

Using provisional liquidation offshore to preserve bondholder claims under keepwell deeds

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Offshore companies are frequently used to facilitate debt finance transactions for large PRC based corporate groups. In the context of a bond issue, the corporate group will often incorporate an offshore subsidiary for the sole purpose of acting as the bond issuer.

Bondholders, naturally, expect some form of credit protection, which the offshore subsidiary cannot usually provide by itself. That is where keepwell deeds (also known as letters of comfort) come in. Through a keepwell deed, the PRC parent company undertakes to keep the offshore bonds issuer solvent and financially stable so that it can meet its payment obligations in respect of the bonds.

An important characteristic of a keepwell deed is that the PRC parent company gives the undertaking to its subsidiary – not to the bondholder. So what is a bond trustee to do when the subsidiary defaults on the bonds because the PRC parent company is in liquidation in the PRC and the subsidiary fails to make a claim in the liquidation under the keepwell deed? The good news for bond trustees (and bondholders alike) is that action can be taken by the bond trustee offshore to kick start the recovery process.

In the case of Peking University Founder Group Company Limited ("PUFG"), PUFG used two BVI subsidiaries for the purpose of issuing a series of fixed and floating rate bonds with a total value of US\$1.7 billion. The PUFG bonds were guaranteed by the immediate Hong Kong incorporated holding companies of the BVI subsidiaries and supported by keepwell deeds from PUFG itself.

In early 2020, PUFG entered administration in the PRC. Trading in the bonds was promptly suspended and the bonds were subsequently delisted from the Hong Kong Stock Exchange. However, the BVI subsidiaries failed to make any claim in the PUFG administration pursuant to the keepwell deeds, leaving the bondholders potentially stranded.

Acting through the bond trustee, bondholders made two separate applications to the BVI Court seeking to liquidate the BVI subsidiaries. By doing so, applications were granted to appoint independent provisional liquidators to the BVI subsidiaries to investigate the viability of claims against related entities including pursuant to the keepwell deeds, with a view to making a claim in the PUFG administration on behalf of the BVI subsidiaries, which would be for the ultimate benefit of the bondholders.

The PUFG case demonstrates that the BVI Court will act quickly to protect the interests of stakeholders and, in appropriate circumstances, appoint provisional liquidators to ensure that claims arising under keepwell deeds are preserved for the ultimate benefit of the bondholders. The appointment of provisional liquidators is likely to be appropriate when there is a risk that the claims against the parent company will be forfeited if not enforced promptly – such inaction can constitute a dissipation of assets, and form the basis for seeking an urgent appointment.

In the PUFG case, there was a risk that the claims of the BVI subsidiaries would be lost if they

were not made prior to a certain date and, as such, the BVI Court was willing to appoint liquidators to the BVI subsidiaries on a provisional basis pending the hearings of the liquidation applications (at which the provisional liquidators were appointed as liquidators).

An application to liquidate an offshore bond issuer can be an essential tool to aid enforcement of bond defaults in times of economic distress. The PUFG case demonstrates that offshore courts will act quickly in appropriate cases to appoint provisional liquidators, so that potential avenues for enforcement are not lost altogether when the bond issuer refuses or is unable to act.

Ogier successfully appointed provisional liquidators over the BVI-incorporated bonds issuers to preserve and facilitate claims pursuant to keepwell deeds provided by PUFG.

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