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U.I.PIL. Vol. 3, 2013

Department of Public and International Law
Faculty of Law, University of Ibadan, Ibadan, Nigeria.

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CONTENTS

1. Constitutional Democracy and Acts of Terrorism:
The Nigerian Perspective
Ayoade M. Adebayo, PhD 1 - 23
2. Constitutionality of Suspension of Legislative Representatives by the
National Assembly
Oluwaseyi Augustine Leigh 24 - 39
3. Corruption, Administration of Justice and The Judiciary in Nigeria
Peter Chukwuma Obutte, LL.D 40 - 56
4. An Appraisal of the Socio-Legal Implications of Population Growth
on the Environment
Fagbemi Sunday Akinlolu 57 - 71
5. The Inadequate Protection for Debenture Holders in Nigeria
Kunle Aina 72 - 90
6. Significance of The Charter of The International Civil Aviation
Organisation to Aviation Safety in Nigeria
Ademola O. Ojekunle 91 - 104
7. An Appraisal of the Free Movement of Goods and Persons under
ECOWAS since the 1993 Revised Treaty
Oluwanike Olufunke Oguntokun 105 - 124
8. The Police in the Criminal Justice Administration: A Clog in the Wheel?
Mercy Emetejife Onoriode 125 - 142
9. Customary Criminal Law in Africa and its Lessons for Western
Jurisprudence
Adeniyi Olatunbosun, PhD and K.O. Amusa, PhD 143 - 156

10. An Appraisal of Library Literacy Skills among Fresh Undergraduate Law Students in Faculty of Law University of Ibadan
Omoike Adenike Damilola 157 - 168

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THE INADEQUATE PROTECTION FOR DEBENTURE HOLDERS IN NIGERIA

KUNLE AINA*

ABSTRACT

This paper examined the legal protection for debenture holders in Nigeria. The debenture holders are investors and not shareholders and are subject to different regime of rights somehow different from that of shareholders. The legal title to the debenture stock is held by the Trustee to the debenture who is in turn appointed by the Company without any input by the debenture holders. The Trustee is the only recognized person to institute actions or realize the security in case of default, and where he fails in his duty the debenture holder is left at the mercy of the company. This paper considered all relevant legal options and current position of the law on how the debenture holders rights may be enforced and protected.

1.0 Introduction

The Company is empowered by law to raise money for its undertakings by either selling its shares or by direct debt finance; this is by approaching the financial institutions for loans to pursue their business plans. The most accessible form of external finance for companies is a loan from a financial institution. The loan capital markets represent an important feature on the corporate finance landscape.²⁵⁹ Whilst it may be easy to raise debt capital from banks, or other financial institutions, they will not wish to take risks, and so will insist on taking a form of security for the loan. The indebtedness of the company to the financial institution is generally acknowledged by way of debenture. In some cases, the company may wish to raise a large capital by simply soliciting the funds from the general public. This may be similar to creating securities in form of shares. The company will simply create a form of security instrument known as debenture stock, this enables many investors to be able to invest in the securities at the same time and on the same terms. The sale of the securities is effected mainly through the stock market or exchanges. The investors simply buy portions of the stocks offered for sale and they become lenders or debentures holders. They do not become members of the company by

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²⁵⁹Dignam A and Lowry J. 2009. *Company law* London; Oxford University Press. 85.

so doing but its creditors. They acquire rights against the company. The rights of the lenders reduced into writing and called the Trust Deed, whilst the law also made some provisions to safeguard their rights. This is important decision, in case of default of payments by the company, the procedure for realizing their investment can only be specified by the agreements and backed by law. The debenture trust deed sets out the voting rights and meetings of the debenture holders. A very important issue here is that the company appoints a trustee under the Trust Deed who acts as intermediary between the company and the debenture holders. The trustees are the legally recognized managers of the funds and representative of the debenture holders. The trustees not only represent the interest of the debenture holders but also serve for administrative ease and convenience. As the financial institution will now deal with the trustees only, and the trustees represent the interests of the debenture holders, the debenture holders deal with the company through the trustees.

The loans are therefore aggregated sums advanced to the company in a lump sum by the trustees. The investors subscribe to the debenture stock or loan stock out of the fund, and the stock forms part of the securities of the company. In this circumstance, the lenders will require security for their money advanced to the company, and it will require that the company charge part of or all their properties as security for the loan.

This paper will examine the legal regime for the creation and regulation of debenture critically, the trust deed, the role of the trustees and the protection of debenture holders' rights, as failure will lead to disastrous effects, to the debenture holders, loss of confidence in the debt capital market of the Nation. The paper will also discuss the legal regime for the enforcement of debenture holders' rights against the trustees and the company.

2.0 Definition of Debenture

A debenture is a method of raising money, and the holder is therefore a creditor of the company as opposed to a shareholder who is a member of the company having rights in the company. The rights of debenture holders center around the repayment of the principal money advanced and the interest accruing thereon; irrespective of whether profits are made by the company or not. The courts have tried in many ways to define a debenture, and in fact, they have expressed the difficulty in doing this. Lindley²⁶⁰ observed thus,

'.....what the correct meaning of debenture is I do not know. I do not find anywhere any precise definition of it. We know that there are various kinds of instruments commonly called debentures. You may have mortgage debentures which are the charges of some kind or property. You may have debentures which are bonds. You may have a debenture which is nothing more than an

²⁶⁰ Section 39 (5) CAMA 2004

*acknowledgement of indebtedness. And you may have a thing like this, which is something more, it is a statement by two directors that the company will pay a certain sum of money on a given day and will also pay interest half-yearly at a certain time and at a certain place, upon production of certain coupons by the holder of the instrument. I think any of these things which I have referred to may be debentures within the Act.*²⁶¹

3.0 Statutory Definition

The history of company law in Nigeria dated back to 1912 when the first Companies Ordinance of that year was promulgated. The ordinance made provisions for debentures. (creation and power to issue). The Ordinance defines debenture simply as, including debenture stocks.²⁶² The same definition was repeated in the 1922 Companies Ordinance²⁶³ however, with the advent of the CAMA 2004, the law adopted a much more expanded and modern definition of debenture, Section 650 of the CAMA describes debenture as, meaning ‘a written acknowledgment of indebtedness by the company, setting out the terms and conditions of the indebtedness and includes debenture stocks, bonds and any other securities of a company whether constituting a charge on the assets of the company or not’. On the other hand the Investments and Securities Act 2007 defined debenture in reference to securities. The law classifies debenture as a security of the company. Section 15 of the ISA defines security as,

- (a) debentures, stocks or bonds issued or proposed to be issued by a government
- (b) debentures, stocks, shares bonds or notes issued or proposed to be issued by a body corporate
- (c) any right or option in respect of any such debentures stocks, shares, bonds or rates etc.

The English Companies Act of 1948 defines debenture as “including debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not.”²⁶⁴ Surprisingly, the Companies Act of 2006 UK retains the definition in the 1948 Act. The authors of Gower and Davies principles of Company law²⁶⁵ writing on the definition are of the view that absence of precise definition has given rise to few problems and few reported cases. This is because part 19 of the Act does not engage in any significant regulation of debentures beyond largely administrative

²⁶¹ *British India Steam Navigation Co. v. IRC.*(1881) 7 QBD. 165.

²⁶² Section 241 Companies Ordinance 1912.

²⁶³ Section 2 Companies Ordinance 1922.

²⁶⁴ Section 455, Companies Act 1948 U.K.

²⁶⁵ Davies P.2008. Gower and Davies Principles of Modern Company Law. 8th ed.London;Sweet and Maxwell,pp 1135-1137.

replacements (the registration of allotments and a register of debenture-holders) and some provisions about debentures trustees.

Debentures are either secured or naked. Where debenture is secured it is done by a charge over the company's property²⁶⁶ or assets. It is a naked or unsecured debenture if it is not secured by any charge. The debenture is secured by making a provision to that effect in the debenture itself, or by the terms of the trust deed drawn up in connection with the issue. The charge securing the debenture is enforceable on the occurrence of the events specified in the debentures or the deed securing same.²⁶⁷ The charge may be in form of a fixed charge over the whole or specified part of the company's undertaking and assets, or by a floating charge over all the company's undertaking, or by both fixed and floating charge over the company's properties and assets.²⁶⁸ A debenture holder is entitled to enforce the security of a series of debentures of which he holds part, the debenture holder is entitled to sue in a representative capacity on behalf of himself and other debenture holders of that series.²⁶⁹ The only issue resolved is that the trustee to the issue is also entitled to enforce the security on behalf of the debenture holders,²⁷⁰ and the only time the individual debenture holder is allowed to enforce the debenture is where probably the trustee refuses to initiate legal proceedings on behalf of the debenture holders. The other unresolved issue is that, the individual debenture holder may only sue in a representative action, where the other members of the same class or holding the same series refuse to join in the action or authorise it. What is the position? We may need to answer this question later in this paper.

4.0 Legal Nature of Debentures

The 'Debenture' is a contractual relationship between a creditor and a debtor, if, which is the case in most debentures, coupled with a charge on the properties and assets of the company, it may be classified as a mortgage transaction as well. The difference between a debenture holder and that of a shareholder is that a debenture holder is a creditor with interests and rights against the company. However, the position of the debenture holder may be closely associated with that of the shareholder. This is because, the debenture holder legally subjects to the provisions of the articles of association, may also be allowed to;

- (1) Appoint a director for the company,

²⁶⁶Section 168(e).CAMA 2004.

²⁶⁷Section 173(1).CAMA 2004.

²⁶⁸ Section 173(3) CAMA 2004.

²⁶⁹ Section 173(2) CAMA 2004.

²⁷⁰ Section 173(4) CAMA 2004.

- (2) Share in the profits (though in his own case, whether profits are made or not or whether the company declares dividend or not)
- (3) Repayment at a premium
- (4) Attend meetings; vote at meetings but not during meetings of extraordinary resolution to convert debentures into equity shares which he will be holding as 'equity security' and when he exercises the right, will become an 'equity security'. Where the debenture is secured by a floating charge he will have an equitable interest in the company different from that of the shareholder.²⁷¹

Generally, "debenture" is applied not to the indebtedness itself but to the document evidencing it.²⁷² But the company, instead of issuing individual debentures evidencing separate and distinct debts, may create one loan fund known as debenture stock divisible among a class of lenders each of whom is given a debenture stock certificate evidencing the part of the whole loan to which he is entitled. The certificate evidencing the debenture stock issued to the debenture holder is the evidence of the quantum of the interest held by the debenture holder in the company.

Because of the distinction between securities whose holders are members, and securities whose holders are outside creditors,²⁷³ the rules relating to the raising and maintenance of capital apply only to the former, subject to the exceptions already mentioned, shares impose a liability, on the holder to pay in cash or in kind than nominal value, and while the company is a going concern, the nominal value or the capital of the company cannot be reduced by repayment nor can the shareholders be paid any return on their investments except out of profits.²⁷⁴ None of these rules applies to the debenture holders, they may be paid out of the company's capital, the shares cannot be sold at a discount, and the debentures may be issued at a discount. Theoretically, the debenture holders are not interested in the company except that they are happy that the company continues to be healthy for the purpose of their investments only.²⁷⁵ In the event of bankruptcy, the debenture holders has a right to be paid their investments whilst the shareholders have nothing to collect, in fact, the receiver, may still call up allotted and unpaid capital.²⁷⁶

²⁷¹ Section 186(2) CAMA 2004. The trustee is empowered to safeguard the right of the debenture holders and to exercise the rights, powers and discretions conferred upon them by the trust deed.

²⁷² *Lemon v Austin Friars Investment Trust Ltd* (1926) Ch.1.

²⁷³ Davies P. 2008. *Gower and Davies principles of modern company Law* .8th ed. London, Sweet and Maxwell.p. 1141.

²⁷⁴ Omotola J. 2006. *The Laws of secured credit*.Ibadan; Evans Brothers (Nigeria Publishers) Ltd. p. 163.

²⁷⁵ Morse G. *Charlesworth and Morse Company Law*.15th ed. London; Sweet and Maxwell. 613.

²⁷⁶ Morey M. 1988.Bondholders and Stock holders.*Journal of Corporation Law*. 13. 20.

4.1 Creation of debenture

By virtue of Section 166 of CAMA 2004, the company is empowered to borrow money for the purpose of its business or objects and may mortgage or charge its undertaking property and uncalled capital or any part thereof, and issue debentures, debenture stock and other securities whether outright or as a security for any debt, liability or obligation of the company to any third party. The point is that the company is a free contracting agent having power to borrow money for the furtherance of its business and objects. The debenture is a contractual document between the company and its creditors.²⁷⁷ Whilst the company is empowered by the law, it must also be guided by its articles of association, where the articles provide for a resolution, the proper resolution of the board of directors must be passed before the company can issue debentures.

When debentures have been issued, the prospectus cannot be looked at to ascertain the contract, but if the contract was intended to be contained in the prospectus and the debenture together, or if the prospectus contains collateral contract the consideration for which is the taking up of the debentures, the prospectus can be looked at.²⁷⁸

A company may issue debentures either individually or in series. The provisions of the CAMA 2004 which makes it illegal to allot shares at discount does not apply to debentures, accordingly they may be allotted at par, at a discount, or at a premium, unless not permitted by the company's articles. However, if debentures are issued at a discount together with a right to exchange them for shares of par value, the debentures are good but the right to exchange is void.²⁷⁹

By virtue of Section 168, of CAMA 2004, every debenture shall include statements on the following matters:-

- (a) The principal sum borrowed,
- (b) The maximum discount which may be allowed on the issue or re-issue of the debentures, and the maximum premium at which the debentures may be made redeemable,
- (c) The rate of, and the dates on which interest on the debentures issued shall be paid and the manner in which payment shall be made,
- (d) The date on which the principal amount shall be repaid or the manner in which redemption shall be effected, whether by the payment of installments of principal or otherwise;
- (e) In the case of convertible debentures, the date and terms on which the debentures may be converted into share and the amounts which may be credited as paid up on those

²⁷⁷Lehn K and Poulsen A. 1991. Contractual resolution of bond holders-stockholder conflicts in leveraged buyouts. *Journal of Law and Economics*. 34. 2. 645-673.

²⁷⁸ Morse G. *Charlesworth and Morse company Law*. 15th ed. London sweet and Maxwell. 612.

²⁷⁹*Jacobs v Badavia and General Plantations Trust Ltd* (1924) 2 Ch. 329.

- shares, and the dates and terms on which the holders may exercise any right to subscribe for shares in respect of debentures held by them, and,
- (f) The charges securing the debenture and the condition subject to which the debenture shall take effect,
- (g) statements made in a debenture or debenture stock certificate shall be *prima facie* evidence of the title to the debentures of the person named therein as the registered holder and of the amount secured thereby.²⁸⁰ Further, the Act provides that if any person shall change his position to his detriment in reliance in good faith on the continued accuracy of any statements made in the debenture or debenture stock certificate, the company shall be estopped in favour of such person from denying the continued accuracy of such statements and shall compensate such person for any loss suffered by him in reliance thereon and which he would not have suffered had the statement been or continued to be accurate²⁸¹.

As we noted above, the power to create debenture is derived from the Act²⁸² as well as the articles of association of the company. This is coupled with appropriate resolutions by the Board of Directors of the company. The resolution must spell out the details of the debenture offer. The type; whether convertible or perpetual etc., and in which proportion this is to be made out. The debentures or debenture stock certificates must be completed and ready for delivery within 60 days of the creation of the debenture or debenture stock.²⁸³

A contract to take up and pay for any debentures of the company may be enforced by an order for specific performance.²⁸⁴ This Section provides an exception to the rule laid down in *South African Territories Ltd v Wallington*²⁸⁵ that specific performance will not be granted of a contract to loan money since damages is an adequate remedy for breach of such contract. Under the Common Law however, an agreement to issue debentures made in consideration of an actual balance of money has the effect in English Law of putting the lender in equity in the same position as if the debenture had actually been issued. In the case of *Simultaneous Colour Printing Syndicate Foweraker*,²⁸⁶ a syndicate agreed to sell goods to a company on the terms that, as part payment \$3000 debentures

²⁸⁰ *Mosely v Koffyfountain Mines Ltd* (1904)2 Ch. 108.

²⁸¹ Section 169(1) CAMA 2004.

²⁸² Section 169(2) CAMA 2004.

²⁸³ Section 168 CAMA 2004. This is important because the borrowing outside the authority of the articles is ultra-vires and void, whilst borrowing by the Directors beyond their power as stipulated in the articles is also beyond powers and void. However, if it is intra-vires the company but ultra-vires the Directors powers, it is ratifiable by the company, and based on the rule laid down in *Royal British Bank v Turguard* (1856)119 E.R. 886, the third party is not affected by the internal management rule of the company, and therefore as far as third parties are concerned it is valid. see also Section 69 CAMA 2004.

²⁸⁴ Section 167(1) CAMA 2004.

²⁸⁵ Section 170 CAMA 2004.

²⁸⁶ (1898) A.C. 309.

charged upon all the company's assets were issued on this agreement, the syndicate allowed the company to remove the goods, which were subsequently taken in execution by F. It was held. Although no debentures were actually issued, the syndicate was in the same position as if they had been and so F. was entitled subject to the charge.

Single transaction will involve only a simple debenture deed which will normally comply with the stipulated contents of the debenture as suggested in Section 168 of CAMA 2004, however, since the Act used inclusive language, it means that the parties are allowed to include their own peculiar covenants and terms that are suitable to the circumstances of the loan transaction,²⁸⁷ where the debenture is issued in series, the debenture will be in form of a debenture stock with the aid of debenture Trust Deed. The contents of the debenture trust deed is quite different from the individual single debenture,²⁸⁸ the company is then trying to raise money from a large number of people and must create a debenture stock, appoint a trustee to the debenture issue and also execute a debenture trust deed, as we shall see later, the company must comply with the listing rules of the Stock Exchange if offered through the Exchange, and Companies and Allied Matters Act.²⁸⁹

1.9 Debenture Stock

A debenture is an instrument evidencing a debt with or without security. There are two parties to a debenture-the company and the loan creditor usually a financial institution. However, Section 650 CAMA includes a debenture stock, bonds, and any other securities of a company whether constituting a charge on the assets of the company or not. An instrument like the single debenture deed, but it is an equitable interest under the instrument creating it.²⁹⁰ The debenture being a single individual transaction is not transferable unless the agreement permits its transfer, but the debenture stock is designed for its transferability, because the stock is expressed in units and in amounts of money per unit, and therefore may be traded in such units and transferred. Thus if a public company wish to raise N1,000,000. It could seek to do so by an issue of series of say N1, N10, N100. Debentures, each representing a separate debt totaling aggregate N1,000,00. This would result in an enormous bundle of paper work for the company to process and subscribers to handle. And if a single debenture holder wishes to sell half of it, he cannot make a legal transfer of that half. If however, the company creates N1,000,000 of

²⁸⁷(1901) 1.K.B. 771.

²⁸⁸ Davies P. 2008. *Gower and Davies principles of modern company law*. 8th ed. London, Sweet and Maxwell page 1140.

²⁸⁹ The debenture trust deed will be discussed below.

²⁹⁰ Omotola J. 2006. *The Laws of secured credit*. Ibadan; Evans Brothers (Nigeria Publishers) Ltd. p.167.

debenture stock,²⁹¹ the individual subscribers then find it easy to transfer the whole or fraction of their holding. Palmers described the debenture stock as “borrowed capital consolidated into the mass for the sake of convenience.”²⁹² The trust deed contains covenants by the company with the trustee to repay the capital sum and interest, and to observe and perform other covenants relating to the conduct of its business. The early forms of trust deed normally supplemented individual debentures but usually contained the security offered by the company. The modern form replaces individual debentures and the holder of loan stock is not usually a direct creditor of the company.²⁹³ He is a beneficiary under the trust by which the trustee holds the debt. Most trust deeds provide for action to be taken by the trustee and pre-empt individual action by a stock holder whose main remedy is against the trustee, to compel it to exercise its powers under the trust deed.²⁹⁴

5.0 Protection of Debenture Holders Rights

Creditor protection had always been a very important aspect of company law from the inception. From the enactment of the most criticised legislation on company law- the Bubble Act of 1720 which simply prohibited the trading in Joint Stock companies due to the very serious fraudulent practices which it engendered.²⁹⁵ The struggle for limited liability took so long due to the fears and ideas which people like Blackstone²⁹⁶ who believed that the Joint Stock companies are principally for general public purpose only.²⁹⁷ The answer had been to encourage publicity as a tool for fighting fraud and deception on the general public. The modern company law had evolved with various doctrines and rules for the protection of the shareholders,²⁹⁸ however, very little protection is afforded the debenture holders of the company securities, while the shareholders are regarded as ‘owners’,²⁹⁹ the debenture holders are mere lenders or creditors; and while the shareholders are regarded as insiders, the debenture holders are seen as outsiders. Unless the articles permit, the debenture holders are not entitled to attend the general meetings of the company or vote in such meetings. They are not also involved in the appointment of Directors, and Managers, and while the Directors are regarded as standing in a fiduciary

²⁹¹ Davies P. 2008 .Davies and Gower principles of modern company law .page 1140.. See Section 738 C.A 2006 U.K.

²⁹² Debenture stock can be created de novo, without necessarily first creating debentures before converting to stock as it is done in relation to shares and stock.

²⁹³ Palmer F and Morse G. 2007.*Palmers Company Law*.25th ed. London, Sweet and Maxwell.Para. 43-64.

²⁹⁴ Pennington. 1985. *Company Law* 5thed. Ch. 12.

²⁹⁵ See Sections 750 and 751 Companies Act 2006. (UK).

²⁹⁶ (Cmmd. 6659 (1945) paras. 61-64

²⁹⁷ Davies P. 2008 .Davies and Gower principles of modern company law .p 1142.

²⁹⁸ Schmitthof C.M. 1939. The origin of joint stock company, Toronto Law Journal.3.74-96

²⁹⁹ Gower L.C.B. 1979. Gowers principles of company law. 4th ed. London; Stevens and Sons. 22

position to the company and indirectly the shareholders, and the shareholders have the right and responsibility to block unauthorized actions, and even bring derivative action on behalf of the company against fraudulent Directors, the position of the debenture holder in this regard is probably to call for the loan, and if the company has not breached any of the contractual covenants in the trust deed, it becomes difficult for the debenture holder to make any move against the company or Directors. Quite clearly, shareholders rely on common law duty of skill and care as well as fiduciary duty, and recently legislative interventions on Directors to protect shareholders interest in the company.

Unlike shareholders, debenture holders in theory do not play the same role in the management of corporate affairs therefore, the legal mechanisms that have evolved for debenture holders protection are flexible. Furthermore, in many cases these protections simply do not apply in the absence of fraud distress, or bankruptcy. These doctrines include priority rules in bankruptcy,³⁰⁰ prohibition on fraudulent conveyance³⁰¹ good faith, tort and equity theories³⁰² and most especially the debenture trust deed or the debenture deed in case of individual debenture. Because of the very narrow application of these remedies, as a general rule, the debenture holder relies on the debenture trust deed for protection.³⁰³

In recent times, the functions of shareholders and debenture holders had become increasingly similar. Both groups supply capital to the company in return for an expected stream of income.³⁰⁴ The only difference between these investors is in their varying risk/return objectives and expectations.³⁰⁵ The decision to invest in a company by buying the shares or the debenture stock is sometime an involuntary choice by the investor, the choice being made principally by their financial advisers, but the implications legally may turn out to be far reaching. The debenture holders may soon discover that contrary to their expectations, they are left basically unprotected by law.

³⁰⁰ Gower L.C.B. 1979. Gowers principles of company law. 4th ed. London; Stevens and Sons. 25.

³⁰¹ Shareholders may not necessarily be classified as owners of the company, in view of the rule laid down in *Solomon v Solomon* but they're still regarded as the controller and determinant of the corporate decisions.

³⁰² Collier. 1991. Collier on bankruptcy. 15 ed.

³⁰³ Manning .B. 1988. *A concise text book on legal capital*. 2nd ed 59. Discussing statutory legal capital schemes that regulate flow of assets to shareholders- "the legal apparatus built by common Law and statute around the concept of striking a partial accommodation of the conflict of interests between owners and creditors. p.1.

³⁰⁴ See Section 39 CAMA 2004, the U.S State fraudulent conveyance laws acts to protect creditors from expropriation of assets. See *United States v West* (1969) 299 F. 661 (D.Del) 1969. The Bankruptcy Code also protects creditors from fraudulent conveyance see 11. U.S.C 548(a)(1) (1988).

³⁰⁵ See *Metropolitan Life Insurance Co. v RJR Nabisco Inc.* 716 F. Supp. 1504, 1507 n.6 (S.D.N.Y 1989).

6.0 Key issues in protection of debenture holders rights

We will now look at some of the very important issues that need to be addressed in the protection of debenture holders rights.

1. Creation of the Debenture Stock

While it is a fact that both the debenture holder and the shareholder are not part of the corporate decision to issue the company securities and offer them for sale to the general public, the modalities for the offer and the sale are generally the same. They are offered to the public after all the stock exchange rules and regulations are complied with by the underwriters or dealers on the open market.³⁰⁶ The shareholders upon payment and the issue become the legal owners of the quantity of their shares, while, in the case of the debenture holder it is totally different. The debenture holder only becomes the beneficiary of the stock purchased, while the legal ownership vests in another entity known as the trustee to the debenture stock. The appointment of the trustee was not done by the debenture holders, the debenture trust deed which encompasses the whole gamut of their rights under the contract was not written by them, they do not participate in the entire process, yet they are expected to abide, and the trust deed is binding upon them. Their relationship to the company is entirely contractual, but it is a contract they have nothing to do with, and cannot do anything about.³⁰⁷ The law in Nigeria has not helped issues here. One may argue, that it may not be possible to allow the investors participate in the appointment of a central party to act as trustee, or invite the participation of the debenture holders in the preparation of the debenture trust deed, and so if all the covenants and clauses are unfavorable to them, they will be without remedy.³⁰⁸ Statutorily, the shareholders of the company appoint the Directors,³⁰⁹ they may not be responsible for the appointment of the first Directors.³¹⁰ The position of the debenture holders is different. They are not entitled to appoint their trustees and even after becoming debenture holders, they may only apply to the court to remove their trustee if only if, there is likelihood of conflict of interest.³¹¹ This cannot be done by

³⁰⁶ Debenture holders are limited to contract remedies in the absence of fraud insolvency or a violation of a statute. See also Davies P. 2008 .Davies and Gower principles of modern company law .page 1148.

³⁰⁷Jensen and Meckling. 1976. Theory of the firm, managerial behaviour, agency costs and ownership structure. *Journal of finance and economics*. 3.305. 308-309 at 311 they expressed the view that the private corporation or firms simply are form of legal fiction which serves as a nexus for contracting relationships and which is also characterised by the existence of divisible residual claims on the assets and cash flows of the organization”.

³⁰⁸ The investor that takes a share rather than debenture stock has made a decision to opt for uncertain dividend payments from the company, and be paid during liquidation after all secured Lenders would have been satisfied.

³⁰⁹ See Section 135 CAMA 2004.

³¹⁰ Section 246 CAMA2004.

³¹¹ Section 168 CAMA 2004.

individual debenture holders; it has to be in conjunction with the majority of the debenture holders, so that the majority can always block any move by the minority. In fact unlike the shareholders there is little or no remedy for the minority debenture holder in a debenture trust deed arrangement.

The solution to this problem can only be found in legislative intervention in Nigeria, the Law needs urgent review to make strict and direct provisions for the full participation of the debenture holders in the appointment, removal and monitoring of the debenture trustee.

In the United States of America (U.S.A.), the Trust Indenture Act 1939³¹² makes ample provisions guiding the appointment and eligibility of trustees,³¹³ these issues are strictly regulated under the law. In Nigeria, the appropriate regulatory agency of government that ought to regulate issue of debenture stock and open market of the securities is the Securities and Exchange Commission (SEC), but they are handicapped because there is no enabling statute like the U.S.T.I.A 1939 or any enabling powers to enable them effectively perform their duties.

2. No Protective Legislation in Nigeria:

Apart from the Common Law position on the protection of the shareholders including the minority shareholders of the company, there has now been statutory recognition of these common law rules to further strengthen and expand protection of the shareholders' interests in the company. This is also coupled with the fiduciary duties of Directors to the company which has also been statutorily recognized.

However, the position is different when it comes to protection of debenture holders rights in the company. There is no single statute regulating or protecting the debenture holders' rights in Nigeria. As far back as 1939, the United States had enacted the indentures Trustees Act 1939 which has been updated severally to bring it up to date.³¹⁴

In Australia, the role of trustees for debentures is properly provided for in chapter 21 of the Corporation Act 2001. In Canada, the Canadian Corporation Act 1982³¹⁵ provided for the appointment and regulation of the Trust indentures. The Act³¹⁶ defines

³¹² As amended.

³¹³Section 7, T.I.A 1939.

³¹⁴*Foss v Harbottle* (1843) 2 Hare 461, *Mozely v Alston* (1847) 1 ph. 790, *MacDougall v Gardiner* (1875) 1 Ch. D. 13 per Mellish L.J. at 25, *Prudential Assurance Co. Ltd v Newman Industries Ltd (No. 2)* (1982) Ch. 204 at 222, see also Farrar J.H. 1986. *Company Law*. London; Butterworths. Page 359, Davies P. 2008 *.Davies principles of Modern company Law*. 8th ed. London, Sweet and Maxwell. Part three.

³¹⁵ The entire exceptions to the rule in *Foss v Harbottle* are designed to protect the minority shareholders of a company. Also the rules formulated for winding up of companies under the Just and Equitable Ground, unfairly prejudicial conduct and Derivative Actions are all rules and doctrines formulated by common Law for the protection of minority shareholders.

³¹⁶ See Sections 279-283 CAMA 2004, chapter 2 of part 10 which is headed General Duties of Directors Companies Act 2006(UK).

trust indenture as any deed, indenture or other instrument or act, including any supplement or amendment made by a corporation after its incorporation or continuance under the Act. Issues debt obligations and in which a person is appointed as trustee for the holders of the debt obligation. Section 84 of the Act specifically provides that only a body corporate incorporated under the laws of Canada may carry on the business of a trust company. Nigeria must carry out a proper assessment of its position, not only must the Debenture Trust be brought under proper regulation, the legislative empowerment must be initiated immediately as a proper foundation for Nigerian debt market transactions.

6.1 Debenture Terms and Covenants

Corporate failures of a number of Nigerian companies and massive losses incurred by debenture holders have highlighted the weakness of the position of members of the investing public who become debenture holders of companies. The weakness and the losses incurred are directly related to the very weak legal safeguard for the investment and inability of the regulator to carry out their statutory functions.³¹⁷ The borrowing company is usually a Public Limited Company (PLC), the lenders members of the general public, often lack the knowledge and ability to determine the true merits of the investment but they are attracted by high or higher than normal interest rates.³¹⁸ The terms of the loan are prescribed by the borrowing company, which naturally tries to avoid provisions that will unnecessarily restrict its operations. It is frequently good business to give the minimum security for the maximum loan. Most lenders are concerned with the interest rate and whether the loan is secured or not. Few bother to examine the full conditions of the loan or understand them if they do.³¹⁹

The Companies and Allied Matters Act (CAMA) made provision for the debentures, trust deed³²⁰ under which the trustee to the debentures is appointed.³²¹ The contents of the indenture trust deed must comply with Section 184 and 185 of the Act.

However, these are the minimum contents and the company is allowed to include as many terms conditions, and covenants as possible. The only aim of these additional terms is to safeguard their interest and that of the trustees to the debentures; the protection offered to the debenture holder is very minimal.³²² These covenants cover a series of

³¹⁷ See also the securities as Exchange Commission Board of India (... Trustees) Regulative 1993 regulating the position of the debenture trust. The principal of the regulative is to regulate the business of the Debenture trustees and protect the rights of the debenture holders.

³¹⁸ Corporation Act 1982 (Canada) Section 82 Part VII.

³¹⁹ Section 82(1) Corporation Act.

³²⁰ Section 183 CAMA 2004.

³²¹ Corporate investors may take time to study the Truste Deed.

³²² Johnson H. 1981-1982. The forgotten securities statute. Problems in the Trust Indenture Act. *University Toronto Law Review*. 13. 92-102 Garret.R. Jr.1966.A borrower's view of the model corporate Debenture Indenture provisions. *The Business Lawyer* 21.3.675-691, Bratten W. 2006. Bond covenants and creditor

issues including restrictions upon the pledging or mortgaging of corporate assets. The covenants may take three general forms:

- (a) The affirmative pledge clause- a promise that if the company there after incurs any secured indebtedness, the debentures holders shall ratably share in the security given.
- (b) The conditional negative pledge clause: that the company will not give security by mortgage, pledge, or lien unless debentures then outstanding are equally and ratably secured thereby.³²³
- (c) The absolute no-pledge clause- that the company will not pledge any of its assets.³²⁴

The debentures trust deed may also include subordination agreements. Debts subordination agreements take many forms but always have three common elements:

- (1) Common debtor who owes unsecured debts to two creditors or groups of creditors
- (2) a "junior creditor" (sometime called "subordinator") who either accepts a note or debentures, the terms of which provide that it is junior or subordinate in payment to certain senior debt, or agrees directly with holder of the senior debt that his debt is so subordinate.
- (3) A "senior creditor" who obtains the benefit of subordination either through his purchase of senior debt having certain priority in payment, or by a separate agreement with the junior creditor. The subordinated debt of a certain class or only specified debt, likewise the senior debt may be all present or future debt, or only specified existing or future debt.³²⁵ The machinery through which the subordination agreement works may be complex, but in a simple forms where A (junior creditor) a debenture holder of C (common debtor) agrees to postpone all payments that are new or may become due to him from C until after payment in full of debt that may at any time be due by C to B (senior creditor).

Whatever type of terms or covenants that are included in a debenture, agreement, the purpose and intention behind these covenants are the most important considerations. Generally, these debt covenants protect the lender from an increase in the number of

protection: economics and law theory and practice, substance and process. *Georgetown Business, Economics and Regulatory Law Research Paper*. No. 902910

³²³ Section 183 CAMA 2004.

³²⁴ Section 186 CAMA 2004.

³²⁵ Bratten W. 2006. Bond covenants and creditor protection: economics and law theory and practice, substance and process. *Georgetown Business, Economics and Regulatory Law Research Paper*. No. 902910

claims on the equity cushion and the risk of insolvency, they also indirectly discharge risky investments- risk debt and risky investments tend to be concomitants.

However, conversely, a healthy borrower with prospects of growth will be restricted due to the covenants, practically; additional debt can provide the borrower with additional capital for good projects, the returns on which make existing lenders more secure. Various and personal are the interests that are being protected by the covenants, every class is entitled to protect their selfish interest. Unsecured creditors can only look to the borrowers unencumbered property, the extent that the property is subject to mortgage, security interest, or other liens, it is not available to pay their claims in liquidation. Secured creditors, moreover are accorded priority in bankruptcy reorganisation to the extent of the value of the property covered by their liens, it follows that contracts governing unsecured debt accordingly tend to restrict the creation of new liens.³²⁶ Subordination clauses in the debenture agreements will seem to protect one group of lenders whilst leaving others to perils or risks and loss of their investment.

The trustee for the debentures must therefore insist on adding clauses that protect its own debenture holders. Clauses that are often resisted by the borrowing companies include covenants on:

- (1) Restrictions on payment of dividend and other payments to shareholders
- (2) Restriction on mergers and sales of assets.
- (3) Restrictions on investments.
- (4) Early warning covenants.
- (5) Event risk, etc.³²⁷

6.2 Conflict of Interest Possibilities

Due to the almost non-existent legal protection or remedies for the protection of the debenture holders, the possibility exist and is in fact the order of the day that shareholders have the ability to expropriate wealth from debentures holders. Unless there are proper safeguards outside the trust deed, there will be no remedy for the expropriation of the debentures holders benefit.

1. Conservation of Value

The interdependence of values that provides shareholders with opportunities for expropriation are generally explained by the theory of conservation of value of the firm , when the company without regard for the interest of the debenture holder pays for intense excessive dividends, the value of the firm may depreciate, since, it is possible for the

³²⁶Bratten W. 2006. Bond covenants and creditor protection: economics and law theory and practice, substance and process. *Georgetown Business, Economics and Regulatory Law Research Paper*. No. 902910

³²⁷ Ibid.

company to re-invest the profits into the firm for value appreciation of the company and this assist in conservation of assets, and ensures that the company remains strong enough to accommodate the interests of the debenture holders.³²⁸

2. Incentives

Shareholders have potential for unlimited gain with the risk of loss only limited to the amount invested, while the debenture holders also bear the risk of losing their investment in case of liquidation and they do not enjoy any possibility of value rise to their investment beyond the contractually agreed terms. Shareholders also enjoy control over corporate policy. Shareholders are therefore able to fashion strategies that increase the possibility of realizing additional value on their residual claims.³²⁹ In contrast, the debenture holders who value the security of their fixed claim are not in a position to direct or control the affairs of the company. The singular advantage of control of managerial decisions by the shareholders, without any legal duty of care for the rights of the debenture holders gives them the supreme opportunity to “feather their own nest” and deprive other shareholders any benefit whatsoever.

3. Right to Sue

Debentures may be secured or unsecured obligations.³³⁰ Both legislative efforts and contract³³¹ are involved in order to protect the interest of the debenture holder. Whether statutorily provided or in the terms of the agreement between the parties, the pertinent question is how can the debenture holder enforce those rights, after all, where there is right there should be remedy.

Section 186(2) of the CAMA 2004 provides,

‘It shall be the duty of such trustees to safeguard the right of the debenture holders and on behalf of, and for the benefit of the Debenture holders, to exercise the rights, power and discretions conferred upon them by the trust deed.

³²⁸Coogan F. Kriplee H and Woiss F. 1965. The outer fringes of Article 9. Subordination agreements security interest in money and deposits, Negative pledge clauses, and participation agreements. *Harvard Law Review*. 79. 2, p. 229-277, Galligar A. 1961. Subordination agreement. *Yale Law Journal*. 70. 376-382. Everett C. 1965. Subordinated debt-Nature and enforcement. *Business Law* 20. 953 p. 959-975.

³²⁹Bjerre C. 1999. Secured transactions inside out. Negative pledge covenants, property, and perfection. *Cornell Law Review* 84. 305-320.

³³⁰ See a comprehensive discussion by Bratten W. op cit., Taggart R. 1988. The growth of the Junk bond market and its role in financing takeovers in Averbach A. ed; Mergers and Acquisitions. Chicago; University of Chicago Press. p. 5 at 19, Kahon A. and Klausmer M. 1993. Anti-takeover provisions in Bonds; Bondholder protection or management retirement?. *UCLA.L. Review*, 40. 931.

³³¹ Stewart G. 1986. Stern-Stewart corporate finance handbook., Harvey D. 2012. Bondholders right and the case for a fiduciary duty. *St. John Law Review*. 65. 4.4.

It is the duty of the trustees to safeguard the rights and interests of the debenture holders, and the sole authority to question the management of the company on behalf of the debenture holders. They possess the legal title to the debenture. Being the legal owner, and intermediary between the company (debtor) and the debenture holders, they hold the documents used as security for the loan, they are also the executors of the trust deed. Though on behalf of the debenture holders, they possess all the powers, competence and wherewithal to enforce the provisions of the law and the deed on behalf of the debenture holders against the company.³³²

Where there is a default by the company or a breach of the debenture deed, the trustees should naturally initiate an action in court against the company to enforce the debenture trust deed, or where the trustees fail or refuse to initiate an action, can the debenture holder sue the company? Under the common law, the debenture holder is not entitled to maintain any individual action against the company. But under the Act, a debenture holder is entitled to maintain an action to realize any security vested in him or any other person for his benefit³³³

Where the debenture is secured by a legal mortgage, the debenture holder may therefore realize the security by taking steps directly by the appointment of receiver to sell off the security or where the debenture is unsecured he may file an action in court for foreclosure, appointment of receiver, sale, winding up proceedings, etc., In most cases, the debenture holder must sue in representative capacity on behalf of the class of debentures they represent.³³⁴ The right to sue by the debenture holders is subject to the conditions provided in the debenture deed and the CAMA.

The CAMA 2004 Act provisions makes alternative provisions that whenever the trustees ought to take action against the company, then the debenture holders are also empowered to take the same action. The problem is, are the debenture holders equipped to take such action? The legal estate is invested in the trustee, the Debenture deed may specify that it is the trustee that takes action on behalf of the debenture holders, and all facilities and documents are normally kept with the trustees, most unfortunately, it is the trustees that call for meetings, except, requisitioned by at least one tenth of the members of that class.³³⁵ The individual debenture holder may find it difficult to press for his right as there is possibility of the majority blocking such court action.³³⁶ However, in the case

³³² Harvey D. 2012. Op. cit p. 8.

³³³ Mayson S Daret F. and Ryan C. 2005-2006. Mayson, *French and Ryan on Company Law*, 22nd ed. London; Oxford University Press. 343.

³³⁴ The debenture trust deed is an example of contractual efforts calculated to enhance the value of the security.

³³⁵ Robertson .S. 1988. Debenture holders and the indenture trustee: controlling managerial discretion in the solvent enterprise. *Harvard Journal of Law and Public Policy* 11.461.

³³⁶ Section 208 CAMA 2004.

of *British America Nickel Corporation Ltd v O' Brien*,³³⁷ the House of Lords in England, a decision of the majority of the debenture holders, modifying their rights was invalidated on the grounds that one of debenture holders whose report, was necessary for the passing of the resolution, was to receive under the scheme a block of ordinary shares which opportunity was not available to other debenture holders. In the *O' Brien* case, Lord Viscount Haldane was of the view that the power of alteration "must be exercised for the purpose of benefiting the class as a whole" Davies³³⁸ argues that the rule, does not apply in a literal sense, as requiring no discrimination against any members of the class.³³⁹

Generally, therefore, the trust deed may not necessarily give debenture holders right to institute action to enforce the trust deed, and legally being only beneficiaries, they are not entitled to sue the company directly except where they join the trustees as a party. Even where the individual wishes to sue, he may be handicapped by the wish of the majority, and also he cannot requisition meeting unless backed by at least one tenth of the members of the class. It follows that the individual right is almost unenforceable.

The trustee duty of care skill and diligence ought to be an exception to the rule since the duty is owed to the individual debenture holder and not to a class, and the law permits the debenture holder to initiate action against the trustee if there is a conflict of interest situation.³⁴⁰ In which case, the court may, require the applicant to give security for the payment of the cost of the trustee,³⁴¹ the window of opportunity to sue the trustee is only limited to the conflict of interest issue and does not extend to negligence cases, which can only be performed by the majority of the class, the problem however is that the majority may also release the trustee from liability.³⁴² The solution to this dilemma will be an amendment to the law to take care of the anomaly created.

Some scholars have advocated for the introduction of fiduciary duty of directors of company and the trustees in favor of the debenture holders.³⁴³ A most devastating argument against this advocacy is that the interests of shareholders and debenture holders are mostly irreconcilable and opposite, it may be therefore unrealistic to assume that a single fiduciary could concurrently serve the interest of two parties that are adversarial. In the United States case of *Broad v Rockwell International Corporation*,³⁴⁴ the court ruled that while shareholders hold fiduciary duty to the holders of convertible bonds, that

³³⁷ Section 209 CAMA 2004.

³³⁸ Davies P. 2008 .Davies and Gower principles of modern company law .page 1140.

³³⁹ Robertson S. 1998. Debenture holders and the indenture trustee: controlling managerial discretion in the solvent enterprise. *Harvard Journal of Law and public policy* 11. 461., Epling R. 1989. Trustee standing to sue in alter ego or other damage remedy actions. *Banker Development Journal* 6.1.

³⁴⁰(1927) A.C. 369.

³⁴¹Davies P. 2008 .Davies and Gower principles of modern company law .page 1149.

³⁴² Ibid. see also *Redwood Master Fund Ltd v TD Bank Europe* (2006) 1.B.C.L.C. 149 a decision relating to a decision by Lenders under a syndicated bank loan facility also applicable to debentures.

³⁴³ Section 186(5) see the provision to the subsection.

³⁴⁴ Section 188 CAMA 2004.

duty is satisfied when the firm complies with the letter of the bond indenture, the decisions in US courts like *Harf v Kerikorian*³⁴⁵ and *Green v Hamilton*³⁴⁶ seems to reject the application of fiduciary concept to the debenture transaction.³⁴⁷ The court in *Metropolitan life Insurance v RJR Nabisco Inc.*,³⁴⁸ concludes the matter by denying that there exist a fiduciary duty in favour of debenture holders when he declares:

*Before a Court recognizes the duty of a "punctilio" of an honour most sensitive it must be certain that the complaint is entitled to more than the 'morals of the market place' ...this court has concluded that Plaintiffs presently before it sophisticated investors who are unsecured creditors are not entitled to such additional protections*³⁴⁹

7.0 Conclusion

The position of the debenture holder seems to be very precarious. He invests his money in a company with a very high expectation of returns, the legal control and monitoring of the investment is not within his powers but vested in another body appointed by the company itself. The legislative protection afforded the debenture holders is far from adequate. The use of other common law protective devices like the concept of fiduciary duty has been found to be unavailable to this type of investors. We may safely conclude that there is urgent need for legislative intervention to amend the law by introducing protective mechanism for the protection of debenture holders in Nigeria.

³⁴⁵Havey D. 2012. Bondholders rights and the case of fiduciary duty. *St John Law Review*. 65. 4.4., McDaniel M. 1988. Bondholders and Stock holders. *Journal of Corporate Law* 13. 205. McDaniel M. 1983. Bondholders and corporate Governance. *Business Law*. 41. 413.

³⁴⁶(1989) 716 F. Spp. 1504 (S.D.N.Y. 1989).

³⁴⁷(1975) 347 A.2d 133 (Del. 1975).

³⁴⁸716 F.Supp.1504, (S.D.N.Y 1989).

³⁴⁹(1977) 437 F. Supp. 732 (S.D.N.Y. 1977).