

## All's Well for Keepwell Deeds?

***A recent ruling by the Hong Kong Court of Appeal has strengthened the robustness of keepwell deeds as enforceable English law governed obligations.***

The Hong Kong Court of Appeal has unanimously upheld the appeals of the liquidators of offshore bond-issuance companies (the appellants) of the Peking University Founder Group Company Limited (PUFG) concerning whether PUFG, as the keepwell provider, breached the keepwell deeds which support the bonds.

### Purpose of Keepwell Deeds

Keepwell deeds have become 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 to meet payment obligations under the bonds. This structure is designed so that the mainland parent would not need 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.

The keepwell obligations are therefore typically qualified such that, provided the parent has, on the balance of probabilities, used its “best efforts” but failed to obtain the regulatory approvals required to make payments in respect of the bonds, then the keepwell provider will not have breached the keepwell deed. 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.

### Effectiveness of Keepwell Obligations Post-Insolvency

The appellants sought declarations from the Hong Kong court on matters governed by English law (the governing law of the keepwell deeds), which they intended then to use in the Beijing Court as a basis for asserting their claims in the PRC reorganisation proceedings of PUFG.

At first instance, Mr Justice Harris had found that, with respect to three of the four appellants, PUFG had failed to comply with its keepwell obligations only *after* the commencement of its reorganisation proceedings in February 2020 (see this [Client Alert](#)). The judge ruled that, following commencement of reorganisation proceedings, PUFG was highly likely to be unable to obtain the necessary regulatory approvals to enable the transfer of funds out of the mainland. That being so, PUFG had discharged its “best efforts” duty under the keepwell deeds and had a defence to any breach of its keepwell obligations.

The noteholder representatives appealed the decision on several grounds, including that the judge had:

1. failed properly to recognise the nature of PUFG's obligations to "see to it" that each issuer maintained a minimum consolidated net worth of at least US\$1 at all times (the "balance sheet obligation"), and provide each issuer with sufficient liquidity to ensure timely payment under the respective bonds (the "liquidity payment obligation"), each under the terms of the relevant keepwell deed; and
2. failed to address the appellants' arguments that there were other modes of performance of PUFG's obligations under the keepwell deed that did not require mainland regulatory approval (and so such obligations could have been performed but were not, notwithstanding PUFG's inability to obtain regulatory approval).

The appeal was refused on the first points but succeeded on the second.

## Balance Sheet and Liquidity Payment Obligations

The appellants argued that the balance sheet obligation was a continuing obligation that gave rise to a liability from the moment the keepwell deeds were entered into, and a claim of damages that was a provable debt in PUFG's insolvency, even without having shown any breach of such obligation. More importantly, since it was a "see to it" obligation, rather than a payment obligation, there was no question of whether relevant approvals were, or could have been, obtained, and the question of when there may have been a breach was immaterial. With respect to the liquidity payment obligation, the appellants argued that the mainland regulatory approval was required for performance of the payment obligation only *prior* to PUFG's insolvency. After PUFG had entered into reorganisation proceedings, the liquidity payment obligation was replaced by the obligation to admit debts to proof and to pay dividends accordingly, for which no regulatory approval was required. In those circumstances, the "best efforts" duty was not engaged and was therefore irrelevant.

The Court of Appeal disagreed with both arguments, holding that there first needed to be a breach of either the balance sheet obligation or the liquidity payment obligation in order for any valid money claim to arise. Absent a breach, the obligations alone did not automatically transform into a provable claim in PUFG's insolvency. In order to determine whether a breach had occurred, the discharge or otherwise by PUFG of the "best efforts" duty must be taken into account.

The balance sheet obligation was neither a guarantee nor a warranty as to the existence of a particular state of events. Any assessment of PUFG's ability to comply with its contractual undertaking could not be divorced from the question of whether failure to obtain regulatory approval contributed to any breach.

As regards the liquidity payment obligation, the Court of Appeal did not agree with the appellants' argument that such obligation was suddenly "replaced", following commencement of PUFG's reorganisation proceedings, by some other obligation which did not require payments by PUFG, such that the "best efforts" duty was no longer engaged. The process of proving in insolvency was a means of enforcing only an existing liability owed by the debtor. It remained essential for the creditor to have an existing valid money claim which was capable of being enforced; and to do so, it needed to demonstrate that there had been a breach that had caused it to suffer loss. This in turn required a consideration of the "best efforts" duty.

## **Was Performance of the Keepwell Obligations Possible Without Regulatory Approval?**

The appeal did however succeed on the ground that PUFG could pursue other methods to perform its keepwell obligations that did not require the movement of onshore assets out of the mainland and therefore did not require regulatory approval. This could have been achieved in a number of ways: the court considered evidence that PUFG might have instead utilised offshore assets, asked a third-party entity not restricted by any PRC law to provide financial support to the issuers, or deposited renminbi into a PRC bank account. It was common ground that at least one of those methods would not have required regulatory approval.

The appellants argued PUFG could have refinanced and procured offshore subsidiaries to transfer funds. Indeed, plans were well underway during the second half of 2019 to issue new bonds to refinance the old bonds, and the evidence suggested that offshore funds could (at least prior to the commencement of reorganisation proceedings) have been used to effect the repayment without the need to seek mainland approval. It followed that PUFG could not escape liability for breaches of its contractual obligations by asserting that one of the modes of performing its obligations was impossible under mainland law. In allowing the appeal, the Court of Appeal also rejected PUFG's contention that regulatory approval could never have been obtained post-commencement of reorganisation proceedings because the administrator of the reorganisation proceedings was an approval authority.

## **What Is the Effect of the Successful Appeal?**

PUFG adduced evidence that the effect of the PRC Enterprise Bankruptcy Law was to terminate the keepwell deeds two months following PUFG's entry into reorganisation proceedings (in April 2020). If the effect of PRC law was as PUFG asserted, it is unclear how the claims resulting from the successful appeal would be admitted in the reorganisation proceedings as provable debts. The Court of Appeal did not express any opinion on the operation and effect of the relevant articles in the PRC Enterprise Bankruptcy Law, but commented that the purpose of the appellants' appeal was only ever to seek declarations on matters governed by English law in an attempt to assist the Beijing Court in dealing with their claims. Having found that, as a matter of English law, PUFG had breached the keepwell deeds prior to April 2020, the practical enforcement of the appellants' claims would now have to be undertaken in the context of the PRC reorganisation proceedings and would be subject to the applicable PRC laws. Although PUFG may yet seek to appeal the decision, at least for the time being, the robustness of keepwell deeds as enforceable English law obligations appears strengthened. In practical terms, however, the decision highlights the likely difficulty of enforcing the judgment in the PRC reorganisation proceedings.

---

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:

**Bruce Bell**

bruce.bell@lw.com  
+44.20.7710.1145  
London

**Howard K. H. Lam**

howard.lam@lw.com  
+852.2912.2570  
Hong Kong

**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**

[Third Circuit Finds Future Royalty Obligations From Sale Transaction Dischargeable in Bankruptcy](#)

[UK Jurisdiction Taskforce Concludes Digital Assets Compatible With English Insolvency Law](#)

[Hong Kong Court Resolves Conflicting Authority on Trust Claims](#)

---

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](http://www.lw.com). If you wish to update your contact details or customize the information you receive from Latham, [visit our subscriber page](#).