KOBRE & KIM | DISPUTES AND INVESTIGATIONS

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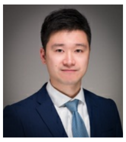

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APRIL 10, 2025

Creditors Should Enforce PRC Keepwell Agreements Overseas

A keepwell agreement is a form of credit protection when PRC offshore subsidiaries issue offshore debt or enter into loan transactions. By using enforcement strategies on keepwell agreements outside of the PRC, offshore creditors can narrow options for the debtor and/or its decision-makers outside of the PRC while expanding the set of assets and adversaries to leverage against (particularly where they often reside at the parent level) to drive near-term movement.

It is now established that keepwell agreements—commitments made by a parent company in the People's Republic of China (PRC) to uphold the financial stability of its subsidiary—are enforceable under Hong Kong law. Beyond enforcing keepwell agreements in the PRC, unsecured creditors should proactively expand their recovery overseas to improve their prospects for recovery.

Keepwell Agreement

A keepwell agreement is a form of credit protection when PRC offshore subsidiaries issue offshore debt or enter into loan transactions. In a typical keepwell agreement, the onshore parent company (i.e., the keepwell provider) undertakes to ensure that the issuer and the guarantor: (i) remain solvent; (ii) have sufficient liquidity to discharge their obligations under the debt instrument and any guarantee; and (iii) maintain a positive net worth, until all liabilities are discharged. Keepwell agreements may not qualify as guarantees requiring registration in the PRC, but they still create clear and enforceable contractual obligations.

Creditors may benefit from a carefully drafted keepwell agreement with the following useful features to enhance the agreement's enforceability:

- **Parties**: Including bond trustees in a keepwell agreement provides bondholders a direct recovery path, minimizing delays in control over the issuer if only the provider and issuer are involved.
- **Sufficient Liquidity**: A "continuous sufficient liquidity" obligation allows creditors to identify insolvency risks early, unlike a snapshot obligation that assesses liquidity only at set intervals.

- **Information Covenants**: Granting creditors the right to request periodic financial health updates, like liquidity notices or reports, helps detect potential breaches in advance and serves as evidence in litigation.
- **Jurisdiction**: Exclusive jurisdiction in Hong Kong simplifies enforcement in the PRC, as Hong Kong judgments are often recognized without extensive review. This provides a streamlined process for creditors and deters jurisdictional disputes, as evidenced by past court rulings.

Latest Legal Position

The Hong Kong Court of Final Appeal has confirmed in the *Peking University Founder Group* case that bondholders (as opposed to the issuer or guarantor) can enforce a Keepwell Deed to recover the outstanding debt and interest. This affirms the parent company's legal obligation to ensure that its subsidiaries (i.e., the issuer and guarantor) remain financially stable and meet their payment obligations.

Unsecured creditors are exploring options to maximize their recovery. The Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters between the courts of the Mainland and the Hong Kong Special Administrative Region (HKSAR) came into effect on January 29, 2024, and bondholders can now enforce Hong Kong court judgments against parent companies based in the mainland.

Alternative Means

In addition to directly enforcing the keepwell agreement, creditors can also advance a favorable return by deploying it to create lawful incentives aimed at an expanded pool of assets and vulnerabilities outside of the PRC. As we've seen on multiple occasions, these efforts encourage negotiation movement and are proven more efficient than passive strategies. This includes:

- **Gathering evidence early.** Creditors should look for other windows of opportunity across jurisdictions to 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 can request post-judgment discovery against the keepwell provider once they obtain 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 with its directors, senior management, and close allies.
- **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 on 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 evidence against the company or create risks of contempt of court.

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

About Kobre & Kim

Kobre & Kim is a global law firm focusing on cross-border disputes and investigations, often involving fraud and misconduct. The firm:

- Focuses on helping clients realize value from their claims, developing investigative, enforcement, and asset tracing/recovery plans in the pre-dispute stage to maximize future monetization.
- Often works with other law firms as special counsel in cases beyond their geographic reach, including in Dubai, to enforce high-value judgments and arbitration awards around the world with our integrated team of former U.S. government lawyers, Hong Kong solicitors, UK solicitors, and barristers (including King's Counsel) and offshore lawyers.
- Maintains our independence as advocates ready to litigate against virtually any institution by avoiding repeat client relationships and the conflicts of interest that come with them.