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Article

Published Version

Law, S. ORCID: <https://orcid.org/0000-0002-5231-2845> and Wong, D. (2023) Opening a door between PRC and Hong Kong in insolvency proceedings: insight from Re Samson Paper Limited. International Corporate Rescue. Available at <https://centaur.reading.ac.uk/114945/>

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Published version at: <https://www.chasecambria.com/site/journal/article.php?id=1581>

Publisher: Chase Cambria

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International Corporate Rescue

Published by

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Published by:

Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:

Subscription prices 2017 (6 issues)

Print or electronic access:

EUR 730.00 / USD 890.00 / GBP 520.00

VAT will be charged on online subscriptions.

For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

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Opening a Door between PRC and Hong Kong in Insolvency Proceedings: Insight from *Re Samson Paper Limited*

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Synopsis

Having recently marked the 25-year anniversary of 'One Country Two Systems' between the People's Republic of China ('PRC') and the Hong Kong Special Administrative Region of the People's Republic of China ('Hong Kong'), under which Hong Kong is able to maintain a separate Common law based legal system, there is now an increasing focus on how to facilitate interaction between the two distinct legal systems. How questions about these two legal systems interact and provide judicial assistance to each other will not only be of interest to local practitioners, but practitioners and scholars everywhere as it foreshadows how the PRC legal system will ultimately cooperate with other foreign jurisdictions around the world. Given the inbound and outbound investment into and out of China over the last 40 years, often through Hong Kong, the ever-growing number of bilateral ties has created increasing demand for legal certainty and transparency from the PRC courts, not least if and when those investments run into trouble. In a landmark move recently, a mutual recognition framework has been established between Hong Kong and PRC to allow the Hong Kong courts to recognise and grant assistance to insolvency practitioners in corporate insolvencies appointed by certain PRC Courts, and vice versa. This is a significant step towards resolving one of the longstanding issues arising from Hong Kong's role, as an international financial centre, being used to raise funds by PRC companies whose main assets and operations are in PRC resulting in 'offshore' creditors not having recourse to 'onshore' assets or security and vice versa, if insolvency ensues. This raises as many questions as there are opportunities to innovate given the lack of a detailed legal framework in the new arrangement, especially from the PRC courts. In search of a more concrete framework following the new arrangement, this article analyses the first PRC court case, *Samson Paper Company Limited*, that granted recognition and assistance to Hong

Kong insolvency practitioners. It sheds the first light for foreign practitioners on the PRC court's attitude and how they intend to play a more facilitative role among parties whilst safeguarding the local public interest. It is unveiled that the practice and standard adopted by the PRC courts which should be incorporated into existing treaty or supra-national law to better fit the needs of key stakeholders in cross-jurisdictional situations, including an important clarification in terms of the scope of the powers the PRC court will grant to the Hong Kong liquidators and provides a pointer as to the future possible ways that the PRC will deal with issues of judicial comity in the increasing important area of cross-border insolvency.

Introduction: A constant knocking at the door for legal certainty

For several decades now the capital and debt markets of the Hong Kong Special Administrative Region of the People's Republic of China ('Hong Kong') have been the doorway for international investors into China. Typical structures used in the Hong Kong market often include offshore holding structures, with a Hong Kong intermediate holding company which then holds the onshore subsidiaries in The People's Republic of China ('PRC') where the assets and operating businesses are ultimately located. In this common structure, as debt and equity are initially issued by offshore entities, holders or investors are immediately (and often deeply) structurally subordinated to the onshore creditors. In good times, when credit is flowing freely through IPO listings, little would we concern what would happen if they ever needed to recover on their investment if things didn't quite go the way of the prospectus. This is a predicament many are facing today as they are left as creditors to bare offshore entities.¹

But amongst the usual doom and gloom that these offshore structurally subordinated creditors have often

Notes

1 Purely for convenience, in this article we shall refer to those parties or entities incorporated in the PRC as 'onshore' and those from elsewhere, including Hong Kong, as 'offshore'.

been faced with when things do go wrong in PRC, there is now a glimmer of hope. On 14 May 2021, in order to further improve the mechanism for judicial assistance between the PRC and the Hong Kong Special Administrative Region ('HKSAR'), the Supreme People's Court ('SPC') and the Government of the HKSAR signed the 'Record of Meeting on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the PRC and of the Hong Kong Special Administrative Region' ('Record of Meeting'). The Record of Meeting sets out a pilot mechanism for the PRC and HKSAR to mutually recognise and to assist the insolvency proceedings initiated in the other jurisdiction ('Pilot Mechanism'). Under the Pilot Mechanism, a bankruptcy administrator ('Administrator') appointed by the PRC Courts is allowed to apply to the High Court of Hong Kong for recognition and assistance. Similarly, a Hong Kong liquidator or provisional liquidator ('Liquidator') is allowed to apply to the respective Intermediate People's Court in Shanghai Municipality, Xiamen Municipality in Fujian Province or Shenzhen Municipality in Guangdong Province for recognition and assistance.

While the problem is not unique, as courts in many jurisdictions have often encountered the issue of whether to and how to recognise insolvency practitioners appointed by the courts of another jurisdiction, the new arrangement is novel as it seeks to establish a mutual mechanism in the absence of a specific treaty or supra-national law such as the UNCITRAL Model Law on Cross-Border Insolvency or the EU directive 1346/2000 on Insolvency Proceedings. It has also attracted much attention for further details and codification, mainly as a result of comparisons to other international conventions,² including questions previously raised by the co-author such as 'whether [the Pilot Mechanism] brings a legal effect...whether it aids in the identification of a company's asset', and 'its impact to court procedures and potential to facilitate information sharing between the two regions'.³ While these questions are validly raised, the ultimate operation of the Pilot Mechanism (as the name suggests) is a

test-bed for the gradual development of the PRC's modern judicial system and, therefore, one must remember the importance of understanding the PRC's local situation when calling for more codification.⁴ Hence, this article continues the above and analyses by examining the first case, *Re Samson Paper Company Limited*,⁵ of a PRC court granting recognition and assistance to Hong Kong insolvency practitioners under the Pilot Mechanism. It sheds the first light on the PRC court's attitude and how they intend to play a more facilitative role among parties, whilst safeguarding the local public interest.

Slowly opening the door to a Pilot Scheme for judicial comity

It is not difficult for creditors to obtain a winding up order and liquidators appointed over indebted companies in Hong Kong, Cayman Islands, British Virgin Islands or Bermuda companies, as these respective Common Law based legal systems share a similar judicial heritage and have case law to deal with such requests. The difficulty lies how to reach assets onshore. The liquidators so appointed in an offshore jurisdiction, being foreign officeholders, need to apply for recognition and assistance of the courts of PRC so that they can have the power to recover or collect assets onshore. As PRC is not a party to any global treaty or model law to deal with the recognition and assistance between jurisdictions in cross border insolvencies,⁶ this is an ongoing challenge. It is particularly curious when we consider that PRC and Hong Kong are part of the same country, though each maintain separate and distinct legal jurisdictions under the 'One Country Two Systems' formula.

Acknowledging this unique lacuna, and similar to other agreements concerning the reciprocal recognition and enforcement of judicial actions,⁷ the Department of Justice of the HKSAR Government and the SPC have sought to address this through the Pilot Mechanism to allow judicial assistance between the Courts of Hong Kong, and three provincial courts in Shanghai,

Notes

- 2 The literatures on this topic have been summarised in the co-author's previously work on Law, Sau Wai and Mak, Charles Ho Wang, 'What Should Come after the Implementation of the Mutual Recognition and Assistance in Cross-Border Insolvency between Mainland China and Hong Kong?' (1 August 2022) *Journal of International Banking Law and Regulation*, 37 (9), 331, pp. 3-5.
- 3 See n. 2 above, p. 1.
- 4 Deloitte (2021), 'The First Hong Kong Liquidation Proceedings Recognized by Chinese Mainland Court under New Mutual Recognition Framework', 23 December 2021, available at: <https://www2.deloitte.com/cn/en/pages/finance/articles/1st-hk-liquidation-proceedings-recognized-by-mainland-court.html> (accessed: 13 Oct 2022).
- 5 Shenzhen Court Decision (2021)粤03认港破1号(2021) Yue 03 Ren Gang Po No. 1, the Shenzhen Intermediate People's Court. Available at <https://www.szcourt.gov.cn/article/906503549358080> (accessed: 13 Oct 2022).
- 6 Neither Hong Kong nor China are UNCITRAL Model Law on Cross-Border Insolvency jurisdictions.
- 7 Article 95, Basic Law HKSAR: 'The Hong Kong Special Administrative Region may, through consultations and in accordance with law, maintain juridical relations with the judicial organs of other parts of the country, and they may render assistance to each other.' Between 1999 and 2021, nine such agreements (including the Pilot Mechanism) have now been entered into. Though the Hong Kong Court has always had the power to deal with such requests even in the absence of specific agreements: Order 39, rule 1 of the *Rules of the High Court*, the Hong Kong Court has jurisdiction to order the issuance of a letter of request and will exercise its discretion to do so where satisfied that the addressee authority would act on such letters of request: *Kwan Chui Kwok Ying v Tao Wai Chun* CACV 194/2002, 13 December 2002 at [22].

Xiamen and Shenzhen, those three cities having been identified as the main economic gateways through which Hong Kong companies had invested in (by place of registration).

To further aid the mechanics of the Pilot Mechanism, the SPC publicized its ‘Opinion on Taking Forward a Pilot Measure in relation to the Recognition of and Assistance to Insolvency Proceedings in the HKSAR’ (‘SPC Opinion’) for practitioners seeking recognition from the PRC Courts, while the Hong Kong Department of Justice issued a ‘Procedures for a PRC Administrator’s Application to the HKSAR Court for Recognition and Assistance, A Practical Guide’ (‘Practical Guide’) to set out details of how it would implement the Pilot Mechanism.⁸

After the introduction of the Pilot Mechanism, there was a flurry of applications by Administrators from the PRC to the Hong Kong Court for recognition under the Pilot Scheme such as *Re HNA Group Co Limited*,⁹ which is the first case, and *Nuoxi Capital Limited v Peking University Founder Group Company Limited*.¹⁰ The Hong Kong Court has willingly granted various orders to these Administrators seeking to use the Pilot Mechanism and the Practical Guide. While the approach taken to the implementation of the Hong Kong Court to the Pilot Mechanism is beyond the scope of this paper, the number of successful cases made in the short time already reflects a growing confidence with this procedure by PRC practitioners.

On the other side of the fence so to speak, the SPC Opinion was promulgated to guide the three relevant courts in the PRC and Hong Kong insolvency practitioners looking for recognition and assistance.¹¹ For present purposes, the key provisions in the SPC Opinion are:

- (a) *Article 1 & Article 5*, which together provide that the debtor’s principal assets must be in one of the pilot areas in the PRC, or it has a place of business or a representative office in the pilot area. The pilot areas refer to Shanghai, Xiamen and Shenzhen.
- (b) *Article 2* provides that the relevant insolvency proceedings shall be compulsory winding up, creditors’ voluntary winding up or scheme of

arrangement promoted by Liquidator and sanctioned by the Hong Kong Court.

- (c) *Article 4* provides that the Pilot Mechanism applies only if HKSAR is the centre of main interests (‘COMI’) of the debtor for more than 6 months.¹² COMI will normally mean the place of incorporation of the debtor, but the Court will also take into account other factors including the place of principal office, the principal place of business, the place of principal assets; and
- (d) *Article 6* provides that Liquidators shall provide certain materials for the application including (i) a letter of request for recognition and assistance issued by the High Court of the Hong Kong Special Administrative Region; and (ii) a copy of the judgment in respect of which the application for recognition and assistance is made.

***Re Samson Paper Holdings* is the first through the door under the Pilot Scheme**

Having created the Pilot Scheme and specified the mechanics for such applications in the SPC Opinion, *Re Samson Paper Company Limited* became the first application after signing the Record of Meeting. Prior to this, Hong Kong liquidators have not been formally recognised by a PRC Court before and so this case is worthy of further study as another milestone in the further development of a formalised mechanism for judicial comity between Hong Kong and PRC jurisdictions.

Samson Paper Holdings Limited (‘Holdco’) is a typical example of the usual structure. Holdco is incorporated in the Bermuda and was listed on the Stock Exchange of Hong Kong. Holdco had a wholly owned intermediate holding company in Hong Kong, Samson Paper Company Limited (‘HKco’), which in turn held further subsidiaries in, including operating subsidiaries NJ Trading (Shanghai) Company Limited. In mid-2020, the auditors of the Holdco raised issues about questions about certain related party transactions undertaken by the executive members of the Board,¹³ which led to concerns about the group’s solvency. Days later, the company applied to the Supreme Court of Bermuda

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- 8 Department of Justice (2021), ‘Procedures for a Mainland Administrator’s Application to the Hong Kong SAR Court for Recognition and Assistance, Practical Guide’, available at: https://www.doj.gov.hk/en/mainland_and_macao/pdf/RRECCJ_practical_guide_en.pdf (accessed: 13 Oct 2022).
- 9 [2021] HKCFI 2897 (16 September 2021).
- 10 [2021] HKCFI 3817; [2021] HKEC 5793, where the Hong Kong Court granted recognition but limited assistance only (upheld on appeal *Nuoxi Capital Limited* (諾熙資本有限公司) (*in liquidation in the British Virgin Islands*) v *Peking University Founder Group Company Limited* (北大方正集團有限公司) [2022] HKCA 1514).
- 11 Department of Justice (2021), ‘The Supreme People’s Court’s Opinion on Taking Forward a Pilot Measure in relation to the Recognition of and Assistance to Insolvency Proceedings in the Hong Kong Special Administrative Region’, available at: https://www.doj.gov.hk/en/mainland_and_macao/pdf/RRECCJ_opinion_en_tc.pdf (accessed: 13 Oct 2022).
- 12 Sidley (2002), ‘Hong Kong Liquidators Reach Mainland Assets’, 9 March 2022, available at: <https://www.sidley.com/en/insights/newsupdates/2022/03/samson-case-summary---hong-kong-liquidators-reach-mainland-assets>.
- 13 See <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/0714/2020071401266.pdf> (14 July 2020).

for the appointment of Provisional Liquidators on a ‘soft touch’ basis to formulate and facilitate a financial restructuring of the company.¹⁴ The company’s substantial assets are mainly located in Shenzhen and are divided into three categories, held through HKco.¹⁵

On 14 August 2020, HKco was subject to a voluntary liquidation by reason of its inability to continue as a going concern and Mr. Derek Lai Kar Yan and Mr. Glen Ho Kwok Leung of Deloitte (‘Samson Paper’s Liquidators’) were appointed as liquidators. As HKco was insolvent, their appointment was confirmed at a meeting of creditors on 25 August 2020 and the liquidation proceeded as a creditors’ voluntary liquidation.

On 30 June 2021, Samson Paper’s Liquidators issued an ex-parte originating summons for judicial assistance to the High Court of Hong Kong, requesting an order that ‘A simplified Chinese version of the letter of request in the form annexed hereto to be issued to the Bankruptcy Court of the Shenzhen Intermediate People’s Court (“Shenzhen Court”) seeking its assistance in aid of the Company’s liquidation and the Liquidators’.¹⁶

In dealing with this first application under the Pilot Scheme, the Honourable Mr. Justice Jonathan Harris observed that under Hong Kong law Samson Paper’s Liquidators had the power to:

- (a) take into their custody, or under their control, all the property and things in action to which HKco is or appears to be entitled;
- (b) sell the real and personal property and things in action of HKco by public auction or private contract, with power to transfer the whole of the property and things in action to any person or company, or to sell them in parcels;
- (c) do all acts and execute, in the name and on behalf of HKco, all deeds, receipts and other documents, and for that purpose use, when necessary, the company’s seal; and
- (d) do all other things as may be necessary for winding up the affairs of the HKco and distributing its assets.

In light of the locale of HKco’s assets, His Lordship was persuaded that it would be desirable if Samson Paper’s Liquidators could exercise same or similar powers to the extent that a PRC Administrator would have under PRC law.¹⁷ Second, His Lordship noted that in similar

circumstances the Hong Kong Court would recognise a letter of request from the Shenzhen Court and provide such recognition and assistance as may be requested, subject to compliance with the procedures under the Pilot Scheme and any other limitations under Hong Kong law.¹⁸

On 30 August 2021, following the decision of the Hong Kong Court, Samson Paper’s Liquidators applied to the Shenzhen Court for an order to recognise creditor’s voluntary winding-up procedure in Hong Kong and recognise them as the liquidators with powers to: (1) take over control of the company’s seal, books, records, documents and other materials in the PRC; (2) decide on the management of HKco’s affairs the PRC; (3) decide on HKco’s daily and other necessary expenses; and (4) to manage and dispose of HKco’s assets located in the PRC – which included shares in the operating subsidiaries.

The application was received and accepted by the Court on 1 September 2021 and, in accordance with the SPC Opinion, the Shenzhen Court then notified known creditors and the subsidiaries in the PRC by an announcement on 6 September 2021. On 10 September 2021, the Shenzhen Court conducted a hearing on the application, though no opposition to the application was received during the hearing.

From the judgement of the Shenzhen Court,¹⁹ and following the criteria in the SPC Opinion, it confirmed that Samson Shenzhen is wholly owned by the HKco, it is incorporated in Shenzhen, its principal place of business is in Shenzhen; and it is a substantial asset of HKco in the PRC. Therefore, the Shenzhen Court was satisfied it had the jurisdiction over this application. Further, the Shenzhen Court also confirmed that HKco was incorporated in Hong Kong in 1981, its principal place of business is in Hong Kong for over 40 years; and its main assets are in Hong Kong, so Hong Kong is the COMI of the HKco. Therefore, the Shenzhen Court formally recognised Samson Paper’s Liquidators and granted the four powers they sought. However, the Shenzhen Court added that if certain duties are involved such as (i) creating security on the property; (ii) transferring assets out of the PRC; and (iii) conducting other acts for disposing of the property that has a major impact on the creditors’ interest, then Samson Paper’s Liquidators would have to return to the Shenzhen Court for additional approval.

Notes

14 See <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/0720/2020072000153.pdf>. (18 July 2020). The use of the ‘soft touch’ provisional liquidation for restructuring purposes is beyond the scope of this article.

15 Wholly-owned subsidiaries, including a wholly-owned subsidiary in Shenzhen, namely Samson Paper (Shenzhen) Company Limited (‘Samson Shenzhen’); and a wholly-owned subsidiary in Shanghai, namely NJ Trading (Shanghai) Company Limited; Receivable in the aggregate sum of approximately HK\$422 million; and an apartment in Beijing.

16 *Re Samson Paper Company Limited (In Creditors’ Voluntary Liquidation)* [2021] HKCFI 2151.

17 See n. 16 above, at [14].

18 See n. 11 above.

19 See n. 5 above.

Questions remain as the door opens wider to more collaboration

From the judgment of the Shenzhen Court, there are a few indicia that the Shenzhen Court was also aware of the significance of its decision.

First, the PRC court itself mentioned this was the first the official letter issued by the Hong Kong Court to seek for judicial assistance for assistance in Chinese (司法協助請求函), which was specifically written in simplified Chinese. Then the court closely examined the relevant documents including the resolution, minutes, financial statements, notice, business registration, and titles to property of the HKco. These documents are believed to be made in Hong Kong and were presumably admitted as evidence in the Hong Kong proceedings. Hence, it appears critical to ensure that the associated evidence to be submitted to the PRC courts is the same as that before the Hong Kong Court, whether or not they are in simplified Chinese (though being written in simplified Chinese appears to be helpful). By scrutinising these documents itself, the Shenzhen Court appears to be looking to satisfy themselves that the appointment of Samson Paper's Liquidators was proper and that they have proper authority under Hong Kong law. Though it is not clear if additional steps had to be taken to verify or authenticate the documents prior to being accepted by the Shenzhen Court. Second, the Shenzhen Court carefully and quite closely followed the procedure set out in the SPC Opinion to confirm both its jurisdictions. Third, the PRC court examines the role of liquidators and their intended tasks to be executed in PRC, and places significance that the application for permission to perform their duties in the PRC and powers sought is not only in compliance with PRC law (specifically the Enterprise Bankruptcy Law and the Pilot Mechanism), but also that they had been approved by HKco's creditors and relevant Hong Kong laws. While there is no detail or discussion in the judgment as to how the Shenzhen Court has satisfied itself as to those last two matters, it does appear to be something the Shenzhen Court would require as a matter of course in such applications.

Fourth, there is a vetting process to confirm the identification and role of the liquidators, the scope, the legal boundary associated with their appointment, and confirmation that there is no violation of the PRC law or cause disturbance to public order and virtue of the society (in Chinese, 公司良俗) which is of critical importance in PRC jurisprudence. Unfortunately, there are no details of what has been done to vet the request and assure itself of these matters, but it appears to have relied on submissions and answers to requisitions made directly between the Samson Paper Liquidators and the Shenzhen Court.

As this is only the first case under the Pilot Mechanism, and one might say it was a fairly straightforward case, it is not surprising there are still many aspects

of the process under the Pilot Scheme which remain unanswered. Much of the uncertainty comes from what is not written in the judgment such as the lack of discussion on key issues about the necessary evidence required in such applications, the scope of powers sought, definition of key concepts such as public order and virtue of the society, and whether certain matters were simply decided in a particular way simply because there was no party to object. It is also far from certain that the procedure in *Re Samson Papers Holdings* is going to be the same or usual process adopted by the Shenzhen Court in future cases under the Pilot Scheme due to the absence of *stare decisis* in PRC law. It is even less certain that the way the Shenzhen Court has dealt with the application in *Re Samson Paper Ltd* will be followed by courts in the other two pilot zones, though this will be watched closely.

Conclusion: The potential of the way through

While *Re Samson Paper Ltd* does leave many questions about how the collaboration under the Pilot Scheme might work, there have been since a number of other applications to the Hong Kong Court for issuances of letters of request for use under the Pilot Mechanism. These include:

1. Zhaoheng Hydropower (Hong Kong) Limited (In Liquidation) [2022] HKCFI 248 (20 January 2022), which involved a compulsory winding up in Hong Kong and letter of request to the Shenzhen Court;
2. Ozner Water International Holding Limited (浩澤淨水國際控股有限公司) (In Liquidation) [2022] HKCFI 363; [2022] HKEC 784 (27 January 2022) which is the third application, and first time where the company involved was incorporated offshore and not a Hong Kong incorporated company;
3. Re CEFC Shanghai International Group Ltd [2020] HKCLC 1; [2020] HKCFI 167, which involved three separate Letters of Request to the Shanghai Court; and
4. Hong Kong Fresh Water International Group Limited (香港浩澤國際集團有限公司) (In Liquidation) [2022] HKCFI 924 (6 April 2022), which involved a Letter of Request to the Shanghai Court for a Hong Kong intermediate holding company and where the Hong Kong Court was satisfied that the COMI was in Hong Kong since at least March 2021 (being the date of the commencement of the winding up in Hong Kong).

These applications, some of which differ from *Re Samson Paper Ltd* in distinct ways as noted above, will allow further development and answer many remaining questions as to the full nature and extent of the

assistance the PRC are willing to offer under the Pilot Scheme and, what, if any other constraints may exist in making such requests. Chief among those is whether only liquidators of Hong Kong incorporated companies can apply under the Pilot Scheme (for example, see *Ozner Water* above), and what is the full extent and nature of powers a PRC court might be willing to grant Hong Kong liquidators? In respect of the latter, for example, would a PRC court grant powers to conduct investigations in the PRC, to seize documents in the PRC and question officers of the company who resided there – powers which a Hong Kong liquidator would have or could seek the under Schedule 25 of Companies (Winding Up and Miscellaneous Provision) Ordinances.²⁰ These powers being fairly common for liquidators in many Common Law jurisdictions, but relatively uncommon or yet to be developed under PRC law. To date, none of these applications have yet been accepted by the respective PRC courts.

Nevertheless, and despite its initially limited scope, the Pilot Mechanism is something that many restructuring and insolvency professionals have been waiting

for many years given the scale of investment in and out of the PRC. By allowing Hong Kong liquidators a formal mechanism to extend their reach across the border into the PRC (and vice versa), it not only further promotes cooperation and efficiencies between the PRC and HK-SAR, it also promotes overall confidence in the two judicial systems which is important from an investment perspective. In time, it is also conceivable (and likely) that this approach may also be used by the PRC courts to facilitate similar requests from other foreign jurisdictions, something that is increasingly common given the history of cross border investments. But for now this Pilot Scheme is not afforded to overseas appointment takers outside of Hong Kong and thereby provides it with a first mover advantage that could allow it to become the primary restructuring hub for Greater China in the short to medium term, especially if its scope could be further expanded to other municipalities, other forms of creditor actions (such as receiverships) and granting liquidators a full array of powers that liquidators would be familiar with in Common Law jurisdictions.

Notes

20 See sections 286A, 286B, 286C and Schedule 25.

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