bearer' it is often an indication that it will be regarded by the law merchant

81 Sykes, *The Law of Securities*, (1986), Chapter 16, pp 649; Everett & McCracken *Financial Institutions Law* (1990) at p225, par.728; R M Goode, *Legal Problems of Credit and Security*, (2nd ed) (1988) at pp 11-13; I Crossley Vaines, *Personal Property*, (3rd ed1962) at pp 361-362.

82 (1866) L R 1 Q B 585.

83 Ibid at 594 cited from Everett D, 'Security over Banking Deposits' (1988) Aust Bus L Rev at 352.

84 See above under 'nature and definition of debenture'. The essence of ease of transferability and title enhancement is a reflection of the fact that legal title is vested in the holder of the instrument: *Commissioners of the State Savings Bank of Victoria v Permewan Wright & Co Ltd* (1914) 19 CLR 457 per Isaacs J at 474.

85 VA Cottrill, 'The effect of the 'Pledge' of a debenture', (1990) 16 *Canadian Business Law Journal* at 455.

86 Above under heading: Nature and Definition of Debenture iii) Negotiable Instruments.

as negotiable. In addition, debentures not made payable 'to bearer' may still be negotiable if the terms of the issue provide that it transfers free of the equities. On the usual wording used in practice, it is necessary for the transferee to be registered to obtain the benefit of the clause.⁸⁷ This means that the debenture document will not be evidence of title to the debt and a pledge in this case will be ineffectual. It has also been noted that where a debenture is more than an acknowledgment of indebtedness and is secured over property of the issuer, this may have the effect of rendering the instrument non-negotiable.⁸⁸

In summary it would appear that a pledge is limited to cases where the debenture is a negotiable instrument perhaps best indicated by the fact that it is made payable 'to bearer' and where the debenture document does not include security over property of the issuer.

Registration is not required as s 262(1)(g) of the *Corporations Law* excludes securities created by deposit of document of title.

Lien

A lien is essentially the same in nature as a pledge except that a lien arises out of retention⁸⁹ of property rather than the express giving of property as security. The main point to note is that a lien will still require the property to be tangible⁹⁰ as is the case for a pledge and as such, it appears to be limited in application to where the debenture is a negotiable instrument.

(ii) Taking your own debentures as security

Mortgage

Given that a mortgage of a debenture is possible, can a corporation take a mortgage over debentures that it has issued? In effect the corporation will be the assignee of a debt which it owes and as a result the corporation will owe the debt to itself. Such an assignment has been rejected in *Broad v Commissioner of Stamp Duties*,⁹¹ in relation to bank deposits which are also legal choses in action. Justice Lee stated that:

any document purporting to achieve such an assignment could only operate as a release of the debt, or a covenant not to sue.⁹²

87 *Re Palmer's Decoration and Furnishing Co* [1904] 2 Ch 149.

88 VA Cottrell, 'The effect of the 'Pledge' of a debenture', (1990) 16 *Canadian Business Law Journal* at 455-456 citing: *Akbar Khan v Attar Singh* [1936] 2 All ER 545 (PC) at 550, per Lord Atkin; *Wirth v Weigel Leygonie & Co Ltd* [1939] 3 All ER 712 (KB) at pp 720-1.

89 See eg cited by Everett D, 'Security over Banking Deposits' (1988) Aust Bus L Rev at 360, cf *Brandao v Barnett* (1846) 12 C & F 787 and in general: Sykes *The Law of Securities*, (1986), Chapter 16 at 267.

90 See eg cited by Everett D, 'Security over Banking Deposits' (1988) Aust Bus L Rev at 360 of Millet J in *In re Charge Card Services Ltd* [1986] 3 WLR 697 at 721 and Everett & McCracken, *Financial Institutions Law* (1990) at pp 231-232, paragraph 738.

91 [1980] 2 NSWLR 40.

92 Ibid at 46D taken from Everett D, 'Security over Banking Deposits' (1988) Aust Bus L Rev at 364.

This view is supported by Millet J in the case of *In re Charge Card Services Ltd*⁹³ where he said:

[a debt] cannot be made the subject of a legal or equitable mortgage in favour of the debtor since this requires a conveyance or assignment by way of security, and this operates as a conditional release.

The analysis above would apply where the debenture is a bare legal or equitable chose in action. It may be argued, however, that if the debenture is a negotiable instrument the mortgage will be effective in conceptual terms. If our analysis of the position of negotiable instruments is valid and an issuer of a negotiable debenture is able to be a holder of it without it being discharged, then the corporation will in effect be holding a right to sue itself which is not possible at common law. If a debenture is a negotiable instrument the normal rule relating to choses in action can be avoided.

It may also be argued that the mortgage will be effective conceptually even if the debenture is non-negotiable. The argument depends on s 1051(1)-(3) being interpreted as attributing to all debentures the ability of being assigned back to their issuer in a similar way that negotiable instruments are treated under s 66 of the *Bills of Exchange Act*.

If a mortgage is possible why would a corporation take its own debentures as security? Upon default the corporation would either have to enforce the debenture against itself which would discharge the debt or, it would sell the debenture, thereby assigning the debt it owes to itself to someone else which it will have to satisfy in the future. The net effect of the transaction is really a set-off of the debt the corporation owes on the debenture and the debt owed to it via the loan.⁹⁴

Charge

It has been held that a charge of a debt in favour of the debtor discharges the debt.⁹⁵ *In re Charge Card Services Ltd* Millet J remarked: 'The objection to a charge in these circumstances is not to the process but to the result'.⁹⁶ It is arguable that these words indicate that there is no conceptual difficulty in a corporation taking a charge over a debenture that it has issued as long as there is no default by the corporation offering the debentures as security.

A charge gives the chargee only a contractual right and no direct proprietary right in the debentures. This means that up until default the corporation taking the security will not hold its own debentures but will hold a contractual right. This would apply whether the debenture is a negotiable instrument or a simple chose in action. If, however, Millet J's judgment means that the rule regarding mortgages of debts in favour of the debtor apply in the

93 [1986] 3 WLR 697 at 719H.

94 Provided that the debenture has a maturity date at the time that the debt becomes due.

95 Millet J *In re Charge Card Services Ltd* [1986] 3 WLR 697.

96 Ibid at 720H.

same way to charges of the same nature, then the argument with respect to s 1051 can be applied here. Similar commercial advantages and disadvantages apply.

Pledge and Lien

As argued above a pledge and lien⁹⁷ may only be effective to give the pledgee or lienee security where the debenture is a negotiable instrument. Pledges and liens have the characteristic of not vesting in the pledgee or lienee any property rights and as such there is inherent difficulty with a corporation taking a pledge or lien over its own debentures. The corporation will not be the assignee of the right to sue itself. In any case if the debenture is a negotiable instrument the issuing corporation would be able to hold such a right by reason of s 66 of the *Bills of Exchange Act*. Once again the commercial advantage is in the ability of the corporation to recoup debts except in this case it will be done by selling⁹⁸ the debenture, in the case of the pledge, and not by exercising it. A lienee only has the right to retain possession of the debenture, there is no inherent power of sale.

Debenture issues in the Euromarket

Pledges or possessory liens are not possible in the case of Eurodebentures under a global debenture because the right against the clearing house is not a negotiable instrument and therefore intangible and not capable of being the subject of possessory security.

Where a borrowing corporation has an interest in a global note held by a clearing house that interest may be mortgaged or charged back to the corporation which issued the global note. The reason is that until default or maturity the issuing corporation will not hold a chose in action against itself, but only a chose in action against the clearing house.⁹⁹

(iii) Offering your own debentures as security

Mortgage

It is evident from our description of negotiable instruments that when a company holds its own debentures the right of action for the debt is not extinguished. This right of action is capable of being mortgaged to a creditor using the methods outlined above. If a mortgage of the chose occurs the creditor will have the right to sue the debtor under the debenture if he defaults on the loan.

97 As to what type of lien the corporation may hold see below under heading: iii) Offering your own debentures as security: Pledge and Lien.

98 Power of sale is the only right a pledgee has. A lienee may only have a power of sale where it is a bankers lien or under some statutory provisions. See below under heading: iii) Offering your own debentures as security: Pledge and Lien.

99 This is the case for a mortgage. Under a charge the issuing/chargee corporation holds a chose in action against the borrowing corporation which upon default will allow access to the chargor's chose in action against the clearing house. This results in the same practical effect as a mortgage.

Can the same be said if the debenture is a non-negotiable chose in action? Under the general law once a chose in action is transferred to the debtor the right of action is cancelled. The result is that there is no longer a chose in action that can be mortgaged. The argument that s 1051(1)-(3) of the *Corporations Law* enables a corporation to hold its own debentures no matter what their legal nature without extinguishing the rights under the debentures means that the rights may be mortgaged. Further 1051(4) lends weight to this reasoning. It states that:

Where a company has... deposited any of its debentures to secure advances on current account or otherwise, the debentures shall not be taken to have been redeemed merely because of the account of the company having ceased to be in debit while the debentures remain so deposited.

Does the subsection contemplate mortgages? The words 'deposit as security' may well limit the application of the sub-section to a pledge of the debenture. A pledge, would fit the literal meaning of the provision in that it would involve a deposit of the debenture. It would not, however, be too great a leap in reasoning to suggest that the words could be applied to an equitable mortgage evidenced by the deposit of the instruments. In most cases where the debenture is assigned it will also be deposited with the creditor. In any event, the legislature in drafting the *Corporations Law*, has adopted a fairly vague distinction between the various security transactions in other areas of the Act¹⁰⁰ and there is no reason to suggest that a different policy would apply to s 1051(4).

The subsection may also appear to be limited to advances on 'current accounts'. Where the rest of the subsection refers to the debenture not being redeemed merely on account of the balance of the corporation ceasing to be in debit, it is obviously dealing with the situation where the corporation has an overdraft facility on its current account. The balance of the account will be fluctuating so that at times the corporation will not be in debt. In normal circumstances the security would revert back to the debtor. However, it is convenient in such a case that the creditor retain the instruments in anticipation that the debtor may make a further overdraft in the future. The sub-section provides that the debenture is not cancelled¹⁰¹ during a time when the creditor holds the security where there is no debt. Such a provision avoids the need for new security to be issued. It would appear unusual if this type of arrangement was intended by the legislature to apply to all forms of advances and not simply to current accounts. However, the words 'or otherwise' would appear not to limit it in such a way.

In summary, it would be reasonable to interpret the subsection as *not limiting* the ability to give debentures as security for advances to current accounts only but, *limiting* the reference to a debenture not being redeemed, to

¹⁰⁰ See examples relating to registration of security under s 262.

¹⁰¹ It uses the word 'redeemed' in this sense to mean cancelled. Cf subsection (1) which says where a debenture is redeemed it is not cancelled.

advances on current account. In any event s 1051(1)-(3) suggests that such security is possible whatever the nature of the advance.

The use of such a security transaction has no apparent commercial benefit. The creditor holds as security the right to sue the debtor corporation on the debenture. In the event that the debtor corporation defaults on its loan the creditor can either sell the debenture or exercise it against the defaulting corporation. It would appear that the fact that the issuing corporation defaults on its loan indicates that it may be unable to pay its debts as they fall due and that it may also not be able to pay on the debentures. The result is that the creditor would find it hard to convince anyone to buy its debentures and suing on the debenture is no better than suing on the loan. One possible reason for entering into such a transaction is that the original debenture issue may be secured over property of the issuing corporation. A subsequent creditor may be unable to access this property and may have to rank later in terms of priority. Section 1051(3), however, provides that a debenture that has been re-issued has the same priority as if it had never been redeemed. In many cases debenture holders even of different issues rank *pari-passu* in terms of security. Accordingly it is apparent that the creditor may be able to access property of the corporation and rank equally with other debenture holders by taking a redeemed, reissued debenture as security. This suggestion is effective if as argued above, an assignment under a mortgage is a re-issue of a debenture.

One other reason for a corporation to take such a security is that it may be required to adhere to a lending policy that requires it to have security over a certain percentage of its loan assets. If this is the case and the corporation is lending without adequate security then using the method suggested above might allow a company to create security that is artificial in the sense that there is no real benefit.

Charge

We have noted that it has been held that a charge of a debt in favour of the debtor was ineffectual so that the debt was automatically discharged.¹⁰² It may be argued the focus by Millet J in *In re Charge Card Services* on the result of the transaction meant that he did not intend to deny that a chargee holds a contractual right and that the chargor retains the property right in the debt.

If this is correct then it would mean that a charge given over a repurchased debenture would result in the original issuing corporation continuing to hold the property right to sue on the debenture. Is this possible? If the debenture is a negotiable instrument then it would appear the answer is 'yes'. It is argued above that it is possible for an issuer of a negotiable instrument to be its holder at a date before maturity.

What if the debenture is simply a chose in action? *Prima facie* a charge

102 Per Millet J in *In re Charge Card Services* [1986] 3 WLR 697 at 720H. See above under heading: (i) Taking your own debentures as security: Charge.

would be invalid as the issuing corporation would continue to hold a right to sue on the debenture which is essentially a right to sue itself. Using the argument that s 1051(3) allows the same result for all debentures as those just described for negotiable instruments, it is suggested that such a transaction is conceptually valid. Section 1051(4) would not appear to help as it refers to the 'deposit' of debenture as security which would not fit the description of a charge. In any case, reliance on s 1051(1)-(3) would appear to be sufficient.

Once again there is little commercial benefit in the transaction. There is even less benefit than where a mortgage is taken. Where there is a default under a charge the creditor may have a contractual right to make the debtor corporation exercise its right under the debenture in its favour. This means that the debtor corporation will have to sue itself and at this stage the debt would discharge. The creditors would have no right to any security under the debentures as that would entail the debtor corporation claiming a right to its own property where it is bankrupt.¹⁰³ If the charge agreement specifies that a power of sale is possible then it is likely that, like the mortgagee, the chargee will be unable to find a buyer. The only possibility is that the transaction creates an artificial security for the sake of appearance. In any event this is only effective as long as there is no default and the debentures have not matured.

Pledge and Lien

A pledge may arise where the debentures are deposited with the creditor as security and s 1051(4) would seem to contemplate this possibility. In what case will a lien arise? The law recognises a number of different kinds of liens that have been established by the law merchant. The traditional banker's lien may be applicable here. The nature and scope of this lien has been the subject of recent discussion, however, it appears¹⁰⁴ that the lien will still be subject to the need for the property to be tangible. A lien may arise if repurchased debentures are deposited with a bank for safe custody and subsequently the bank were to make a loan to the corporation that deposited them.

In accordance with our previous arguments, the current discussion is directed to the case of a debenture that is a negotiable instrument.¹⁰⁵ Once again there is a potential problem in that the debtor corporation will hold the property rights in the debenture even though possession is in the hands of the creditor. It follows that the debtor company will hold the right to sue itself. However there is no conceptual problem at this stage because a negotiable instrument is able to be held by its issuer prior to maturity.

103 Excepting if the charge document includes the power to foreclose which would result in the chargee taking title in the debenture, therefore the chargee would have access to property secured under the debenture.

104 See: *Halesowen Presswork and Assemblies Ltd v Westminster Bank Ltd* [1970] 3 All ER 485 and *In re Charge Card Services Ltd* [1986] 3 WLR 697. For a discussion of the cases and the nature of a banker's lien see: Everett D, 'Security over Banking Deposits' (1988) Aust Bus L Rev at 352 and W S Weerasoora, *Banking Law and the Financial System in Australia*, (2nd ed 1988) Ch 22.

105 See above under heading: Nature of transactions with debentures: Pledge.

The only benefit of such a transaction is where a corporation wishes to appear to be holding a security. It has no other effect as security¹⁰⁶ because in the event of default the pledgee or lienee can only exercise a power of sale and nobody would be willing to buy debentures of a company that cannot meet its debts. If the debentures were secured over property of the company the pledgee and lienee would not have a claim to this as at most their rights extend only to a power of sale and not to exercising the debenture.¹⁰⁷ Can it be argued that because the debenture is a negotiable instrument evidence of title to the security is manifest in the fact that they hold the instrument? This could possibly be the case but we have noted that a debenture that is secured over property will not be regarded as negotiable.¹⁰⁸

Euromarket issues

Giving a true possessory pledge or lien of a Eurodebenture is impossible for the same reasons that taking a pledge or lien over intangible property is impossible.

Complications may arise when a mortgage or charge is given over Eurodebentures that are being held by the corporation that issued them under a global note.

If the argument, that before default an issuing company can hold its own Eurodebentures, is accepted, then there is no problem with a mortgage of the debenture holders' contractual right against the clearing house. Where both the mortgagor and mortgagee are members of the clearing house system the securities account of the mortgagor is debited and mortgagee's account credited¹⁰⁹ upon notice being given to the clearing house. This satisfies the requirements for a legal mortgage if the notice is in writing and signed.

If on the other hand the mortgagee is not a member of the clearing house, the mortgage or transfer may not be effective at law¹¹⁰ as no notice in writing is given to the clearing house. Only an equitable mortgage would arise. The right under the deed poll may not pass with the equitable mortgage as the

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- 106 This was discussed by VA Cottrill, 'The effect of the 'Pledge' of a debenture', (1990) 16 *Canadian Business Law Journal* at 459-10 where the author concludes that just because the security is ineffectual at commercially does not mean that it is ineffectual conceptually in terms of the law.
- 107 Note that the secured lender may not actually be able to access the secured property. In *Seawater Products (Nfld) Ltd v Royal Bank of Canada* (1980) 36 CBR (NS) a Canadian Supreme Court held that a debenture holder who had a pledge over the debenture had to first sell the debenture before any action could be taken against the secured property. The debenture was effectively 'down-graded' because it was used as security. For a detailed outline of this see Cottrill, 'The Effect of the 'Pledge' of a Debenture', (1990) Vol 16 *Canadian Business Law Journal*, July 90. It should be noted that the power of sale of a lienee has not been confirmed. For a discussion on this see Everett & McCracken, *Financial Institutions Law* (Serendip Publications, 1987) paragraph 835.
- 108 VA Cottrill, 'The Effect of the 'Pledge' of a debenture', (1990) 16 *Canadian Business Law Journal* 1990 at 455-456 citing: *Akbar Khan v Attar Singh* [1936] 2 All ER 545 (P C) at 550, per Lord Atkin; *Wirth v Weigel Leygonie & Co Ltd* [1939] 3 All ER 712 (K B) at pp 720-1.
- 109 Euro-clear, Terms and Conditions, s 6.1(a)(i).
- 110 If it were in Queensland s 199 of the *Property Law Act* 1979 would require the transfer of the chose in action to be in writing and signed. Luxembourg or Belgian law has basically the same requirements.

deed poll relies on the clearing house to keep track of who are the subscribers to the global note 'from time to time'. It may be possible to give notice to the clearing house to get around the problem. If the chose in action is assigned more than once then priority will be determined by the time that notice is given to the clearing house.¹¹¹

Where a Eurodebenture is charged by the issuing corporation the chargee will have a contractual right to access the chose in action that the issuing corporation holds against the clearing house before default.

In the case of mortgages, after default by the issuing corporation, the contractual right against the clearing house converts to a chose in action against the issuing corporation. If the issuing corporation is holding the debenture at this time the problems discussed above with a company holding its own debentures arise. If, however, the debenture has been mortgaged before default these problems will not be encountered as legal title to the debentures will be in the hands of the mortgagee, not the issuing corporation.

The same problem would arise in relation to charges as the agreement between the parties is only contractual and the clearing house would have no knowledge of this. On default the charge will not be effective as the chargor corporation will once again hold the right to sue itself. The chargee's argument will once again be that s 1051 of the *Corporations Law* avoids this problem.

Suggested Solutions to conceptual problems

The following structures, attempt to avoid the conceptual problems that arise where an issuer of a debenture holds the right to sue himself either as a result of redeeming but not cancelling the debenture¹¹² or, by the operation of the security transactions.¹¹³ The problems arise in the following situations:

- i) where the company takes its own debentures as security by way of a mortgage or charge.¹¹⁴ (Pledges and liens are not included as they never actually involve the pledgee or lienor holding property rights in debt).
- ii) in the case of a company offering its own debentures as security: by way of a charge, pledge, or lien. (Mortgages are not included as the right to sue has been assigned).

The suggestions may help avoid the apparent abrogation of the rule that precludes a borrower holding a right to sue itself. It would be even more important if s 66 of the *Bills of Exchange Act* were held not to mean that the holder of negotiable instruments are able to abrogate this law at any time up

111 The rule in *Dearle v Hall* (1821) 3 Russ 1.

112 Under s 1051 *Corporations Law*.

113 Discussed above: Debentures as Security.

114 Depending on how the judgement of Millet J is interpreted: *In re Charge Card Services* [1986] 3 WLR 697 at 720H.

until the instrument matures. If in any case it is decided that negotiable instruments are able to abrogate the rule, the suggestions put forward here are relevant where the debenture is non-negotiable especially if s 1051 is interpreted not to mean that all debentures are given the benefit of abrogating the rule.

It should be noted that the suggestions may only help where this conceptual conflict exists before the maturity of the debentures. Once matured the debenture is discharged. In addition it will only help resolve the conceptual conflicts as long as the party offering the debentures as security does not default. It does *not* help overcome the commercial inadequacies of the security, outlined above, once default occurs.

(i) *Trustee as Intermediary*

In most cases where debentures are issued by a corporation, a debenture trust deed is required.¹¹⁵ Typically this trust deed acts:

as a contract between the borrowing company and the trustee, and as an instrument of trust governing the position between the trustee and debenture holders, and the relationship of debenture holders as between themselves.¹¹⁶

It has been argued that a debenture holder under a trust deed does not have any direct right against the borrowing corporation. Commentators have suggested¹¹⁷ that *Re Dunderland Iron Ore Company Ltd*¹¹⁸ held that where there is no covenant by the borrowing corporation with the debenture holders to repay, but only a covenant with the trustee, then the debenture holders cannot be said to be creditors. If this is the case, it is arguable that where a corporation issues debentures and subsequently holds them, it does not hold the right, as a creditor, to sue itself.

It is submitted that this conclusion cannot be drawn from the case. The reason for this is *Dunderland's case* considers 'debenture stock holders' as opposed to 'debenture holders'.¹¹⁹

In a normal issue of debentures to the public the trustee holds the covenants of the debentures on trust for the debenture holders and each debenture holder has an individual chose in action against the borrowing company. In contrast, debenture stock is issued by a trustee who has a single chose in action against the borrowing company. Each debenture stock holder will be a beneficiary of the trustee, and will therefore have an equitable interest in the chose in action. Although the names are similar the legal processes behind a 'debenture stock' issue and a 'debenture' issue are significantly different.

¹¹⁵ *Corporations Law* s 1052.

¹¹⁶ JK Ammitage, *The Debenture Trust Deed*, Ch 10 of Austin & Vann, *The Law of Public Company Finance* (1986) at 265.

¹¹⁷ *Ibid* at p 266.

¹¹⁸ [1909] 1 Ch 446.

¹¹⁹ *Re Dunderland Iron Ore Company Ltd*: Swinfen Eady J points out at p 452: 'They are not debenture-holders. They are debenture stockholders'.

A debenture stock holder may not have a chose in action against the borrowing company, as by definition they hold only parts of a whole debt held by the trustee,¹²⁰ the same cannot be said of the debenture holder.

In any case, if the original interpretation of the decision in *Dunderland's* case is correct then it can also be criticised as it failed to look at cases supporting the principle that a beneficiary can enforce contractual rights held on trust for him against a third party¹²¹ and on this basis a holder should be regarded a creditor of the issuing corporation.

In addition the argument that debenture holders are not creditors of the issuing corporation may not be valid when applied to Australian corporations. One commentator has noted¹²² that in most cases the trust deed will contain a covenant with the provision enabling each debenture holders to sue for amounts due to them individually. However, it appears that this provision is qualified by a discretion given to the trustee not to allow it. Another point to note is that debenture holders are generally treated as direct creditors for the purposes of schemes of arrangement under Part 5.1 of the *Corporations Law*.

In summary, it would appear that there are enough arguments for a holder of a debenture being a direct creditor of the issuing corporation. A trust deed, therefore, does not have the effect of stopping the corporation holding a right to sue itself as a creditor.

(ii) *Subsidiary or Related company as an Intermediary*

Where a corporation takes its own debentures as security, the problem of the corporation holding its own debentures may be avoided where a third party, such as a subsidiary or associated entity, takes the debentures as security. The argument is that the issuing company never holds its own debentures.

An analysis by Professor Everett in relation to bank deposits can be applied to the circumstances here. In summary, Professor Everett asserts¹²³ that the use of a subsidiary will most probably only be effective where the security is by way of mortgage as a charge is only enforceable by contract and therefore, requires consideration to be given by the subsidiary which in most cases is not.

In the case of a corporation offering its own debentures there are two possible transactions. Firstly, where the company has its subsidiary purchase the debentures from holders rather than repurchasing them itself. The subsidiary then guarantees the loan to the parent company. In a guarantee the subsidiary would incur a direct contractual liability to the creditor of the parent company

120 See above under heading 'Equitable choses in action'.

121 *Palmer's Company Law* (23rd ed 1982) Vol 1, Ch 46-01 and note 4.

122 JK Ammitage, 'The Debenture Trust Deed', Ch 10 of Austin & Vann, *The Law of Public Company Finance* (1986) at 265.

123 See Everett D, 'Security over Banking Deposits' (1988) *Aust Bus L Rev* at 371-372.

where the parent company defaults. A problem exists in that when the subsidiary company is deciding whether or not to guarantee the parent, it must consider its own interests rather than the interest of the group. This is known as the doctrine of corporate benefit. In most cases a guarantee will be said to be of corporate benefit if the 'guarantors welfare is so enmeshed with the welfare of the group that what is good for the group is good for the guarantor'.¹²⁴ Proving this corporate benefit will be much harder where the parent company is in trading difficulty and the guarantor is not. In this case it will only be of corporate benefit to give a guarantee if the 'group has substantially similar creditors who will obtain the group assets on collapse'.¹²⁵ Whether or not there is any corporate benefit will then, depend on the particular circumstances of the case. If there is a corporate benefit then the use of an intermediary as a guarantor may overcome the conceptual conflict of a debenture issuer as holder.

Commercially, the creditor will still be relying on the credit-worthiness of the original issuing company. The creditor will exercise the guarantee if the parent company defaults. The subsidiary will be relying on the debentures it holds to meet the guarantee and these will most likely be ineffective as the parent company is insolvent. The only benefit is if they are secured debentures and therefore property of the parent is available.

Conclusion

If the interpretation of s 1051 of the *Corporations Law* and s 66 of the *Bills of Exchange Act* is that a debenture is able to be held by its issuer before maturity, two results follow:

- i) The issuer holds, in effect, a right of action against itself which is not cancelled (as would normally be the case) and as such there is the possibility that it can be offered as security for loans or advances made to the corporation.
- ii) The corporation may be able to take security over its own debentures for advances made by it to another entity.

The effectiveness of this argument is, of course, stronger where the debenture is a negotiable instrument. Where a debenture is a non-negotiable instrument the effect of s 1051 appears to be wholly artificial and opens the way for abuse by companies seeking to give the appearance of holding satisfactory security.

We have seen that there is very little commercial benefit where a creditor takes security over debentures that have been repurchased by the

¹²⁴ G Burton, *Australian Financial Transactions Law*, (1991) at 372.

¹²⁵ Ibid at 373. See cases given as examples: *ANZ Executors & Trustee Co Ltd v Qintex Ltd and Qintex Australia Ltd* (1990) 8 ACLC 791 affirmed on appeal: (1990) 2 ACSR 676; 8 ACLR 980. Byrne J decided that an agreement to give a guarantee, although it took the form of a deed, was incapable of being the subject of an order for specific performance where the giving of the guarantee would not, at the time it was sought to be implemented, be for the corporate benefit of the guarantor.

issuing/debtor corporation. In addition, such purported security transactions will be limited to mortgages and charges unless the debenture is a negotiable instrument, in which case a pledge or lien is also possible. A mortgage, however, appears to be the only transaction which will provide any security benefit at all as the creditor may be able to access property of the debtor corporation which has been given as security for the debenture holders. The other three transactions will not give such access.

Where the corporation takes its own debentures as security there is a commercial benefit in that the security will act as a set-off upon default in the case of a mortgage or a charge. In the case of a pledge or lien the benefit arises only if there is a power of sale allowing the corporation to recoup the money lent.

In light of all this it would appear that the legislation needs to be redrafted to make it clear whether s 1051 is intended to erode the distinction between negotiable instruments and other choses in action and whether the results described in this paper are desirable.