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BANKING

Definition of ‘Shares’ in Share Charge Captures Shareholder Loans

by **Neil O’Keeffe**

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17th October 2014 | by Neil O'Keeffe

The standard definition of 'shares', in a charge over shares, includes shareholder loan agreements. That was the conclusion of the English Court of Appeal in Fons HF v Corporal Ltd and another, a decision that may have consequences for lenders, investors and how they structure their transactions.

Fons HF v Corporal Ltd and another

The chargor, Fons HF, held shares in Corporal Limited and made two unsecured loans to Corporal through two shareholder loan agreements. Fons, as charger, subsequently granted a share charge in favour of Kaupthing Bank Luxembourg S.A..

The term 'Shares' was defined in the share charge as meaning: "all shares (if any) specified in Schedule 1 (Shares), and also all other stocks, shares, debenture, bonds, warrants, coupons or other securities now or in the future owned by the Chargor in Corporal from time to time or any in which it has any interest."

Kaupthing claimed that the rights of the chargor under the shareholder loans were charged either as 'debentures' or as 'other securities' under the definition of 'Shares'. In other words, the rights in the charge included rights to repayment under the unsecured loan agreements. The claim was rejected by the High Court in the first instance. The core issue in the Court of Appeal was the meaning of the term 'debenture' and whether the shareholder loan agreements were debentures: the High Court decision was overturned.

Debentures

Patten LJ in the Court of Appeal, noted that the rather nebulous term 'debenture' can apply to "any document which creates or acknowledges a debt; does not have to include some form of charge; and can be a single instrument rather than one in a series." The Court of Appeal unanimously held, on this basis, that shareholder loans were debentures and the rights and receivables under those loans were caught by the share charge. It further held that its judgment was not affected by the fact Kaupthing, as beneficiary of the share charge, was unaware of the shareholder loans when the charge was taken.

Comment

The definition of 'debenture' in the Irish Companies Acts is the same as that in English company legislation, so it is likely that this judgment would be followed by the Irish courts.

The decision has obvious benefits for secured lenders, especially those which have mere share security from investors that is structurally subordinated to the unsecured creditors of the underlying company's business. This decision would also relate to subsequent shareholder loans to the underlying business, which might be of particular relevance where a shareholder gives financial support to a struggling business.

From the perspective of a shareholder or a sponsor, this decision has created obvious restrictions, especially where shareholders' subordinated loan notes or promissory notes were intended to be largely transferrable and liquid instruments. Exclusions, consents and waivers may now be required from the secured lender.

If you would like more information, please contact Neil O'Keeffe at nokeeffe@lkshields.ie or any member of the Banking Team.

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