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DEBENTURES: IS APPOINTMENT OF A DEBENTURE TRUSTEE MANDATORY?

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Introduction

Debenture trustee is a person who safeguards the interest of debenture holders and serves as a liaison between the issuer company and the debenture holders.

The concept of debenture trustees was evolved due to the difficulties being faced by an issuer company while dealing with each debenture holder separately for obtaining their consent on various matters and carrying out compliances, when the debentures were issued to multiple debenture holders. In order to overcome this practical difficulty, the need for a single point of contact was felt, which would deal with the issuer company and perform its duties on behalf of numerous debenture holders as per the directions given by the debenture holders in terms of the provisions of the debenture trust deed.

In Indian laws, the concept of a debenture trustee was introduced for the first time in the SEBI (Debenture Trustees) Regulations, 1993 ("**Regulations**"), which *inter alia* govern the eligibility criteria for registration with SEBI, code of conduct and other regulations to monitor and review the working of debenture trustees. Later, the concept of debenture trustees and trust deed was also introduced in the Companies Act, 1956, by way of the Companies (Amendment) Act, 2000, only for the **public issue** of debentures.

In this Article, we have discussed and analysed the appointment of a debenture trustee under the following categories:

1. **Public issue** of debentures;
2. **Listing** of debentures issued or to be issued on private placement **basis by an unlisted company**;
3. Issue of **unlisted unsecured** debentures on private placement basis to selected group of persons;
4. Issue of **unlisted secured** debentures on private placement basis to selected group of persons; and
5. Appointment of a debenture trustee **as required by other regulators** as per their respective guidelines.

Public issue of debentures

SEBI guidelines

Non-convertible Debentures: The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008 ("**Debt Regulations**"), deals with the provisions relating to public issue of **non-convertible debt securities**. As per Regulation 4(4) of the aforesaid Debt Regulations, the appointment of a debenture trustee has been made mandatory. The relevant extracts of the aforesaid Regulation 4(4) are reproduced below for ease of reference:

“(4) The issuer shall appoint one or more debenture trustees in accordance with the provisions of section 117B of the Companies Act, 1956 (1 of 1956) and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993.”

Convertible Debentures: The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 (“**ICDR Regulations**”) deals with the public issue and rights issue of convertible debentures by listed entities, whether compulsorily or optionally convertible. In terms of Regulation 20(1)(b) of the ICDR Regulations, the appointment of a debenture trustee has been made mandatory. The relevant extracts of the aforesaid Regulation 21(1)(b) are reproduced below for ease of reference:

“20. (1) In addition to other requirements laid down in these regulations, an issuer making a public issue or rights issue of convertible debt instruments shall comply with the following conditions:

.....
(b) it has appointed one or more debenture trustees in accordance with the provisions of section 117B of the Companies Act, 1956 and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993;”

Companies Act, 2013

The requirement for appointment of a debenture trustee is also stipulated in Section 71(5) of the Companies Act, 2013 (“**Act**”). The relevant extracts of the aforesaid Section 71(5) are reproduced below for ease of reference:

*“(5) No company shall issue a prospectus or make **an offer or invitation to the public** or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.”*

In addition to the provisions of SEBI regulations, the aforesaid Section 71(5) also mandates the appointment of a debenture trustee when the offer or invitation is made to the public. Hence, it is important to determine when an ‘**issue**’ will be considered to be made to the ‘**public**’. The Act does not stipulate any specific provision for situations ‘**when an issue will be deemed to be made to the public**’. However, the reference of the same could be taken from Section 42(2) of the Act (*as amended recently*), wherein, the threshold limit for private placement is defined as 50 persons in a financial year. Hence, any issue to more than 50 persons would be outside the purview of ‘**private placement**’ and shall be construed as an issue to the ‘**public**’.

In view of the above, it is clear that the requirement for appointment of a debenture trustee is mandatory in case of debentures issued to the ‘**public**’ or to the ‘**members of the issuer company exceeding 500**’.

Listing of Debentures issued or to be issued on private placement basis by an unlisted company

Non-convertible Debentures: In terms of Regulation 19(3) and Schedule I of the Debt Regulations read with the provisions of the prescribed Listing Agreement for the debt securities, the aforesaid requirement(s) pertaining to the appointment of debenture trustee has also been made mandatory for such companies which intend to get its **non-convertible debentures** (issued or to be issued on private placement basis) listed on the floor of a stock exchange.

Convertible Debentures: There is ambiguity regarding the listing of convertible debentures which are issued on private placement basis by an unlisted company. Hence, we have not analysed the requirement of appointment of a debenture trustee under this head.

Issue of unlisted unsecured debentures on private placement basis to selected group of persons

From the plain reading of the aforesaid Section 71(5) of the Act read with Rule 14(2) of the Private Placement Rules, it could be inferred that the appointment of a debenture trustee is not mandatory in case of **unlisted unsecured** debentures issued on private placement basis provided:

1. the total number of intending debenture holders does not exceed 50 (Fifty), where the debentures are intending to be issued to persons other than members of the issuer company; and
2. in case the debentures are intended to be issued to the members of the issuer company, the total number of debenture holders does not exceed 500 (Five Hundred).

Issue of unlisted secured debentures on private placement basis to selected group of persons

In relation to the appointment of debenture trustee for issue of unlisted secured debentures on private placement, it is imperative to analyse the provisions of Section 71(3) of the Act read with Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 ("**Debenture Rules**") in addition to the provisions of Section 71(5) read with Rule 14(2) of the Private Placement Rules. The provisions of Section 71(3) and Rule 18 of the Debenture Rules which are made applicable in case of secured debentures are reproduced below for ease of reference:

Section 71(3)

"(3) Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed."

Rule 18(1)(c)

*"18. (1) The company **shall not issue secured debentures, unless it complies with the following conditions, namely:—....***

(c) the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders; and”

Rule 18(2)

“The company shall appoint debenture trustees under sub-section (5) of section 71, after complying with the following conditions, namely:—.....”

There is a debatable issue regarding the appointment of a debenture trustee, where the secured debentures are issued on a private placement basis. Some experts are of the view that the provisions of Section 71(3) of the Act read with Rule 18(1)(c) of the Debenture Rules is mandatorily required to be complied with in case of issue of secured debentures irrespective of the fact whether the debentures are issued on ‘**private placement**’ or to less than 500 members. This means that in case secured debentures are issued even to a single debenture holder, the requirement of appointment of a debenture trustee becomes mandatory, which view seems to be against the spirit and intent of the lawmakers on the subject due to the following reasons:

1. In the erstwhile Companies Act, 1956, the requirement of appointment of a debenture trustee was made applicable only in case of a public issue and not in case of issue of debentures by private placement; and
2. The concept of debenture trustee was introduced to safeguard the interest of debenture holders where they are large in numbers. No purpose would be achieved in appointing the debenture trustee in case the debentures are issued to a single debenture holder or where the debenture holders are less in number since all the dealings between the issuer company and the debenture holder(s) may conveniently be handled by them without involving a debenture trustee. However, it should ideally be the discretion of the company and the debenture holders if they are willing to appoint a debenture trustee and there should not be any compulsion or obligation under the law in this regard.

For example:

In case a small private limited company issues debenture(s) to another entity for a sum of Rs. 1,00,000 (Rupees one lakh) which are secured by way of movable and immovable property of the issuer company. Such small private limited company has to mandatorily appoint a debenture trustee as per the interpretation given by the aforesaid experts. In our view, this could not be the intention of the legislature since the cost of the appointment debenture trustee may be more than the issue size and this provision may be too harsh for small companies which are desirous to issue secured debentures on private placement basis.

3. The Companies Bill, 2009 as introduced in the Lok Sabha on August 3, 2009 to replace the Companies Act, 1956 was drafted by an expert committee under the chairmanship of Dr. J J Irani.

The explanation to Clause 64 of the Companies Bill, 2009 which deliberates over the appointment of debenture trustees states that “*The company shall not issue prospectus to more than five hundred persons without appointing a debenture trustee*”. Evidently, the intention of the lawmakers was to make the appointment of a debenture trustee mandatory only in cases where the issue of debentures was being offered to persons in excess of 500;

4. The Act has a specific provision with respect to the appointment of a debenture trustee i.e. Section 71(5) of the Act. Therefore, any provisions appearing elsewhere in the Debenture Rules should be read only in the context of Section 71(5) of the Act;
5. Rule 18(2) which has been made applicable in case of issue of secured debentures also refers to the appointment of a debenture trustee only in terms of Section 71(5) of the Act;
6. Doctrine of Harmonious Construction: The Doctrine states that a provision of the statute should not be interpreted or construed in isolation but as a whole, so as to remove any inconsistency or repugnancy. Therefore, Rule 18(1)(c) should be read in conjunction with the provisions of Section 71(5) of the Act and Rule 18(2) of the Debenture Rules;
7. Had the intention of the legislature been mandatory for the appointment of a debenture trustee in case of secured debentures even if the same are issued on a private placement basis, the Act would have been specifically mentioned the same in Section 71(5) and there would not have been any criteria laid down for the appointment of debenture trustees;

In view of the aforesaid reasons, Rule 18(1)(c) of the Debenture Rules cannot be read in isolation from the rest of the provisions otherwise the entire concept of appointment of a debenture trustee will be defeated in case of issue of unlisted secured debentures on private placement basis and the issuer companies will be needlessly burdened with the unnecessary cost that comes with the appointment of debenture trustees.

Appointment of Debenture Trustee as required by other regulators as per their respective guidelines

There may be instances when a regulator mandates the appointment of a debenture trustee in terms of its respective guidelines or directions issued by it. A few such instances are mentioned in this section for ease of understanding.

The Reserve Bank of India, in its Master Direction on Money Market Instruments: Call / Notice Money Market, Commercial Paper, Certificates of Deposit and Non-Convertible Debentures (original maturity up to one year) makes the appointment of a debenture trustee mandatory in cases when companies (including a Non-Banking Financial Company) issues debentures of a maturity of up to one year.

Further, in case of housing finance companies, the National Housing Bank vide its Master Circular on Housing Finance Companies issuance of Non-Convertible Debentures on private placement basis (NHB) Directions, 2014 mandates the appointment of a debenture trustee in case of issue of non-convertible debentures by such companies on private placement basis.

The aforesaid requirements need to be mandatorily complied with by the issuer company though the appointment of a debenture trustee may not be mandatory in terms of the provisions of the Act.

Conclusion

We have summarized the above position in tabular form below for ease of reference:

Relevant category	Appointment of debenture trustee
Public issue of debentures	Mandatory
Listing of NCDs issued or to be issued on private placement basis	Mandatory
Issue of unlisted unsecured debentures on private placement basis	Not mandatory, if debentures are issued to less than 50 persons or members not exceeding 500.
Issue of unlisted secured debentures on private placement basis	Debatable issue. However, in our view, the appointment of a debenture trustee does not seem to be mandatory unless debentures are issued to more than 50 persons or members exceeding 500.
As required by other regulators	Mandatory

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.