

The Hong Kong Court Refuses to Stay ‘Keepwell’ Claims

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In a noteworthy decision handed down on 17 December 2021 (“Decision”)¹, the High Court of Hong Kong recognised the Mainland China bankruptcy administrator (“Administrator”) of Peking University Founder Group Limited² (PKU) and granted the Administrator various forms of assistance. However, and most significantly, the Court declined to accede to the Administrator’s request to stay four sets of Hong Kong proceedings commenced against PKU by the issuers and guarantors of PKU’s offshore-issued bonds under so-called keepwell deeds.

The Decision marks an important development in ongoing litigation relating to keepwell deeds (a form of credit enhancement that has been widely used in respect of offshore bonds issued by Chinese groups, as explained in more detail in our prior [alert](#)) and provides useful guidance on key jurisdictional issues that will likely surface in future cases. It remains to be seen, however, to what extent claims under keepwell arrangements will be afforded recognition in Mainland China bankruptcy proceedings.

Background

In brief, the Decision emerged in the following context:

- In August 2020, two PKU British Virgin Islands (BVI)-incorporated subsidiaries (Kunzhi Limited and Nuoxi Capital Limited—together, “Issuers”) defaulted on payment obligations under various series of bonds with a total aggregate principal value of USD 1.7 billion (collectively, “Keepwell Notes”).
- The Keepwell Notes benefit from credit protection in the form of English law-governed keepwell deeds (“Keepwell Deeds”) entered into by PKU in favour of the Issuers and Hong Kong-incorporated guarantors of the Keepwell Notes (“Guarantors”). The Keepwell Deeds contain an exclusive Hong Kong court jurisdiction agreement.
- Following PKU’s entry into Enterprise Bankruptcy Law reorganisation proceedings in Mainland China in February 2019 (“PKU Bankruptcy”), the Issuers (acting by their liquidators appointed in the BVI) and Guarantors (acting by their liquidators appointed in Hong Kong) submitted proofs under the Keepwell Deeds (broadly

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approximating to the outstanding amounts due to holders of the Keepwell Notes) in the PKU Bankruptcy.

- The Administrator rejected all but one of the claims on the basis that the relevant claimant was not on the PKU list of creditors. The remaining claim had not yet been adjudicated at the time of the Decision.
- The Issuers and Guarantors (together, “Plaintiffs”) subsequently commenced proceedings against PKU in Hong Kong (in accordance with the exclusive jurisdiction agreements mentioned above) to seek declarations with respect to their rights against PKU under the Keepwell Deeds (the “Keepwell Proceedings”).

The Decision

The Administrator sought to persuade the Hong Kong Court to depart from the exclusive jurisdiction agreements in the Keepwell Deeds by ordering a stay of the Keepwell Proceedings in Hong Kong in favour of the relevant claims being determined by the Beijing No. 1 People’s Court within the context of the PKU Bankruptcy.

The key arguments advanced in support of this position were that (i) since the Plaintiffs had already submitted claims in the PKU Bankruptcy, they had effectively elected to forgo the right to have those claims determined by the Hong Kong Court and (ii) the Beijing Court would not recognise a decision of the Hong Kong Court in the Keepwell Proceedings given the effect of Article 21 of the Enterprise Bankruptcy Law, which requires all claims commenced against a company subject to Mainland bankruptcy proceedings to be commenced before the Mainland court presiding over those proceedings.

Mr. Justice Harris rejected these arguments, finding, among other things, that:

- The submission of claims in the PKU Bankruptcy did not bar the Plaintiffs from commencing the Keepwell Proceedings for the purpose of accessing the Hong Kong Court’s adjudicatory function.
- The Plaintiffs had limited themselves to seeking declarations from the Hong Kong Court and so were not looking to gain an advantage over other creditors by enforcing rights and accessing offshore assets of PKU outside of the context of the PKU Bankruptcy.
- The Hong Kong Court is best placed to determine relevant issues of English law under the Keepwell Deeds (e.g., issues of construction of the agreements), and a Hong Kong judgment may therefore be of value to the Plaintiffs (and helpful to the Beijing Court) for the purpose of proving and addressing objections in the PKU Bankruptcy.
- The idea that the Beijing Court will refuse to place weight on a Hong Kong judgment dealing with issues of English law had not been adequately addressed by the Administrator in evidence and was, in any event, unattractive given the similarity and tied history of the English and Hong Kong common law traditions.

Cooperation Between Mainland and Hong Kong Courts

Mr. Justice Harris also took the opportunity to clarify his expectations for effective communication and cooperation between Hong Kong and Mainland courts in cross-

border insolvency and restructuring matters (mindful of the recently introduced pilot measures we discussed in our recent alert [here](#)).

He observed that, in order for the courts in the respective jurisdictions to cooperate effectively, it would be necessary for Mainland bankruptcy administrators and their Mainland lawyers to provide Mainland courts with “complete and balanced” information regarding Hong Kong’s substantive and procedural laws.

This, it appeared, had not obviously happened in the present case. In particular, Mr. Justice Harris expressed his hope that the Decision would assist the Beijing Court “to understand that under Hong Kong law the application for a stay is not as straightforward as it may have been led to believe”. Further, and plainly with forward-looking cooperation in relation to the Keepwell Proceedings in mind, Mr. Justice Harris directed the Administrator to update the Beijing Court on the Decision and gave it permission to apply for directions suggested by the Beijing Court for the further conduct of the Keepwell Proceedings, noting that the Beijing Court may wish to consider “that it may be possible for the courts to agree the way in which the issues are to be determined, with the Hong Kong court dealing with issues of construction of the Keepwell Deeds”.

Key Takeaways

Having dismissed the Administrator’s application for a stay, the Keepwell Proceedings are expected to progress to trial in Hong Kong (the timing of which will be decided in due course). In light of the perceived robustness of the Hong Kong judicial process and common law system, the Hong Kong Court’s continuing adjudicatory role with respect to the substantive English law-governed rights of the Issuers and Guarantors against PKU under the Keepwell Deeds will be welcome news for holders of the Keepwell Notes and comforting for holders of keepwell-backed notes issued by other Chinese groups.

The Decision also provides helpful practical guidance for holders of such securities on rights and remedies and optimal enforcement routes with respect to keepwell arrangements. Most importantly, the Decision confirms that the Hong Kong Court will not lightly deprive the beneficiaries of keepwell arrangements of their “important and substantial” right to have keepwell claims determined in accordance with a Hong Kong exclusive jurisdiction agreement (a feature of many keepwell deeds) unless there is a “compelling reason” to do so.

While every situation is liable to turn on unique facts to some extent, the Decision therefore preserves the pathway for such beneficiaries³ to seek a declaration of their rights under a keepwell arrangement in Hong Kong even where (i) the keepwell provider has already entered Mainland bankruptcy proceedings and (ii) claims under the keepwell arrangements have already been submitted to (and possibly rejected by) the Mainland bankruptcy administrator.

At the same time, it remains to be seen how a number of key matters will play out, including:

1. The extent to which Mainland and Hong Kong courts will cooperate in practice in relation to the determination and acceptance/rejection of keepwell claims—the PKU example effectively serving as a test case.

2. Whether a Mainland bankruptcy administrator will accept a declaratory judgment from a Hong Kong court (of the type being sought by the PKU Plaintiffs) as conclusive evidence of a party's rights and obligations under the relevant keepwell arrangement. Further, even if a Hong Kong judgment does serve this role, it is unclear whether keepwell claims will ultimately be recognised in a Mainland bankruptcy context given various factors that may need to be considered.
3. The extent to which the Hong Kong Court would reach a different outcome on a stay application relating to claims under a keepwell deed containing a non-exclusive (as opposed to exclusive) jurisdiction agreement in favour of the Hong Kong courts.

¹ [2021] HKCFI 3817.

² PKU is a Mainland China-incorporated holding company for a commercial conglomerate.

³ Such beneficiaries may, in practice, comprise court-appointed officeholders of an insolvent issuer and/or guarantor, rather than noteholders themselves.

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