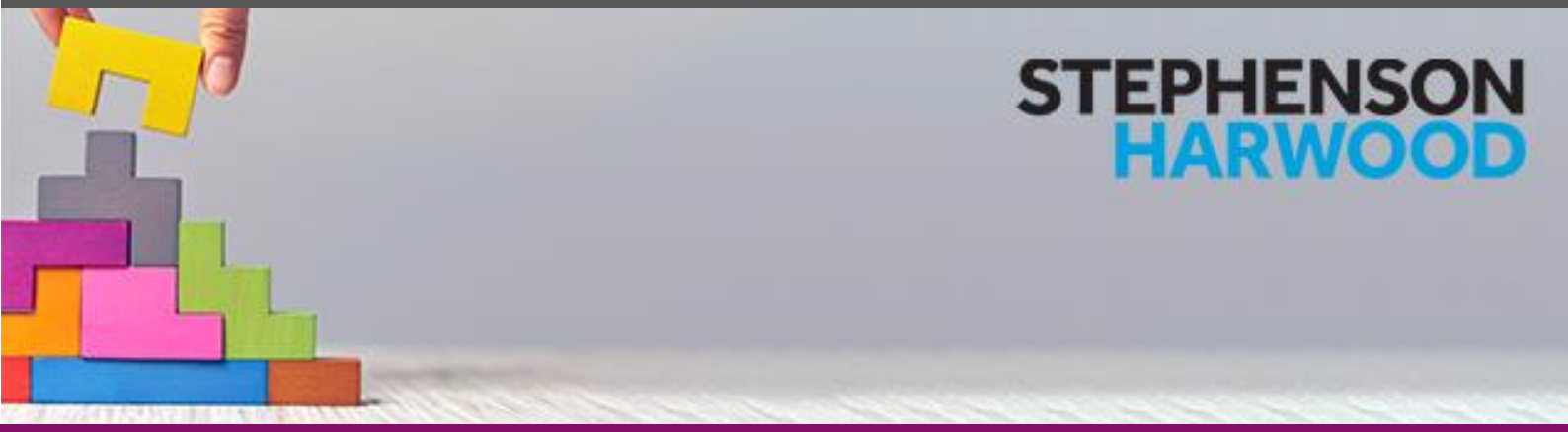

Trustee Basics: Edition 3

Identifying a "Noteholder"

The issue

In our previous thought piece "Who is the Noteholder? Confusion between the law and practice" we discuss, when attempting to determine the identity of a "holder" of a bond or note, the challenges posed by the differences between the legal nature of a definitive bearer bond, the market practice in the holding and trading of bonds through clearing systems and the varying definitions of a bondholder or noteholder in transaction documentation.

The attempts in recent years by Rizwan Hussain and various vehicles controlled by him to pass themselves off as a noteholder or as an authorised agent of noteholders[1] have highlighted clearly how important it is for trustees to adopt a robust approach to the verification of identity.

The current law

In 2017, in *Secure Capital SA v Credit Suisse AG*[2], the Court of Appeal looked at whether an investor with an interest in notes issued in bearer form and held through the Clearstream system had a direct claim for breach of contract against the issuer of the notes in respect of an alleged breach of the so-called "misleading statements term" in the transaction documents[3].

The Secure Capital note issue involved a fiscal agency structure, rather than involving a note trustee holding the benefit of the issuer covenants on trust and through whom enforcement action would usually be taken. The documentation stated that it was only the "holder" of the notes who had locus to sue the issuer for breaches of covenant. The Court of Appeal concluded that the "holder" of the notes for this purpose was the common depositary as holder of the permanent global note. The effect of the judgment was, therefore, to remove from the investors contractual recourse against the issuer, as the common depositary will never, in practice, take action on their behalf.

Where notes are constituted under a trust deed and are issued in global form, there have also been various cases in which the courts have confirmed that the legal holder of the notes is the common depositary and therefore the legally relevant question is whether the person claiming to be a noteholder is a holder of the *beneficial interest* in the notes. These cases have often then gone on to look at what is meant by a holder of the beneficial interest in the notes (which is often defined as being those persons in whose names the relevant Notes are held in the records of the clearing systems (i.e. the account holders at Euroclear and Clearstream, Luxembourg))[4].

This accords with the so-called "no look through principle" which limits an ultimate investor's ability to sue anyone in an intermediated securities chain beyond their immediate intermediary. The no look through principle is consistent with trust law, under which there is a general rule that a beneficiary of a

---

[1] See, for example, Fairhold Securitisation Limited and Another v Clifden (IOM) No.1 Limited and Others [2018] 8 WLUK 114

[2] [2017] EWCA Civ 1486

[3] This was how the judge referred to the relevant term in the judgment. The term in question in the transaction documents stated that Credit Suisse had taken all reasonable care to ensure that the information contained in the documentation was true and accurate in all material respects and that there were no other material facts the omission of which would make any statement misleading.

[4] For example *Business Mortgage Finance 6 Plc v Greencoat Investments Limited [2019] EWHC 3900 and BMF Assets No 1 Ltd & Ors v Sanne Group Plc & Ors* [2022] EWHC 140 (Ch)

sub-trust may not have recourse against the head trustee. In *Re Lehman Brothers International (Europe) (In Administration)*[5] the court categorised the legal nature of an intermediated securities chain as a series of trusts and sub-trusts[6].

The no look through principle has been criticised by some as it leaves the ultimate investor taking all the economic risk of purchasing and holding the relevant securities, while its legal redress is limited to any action it can take against its immediate intermediary.

The English court has on occasion found ways of ensuring that ultimate investors are not unduly prejudiced by the no look through principle[7]. Also, in the context of bond restructuring it is now common for ultimate investors to vote directly on schemes of arrangement under the Companies Act 2006 on the basis they are "contingent creditors". Our article "Who is the creditor in a bond restructuring?" explored this topic in further detail.

Practical tips

Notes are very often held via long intermediary chains. So, does this mean that a note trustee only ever needs to concern itself with the identity of the person shown in the records of Euroclear or Clearstream, Luxembourg as being entitled to the relevant notes at a particular time or through a particular period?

We would argue that this would not always be a safe assumption for a note trustee to make. This is particularly the case where the note trustee is being presented with directions to take a particular action outside the ambit of a noteholder resolution. For example, directions by a requisite percentage of holders to accelerate notes after an event of default.

As well as needing to consider the definition of "Noteholder" (or similar) used in the relevant transaction, a note trustee should bear in mind the fundamentals of a trust relationship when seeking to verify the identity of a person purporting to be a noteholder. The trust assets are held by the trustee for the benefit of the ultimate investors in the notes, who are the beneficiaries of the trust. In the context of a note issue, the beneficiaries are the persons with the beneficial, or economic, interest in the notes. It follows that the trustee needs to ascertain whether any person purporting to be a noteholder is a person with the beneficial interest in the notes. Additionally, when dealing with a representative (such as an intermediary, custodian, accountholder, tender agent or adviser), the trustee should ensure that the representative is a person duly authorised by the beneficiary to act on its behalf.

We would suggest the following steps:

- Most note trust deeds will provide that the note trustee is entitled to require "a certificate or letter of confirmation certified as true and accurate and signed on behalf of Euroclear or Clearstream Luxembourg to the effect that at any particular time or through any particular period any particular person [the **Accountholder**] is, was, or will be, shown in its records as entitled to a particular number of notes". If the relevant trust deed contains this or a similar provision, and even if it does not, the note trustee should ensure that the relevant clearing system certifies direct to the trustee that a named Accountholder is shown in its records as holder of a particular number of the relevant notes and, if the notes are required to be blocked from trading, further confirm that they are blocked and the period for which they are blocked.
- If the Accountholder is a custodian for another person, the note trustee should require a signed letter from the Accountholder confirming the identity of the person for whom it holds the notes.
- If that person is not the beneficial owner but is an intermediary for another person, the note trustee should require a signed letter from the intermediary confirming the identity of the person for whom it holds the notes.
- If that person is also an intermediary, this chain of confirmations needs to continue until the beneficial owner is identified.

---

[5] [2012] EWHC 2997 (Ch)

[6] See also *Re Lehman Brothers International (Europe) (In Administration) [2010] EWHC 2914 (Ch) and Re Lehman Borthers International (Europe) [2011] EWCA Civ 1544.*

[7] In *SL Claimants v Tesco Plc [2019] EWHC 2858* (Ch) the claimants held shares in Tesco, issued in dematerialised form via CREST, via intermediary chains. The claimants sued Tesco for compensation for making untrue or misleading omissions in the prospectus. The relevant sections of the Financial Services and Markets Act 2000 ("**FSMA**") referred to the need for claimants to have an "interest in securities" and Tesco argued that investors who held their interests at the bottom of custody chains did not have such an "interest in securities". The court disagreed. At the same time as accepting the operation of the no look through principle, the court held that the "right to a right" held by the ultimate investor in the custody chain is, or can be equated to, an equitable property for the purposes of the underlying shares and this qualified as an "interest in securities" for the purpose of the relevant sections of FSMA.

- The beneficial owner should then confirm to the note trustee in a signed letter that it is the beneficial owner of the specified number of notes.
- If the Accountholder, an intermediary or any other person claims to have the authority to act on behalf of the beneficial owner, it must as a minimum be asked to produce evidence satisfactory to the trustee of its authority to do so, including the scope and limitations of that authority. Ideally, the beneficial owner should itself provide this confirmation direct to the trustee.

Key contacts

Jayesh Patel
Partner
T: +44 20 7809 2238
E: jayesh.patel@shlegal.com

Charlotte Drake
Of Counsel
T: +44 20 7809 2583
E: charlotte.drake@shlegal.com

STEPHENSON HARWOOD