May 2, 2023

A Leg to Stand on — Key Takeaways for Bondholders Seeking Direct Action Following the Cayman Grand Court Decision in Shinsun Holdings

SUMMARY

In the recent decision of *Re Shinsun Holdings (Group) Co., Ltd.* FSD 192 of 2022 (DDJ) (21 April 2023) (unreported), the ultimate beneficial owner of bonds held through Euroclear failed to evidence that it was authorised, or had standing, to pursue a winding-up petition against the issuer. This decision demonstrates the pitfalls that bondholders who hold their securities via clearing systems will need to avoid when directly enforcing claims against issuers, and we discuss some of the practical steps that bondholders could take in this context.

Factual Background

Shinsun Holdings (Group) Co. Ltd ("**Shinsun Holdings**") is the Cayman Islands-incorporated holding company of a Chinese real estate developer. Shinsun Holdings issued $200,000,000 12% Senior Notes Due 2023 (the "**Notes**") pursuant to a New York law governed indenture (the "**Indenture**") in book-entry form through the facilities of Euroclear and Clearstream. China Construction Bank (Asia) Corporation Limited acted as trustee (the "**Trustee**") and as the common depository of the Notes (the "**Common Depositary**") for Euroclear and Clearstream. The Notes were evidenced by a global note which specified that the registered holder was CCB Nominees Limited ("**CCB Nominees**") as the nominee of the Common Depositary. Importantly, no certificated notes ("**Certificated Notes**") were issued under the Indenture at the time of the hearing and the sole "Holder" for the purposes of the Indenture was CCB Nominees.

On the evidence, Shenwan Hongyuan Strategic Investments (H.K.) Limited (the "**Petitioner**") owned $50 million of the principal amount of the Notes (representing 25% of the aggregate outstanding principal). The Petitioner's interest in the Notes was held by the Hong Kong Monetary Authority (the "**Participant**"), who

was in turn a participant of Euroclear and held such principal holding of Notes in the Participant's Euroclear account. The chain of holding within Euroclear was evidenced to the Court by way of statement of account letters issued by Euroclear in October 2022 and February 2023 (the "**Euroclear Letters**").

Shinsun Holdings failed to make payment of the interest due in respect of the Notes on February 18, 2022. In March 2022, the Petitioner apparently directed the Trustee to issue a notice of acceleration in respect of the Notes (the "**Acceleration Notice**"). The Acceleration Notice was issued by the Trustee on April 1, 2022. The Petitioner subsequently filed the petition to wind-up Shinsun Holdings on September 16, 2022.

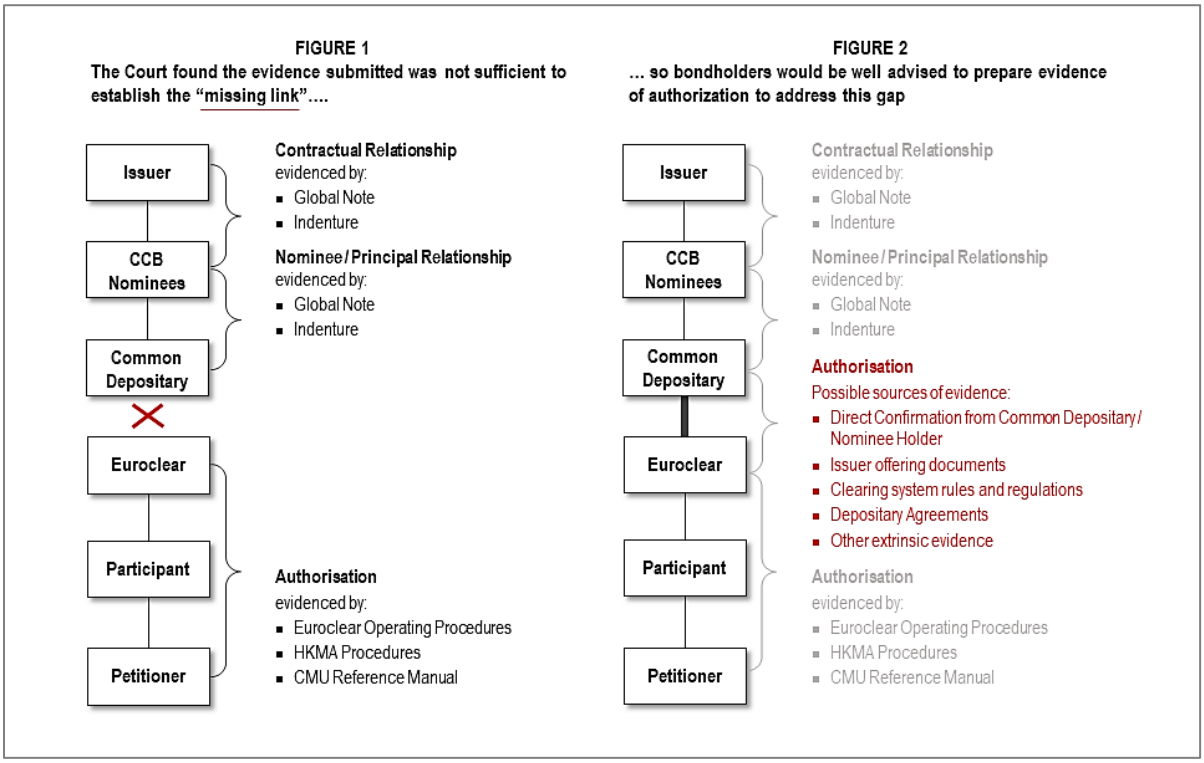
The Court's Findings

As it was common ground among the parties that the Petitioner was not the registered holder of the Notes, the Court's decision turned on whether, on the evidence, the Petitioner had established that either (i) it was authorised to bring suit for the enforcement of any payment of principal or interest on the Notes, or (ii) it was a contingent creditor with standing to bring the petition by virtue of its right to demand Certificated Notes under the terms of the Indenture (although as at the date of the hearing no such request had been made).

The Petitioner sought to rely on the Euroclear Letters, and on certain provisions of the Euroclear Operating Procedures,[1] to establish its authority for bringing the winding-up petition. Doyle J found that, on the evidence that was available before him, the Petitioner did not establish that it had been duly authorised for the purposes of the Indenture. Doyle J found that as it was the Holder (which, in this case, is CCB Nominees as the nominee of China Construction Bank (Asia) Corporation Limited as the Common Depository), and not Euroclear, who was the registered holder of the Notes, the Petitioner had therefore failed to establish that it had been granted any authority by the Holder to enforce the rights of the Holder under the Indenture. In this respect, the Petitioner's heavy reliance on the Euroclear Operating Procedures was dismissed on the basis that they were not incorporated into, and therefore could not alter, the express provisions of the Indenture.

As to the question of standing, the Petitioner's argument was that as the Indenture allowed for the delivery of Certificated Notes, whereby the underlying beneficial holder could become a registered holder and therefore a direct creditor of Shinsun Holdings, this was sufficient to establish the Petitioner's standing as a contingent creditor. This argument was also dismissed by Doyle J. Given that the terms of the Indenture only contemplated delivery of Certificated Notes upon the direction of a Holder, the Petitioner's ability to procure the Participant, and in turn Euroclear, to deliver Certificated Notes in the future did not give rise to any *present* right against Shinsun Holdings. The Petitioner failed to evidence an existing relationship with the issuer sufficient to establish its status as a contingent creditor.

The following diagram summarises the Court's analysis on these two issues and its practical implications for bondholders (as further described below).



In the course of his judgment, Doyle J also notably found that the purported acceleration by the Trustee under the Acceleration Notice was not valid. This aspect of his decision rested on his finding that there had been no evidence before him to establish the instructions provided the Petitioner were, in fact, provided by the Holder.

Discussion of the Decision

It is very clear from the judgment that Doyle J was confined to consider only the evidence that had been put before him in determining the issues at hand. Viewed in this light, although the outcome of the case was somewhat surprising in light of the broader context, it is perhaps not surprising that the judge reached the conclusion that he did. At its core, Doyle J's conclusions all emanated from his finding that there was an evidentiary gap that the Petitioner had failed to bridge between the Holder and its relationship with Euroclear. Indeed, given that Shinsun Holdings' own experts accepted that the Holder's principal was the Common Depository,[2] the "missing link" evidently appeared to be solely as between the Common Depository (for whom CCB Nominees acts as its nominee as the Holder) on one hand, and Euroclear on the other.

While the authors of this article were not privy to the deliberations in Court, we can surmise from the judgment that if there had been sufficient evidence to establish that Euroclear had sufficient authority to grant authorisations on behalf of the Holder and/or the Common Depository for the purposes of the Indenture and the Notes, then the Court may well have (and in the view of the authors, should have) reached

a different conclusion.[3] In this respect, beneficial holders of registered global notes who wish to directly petition for winding-up or otherwise bring suit to enforce payment would be well advised to ensure that the full chain of authority is appropriately established and evidenced, so that this "missing link" can be closed (see Figure 2, above).

There are various provisions in the Euroclear Operating Procedures and other documentation that lend credible evidence in support of establishing the relationship between a common depository and Euroclear.[4] This relationship is also typically supplemented by and described in the offering memorandum prepared by Issuers in connection with the issuance of notes.[5] In the context of this case, there are public releases from May 2020 issued jointly by Euroclear, Clearstream and China Construction Bank (Asia) Corporation Limited announcing China Construction Bank (Asia) Corporation Limited's appointment by Euroclear and Clearstream as their common depository. Other evidence that bondholders could look to obtain may include copies of the common depository agreements entered into by the relevant common depository.

In practical terms, it would be helpful to obtain direct confirmation of the above from the common depositary and the Holder (as its nominee). This might be achieved, for example, by instructing (via Euroclear, or on the basis of the authorisation granted by Euroclear) the common depository (and/or its nominee as the registered holder) to confirm that they hold the Global Note for the benefit and on behalf of Euroclear (or the relevant clearing system), and/or that the authorisation provided by Euroclear to the beneficial owners to maintain proceedings against the issuer in respect of the relevant securities is binding upon it.

* * *

ENDNOTES

[1] See Clause 5.3.1.3(d) of the Euroclear Operating Procedures (May 2023), which authorise "*the underlying beneficial owners… to maintain proceedings against issuers, guarantors and any other parties. This is to the extent that we, our nominee, a Depository or their nominee acts as registered owner of any security held in the Euroclear System, or in any other relevant situation*." This provision is substantially the same as the wording contained in the Euroclear Letters.

[2] See para 38 of the judgment.

[3] To the extent that the full chain of authority can be established on the evidence, a determination that the Petitioner was properly authorised by the Holder, in our view, would not have required any finding that the Indenture had been modified by the Euroclear Operating Procedure, as the judge had (in our view rightly) declined to so find.

[4] For example, see the Terms and Conditions governing use of Euroclear, May 2022, section 4(c) and (d), which expressly provide that Euroclear may designate for any issue of securities held in Euroclear one or more Depositories to hold such securities, and that "any securities so deposited or held… are to be carried in a customers' securities account of us or a nominee of us with such Depository." See also the Euroclear Operating Procedures, section 5.3.2.10, which provides that, in respect of global securities entrusted to a Common Depository, the Common Depository is "responsible for holding the global security for Euroclear and Clearstream", and it is "contractually bound to follow our and Clearstream's instructions as regards the disposition of global securities." It is unclear from the judgment whether these (or other) provisions had been drawn to the attention of the Court.

[5] See, for example, the offering memorandum issued by Shinsun Holdings dated August 12, 2021 in respect of the Notes, at page 208 under the heading *Book-Entry; Delivery and Form*: "On the Original Issue Date, the Global Note will be deposited with a common depositary and registered in the name of the common depositary or its nominee for the accounts of Euroclear and Clearstream"; or page 209 under the heading "*Global Notes*": "As such, 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 the Indenture." (emphasis added).

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