

KIRKLAND & ELLIS

Kirkland Alert

Landmark Hong Kong High Court Decision on Enforceability of Keepwell Deeds in *Peking University Founder Case*

24 May 2023

On 18 May 2023, the High Court of Hong Kong gave the first of two landmark rulings on the enforceability of keepwell deeds in [Nuoxi Capital Ltd & Others v Peking University Founder Group Company Limited](#) [2023] HKCFI 1350. The key takeaways are as follows:

- As a matter of general principle, keepwell obligations are binding and enforceable contractual obligations, and there is no “public policy” objection to them *per se*. However, they are not guarantees and ordinary damages principles apply to the quantification of claims.
- On the terms of the keepwell deeds in question, the keepwell provider would be relieved of its keepwell obligations if it could prove on the balance of probabilities that despite using its best efforts it could not have obtained the necessary regulatory approvals to comply. In other words, regulatory approvals are in the nature of a defence.
- Unlike a guarantee, a keepwell agreement is unlikely to generate a claim that can be submitted in a PRC reorganisation process because the onset of the process is likely to prevent the necessary regulatory approvals from being obtained. This is a material limitation on the credit support a keepwell agreement is likely to provide.
- The judgment is declaratory only (i.e., it is not enforceable against the assets of the keepwell provider). This was by agreement of the parties in the case, and had nothing to do with the keepwell deeds in question.

The second landmark decision in *Citicorp International Limited v Tsinghua Unigroup Co. Ltd* (HCA 1269 of 2021) is eagerly anticipated.

Factual background

The Defendant is Peking University Founder Group Company Limited (“PKU”). PKU is the PRC incorporated holding company of a large commercial group specialising in IT, healthcare and pharmaceutical trading businesses (“PKU Group”).

Between 2017 and 2018, two members of the PKU Group, namely, Nuoxi Capital Limited (“Nuoxi”) and Kunzhi Limited (“Kunzhi”), issued bonds, guaranteed by HongKong JHC Co Limited (“HKJHC”) and Founder Information (Hong Kong) Limited (“FIHK”), respectively (the “Bonds”). All four entities are incorporated in either the BVI or Hong Kong and are in liquidation.

In parallel, PKU entered into keepwell deeds with Nuoxi, Kunzhi, HKJHC and FIHK on materially identical terms. The keepwell deeds were English law governed and subject to the exclusive jurisdiction of the Hong Kong courts. By the keepwell deeds, PKU undertook, among other things, to (i) cause each of Nuoxi, Kunzhi, HKJHC and FIHK to have a consolidated net equity of at least US\$1 at all times (the “Net Equity Obligation”); (ii) to have sufficient liquidity to ensure timely payment by each of Nuoxi, Kunzhi, HKJHC and FIHK of any amounts payable under the Bonds or guarantees (the “Sufficient Liquidity Obligation”); and (iii) HKJHC to have an aggregate total equity of at least HK\$9,980,000 at all times (the “HKJHC Total Equity Obligation”). PKU further undertook to use its best efforts to obtain the necessary regulatory approvals to perform these obligations.

The financial state of the PKU Group subsequently deteriorated. On 19 February 2020, the Beijing First Intermediate People’s Court ordered that PKU commence reorganisation pursuant to the PRC Enterprise Bankruptcy Law. On 21 February 2020, the Beijing Court directed PKU’s creditors to submit their claims to the Administrator of PKU.

The Bonds only became immediately due and payable after 19 February 2020, following a series of events of default. Before that, no principal was due and all interest had been paid.

Each of Nuoxi, Kunzhi, FIHK and HKJHC submitted claims to the Administrator on the basis that PKU had breached the keepwell deeds by failing to ensure Nuoxi, Kunzhi, HKJHC and FIHK could discharge their payment obligations in respect of the Bonds. However, the Administrator rejected the claims of Nuoxi, Kunzhi and FIHK and refrained from adjudicating HKJHC’s claim.

Thereafter, the liquidators of Nuoxi, Kunzhi, FIHK and HKJHC initiated proceedings before the High Court of Hong Kong. In December 2021, the High Court rejected PKU's challenge that the Court lacked jurisdiction to hear the case on the basis that the claim was subject to the PRC reorganisation proceedings. The case then proceeded to trial in January and February 2023, and judgment was handed down on 18 May 2023.

Ruling

Justice Harris dismissed the claims of Nuoxi, Kunzhi and HKJHC, but upheld the claim of FIHK and declared that PKU was liable for a loss of RMB1,154,012,000 (approximately US\$166,670,837) to FIHK.

In arriving at this decision, Justice Harris held:

1. The keepwell deeds are generally binding on their terms, noting that *"It must reasonably be assumed that the Keepwell Deeds ... were intended to create substantive rights, even if in practice they had less financial value than purchasers of the Bonds assumed, and any qualification to such rights was likely to be carefully circumscribed."* (at [54]).
2. On the basis of the factual evidence and pleaded cases:
 - a. **Net Equity Obligation:** PKU failed to comply with this obligation in connection with: (i) Nuoxi and Kunzhi from 31 October 2020; (ii) HKJHC as at 16 April 2020; and (iii) FIHK as at 31 December 2019 (which had a negative consolidated net equity of RMB1,154,012,000, approximately US\$166,670,837) (at [66] to [68]).
 - b. **Sufficient Liquidity Obligation:** This obligation required PKU to ensure each issuer and guarantor had sufficient liquidity to make payments as they fell due. PKU therefore only failed to comply with this obligation after the Bonds became immediately due and payable, namely, after 19 February 2020 (at [70]).
 - c. **Total Equity Obligation:** PKU failed to comply with this obligation from 30 June 2020 (at [72]).
3. PKU would be relieved of its obligations if it could prove on the balance of probabilities that despite using its best efforts it could not have obtained the necessary regulatory approvals to comply. In other words, regulatory approvals are in the nature of a defence.
4. Based on the expert evidence, once PKU entered into the reorganisation proceedings, there was no *"realistic prospect of the approvals being given"* (at

[86]). On this basis, Justice Harris dismissed all claims pertaining to failures to comply with the keepwell deeds that occurred after 19 February 2020, but accepted pre-19 February 2020 claims. Accordingly, only FIHK's claim for a breach of the Net Equity Obligation as at 31 December 2019 was upheld (at that time, negative US\$166,670,837 so this is the amount of the judgment). Nevertheless, Justice Harris made clear that but for this timing issue, he would have found in favour of the other Plaintiffs (at [93] to [94]).

Conclusions

Keepwell deeds have been a common feature of financing arrangements entered into by Mainland China-based business groups and foreign lenders for some time, and continue to be utilized in transactions as a means of credit enhancement. Justice Harris' decision is significant because it clarifies that keepwell obligations are binding and enforceable contractual obligations, and there is no "public policy" objection to them *per se* under Hong Kong and – at least based on the expert evidence filed in the proceedings – PRC law. In this sense, Justice Harris' interpretation of the contractual provisions is creditor friendly. Although the outcome of this decision will be disappointing to PKU bondholders, it is important to bear in mind that the decision is highly fact-sensitive. The key issue was whether the keepwell provider could have realistically used its best efforts to obtain regulatory approvals to comply with the relevant obligations *at the time of its failure to perform them*. Justice Harris indicated that he would have found for the plaintiffs in the PKU case but for the timing issue.

Justice Harris has yet to hand down his decision in the connected case, *Citicorp International Limited v Tsinghua Unigroup Co. Ltd* (HCA 1269 of 2021), although he has indicated that he will do so "comfortably in advance" of 3 August 2023. We will circulate a summary of this decision as and when it is handed down. In the meantime, if you have any questions, please contact the authors directly or your usual contact at Kirkland & Ellis.

Authors

Fergus Saurin

Partner / Hong Kong

Simon Shiu

Associate / Hong Kong

Zoey Zhang

Associate / Hong Kong

Related Services

Practices

- Restructuring
- Litigation

Suggested Reading

- 08 February 2023 Kirkland Alert Enforceability of Keepwell Deeds Tested Before Hong Kong Courts

This publication is distributed with the understanding that the author, publisher and distributor of this publication and/or any linked publication are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. Pursuant to applicable rules of professional conduct, portions of this publication may constitute Attorney Advertising.

© 2023 Kirkland & Ellis