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BVI Court rules that bondholder stands as contingent creditor

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Does a bondholder have standing to petition for winding up? In the landmark decision of *Cithara Global Multi-Strategy SPC v Haimen Zhongnan Investment Development (International) Co. Ltd*[1], the BVI Court held that the applicant ("**Cithara**"), being the ultimate beneficial holder of notes issued by the respondent ("**Haimen**"), was a contingent creditor possessing the requisite standing to present an application for winding-up under s.162(2)(b) of the BVI Insolvency Act (2003) (the "**Act**") (the "**Decision**" or "**Re Cithara**").

This briefing discusses the Decision, how it squares up against the position in other offshore jurisdictions, and takeaways for investors and issuers alike.

The Background

In June 2021, Haimen, as issuer, authorised the issuance of up to US$150,000,000 of 12% Guaranteed Senior Notes (the "**Notes**") pursuant to a New York law indenture entered into between Haimen, its parent company as guarantor, and the trustee (the "**Indenture**").

The structure involved 'global notes' being delivered to and registered in the name of the Common Depository or its nominee for the accounts of Euroclear and Clearstream. Participants holding accounts with Euroclear and/or Clearstream could buy/sell beneficial or economic interests in the Notes through their accounts. Investors without accounts could do so through a participant holding the Notes on its behalf. Cithara held the ultimate beneficial interest in the Notes in the principal sum of US$7,000,000 as an indirect participant through participants with book-entry interests registered in Euroclear's system.

The Notes were due on 8 June 2022, with interest payable on 9 December 2021 and 8 June 2022. Haimen defaulted on the principal and second interest payment of the Notes. Following the service of a statutory demand on Haimen, Cithara filed an application for the appointment of liquidators in October 2022. Haimen challenged the standing of Cithara as a "creditor" for the purpose of section 162(2)(b) of the Act.

The Decision

The Honourable Justice Mangatal (the "**Judge**") considered the question of whether Cithara was a "creditor" to be a mixed question of New York law (i.e. the nature and extent of parties' rights and obligations arising from the Notes and the Indenture) and BVI law (i.e. whether those rights and obligations were sufficient to make Cithara a creditor under the Act). Ultimately, the Judge held that Cithara had standing as a creditor to present the winding-up petition.

The key aspects of the Judge's reasoning are set out below:

a. First, applying principles of construction to the documentation, Cithara was a contingent creditor under New York law. Cithara had the right to receive the Certificated Note[2] and become the registered holder itself.

1 BVIHC(COM) 2022/0183.
2 Defined in §1.1 of the Indenture as "the Notes (with the Parent Guarantee endorsed thereon), in certificated, registered form, executed and delivered by the Issuer (and the Parent Guarantor) and authenticated by or on behalf of the Trustee in exchange for the Global Notes, upon the occurrence of the events set forth in the second sentence of Clause 2.4.5..."

b. Second, a contractual relationship between Cithara and Haimen was not the only basis upon which contingent obligations could arise. The Judge referred to the decision of the UK Supreme Court in *Re Nortel*[3] closely and opined that the modern trend is to give an expanded definition to a contingent obligation.

c. Third, the express provisions of the Act made it clear that a contingent liability is capable of giving rise to a claim in liquidation proceedings, which consequently makes the person to whom the debt will be owed as a result of the contingency a creditor for the purposes of section 162(2)(a) of the Act. A wide approach to the provisions of the Act fit with "*commercial reality*" and gave "*due regard to the important underlying rights of those with the real economic interests.*"

Interestingly, the Judge distinguished the Bermuda Court's decision of *Bio-Treat Technology Ltd. V Highbridge Asia Opportunities Master Fund*[4] and the recent Cayman Islands Grand Court decision of *In the Matter of Shinsun Holdings (Group) Co. Ltd.*[5]

Bermuda – *Bio-Treat*

In *Bio-Treat Technology Ltd. v Highbridge Asia Opportunities Master Fund*[6], the applicant ("**Highbridge**") was not a direct investor in the bond issuer company. The bonds were issued in the form of a global bond, the holder of which was the Bank of New York Depository (Nominees) Limited ("**BNY**"). BNY held the global bond for the account of two international clearing systems, one of which (Euroclear) had contractual relationships with Goldman Sachs. Goldman Sachs had the contractual relationship with Highbridge.

The Bermuda Court found that Highbridge did not have standing as a contingent creditor to present a winding-up petition. A pre-existing direct contractual relationship between the contingent creditor and the debtor would be required to make the argument that a liability could arise upon the happening of some future event and enable Highbridge to properly be classified as a contingent creditor or potentially even as a creditor in equity.

The BVI Court in *Re Cithara* distinguished *Bio-Treat* on the facts, such as dissimilarities in contract terms, and on the legislative provisions as it was not apparent from the *Bio-Treat* judgment whether the Bermuda Companies legislation had sections equivalent to the wide and express statutory provision in the BVI Act that set out the meaning of "creditor".

Cayman Islands - *Shinsun*

In *Shinsun Holdings (Group) Co. Ltd.*[7], the applicant ("**Shenwan**") was similarly an indirect investor in the bond and had no direct contractual relationship with the bond issuer company. The company issued certain senior notes pursuant to a New York law governed indenture. The parties to the indenture were the company, various entities as subsidiary guarantors and the trustee which also acted as the "Common Depository". The notes were registered in the name of CCB Nominees Limited ("**CCB**") and traded through Euroclear. Through the Hong Kong Monetary Authority, which was a participant of Euroclear, Shenwan acquired an interest in the notes. Shenwan thus held a 25% interest in the issued notes which CCB remained the sole registered holder of.

The company defaulted on an interest payment which triggered Shenwan to instruct the trustee to issue a notice of acceleration. After the company also failed to settle the outstanding debt, Shenwan proceeded to file a winding-up petition directly against the company. The Cayman Court similarly held that Shenwan was not a contingent creditor as there was no obligation upon the company to Shenwan whether in contract, tort, equity or otherwise. The principle of privity of contract and the "no look through" principle, where each party has rights only against their counterparty such that an investor's rights are exercisable only through and against its own intermediary, were in play.

The BVI Court in *Re Cithara* considered that a distinguishing feature in *Shinsun* was the fact that the petitioner's right to obtain the certificated note and become the registered holder was disputed, whereas Cithara's right to do so was unarguable.

3 [2013] UKSC 52.
4 [2009] Bda. L.R. 29.
5 FSD 192 of 2022.
6 [2009] Bda. L.R. 29.
7 FSD 192 of 2022.

Continued

Conclusion

The Decision is an important reminder that the terms of the indenture and ancillary documents must be examined closely together with the applicable insolvency laws. How the principles in the above cases will be applied will be subject to the exigencies of the peculiar factual circumstances of each case. Bondholders should be mindful of whether they are likely to have any direct recourse against an issuer in the relevant jurisdiction.

It remains to be seen how this area of law will continue to develop in both offshore and onshore jurisdictions[8], as different courts have diverged in approach in recent years.

Carey Olsen has extensive experience assisting clients navigate bond and investment disputes in offshore jurisdictions.

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PLEASE NOTE

8 For example, in *In Re Leading Holdings Group Limited* [2023] HKCFI 1770, the Hong Kong Court held that an individual noteholder holding only an interest in a global note did not have standing to present a winding-up petition as a contingent creditor against a note issuer. The noteholder would be required to act through the trustee.