

Global Notes Explained: Individual Noteholders Lack Standing to Wind-up Issuers

Points for corporate trustees and noteholders to consider following the recent Hong Kong Court decision *In the Matter of Leading Holdings Group Limited* [2023] HKCFI 1770 and the Cayman Court decision *In the Matter of Shinsun Holdings (Group) Co. Ltd* [FSD2022-0192]

Executive Summary

The recent decision of *In the Matter of Leading Holdings Group Limited* handed down in July 2023 is the first occasion where the Hong Kong Court held that an individual noteholder (holding an interest in a global note through Euroclear and Clearstream) had no standing to present a winding-up petition as a contingent creditor against a note issuer. The reasoning followed decisions by the Courts of Hong Kong and the Cayman Islands (in February and April 2023 respectively), namely *In the Matter of China Oceanwide Group Limited* [2023] HKCFI 455 and *In the Matter of Shinsun Holdings (Group) Co. Ltd*.

This case serves as an important reminder to individual noteholders that the Hong Kong Court recognises the “no look through” principle under a global note structure in winding-up proceedings, where individual noteholders would be required to act through the trustee as the exclusive channel of enforcement with no directly enforceable rights against the issuer. Accordingly, an individual noteholder’s efforts to issue a winding-up action in the Hong Kong Court, whether to substantive or tactical end, could prove futile.

As of the date of this publication, we are not aware of any appeals of *In the Matter of China Oceanwide Group Limited* and *In the Matter of Leading Holdings Group Limited*. We are closely monitoring the increasing number of common law judgments around some of the issues discussed in this article, including the most recent judgment handed down by the BVI Court (*Cithara Global Multi-Strategy SPC v Haimen Zhongnan Investment Development (International) Co. Ltd* [BVIHC(COM) 2022/0183]) which will be analysed in greater detail in a further article to be published shortly.

Factual background

In 2021, Leading Holdings Group Limited (the **Company**) issued senior notes (the **Notes**) under a New York law governed indenture (the **Indenture**). The Notes were represented by a global note held by a common depositary for Euroclear and Clearstream, the European international clearing systems. The petitioner (**Petitioner**) is an individual noteholder who invested in a portion of the Notes via an intermediary bank holding a Euroclear account. The Petitioner is not, crucially, a party to the Indenture.

In 2022, the Petitioner filed a winding-up petition (the **Petition**) against the Company following the Company’s failure to pay the principal sum and interest of the Petitioner’s Notes. The Petitioner pleaded in the Petition that he is the **beneficial and equitable** holder/owner of the Notes, and is entitled to present the Petition as a contingent and prospective creditor. The Company subsequently applied for the Petition to be struck out.

Key Issues

The Hong Kong Court considered the following three key issues:

- i. whether the Petitioner is the “Holder” of the Notes under the Indenture such that it has directly enforceable rights against the Company (the **Rights Issue**);
- ii. whether the Petitioner, as the beneficial owner of the Notes, has the same standing to present a winding-up petition as an equitable assignee (the **Beneficial Owner and Equitable Assignee Issue**); and
- iii. whether the Petitioner has standing to present a winding-up petition as a contingent or prospective creditor (the **Contingent Creditor Issue**).

Hong Kong Court’s Decision

Deputy High Court Judge Suen SC answered “No” to each of the three issues and struck out the Petition.

The Rights Issue

The Hong Kong Court examined the terms of the Indenture and noted that only the common depositary (or its nominee) will be considered the “Holder” of the Notes while they are represented by the global note, and only such Holder has the right to institute proceedings or enforce payment of the Notes against the Company. While the Hong Kong Court accepts that the Petitioner is a beneficial owner of the Notes by holding book-entry interests, the Petitioner is not a party to the Indenture and is therefore not a defined “Holder” of the Notes under the Indenture who is entitled to pursue certain specified enforcement actions. This approach is consistent with *In the Matter of China Oceanwide Group Limited*, an earlier Hong Kong case involving a global note structure and an indenture with similar terms as the present case, where Linda Chan J concluded that the petitioner, who was a beneficial holder, was not a Holder of the notes in global form for the purpose of certain enforcement rights under the relevant indenture and therefore did not have the right to commence proceedings with respect to the indenture or the notes.

The Beneficial Owner and Equitable Assignee Issue

The Hong Kong Court distinguished between the positions of an equitable assignee and a beneficiary under a trust. An equitable assignee of a debt is its true owner and has standing to present a winding-up petition. On the other hand, the position of a beneficiary of a debt (such as the Petitioner) is different and generally has no independent right to sue. Specifically in the context of a global note structure, individual noteholders holding indirect beneficial interests cannot bring action against the issuer directly as they are required under the terms of the Notes to act through the trustee as the exclusive channel of enforcement. In addition, noteholders cannot get a judgment in priority to the other noteholders and there should not be a duplicity of possible actions by the trustee and the noteholders at the same time.

The Contingent Creditor Issue

The Hong Kong Court endorsed the analysis in *In the Matter of Shinsun Holdings (Group) Co. Ltd* that an individual noteholder is not a contingent creditor, and accordingly lacks standing as such to present a winding-up petition. The Cayman Court emphasised the need for a creditor, whether contingent or prospective, to have an existing legal relationship with the company or an existing obligation owed by the company. The Hong Kong Court followed the same reasoning, given that the Petitioner has no existing contractual relationship with and no directly enforceable rights against the Company. We note at this juncture that the BVI Court in *Cithara Global Multi-Strategy SPC v Haimen Zhongnan Investment Development (International) Co. Ltd* considered this issue in length, and our follow-up article will seek to address this in further detail.

Considerations For Noteholders And Corporate Trustees

The Hong Kong Court made it clear that unless or until the Petitioner obtains definitive notes in its name, it cannot establish that it is a creditor of the Company. When considering an exchange of interests in a global note for a definitive note in order to create a direct contractual link to an issuer, there follow important issues to note:

- i. The circumstances under which definitive notes may be issued are limited and bespoke to each indenture. There is a substantial risk that the issuer (who is already in default of payment and/or other obligations under the relevant indenture) may not comply with a noteholder’s request. Without the issuer’s assistance, a definitive note cannot be validly issued. Other parties including the trustee, authenticating agent or registrar are entitled to an indemnity and/or pre-funding prior to complying with a request from a holder to exchange their interests in a global note into a definitive note. It will be important to check and comply with such requirements to facilitate a request to exchange beneficial interests in a global note for a definitive note.

- ii. Even if an individual holder manages to exchange its interests for a definitive note and therefore can be considered a registered “Holder”, its enforcement rights will still be subject to the terms of the relevant indenture. For instance, an “no action clause” found in a typical indenture could still apply, e.g. specifying a certain percentage threshold of Holders must have had given directions to the trustee to pursue a remedy, against the trustee’s right to be indemnified and/or secured.

Practically speaking, it could be challenging for noteholders to take substantive enforcement action directly without going through the trustee, whether they hold a definitive note or an interest in a global note. Whilst ***In the Matter of Leading Holdings Group Limited*** focussed on the standing of the holder of a beneficial interest in a global note to bring enforcement action, in our view there would be other potential obstacles even for a “Holder” of definitive notes.

If you have any questions or concerns, or would like to discuss these issues further, please contact the team below.

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