

Hong Kong Court Confirms Enforceability of Keepwell Deeds

Two recent landmark decisions provide valuable guidance on this commonly used form of credit enhancement.

Keepwell deeds have in recent years grown into a common form of credit enhancement used by companies in mainland China for offshore bonds issued by their subsidiaries. Under a typical keepwell deed, a parent company in mainland China undertakes to ensure that its offshore issuer subsidiary will remain solvent and that it will have sufficient liquidity in order to meet payment obligations under the bonds. This structure is designed to avoid the mainland parent needing to obtain regulatory approvals to overcome restrictions on mainland businesses borrowing in foreign currencies as well as currency exchange limitations in servicing and repaying such borrowings. For similar reasons, it is important that a keepwell obligation falls short of an outright guarantee and most are carefully drafted to avoid this outcome. Once a keepwell obligation has been triggered, the mainland parent will be required to obtain regulatory approvals in order to perform it.

Keeping Well Post-Default?

When the mainland keepwell provider is itself subject to mainland China restructuring proceedings, the difficulties become all too apparent — as seen in the recent cases *Nuoxi Capital Ltd & Others v. Peking University Founder Group Company Limited (PUFG)*¹ and *Citicorp International Limited v. Tsinghua Unigroup Co., Ltd (Tsinghua)*.² Both cases were heard by Mr Justice Harris, who found their facts “remarkably similar”:

- Both cases concerned keepwell deeds and equity interest purchase undertakings (EIPUs) entered into by parent companies in mainland China for their respective subsidiary’s US dollar bond issuances, which were guaranteed by other offshore subsidiaries.
- Both keepwell deeds were governed by English law and contained Hong Kong-exclusive jurisdiction clauses.
- Both mainland parents defaulted under the bonds and were placed into bankruptcy reorganisation proceedings by the Beijing First Intermediate People’s Court under the Enterprise Bankruptcy Law,³ pursuant to which administrators were appointed to conduct the reorganisations.
- The issuers and guarantors of the respective bonds entered into liquidation proceedings in their offshore jurisdictions of incorporation.

- The respective plaintiffs submitted proofs of debt in the onshore reorganisation proceedings:
 - in *PUGF*, the administrators rejected the proof without reason; and
 - in *Tsinghua*, the proof was given “pending” status, which precluded the note trustee from participating in the reorganisation proceedings prior to their termination in July 2022.

Timing Is Everything

In *Tsinghua*, the default occurred prior to the commencement of the reorganisation proceedings in July 2021, whereas in *PUGF* the defaults under the majority of the bonds occurred after the commencement of reorganisation proceedings in January 2020. This timing proved critical because it was clear to the judge that any efforts by the respective parent company in mainland China to perform its obligations under the keepwell deed were in all practical senses impossible after the commencement of reorganisation proceedings: in Mr Justice Harris’s words, any such efforts “would probably have been futile”.

In each case, the keepwell obligation was qualified to the extent that the mainland parent had obtained the necessary regulatory approvals. This qualification was itself qualified by a “best efforts” undertaking. The judge accepted that, provided that the mainland parent had used its best efforts and, despite such best efforts, had not obtained the necessary regulatory approvals, the mainland parent would have a defence for any resultant failure to fulfil the keepwell obligation. In both *PUGF* — with respect to one of the four plaintiffs⁴ — and *Tsinghua*, the mainland parent was found to have failed to discharge its best efforts obligation. Consequently, the mainland parents were not entitled to rely on the best efforts provision as a defence for their breaches. It was insufficient to adduce expert evidence after the fact to show that obtaining the regulatory clearances would have been difficult to achieve; what mattered was the steps (or lack of them) *Tsinghua* had made at the time. At no point had *Tsinghua*, in anticipation of the maturity of the bonds and its inability to repay them, formulated a plan to fulfil its obligations. Further, *Tsinghua* had “never explored with the [appropriate mainland approval authorities] whether whatever consents were required were likely to be given”.

Conversely, in *PUGF*, with respect to the other three plaintiffs, it was pleaded, and the court found that the mainland parent had failed to comply with its keepwell obligations only *after* the commencement of the reorganisation proceedings. As noted above, Mr Justice Harris was of the view that, after the reorganisation proceedings had commenced, obtaining the necessary regulatory approvals to enable any transfer of funds out of the mainland was highly unlikely. Therefore, the mainland parent’s failure to make any effort to obtain the approvals did not prevent it from relying on the best efforts provision as a defence, because such effort (even if made) would not have changed the outcome. Given such “insuperable obstacle” to obtaining the necessary approvals, the mainland parent was not required to do anything more to discharge its best efforts obligation and was therefore entitled to rely on the relevant provision as a defence to relieve it from all its post-commencement obligations owing to those three plaintiffs.

No Discharge Through Participation in Mainland Reorganisation

In both cases, the judge ruled that filing of a proof of debt in the reorganisation proceedings did not amount to a discharge of the debt. *PUGF* argued unsuccessfully that the plaintiff had submitted to the mainland reorganisation proceedings and, as such, an exception to the Rule in *Gibbs* applied that prevented it from bringing its case before the Hong Kong courts. The judge disagreed: taking steps outside of a foreign insolvency proceeding with a view to advancing a claim made in the foreign insolvency proceeding (such as the plaintiffs in *PUGF* and *Tsinghua* were doing in the onshore reorganisation proceedings) was not the same as taking steps outside of the foreign insolvency process

inconsistent with the principles of modified universalism or designed to place the creditor in a better position than other creditors (as Tsinghua had argued).

A Lasting Victory?

Keepwell deeds are of practical effect only insofar as creditors are in a position to identify and prove that a default has occurred before the commencement of reorganisation proceedings. The combined effect of the judgments is to confirm that, at least as a matter of Hong Kong law, there is no public policy barrier to prevent the enforceability of keepwell deeds and EIPUs in accordance with their terms. Indeed, the expert evidence filed in the cases suggests that this is also the case under the People's Republic of China (PRC) law. In answer to PUFG's argument that the Hong Kong judgment would be of no utility in advancing claims in the mainland reorganisation, Mr Justice Harris considered that "it would be remarkable if the Beijing Court took no notice of the Hong Kong court's opinion". Having cleared the first hurdle, it remains to be seen how these decisions will affect the treatment of the claims of the trustees and other plaintiffs in the context of the mainland reorganisation proceedings. This will be closely watched by all market participants.

If you have questions about this Client Alert, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

[Howard K. H. Lam](#)

howard.lam@lw.com
+852.2912.2570
Hong Kong

[Bruce Bell](#)

bruce.bell@lw.com
+44.20.7710.1145
London

[Flora F. W. Innes](#)

flora.innes@lw.com
+852.2912.2643
Hong Kong

[Tim Bennett](#)

Knowledge Management Counsel
tim.bennett@lw.com
+44.20.7866.2664
London

You Might Also Be Interested In

[In Defence of Gibbs?](#)

[Hong Kong Airlines — A Restructuring Unparalleled](#)

[Hong Kong Court of Final Appeal Rules on Exclusive Jurisdiction Clauses in Insolvency](#)

[Hong Kong Court Breathes New Life Into Rule in Gibbs](#)

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the lawyer with whom you normally consult. The invitation to contact is not a solicitation for legal work under the laws of any jurisdiction in which Latham lawyers are not authorized to practice. A complete list of Latham's Client Alerts can be found at www.lw.com. If you wish to update your contact details or customize the information you receive from Latham, [visit our subscriber page](#).

Endnotes

¹ [2023] HKCFI 1350.

² [2023] HKCFI 1572.

³ Enterprise Bankruptcy Law of the People's Republic of China (Standing Committee of the National People's Congress 2006).

⁴ Namely, FHK, vis-à-vis whom the mainland parent's keepwell obligations arose and were breached prior to commencement of the reorganisation proceedings.