

Recent PRC court case puts the use of keepwell deed under scrutiny



In our client alert "Recent PRC court case puts the use of keepwell deed under scrutiny" published in June 2020, we discussed the ongoing restructuring case involving a keepwell deed provided by the Peking University Founder Group, where the PRC court cast doubt on enforceability of keepwell deeds.

Whilst we await further update to the Peking University Found Group case, there was recently a separate, new development in relation to the recognition of keepwell deeds in the PRC as the Shanghai Financial Court (上海金融法院) issued a ruling in November 2020 and recognised the decision handed down by the Hong Kong Court of First Instance for the order of CEFC Shanghai International Group (**CEFC**), a PRC-incorporated company, to pay noteholders on account of a keepwell deed.

The case

In October 2017, a BVI subsidiary of CEFC issued a €29 million note which was backed by an English law-governed keepwell deed issued by CEFC. This keepwell deed provided for the exclusive jurisdiction of the Hong Kong courts as the dispute resolution forum. In July 2018, the noteholder commenced proceedings against CEFC at the Hong Kong Court of First Instance for breach of the keepwell deed and obtained a default judgment against CEFC (**the Hong Kong Judgment**) as the latter did not appear in the Hong Kong proceedings. In May 2019, the noteholder commenced proceedings against CEFC in the Shanghai Financial Court for recognition and enforcement of the Hong Kong Judgment.

Interestingly, one of the arguments that CEFC put forward in its defense of the Shanghai Financial Court proceedings was that the keepwell deed constituted a guarantee and hence should have been filed for registration with the State Administration of Foreign Exchange, and since such registration was not done, then the subsequent recognition and enforcement of the Hong Kong Judgment would be against public interest in the PRC.

Despite such an argument, the Shanghai Financial Court ruled that the Hong Kong Judgment shall be recognised and enforced in the PRC in accordance with the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters between the Courts of the Mainland and of the HKSAR pursuant to the Choice of Court Agreements between Parties Concerned (the Arrangement).

Implications

Although the decision of the Shanghai Financial Court may, at first sight, appear to offer some comfort to those who seek to rely on keepwell deeds as a credit enhancement measure in transactions involving PRC entities, market participants should be cautious and not treat this as conclusive evidence that a PRC court would always be ready and willing to recognise the enforceability of keepwell deeds in the PRC.

This is mainly because the Shanghai Financial Court appears to have focused on the Arrangement, and the issue of whether CEFC could demonstrate that the recognition and enforcement of the Hong Kong Judgment would be against public interest in the PRC. The Shanghai Financial Court did not inspect or express any view on the actual content, nature or merits of the keepwell deed.

Indeed, according to an article on the official Weixin account of the Shanghai Financial Court decision¹, the Shanghai Financial Court recognised that, since the keepwell deed in question was not governed by PRC law, it therefore would not consider whether the nature and efficacy of keepwell deeds were against the public policy in the PRC or recognised by PRC law.

¹ At the time of publication, the Shanghai Financial Court has not been made the actual text of this decision publicly available.

Also, a decision of this nature may often hinge on the specific facts or circumstances of the underlying case. Hence, market participants should also take care to not generalise or come to any sweeping conclusion based on this one particular case.

Conclusion

Given that the effectiveness of keepwell deeds in the PRC remains uncertain, we maintain the views expressed in our June client alert – that market participants should, to the extent the situation would permit, consider adopting alternative credit enhancement options which are commercially certain and legally sound, such as a buy-back obligation in the context of a sale and purchase transaction or a standby lease agreement in the context of an asset finance transaction.

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