Beneficial Noteholders and Insolvency Standing: Why Cayman and BVI Reached Opposite Conclusions

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Offshore note issuances regularly involve New York law-governed instruments held through global clearing systems such as Euroclear and Clearstream. While these structures facilitate trading in the market and settlement, they also create a potential disconnect between legal ownership and economic ownership.

An issuer's obligations are typically owed to a registered holder or nominee, while the economic consequences of a default are borne by investors holding beneficial interests through a chain of intermediaries. When insolvency proceedings become necessary following default on interest payments or the payment of principal by the issuer, that distinction raises an important question: Can a beneficial noteholder who lacks direct contractual privity with the issuer nevertheless qualify as a creditor with standing to invoke insolvency remedies?

Shinsun Holdings (Group) Co. Ltd[1]

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The issue was considered by the Grand Court of the Cayman Islands in *Shinsun*, where Doyle J held that the ultimate beneficial holder of notes did not have standing to pursue a winding-up petition. Shinsun Holdings (Group) Co., Ltd., a Cayman exempted limited company, issued 12 percent senior notes due in 2023 pursuant to a New York law-governed indenture, with China Construction Bank (Asia) Corporation Limited designated as trustee and common depository of the notes. The notes were registered in the name of CCB Nominees Limited and traded through Euroclear.

Shenwan Hongyan Strategic Investments (H.K.) Limited (HKMA), who was the petitioner, owned 25 percent of the aggregate outstanding principal of the notes through the Hong Kong Monetary Authority as a participant of Euroclear. The petitioner was not a party to the indenture.

Shinsun defaulted on its interest payments under the notes, and the petitioner directed the trustee to issue a notice of acceleration under the indenture. When Shinsun failed to settle the outstanding debts, the petitioner presented a winding-up petition and claimed it had standing to do so because it (1) was a contingent creditor of Shinsun by virtue of holding the ultimate beneficial interest in the notes; and/or (2) had the requisite authority from a statement-of-account letter issued by Euroclear to the HKMA authorizing beneficial owners to commence proceedings.

The Standing Issue

The petitioner argued that it had a right, under the terms of the indenture, to require the delivery of certificated notes via an instruction to HKMA, which could then instruct Euroclear, which would eventually make it the holder of the notes. In response, Shinsun argued that the petitioner did not have standing because it had no contractual relationship with Shinsun and could only establish such a relationship once it received the certificated notes.

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Section 94(1)(b) of the Cayman Companies Act gives standing to "any creditor or creditors (including any contingent or prospective creditor or creditors)" to petition for the winding up of a company. Doyle J relied on the definition of "contingent creditor" set out in the English case of *Re William Hockley Ltd.*,[2] which is "a person towards whom an existing obligation, the company may or will become subject to a present liability upon the happening of some future event or at some future event." The Supreme Court of Bermuda's decision in *Bio-Treat Technology v Highbridge*[3] was also cited, where Bell J referenced *William Hockley* and noted that "the critical words are of course 'under an existing obligation'" and that a distinction should be drawn 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."

New York law expert evidence on the rules of the construction of the indenture, provided by **Daniel Glosband** for Shinsun and Ryan Kane for the petitioner, confirmed that there was no contractual relationship between Shinsun and the petitioner. Accordingly, Doyle J held that the principle of privity of contract applied (also referred to as the "no-look-through principle" under English law), which is that only the parties

1 [2023] (1) CILR 473.

2 [1962] 1 WLR 555.

3 [2009] SC (Bda) 26 Civ.

to a contract are bound by its terms and can enforce the relevant obligations under the contract. In other words, in a capital markets structure where there is an issuer, clearing system, custodian and ultimate beneficial owner, each party has legal rights only against their immediate counterparty. The petitioner therefore had no standing, as the evidence established that there was "no obligation, whether existing or otherwise, upon the company to the petitioner whether in contract, tort, equity or otherwise."

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The court held that the petitioner had conflated the concepts of "contingent creditor" with "contingent standing." Given that the petitioner had not received certificated notes or successfully taken any steps to obtain them, its standing was contingent upon it successfully bringing itself into a direct contractual relationship with Shinsun. The petitioner was therefore unable to prove, on the balance of probabilities, that it had actual standing as a contingent creditor at the date of the hearing.

The Authority Issue

Doyle J also rejected the argument that the statement-of-account letter provided the petitioner with the requisite authority to progress the petition. The letter had not been issued pursuant to the terms of the indenture, which expressly stated that the proxy or other appropriate authority to petition was required to come from the registered holder, which was CCB Nominees (not Euroclear).

Cithara Global Multi-Strategy SPC v Haimen Zhongnan Investment Development (International) Co. Ltd.[4]

The BVI court reached an opposing view in the case of *Cithara*. In that case, Haimen Zhongnan Investment Development (International) Co. Ltd., an offshore financing vehicle incorporated in the BVI (Haimen), as issuer, authorized the issuance of up to US$150,000,000 aggregate principal amount of 12 percent Guaranteed Senior Notes Due in 2022 pursuant to a New York law indenture dated 9 June 2021 entered into between Haiman, Jiangsu Zhongnan Construction Group Co. Ltd. (the parent company of Haimen (Jiangsu)) as guarantor and Citicorp International Limited as trustee. The global note was delivered to and registered in the name of Citibank Europe PLC (as common depository) or its nominee for the accounts of Euroclear and Clearstream. The nominee was Citivic Nominees Limited.

Participants (including Credit Suisse AG) held accounts with Euroclear and/or Clearstream, and investors, such as Cithara, bought and sold notes through the participants. Haimen failed to pay interest and principal on the maturity date of the notes, and Jiangsu failed to meet its obligations under the guarantee. As a result of these events of default, Cithara issued a statutory demand against Haimen in the BVI, which was not satisfied or set aside, and subsequently applied for liquidators to be appointed over Haimen.

Haimen resisted the application on the basis that Cithara had no standing, as it was not a "holder" of the notes pursuant to the definition under the indenture. Haimen also argued that as Cithara lacked any direct contractual relationship with Haimen, it was also not a "creditor" under the provisions of the BVI Insolvency Act. The parties relied on the evidence of the same experts that had given evidence in Shinsun: Mr. Glosband for Haimen, and Mr. Kane for Cithara.

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A Different Conclusion

Mangatal J approached the issue of Cithara's standing as creditor as a mixed question of New York law and BVI law. The judge first determined the nature and extent of Cithara's rights under New York law, preferring the evidence of Mr. Kane and holding that, properly construed, the indenture incorporated the Euroclear procedures, which in turn incorporated a right for Cithara to obtain certificated notes on the issuer's default. This meant that Cithara had enforceable rights and at least a contingent right to payment.

Turning to BVI law, the judge adopted a broad, modern approach to the meaning of "creditor" and "contingent creditor," emphasizing the wide statutory language of the BVI Insolvency Act and the principle (drawing on the U.K. Supreme Court case of *Re Nortel GmbH*[5]) that contingent liabilities are not confined to existing contractual obligations. In particular, Mangatal J relied on the reasoning that a company incurs an "obligation" where it has taken steps that place it in a legal relationship that renders it vulnerable to a future liability, even if that liability is contingent on future events.

Applying that framework, the issuance of the notes and entry into the indenture were sufficient steps to create such a legal relationship: The issuer had committed itself to a structure in which it could become liable to ultimate beneficial holders, including upon default and the triggering of rights to obtain certificated notes.

Mangatal J emphasized that *Re Nortel* disapproved earlier authorities that had adopted a narrow, contract-focused definition of contingent liabilities, including cases influenced by *William Hockley*. The judge treated *William Hockley* as representing an older line of authority that insisted on a pre-existing legal obligation owed directly to the alleged creditor, and considered that reasoning to be inconsistent with the modern insolvency principle that "all possible liabilities within reason" should be captured within the regime. As a result, the judge concluded that reliance on *William Hockley* (and cases such as *Community Development Pty. Ltd. v Engwirda Construction Co.*,[6] which applied it) was "tenuous" and could not provide a firm foundation for determining standing under the BVI statutory scheme.

4 BVIHC(COM) 2022/0183.

5 [2013] UKSC 52.

6 (1969) 120 CLR 455.

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Against that backdrop, Mangatal J declined to follow *Bio-Treat*. The judge held that *Bio-Treat* had proceeded on the erroneous premise that a direct contractual relationship is required before a contingent claim can arise, and therefore failed to reflect the broader understanding of contingent liabilities endorsed by the U.K. Supreme Court in *Re Nortel* and embedded in the BVI Insolvency Act. The judge also noted that *Bio-Treat* might not have involved the same contractual framework (in particular, provisions equivalent to those incorporating Euroclear procedures) and was decided without the benefit of expert evidence on New York law, further limiting its persuasive force.

Accordingly, Mangatal J reframed the inquiry away from whether Cithara had an existing contractual right against the issuer and toward whether the issuer had entered into a set of arrangements that could give rise to liability to Cithara upon the occurrence of specified contingencies. On that analysis, the absence of privity was not determinative; the relevant question was whether the statutory concept of "creditor" (which includes contingent liabilities) was satisfied. Applying the *Re Nortel* approach, the judge held that it was, and that Cithara fell within the class of contingent creditors despite the interposition of the clearing system and nominee structure.

Comment

There are a few distinguishing features between *Shinsun* and *Cithara* that are worth noting. First, in *Cithara*, the notes had matured before the statutory demand was served, which meant that Cithara had a specific right to receive the certificated notes and become the registered holder. This is in contrast to *Shinsun*, where the notes had not been properly accelerated (despite the petitioner's request to the trustee) and so were not due and payable.

Second, the indenture in *Cithara* incorporated the Euroclear operating procedures, which permitted beneficial noteholders to maintain legal proceedings in connection with the securities. This was not included in the *Shinsun* indenture.

Third, it is possible that the definition of "contingent creditor" will be given a wider interpretation in BVI compared to Cayman. Section 10(2) of the BVI Insolvency Act defines a liability as being "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." This is similar to the definition under Rule 13.12(3) of the English Insolvency Rules 1986, where the U.K. Supreme Court in *Re Nortel GmbH* noted that "contract is not the only legal basis on which a contingent obligation of this kind may arise."

Shinsun is the only Cayman case to date that has considered whether a beneficial noteholder has standing to pursue a winding-up petition. Given that this decision is at odds with *Cithara*, there will be some uncertainty going forward until the issue is resolved by an appellate court. As things currently stand, it would be prudent for beneficial noteholders of notes issued by Cayman companies seeking to take enforcement action to first do so by instructing the trustee to take the required steps under the transaction documents.

Regarding beneficial noteholders seeking redress against BVI issuers, the outcome in *Cithara* suggests that petitioners should, as a matter of best practice, ensure that their evidence clearly establishes (1) the contractual and operational chain through the clearing systems, (2) any express or incorporated authorizations (such as Euroclear procedures) permitting enforcement by beneficial holders, and (3) any accrued or crystalized rights (such as the right to obtain certificated notes), so as to demonstrate contingent creditor status on the face of the liquidation application. abi