



Creditors Should Enforce PRC Keepwell Agreements Overseas

With defaults of Chinese debt issuers rising, what can general unsecured creditors do to maximize their chances of recovery? One possible option is to enforce keepwell agreements overseas, expanding enforcement targets to bigger parent companies. We explain below.

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Amid the ongoing wave of defaults by debt issuers based in the People's Republic of China (PRC), general unsecured creditors are looking to exhaust every possible avenue to maximize recovery.

The overseas enforcement of keepwell agreements – promises by a PRC onshore parent company to maintain a debt issuer's liquidity and solvency – could expand a creditor's enforcement targets to parent companies with greater assets and more influential decision-makers, opening up a range of cross-border tools to achieve recovery.

Keepwell Agreements

Keepwell agreements are an increasingly common form of credit protection when PRC offshore subsidiaries issue offshore high-yield bonds, and involve a PRC company's pledge to maintain the financial health of the debt issuer. Keepwell agreements are not guarantees, which must be registered in the PRC in certain contexts, but nevertheless impose clear contractual duties.

Critically, these agreements are often governed by the law of jurisdictions outside the PRC, offering significant advantages to creditors holding distressed or defaulted offshore notes. Courts in these jurisdictions increasingly recognize PRC keepwell agreements. In 2021, for example, the Hong Kong High Court refused to stay proceedings over a Hong Kong-linked keepwell agreement.

Creditors can advance a more favorable return by deploying effective alternative ways for offshore creditors to enforce keepwell agreements outside of the PRC or by using it to create lawful incentives aimed at an expanded pool of assets and vulnerabilities outside of PRC. This includes:

Gathering evidence early. Creditors should look to other windows of opportunities across jurisdictions to simultaneously support their case and add incentives to the keepwell issuer in negotiations. For example, specialized discovery proceedings can yield wide-ranging discovery for use in a pending or contemplated foreign proceeding, potentially producing valuable information about the keepwell issuers' compliance with the keepwell agreement, such as financial standings, global fund flows and use of funds.

Exerting pressure through post-judgment discovery. Creditors are entitled to request post-judgment discovery against the keepwell provider once they obtained a judgment or award. The judgment or award can be easily exported among common law jurisdictions. Creditors can also unlock discovery such as on the keepwell provider's international transactions to its directors, senior management and close allies. Both of which can lawfully maximize incentives on the debtor.

Focusing on parent-level decision makers. Focusing on key individual decision makers is another effective strategy. In most jurisdictions, directors and senior management of the keepwell provider (or third parties in possession of such information such as accountants and auditors) are usually required to provide information of the company's assets and financial affairs. An examination order obtained in a jurisdiction where an important ally of the key decision maker resides could develop harmful evidence against the company or create risk of contempt of court.

By using enforcement strategies on keepwell agreements outside of the PRC, offshore creditors can simultaneously narrow options for the debtor and/or its decision makers outside of PRC while expanding the set of assets and decision makers to leverage against (particularly where true ultimate decision makers often reside at the parent level) to drive near-term movement. As we've seen on multiple occasions, these efforts often have significant movement in negotiations and are proven to be more efficient than passive strategies.

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