

“Fair Value” and “Fair Value to the Obligor”

Article

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The mortgage bond indenture (herein called a “Mortgage”) under which many electric and gas utility companies in the United States issue debt securities (herein generically called “bonds”) may be one of the most unloved instruments in all corporate finance. Many of them were written nearly one century ago, in formal, legalistic language (hardly “plain English”). Mortgages contain complex provisions relating to, among other things (1) the release of property from the lien of the Mortgage and (2) the use of property held by the company as a basis for the issuance of bonds, the release of other property from the lien of the Mortgage and the withdrawal of cash held by the trustee under the Mortgage (each of the uses of property listed in this clause (2) being called an “Authorized Purpose”). Of particular interest, and the subject of this note, are the requirements for certification of fair value in connection with these operations. These provisions reflect specific requirements of the Trust Indenture Act of 1939 (the “TIA”). Accordingly, this note will commence with a brief discussion of the TIA.

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Trust Indenture Act of 1939

The TIA, one of the federal securities laws administered by the Securities and Exchange Commission (the “SEC”), was enacted for the purpose of protecting holders of debt securities that are offered and sold in public offerings (and hence are registered under the Securities Act of 1933). Holders of debt securities do not have the benefit of laws that set forth their rights and remedies, as stockholders have the benefit of state corporation laws. Among other things, the TIA requires that debt securities that are publicly offered be issued under an indenture that sets forth the rights and remedies of the debtholders and appoints a trustee to act for the benefit of the debtholders and enforce their rights and remedies. Importantly, these indentures are deemed by

operation of law to contain certain provisions of the TIA, and, thus, in the event of a conflict between such provisions of the TIA and those of an indenture, the provisions of the TIA prevail.

Under Section 314(d)(1) of the TIA, when property is to be released from the lien of a Mortgage, the obligor on the bonds is required to furnish to the trustee a certificate or opinion of an engineer, appraiser or other expert (an “Expert”), who, under certain circumstances, must be independent, as to the “fair value” of the property to be released. This “fair value” is eventually reported to the bondholders. The TIA contains no definition of the term “fair value”, and there is no legislative history on point.

Under Section 314(d)(2) and (3) of the TIA, when property is being subjected to the lien of a Mortgage (or otherwise certified to the trustee) as the basis for an Authorized Purpose, the obligor on the bonds is required to furnish to the trustee a certificate or opinion of an Expert, who, under certain circumstances must be independent, as to the “fair value to [the] obligor” of such property. As with the term “fair value”, the TIA contains no definition of the term “fair value to [the] obligor”, and there is no legislative history on point.

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