Can a noteholder petition to wind up the issuer?

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Last year, the Courts in the Cayman Islands, the British Virgin Islands and Hong Kong were asked to consider the question of whether the ultimate beneficial owner of US law governed notes has standing to petition for the winding up of the issuer of the notes on the basis that they are a contingent creditor.

While the Grand Court of the Cayman Islands and the Hong Kong Court of First Instance both determined that a bondholder did not have standing to petition, the BVI Court took a different approach and found that the petitioner was a contingent creditor with standing to seek the winding up of the issuer.

This article considers the approach in each of these cases and outlines the nuances which led the Courts to reach different outcomes as to whether the petitioning noteholder had standing as a contingent creditor. The article notes that although there is some helpful guidance for noteholders, bondholders and issuers from these decisions, until there is appellate authority dealing with the question it remains unclear whether an ultimate beneficial noteholder is a contingent creditor of the issuer or merely has contingent standing to become a creditor.

The framework of global note and bond issuances

The challenges presented in the cases examined in this article arise from the nature of global note and bond issuances which often use similar structures.

Under this structure:

- the noteholders or bondholders typically only have an indirect beneficial or "book-entry" interest in a global note through a clearing house such as Euroclear or Clearstream [1]
- the trustee of the notes is usually the only party authorised by the underlying transaction documents to take enforcement action against the issuer on behalf of the noteholders or bondholders as a class

- where such enforcement action is taken against a defaulting issuer, recoveries are distributed among the noteholders or bondholders pro rata in accordance with a waterfall prescribed by the transaction documents

The note or bond structures generally involve a descending succession of interests, with the trustee holding the notes on behalf of a clearing house which facilitates trading in the notes by crediting interests in the global note to account holders or "participants" in the clearing house who may, in turn, hold those notes as custodians for the ultimate beneficial owner.

Each party in the chain has contractual rights enforceable against the **immediate** counterparty and there is generally no contractual relationship between the issuer and the ultimate beneficial owner. As a result of this structure, individual noteholders and bondholders are usually precluded from proceeding directly against a defaulting issuer except in very limited circumstances.

Re Shinsun – the Cayman approach

Facts

The first decision which considered the issue of noteholder standing was the decision of Doyle J in *Re Shinsun Holdings (Group) Co Ltd* [2] (***Re Shinsun***). The facts in *Re Shinsun* were as follows:

1. Shinsun Holdings (Group) Co Ltd was the issuer of $200 million 12% Senior Notes Due 2023 pursuant to a New York law governed Indenture entered into with China Construction Bank (Asia) Corporation Limited which was designated as "Trustee" and "Common Depository" of the Notes

2. The Notes were registered in the name of CCB Nominees Limited as nominee of the Common Depository and were traded through Euroclear. Below the registered holder, the structure in descending order was as follows:

1. a. Euroclear as clearing house

   b. the Hong Kong Monetary Authority (**HKMA**) as Euroclear participant or accountholder

   c. the petitioner as the ultimate beneficial noteholder of a 25% interest in the Notes

3. The petitioner was not a party to the Indenture and, therefore, had no direct contractual relationship with Shinsun Holdings. Although the petitioner had a right to require the delivery of Certificated Notes, which would mean it became the legal holder, it had not yet taken steps to do so

4. Shinsun Holdings defaulted on payment under the Notes and the petitioner instructed the Trustee to issue a notice of acceleration under the Indenture

The petitioner presented a winding up petition against Shinsun Holdings arguing that it had standing to bring the petition on the basis that:

1. a. it was a contingent creditor of the issuer [3]

   b. or, it had authority to do so under a statement of account letter issued by Euroclear to HKMA providing authorisation for beneficial owners to commence proceedings

Analysis

Doyle J found that, in order to progress the winding up petition based on a disputed debt, a petitioner must prove on the balance of probabilities that it is a creditor of the company. [4] Although "contingent creditor" is not defined in the Cayman Companies Act, Doyle J relied on the approach in *Re William Hockley Ltd* [5] (***Re William Hockley***) where the English Court explained that a contingent creditor was a person "towards whom under an existing obligation, the company may or will become subject to present liability upon the happening of some future event or some future date". [6]

As to what constituted an "existing obligation" giving rise to contingent creditor status, Doyle J relied on the Supreme Court of Bermuda decision in *Bio-Treat Technology Limited v Highbridge Asia Opportunities Master Fund LP* (***Bio-Treat***) which involved similar facts.

In *Bio-Treat*, the Court emphasised the distinction between "an existing obligation which may give rise to a liability, and an obligation which will lead to a contractual relationship between different parties, which **once established** may give rise to a liability."

Applying the "no look through" principle, [7] Doyle J found that there was "no obligation, whether existing or otherwise, upon the Company to the Petitioner whether in contract, tort, equity or otherwise". [8] The petitioner argued that it had standing as a contingent creditor as it had a present right, under the terms of the Indenture, to require the delivery of Certificated Notes via instruction to the HKMA which would then instruct Euroclear, which could make the petitioner the holder of the Notes under the terms of the Indenture.

However, Doyle J found that this confused the concept of "contingent creditor" with "contingent standing". [9]

His Lordship said that what was required of the petitioner was to establish standing as at the date of the hearing and "it is wholly inadequate for a party to plead, in effect, that its standing is itself contingent upon the happening of some future event at some future date." [10]

Doyle J also rejected the contention that the statement of account letter gave the petitioner standing as the letter had not been issued pursuant to the Indenture and could not vary the terms of the Indenture. Instead, Doyle J found that the Indenture only permitted the registered holder of

the Notes (CCB Nominees) to authorise a person to take action which it is contractually entitled to take. In circumstances where the holder had not given a proxy or authority, his Lordship found that the petitioner was not authorised to progress the petition. In determining this issue, Doyle J highlighted that proper procedure, as set out in the Indenture, must be followed and there was no room for impermissible shortcuts given the importance of certainty in commercial structures. [11]

Re Leading Holdings – The Hong Kong approach

A similar approach was taken by the High Court of the Hong Kong Court SAR in *Re Leading Holdings Group Limited* [12] (***Re Leading Holdings***), which involved a noteholder in a similar position to the noteholder in *Re Shinsun* save that the Common Depository and Trustee under the Indenture (The Bank of New York Mellon, London Branch) was also the registered holder of the Notes.

The petitioner contended that it had standing to present the petition on the basis that, *inter alia*, it was a contingent creditor since it could request the issuance of Certificated Notes following which it would then become the legal holder.

Deputy High Court Judge Suen SC found as follows:

1. Taking into account the global note structure (as outlined above), in which the trustee is vested with enforcement rights on behalf of those holding the beneficial interests, it would be an anomalous outcome if an ultimate beneficial owner could not exercise any direct rights under the Notes against the issuer, but could petition for winding-up and thereby bypass the limitations otherwise imposed under the global note structure and the "no look through" principle. [13] In addition, allowing beneficial interest holders such as the petitioner to commence winding up proceedings would also risk duplicity of proceedings in respect of the same debt [14]

2. The Court should follow the approach to the definition of contingent creditor as outlined in *Re Shinsun* (and the case law applied therein) as requiring that there be an existing obligation and, that out of that obligation, a liability arises on the part of the company to pay a sum of money upon some future event [15]

3. The decision of *Re Shinsun* was "directly on point and its reasoning is sound" and attempts by the petitioner to distinguish it on its facts should be rejected. [16] As such, until the petitioner obtained Certificated Notes in its own name, it could not establish that it was a creditor, either actual or contingent, because there was no existing contractual relationship or obligation between the petitioner and the issuer

The Hong Kong Court expressly rejected the argument by the petitioner that the Court ought to adopt an approach analogous to that adopted for voting purposes in connection with schemes of arrangement (which enables beneficial owners to vote in their capacity as contingent creditors).

Consistent with the approach adopted in *Re Shinsun,* where Doyle J confined those authorities to their context, Suen DHCJ distinguished the scheme authorities and held: "cases on schemes of arrangement are a far cry from the present case. In those cases, what is at stake concerns voting rights on schemes which may affect economic interests, as distinct from locus to present winding-up petition which is a more draconian right than a mere voting right for schemes." [17]

Re Haimen Zhongnan – the BVI approach

Facts

The BVI Court in *Cithara Global Multi-Strategy SPC v Haimen Zhongnan Investment Development (International) Co Ltd* [18] (**Re Haimen Zhongnan**) took a different approach.

Re Haimen Zhongnan involved a very similar note structure to both *Re Shinsun* and *Re Leading Holdings* with a global note registered in the name of Citibank Europe PLC which was party to the Indenture, and the petitioner having an indirect beneficial book-entry interest in the Note via its intermediaries (Euroclear as clearing house and three separate participants).

The petitioner sought to wind up the issuer, arguing that it was a contingent creditor and that the approach taken by Doyle J in *Re Shinsun* was incorrect.

Meaning of contingent creditor

Mangatal J relied on the UK Supreme Court decision of *Re Nortel GmbH* [19] (***Re Nortel***) which gave a broader definition to the term contingent creditor. In *Re Nortel* Lord Neuberger found that "an arrangement other than a contractual one" can give rise to an "obligation" [20] while Lord Sumption said that "contract is not the only legal basis on which a contingent obligation of this kind may arise." [21]

The UK Supreme Court in *Re Nortel* had expressly found that a number of cases, which defined contingent creditor more narrowly were wrongly decided, [22] including the decision of *R (Steele) v Birmingham City Council* [23] (***Steele***). Crucially, although *Steele* was not referred to in *Re Shinsun*, [24] the English Court in *Steele* relied on *Re William Hockley,* which Doyle J had followed.

Mangatal J therefore accepted the petitioner's submission that since *Re William Hockley* relied on the same narrow conception of contingent creditor that had been expressly overruled by the Supreme Court in *Re Nortel*, [25] the definition of contingent creditor adopted by Doyle J, which was reliant on the identification of an "existing obligation", was unduly narrow and should not be followed.

Mangatal J also found that the "no look through" principle discussed in *Re Shinsun* was not applicable as it only applied to direct contractual claims and the interpretation of standing as a contingent creditor under statute was a separate matter. [26]

Additionally, unlike the Courts in *Re Shinsun* [27] and *Re Leading Holdings* [28] where the Cayman and Hong Kong Courts rejected the suggestion that an analogy ought to be drawn to the treatment of beneficial owners of global notes for the purposes of voting at scheme meetings, Mangatal J was persuaded to follow a number of first instance English decisions on this issue. [29]

Accordingly, Mantagal J found that the petitioner was a contingent creditor and was therefore entitled to seek a winding up order against the issuer.

Bases for divergence?

It remains to be seen whether this uncertainty will be resolved by an appellate court. However, in the meantime, it is worth noting some of the factual and legal distinctions:

1. In *Re Haimen Zhongnan*, Mangatal J found that the narrow definition of contingent creditor applied in *Re Shinsun* should be rejected based on the provisions in the BVI Insolvency Act which, similar to the English Insolvency Rules, [30] leaves it open for a BVI court to define a contingent creditor more broadly. [31] There is no similar set of provisions in the Cayman Companies Act [32] or the Hong Kong Companies (Winding Up and Miscellaneous Provisions) Ordinance. [33] Accordingly, it might be argued that the definition of contingent creditor is narrower in Cayman and Hong Kong and the construction applied in *Re Nortel*, which considered the definition under the English Insolvency Rules, is not applicable in those jurisdictions

2. In addition, there are some factual distinctions between *Re Shinsun* and *Re Haimen Zhongnan* which are notable. **Firstly**, in *Re Haimen Zhongnan*, the Notes had matured before the statutory demand was served so there was no question that the petitioner had the right to receive the Certificated Notes and become the registered holder itself. [34] By contrast in *Re Shinsun*, the Grand Court found that the Notes had not been properly accelerated and were therefore not due and payable. [35] **Secondly**, the Indenture in *Re Haimen Zhongnan* had a clause [36] which provided an express reference to clause 5.3.1.3 in the Euroclear Operating Procedures which itself authorised participants and their underlying beneficial owners to maintain proceedings against issuers. There was no similar clause cited in *Re Shinsun* [37](although there was an identical clause in *Re Leading Holdings* [38])

However, given that *Re Leading Holdings* was published shortly after *Re Haimen Zhongnan*, Mangatal J did not consider nor deal with that case. In *Re Leading Holdings,* the petitioner did not have the same factual issues under the governing documents as the petitioner in *Re Shinsun* did and therefore, arguably, that case went further and suggested that an ultimate beneficial owner *only* becomes a creditor upon becoming listed as a registered holder of notes. *Re Haimen Zhongnan* also did not consider some of the policy considerations which Suen DHCJ considered to be influential to his judgment relating to the purpose and structure of global notes and the need to prevent duplication of proceedings by both trustees and beneficial noteholders. It is an open question as to whether, if they were considered in *Re Haimen Zhongnan*, such considerations could

be reconciled with the broad provisions in the BVI Insolvency Act.

Conclusion

In the present climate of higher interest rates and ongoing economic volatility in Mainland China, there is likely to be an increased volume of defaults with more investors who are the beneficial owners of notes or bonds looking to bring enforcement action against issuers.

The recent cases considered in this article provide conflicting approaches as to the ability and circumstances in which such investors may bring winding up proceedings directly against a defaulting issuer. On the current state of the law in the Cayman Islands (and subject to any decision of the appellate courts), holders of global notes and bonds would be well-advised to explore the availability of collective enforcement action in the first instance by instructing the trustee to take such steps as may be prescribed in the transaction documents (likely with the benefit of an indemnity) on behalf of the class of holders. Should enforcement not be possible through the trustee, factors relevant to whether an investor may take direct action against a defaulting issuer will include:

- the existence of an immediate and enforceable contractual right to obtain certificated notes or bonds;
- the availability of other enforcement rights prescribed in the indenture
- the legislative scheme and definition of 'contingent creditor' in the relevant jurisdiction.

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Notes

[1] The Euroclear system is the world's largest clearance and settlement system for internationally traded securities. It also provides a custodian service for securities and is an international central securities depositary (**ICSD**). The majority of participants in the system are banks, brokers, dealers, custodians, and other institutions professionally engaged in managing new issues of securities, market making, trading or holding the wide variety of securities accepted in the system. The participants trade in the system as principals, notwithstanding that they may trade on their own behalf or on behalf of an underlying investor': *Re Jinro (HK) International Ltd (No 2)* [2003] 4 HKC 637 at [31]

[2] (Unreported, 21 April 2023, Doyle J)

[3] Section 94 of the Companies Act provides that an application to the Court for the winding up of a company shall be by petition presented by "any creditor or creditors (including any contingent or

prospective creditor or creditors)"

[4] *Re GFN Corporation Limited* [2009 CILR 650] at [94], [101]

[5] [1962] 1 WLR 55

[6] *Re William Hockley Ltd* [1962] 1 WLR 55 at 558. Although only a first instance English decision, the approach in *Re William Hockley Ltd* has been applied by the High Court of Australia in *Community Development Pty Ltd v Engwirda Construction Co* (1969) 120 CLR 455 and the Grand Court of the Cayman Islands in *Perry v Lopag Trust* (Unreported, 23 February 2023, Segal J)

[7] The principle upon which international securities depositories operate whereby "each party has rights only against their own counterparty", upheld by the English Court of Appeal in *Secure Capital SA v Credit Suisse AG* [2017] EWCA Civ 1486 at [10]

[8] *Re Shinsun* at [143]

[9] *Re Shinsun* at [151]

[10] *Re Shinsun* at [152]

[11] *Re Shinsun* at [165]

[12] [2023] HKCFI 1770. The earlier decision of the Hong Kong Court of First Instance in *Re China Oceanwide Group Limited* [2023] HKCFI 455 involved a similar factual scenario, however, Chan J refused to hear any argument on the question of whether the petitioner was a contingent creditor given that it was not pleaded in the petition and the petitioner had not sought leave to amend the petition

[13] *Re Leading Holdings* at [65], [118]

[14] *Re Leading Holdings* at [91], [119]

[15] *Re Leading Holdings* at [108]

[16] *Re Leading Holdings* at [110]-[116]

[17] *Re Leading Holdings* at [136]

[18] Claim No. BVIHC(Com) 2022/0183

[19] [2014] AC 209

[20] *Re Nortel* at [76]

[21] *Re Nortel* at [132]

[22] Lord Sumption referred to these cases as "a legacy of the older principle which admitted only contractual debts to proof": *Re Nortel* at [136]

[23] [2006] 1 WLR 2380

[24] Mangatal J also accepted the submission that the Supreme Court of Bermuda decision of *Bio-Treat* (relied on in *Re Shinsun*), which also did not refer to *Steele* but adopted the same reasoning on the definition of contingent creditor, should not be followed: *Re Haimen Zhongnan* at [165]-[170]

[25] As noted by Mangatal J, although Doyle J referred to *Re Nortel* in *Re Shinsun*, he did not refer to the paragraphs in which the Court found that a contract is not the only basis upon which contingent obligations may arise: *Re Haimen Zhongnan* at [179]

[26] *Re Haimen Zhongnan* at [180]

[27] Doyle J found that contingent creditor "may mean one thing in one context and another thing in another context": *Re Shinsun* at [147]

[28] *Re Leading Holdings* at [136]

[29] *Re Haimen Zhongnan* at [187]. These first instance English decisions included *Re Castle Holdco 4 Ltd* [2009] EWHC 3919 (Ch); *Re Gallery Capital SA* [2010] 4 WLUK 287; *Re Co-operative Bank Plc* [2013] EWHC 4072 (Ch); *Re Noble Group Ltd* [2019] BCC 349; *Re CFLD (Cayman) Investment Limited* [2022] EWHC 3496 (Ch)

[30] See *Insolvency (England and Wales) Rules 2016*, rules 14.1, 14.2

[31] Mangatal J in *Re Haimen Zhongnan* at [185] relied on the following provisions of the BVI Insolvency Act: (1) section 10(2) which defines a liability as follows: "A liability may be present or future, certain or contingent, fixed or liquidated, sounding only in damages or capable of being ascertained by fixed rules or as a matter of opinion"; (2) section 11(2)(a) which provides that "liabilities of the company" are admissible as claims in the liquidation; and (3) section 9(1)(a) which provides that a creditor is a person that has an admissible claim in the liquidation of the debtor

[32] See Companies Act, s 139(1)

[33] See Companies (Winding Up and Miscellaneous Provisions) Ordinance, section 264

[34] *Re Haimen Zhongnan* at [118]

[35] Doyle J found that under the express terms of the Indenture, only the Trustee of the Notes could validly accelerate the debt upon written direction from the Holder, not the petitioner: *Re*

Shinsun at [168]. However, there was no similar finding against the petitioner in *Re Leading Holdings* and it had also filed a statutory demand after the Notes matured as in *Re Haimen Zhongnan*

[36] Clause 2.6 provided: "... participants must rely on the procedures of Euroclear and Clearstream and indirect participants must rely on the procedures of the participants through which they own book-entry interests in order to transfer their interests in the Notes or to exercise any rights of Holders under this Indenture."

[37] *Re Haimen Zhongnan* at [183]

[38] *Re Leading Holdings* at [9]

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